

CENTRAL BANK DIVERSIFICATION POST-SANCTIONS: EFFECTS ON INTERNATIONAL TRADE AND INVESTMENT

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Abstract

The deployment of sanctions as a deterrence and compliance tool has surged in recent years, creating significant uncertainty and turbulence in the global economy. The weaponization of the Russian Central Bank's foreign reserves by Western powers is prompting a substantial shift in the international financial order. In response, central banks outside Western countries are diversifying their external reserves away from assets denominated in Western currencies. Firms' internationalization has increasingly intertwined with complex political processes, making political intervention in international business more unpredictable. Multinational enterprises (MNEs) have suffered considerable losses due to the sanctions imposed on Russia by the West and the subsequent countersanctions by Russia. Predicting political interventions and necessary adaptations remains challenging due to the volatile nature of international relations. To build resilience against the risks posed by unexpected sanctions, MNEs should implement strategies focused on risk management, flexibility, adaptability, information gathering, monitoring, and strategic investments. This paper examines the impact of recent sanctions on MNEs and proposes a framework for enhancing resilience in an unpredictable political landscape.

INTRODUCTION

The distinguishing feature of today's business environment is that change is fast, continuous, and primarily unpredictable, with many uncertainties. Consequently, the traditional marketplace has been transformed into a knowledge-driven connected economy (Voelpel et al., 2004). The decision of firms to expand into another market is driven by the desire for a healthy and diversified portfolio of earnings, providing a natural hedge against the volatility of local growth, country risk, and currency risk, and allowing them to obtain critical resources economically. Companies that want to flourish and remain relevant in today's business environment must continuously re-invent business strategies, develop several new business models, and upgrade existing ones. The cross-border expansion of a business into the global market offers fresh opportunities to produce, distribute, market, and sell products and/or services, with the objective of engendering growth and increasing profits by leveraging skills and products over a broader market spectrum. However, the internationalization of firms is risky if a proper study of the targeted market is poorly conducted.

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International firms must navigate many entry and operational challenges, including language barriers, cultural differences, currency exchange risk, inflation rates, and the nuances of foreign politics. Global business risks have recently escalated with the rise of protectionism in mature liberal markets, climate changes, the novel coronavirus (COVID-19) pandemic, and the sanctions and countersanctions precipitated by the ongoing Russia-Ukraine war. Following Russia's invasion of Ukraine on February 24, 2022, the G7 countries and the EU imposed ten groups of economic sanctions with multi-dimensional characteristics on Russia to compel a course reversal and weaken its ability to prosecute the war against Ukraine. These economic sanctions include freezing the gold and foreign exchange reserves of the Central Bank of the Russian Federation (CBRF) and the National Welfare Fund of the Russian Federation, freezing the assets of several banks on correspondent accounts outside the Russian Federation, disconnecting individual banks from the SWIFT international system, imposing complete or partial bans on the export of goods and services to the Russian Federation, implementing complete or partial bans on the import of energy resources from the Russian Federation, and various personal sanctions against officials of the Russian Federation and prominent businessmen (oligarchs) who have earned their fortunes through warm relations with the Russian authorities (Shapran and Britchenko, 2022). Due to the rash of economic and financial sanctions imposed on Russia by the G7 and European Union bloc since Russia's invasion of Ukraine, Russia is now the most sanctioned country in the world, with a total of more than 16,500 sanctions. The freezing of foreign exchange reserves of the Central Bank of Russia held abroad, amounting to more than \$300 billion in the West, and the plan to confiscate these assets to channel them to Ukraine as reparations for war damages, is causing a wave of concern across the global south. The sanctions have imposed significant economic costs on Russia and Europe. However, these economic costs have not translated into political concessions that could open the door to ending the conflict and saving lives and critical infrastructure from daily destruction.

In his book "The Economic Weapon: The Rise of Sanctions as a Tool of Modern War," Mulder (2022) argued strongly that the "imposition of economic sanctions is morally fraught as it ultimately damages an entire population when, in most cases, the target is the government and significant influences around the government". While the intention was to pressure business oligarchs with strong connections to the Kremlin, many industries and business owners with no political affiliation in Russia were transformed into bad borrowers overnight due to the sanctions triggering a decline in the quality of risky assets. Shapran and Britchenko (2022) provided an example of Russian airlines that, as a consequence of the sanctions, saw insurance companies providing aviation insurance for the mostly leased aircraft withdraw their services and demand that the aircraft leave Russia. Not surprisingly, the Russian government blocked the return of planes worth approximately 13 billion US dollars. The ongoing Russia-Ukraine war continues to have a debilitating impact on the global business ecosystem. The global supply chain, built decades ago during the push for globalization to support companies' movement of manufacturing to cost-effective and efficient offshore locations, was disrupted in the early days of coronavirus lockdowns and quarantines and has been further disrupted by the sanctions on and countersanctions by Russia. This has led to the decimation of enterprise value. This disruption of global supply chains has caused a rise in food and energy prices, leading to global inflationary pressures. Experts have proposed many remedies for companies operating globally, including restructuring supply chains, balancing resilience with efficiency, reducing costs, and reshoring. The novel financial sanctions imposed on Russia by the G7 countries and the EU bloc has expanded the dimension and impact of political risks on firms' internationalization.

In recent years, the internationalization of firms has become increasingly entangled with contextual political processes at multiple levels. Unfortunately, firm strategies and processes, international business theories, and models have not yet fully adapted to this increasing politicization. The dimension of political intervention in international business is constantly evolving, and over the last half-decade, this process has accelerated. The

boards and management of international enterprises need to equip themselves with the necessary strategies, operations, and mindsets to effectively navigate these political contingencies in internationalization.

Research aim

This research explores the negative impacts of deploying sanctions as a tool for deterrence and compellence in the global economy, particularly the uncertainty and turbulence it creates for international investment. It will analyze the resulting uncertainty and turbulence in international investment and the grave impact on multinational corporations (MNCs). The ultimate goal is to highlight the futility of sanctions and propose alternative approaches for MNCs to navigate geopolitical conflicts.

METHODOLOGY

This research will adopt a qualitative approach, relying on in-depth analysis of textual data to understand the complexities of the issue.

The primary source of data for this academic research will be scholarly journals in fields such as international relations, economics, and business, relying on journals published by reputable organizations that focus on international political economy, global governance, or international trade. Another source of data will be the opinions and analyses of subject matter experts, and lastly, data will be sourced from statements by government officials. Public statements and speeches by government officials from countries imposing and receiving sanctions offer valuable perspectives on the intended goals and perceived effectiveness. Thematic analysis will be employed to identify recurring themes and arguments within the collected data. This will involve coding the data to categorize key concepts related to the consequences of sanctions and their impact on international investment. Process tracing will be used to understand the causal mechanisms at play. This will involve analyzing the sequence of events leading to the imposition of sanctions, their intended effects, and the actual consequences observed.

Ethical considerations

Authorship, affiliation, and reputation have been verified to ensure the credibility of all sources. Scholarly journals are peer-reviewed, and expert reports and opinions come from reputable organizations. Efforts have also been made to strive for a balanced and objective approach. The methodology provides a framework for conducting a comprehensive and insightful study on the dangers of sanctions as a tool for deterrence and compellence. The research can contribute significantly to the ongoing debate on this critical issue by employing a qualitative approach and utilizing various data sources.

RESULTS

Intervention and contribution

This research will contribute to the ongoing debate by highlighting the negative consequences of sanctions on the global economy and international investment. By showcasing the ineffectiveness of sanctions as a tool for achieving political goals, the research can encourage policymakers to explore alternative strategies for conflict resolution. The research findings can also be used to develop recommendations for MNCs on navigating the uncertainties created by geopolitical conflicts and mitigating the risks associated with sanctions.

The weaponization of sanctions

Superpowers typically possess various foreign policy tools including military might, cultural influence, diplomatic persuasion, technological capabilities, and economic aid (Drezner, 2021). However, over the past decade, US foreign policy has increasingly relied on economic sanctions above all other engagement tools. The sanctioning tool, which allows one country to disrupt economic exchanges with another, has become the go-to solution for nearly every foreign policy challenge the US faces (Drezner, 2021). For various reasons, an average of 500 entities per year was designated for sanctions during President Obama's first term. President Donald Trump nearly doubled this figure during his term in office.

President Joe Biden further escalated sanctions by imposing new measures against countries deemed unfriendly, while retaining most of President Trump's sanctions except those against the International Criminal Court (ICC). Sanctions are non-military coercive tools used by the sanctioning government (the sender) to induce, persuade, intimidate, or force a sanctioned government (the target), corporations, or individuals to alter their behavior (Meyer et al., 2023). They have the potential to disrupt the international business environment with little notice and change the rules of engagement. The deployment of sanctions as deterrent and compellence tools has significantly increased in recent years, leading to heightened uncertainty and turbulence in the global economy. There is a suggestion that rising geopolitical tensions will exacerbate the scale, scope, and frequency of sanctions, which have already been on the rise, potentially triggering further increases in government interventions that constrain international business (IB) activities (Meyer et al., 2023). For multinational enterprises, sanctions represent institutional changes in both host and home markets that impact various aspects of their operations. They often lead to reversals in developing market-supporting institutions and create barriers to cross-border economic activities. International sanctions compel multinational enterprises and domestic firms to critically assess their business strategies and make strategic decisions regarding their operations. These decisions may include exiting the country, partially divesting operations, exploiting loopholes in the sanctions regime, or relocating operations to third countries, all of which have short-term and long-term consequences for the affected companies' operations and organizational structure.

Freezing of Central Bank of Russia (CBR)'s assets

The freeze imposed on Russia's foreign central bank assets by the G7 countries and the EU is considered innovative and, according to the Wall Street Journal (2022), "the most powerful weapon in the West's financial arsenal," designed to strike at the heart of Russia's financial system. In early February 2022, the CBR had built up healthy foreign reserves of about \$643 billion (Central Bank of Russia, 2022a), with approximately 40% of these reserves held in North America and Europe, where Germany and France together accounted for roughly 25% of Russia's foreign reserves, and around 17% held in China (Central Bank of Russia, 2022b). The EU's decision to freeze the foreign reserve assets of the CBR held by other central banks has been criticized as an irregular enlistment of these central banks in monetary and financial warfare (Quaglia and Verdun, 2023). The move has been argued to be capable of destabilizing economies and financial systems, violating the principle of an open market, and challenging the independence of European Central Bank (ECB) from political authorities as enshrined in treaties and national legislations. As events unfold, using the financial system as a weapon of warfare may be risky because the politicization of the financial system could potentially undermine it in the long run if some players choose to diversify and use alternative systems, as suggested by the BRICS group (Quaglia and Verdun, 2023). The CBR is one of sixty-three central bank members of the Bank for International Settlements (BIS), and it participates in the Financial Stability Board and the Basel Committee on Banking Supervision. This financial sanction against the CBR marks the first coordinated action by all G7 and EU countries against a central bank, and notably, the CBR is the first member of the BIS to be targeted with financial sanctions (Quaglia and Verdun, 2023). The argument by Meadway (2022) that this was 'an economic weapon' that could 'be utilized at no economic cost to those wielding it' may be debatable in light of threats from the Russian government, warning against the recent decision of the West to expropriate the frozen CBR foreign reserves for the reconstruction of post-war Ukraine. Kapoor as cited in Fairless (2022) may be accurate in likening the freezing of the CBR's foreign reserves to a nuclear bomb in the world of global finance.

The legality of confiscation of Russia's \$300 billion assets

There is an argument that natural justice demands that any losses or damages incurred by Ukraine as a result of Russia's invasion of Ukraine should be borne by the Russian Federation rather than Ukraine or the international

community. A precedent for this can be seen in the UN Compensation Commission (UNCC) established by the Security Council in 1991, which processed claims and paid compensation funded from "proceeds from the sale of Iraqi oil for losses and damage suffered as a direct result of Iraq's unlawful invasion and occupation of Kuwait" (Kamminga, 2023:2). Over 30 years, the UNCC awarded \$52.4 billion to approximately 1.5 million claimants. There has been robust debate but no consensus regarding the legality of seizing and proposing to confiscate the frozen foreign reserves of the CBR by the West and channeling them to Ukraine for reparations. Zelmenis (2023) conducted a study that provided an indepth examination of the legal bases for current asset freezes in the EU and the US, focusing on the potential confiscation of frozen state assets of Russia as a means to achieve reparations. The study highlighted how the principle of sovereign equality of states protects the assets of Russia's central bank from court proceedings and execution in another state, thereby deterring such actions. The author concluded that there are no legal bases for expropriating Russian sovereign assets.

Moiseienko (2023) reviewed two salient issues regarding the freezing of the Russian Central Bank's foreign reserves while examining the compatibility of this measure with the immunity of the state under international law. The first issue is whether the law of state immunity, other than judicial process, permits the executive to freeze the property of another country's central bank, and the second is whether such measures violate international law and whether circumstances precluding wrongfulness render them lawful. Moiseienko (2023) concluded that the answer to the first question is finely balanced, unlike Zelmenis (2023), who emphatically stated that the expropriation of Russian sovereign assets is illegal and believes that the ongoing attachment of CBR's assets constitutes lawful countermeasures.

A question raised by the freezing of CBR's foreign assets is whether the asset freeze was permissible as a countermeasure (defined as a measure against a state responsible for an internationally wrongful act to induce compliance with its obligation not to commit aggression) or as a third-party countermeasure, since the measure was undertaken collectively by the G7. Kamminga (2023) concluded that based on Article 54 ARSIWA; there is a legitimate ground under international law as a 'lawful measure' to support the G7's expropriation of CBR's foreign assets to rebuild Ukraine. Following this line of argument, the question arises whether a state can invoke this lawful measure outside the authority of the UN. However, a school of thought argues that the legal position on Article 54 ARSIWA is uncertain because there appears to be no clearly recognized entitlement to take third-party countermeasures under international law.

Kamminga (2023) also examined whether confiscating the frozen assets of the CBR and redirecting the proceeds toward the post-war repair and reconstruction of Ukraine would constitute a permissible countermeasure. He argued that freezing or confiscating foreign central bank assets through direct executive action as a third-party countermeasure to halt severe aggression cannot be estopped by arguments of state immunity. He suggested that confiscation might be permissible as a 'lawful measure' to repair the damage but would not strictly qualify as a countermeasure. Kamminga's (2023) assertion that the freezing of Russian Central Bank assets did not violate international immunity law because it was carried out through direct executive action rather than through a court of law cannot be sustained, as unilateral executive actions against foreign assets within each country's jurisdiction, unsupported by international law, risk promoting a rule of might over right and potentially causing chaos in international relations.

Kamminga (2023) attempted to extend the interpretation of the UN General Assembly resolution of 14 November 2022, which holds Russia accountable for its aggression against Ukraine and calls for it to bear the legal consequences of its internationally wrongful acts and repair the damage caused. However, it would be misleading to rely on this non-binding resolution to confer authority on the G7 and the EU to confiscate the foreign reserves of Russia's central bank.

Beyond the legality of seizing Russia's assets, the freezing of the Russian Central Bank reserves by the West and the decision to use the seized assets for the restoration of post-war Ukraine raise significant ethical concerns. Freezing an asset owned by a sanctioned entity does not alter ownership, as the sanctioning state merely takes control of the property with the prospect of its return upon satisfactory resolution (Stephan, 2022). There is no international law or rule-based order that grants the West the authority to expropriate another country's assets. This decision also presents an ethical dilemma and may imply a double standard, as colonial and neo-colonial countries in the G7 and EU, such as the US, UK, and others, have not agreed to pay reparations for historical injustices like resource exploitation and slavery in Africa and other parts of the world. Similarly, the US has not taken responsibility for its military interventions in Iraq, Libya, and Syria. How, then, can it advocate for reparations for Ukraine?

If the decision to sanction Russia and seize its reserves aims to punish President Vladimir Putin and his allies, seizing these funds may inadvertently harm the Russian people, leading to unintended consequences. Successfully enforcing such actions could establish a precedent for the unilateral seizure of assets of other countries in future disputes, potentially triggering retaliatory actions with severe consequences for international trade and investment.

Russia government's counter-sanctions

Since the West launched the sanctions barrage against Russia over its invasion of Ukraine, foreign investors in Russia have been confronted with a dilemma: sell their business and leave the country, suspend or gradually wind down operations, or 'keep going'. As a response to the sanctions, the Russian government has unleashed countersanctions against foreign investors from what it called "unfriendly countries," including the EU, G7, Switzerland, South Korea, Singapore, and Taiwan, all of which have worsened the situation of these investors. Russia's President Putin, on 4 August 2023, signed into law the "Corporate Relations Law," which permits foreign holding companies associated with "unfriendly" countries to be excluded from holding corporate rights in significant Russian businesses. The law, which became effective on 3 September 2023, permits Russian indirect shareholders or beneficial owners of those businesses to apply to a Russian court to exclude foreign investors from the chain of ownership, transferring the foreign shareholdings to them (Bradshaw and Korshunava, 2023). According to Lalive, this new law appears to target foreign investors that, in many cases, have been unable to divest from Obasun 127

their local businesses and thus decided to maintain their operations for the time being. Foreign investors that may be forced out of their investments in Russia against their will include many of the largest banks in Russia, an industry classified as economically significant under the new law. Before the promulgation of this new Corporate Relations Law, Russia had issued decrees to frustrate the abilities of investors, who clearly wanted to exit their investments in Russia to avoid potential compliance and reputational issues, from withdrawing from Russia. Two such Decrees, as explained by Bradshaw and Korshunava (2023), are Decree No. 520, enacted in August 2022 and effective till 31 December 2023, which prohibit foreign investors from "unfriendly" States from restructuring or selling their interests in Russian strategic enterprises, banks, or specific energy and mining projects unless approved by the President. The other is Decree No. 618 (effective from 8 September 2022), which requires the approval of the Russian Governmental Commission for Control over Foreign Investments for any transaction involving "unfriendly" investors that create, modify, or terminate ownership or management rights in Russian limited liability companies. Government approval is generally required for any decision by "unfriendly" foreign investors to divest their interests in a Russian subsidiary.

There is a stipulation by the Governmental Commission for Control over Foreign Investments to approve any proposed sale. The sale must be made at a discount of at least 50% of the asset's market value. In addition, a

"voluntary" contribution to the Russian State budget of at least 10% of half of the appraised market value must be made. Bradshaw and Korshunava (2023) further explained that for foreign investors inserting buyback options in their sales agreements in the hope that they might repurchase their investments in a post-war, postsanctions world, the Commission stipulated that any such option must be for a maximum of two years, with the exercise price set at market value. The intention is to ensure that investors from 'unfriendly' countries cannot realize significant proceeds from the sales of their investments. Since Russia invaded Ukraine, all of the Russian businesses listed both in Russia and overseas have had their shares suspended in terms of trading. A foreign investor holding shares in a Russian business cannot sell because they are frozen. The two Russian businesses that have recently announced share Buybacks, MTS, and Magnit, are doing this because they want to take out overseas shareholders. In a Reuter's report of 27 April 2024 with the header "Russia's MTS proposes discounted buyback for foreigners' stranded shares," MTS, which is Russia's largest mobile phone operator, proposed a share buyback of about 84 million shares priced at 95 rubles per share to foreign shareholders representing a discount of around 69%. According to MTS, the offer primarily targets non-resident shareholders who cannot buy or sell the company's shares and have until 28 May 2024 to accept the offer.

Reuters reported that Magnit, one of the largest food retailers in Russia with more than 28,000 stores, announced in September 2023 that it had completed a deal to buy back blocked shares from Western investors at a 50% discount by purchasing just under 30 million shares, held through Euroclear, valued at 2,215 Rubles each which is around \$25 in a transaction that totaled \$507 million (Marrow, 2023). It further reported in November 2023 in its report titled 'Russia's Magnit completes \$736 million buyback from foreign shareholders' that the company had announced an additional purchase of 8 million shares from overseas shareholders, bringing the total value of the share buyback to \$736 million. Magnit's shares traded immediately following the completion of the share buyback transaction at 6,200 Rubles each, translating into a more than 65% discount, above the 50% threshold imposed by the Russian government. This is a huge loss for foreign investors who can only recover 35% of the worth of their investments. The government of Russia has also put hurdles in the way of investors from countries deemed 'unfriendly' that have managed to negotiate their exit from the Russian market with the enactment of Decree 302, which took effect on 23 May 2023 and confers on the Government the power to assume 'temporary' administration on investments of investors associated with "unfriendly" States, including movable and immovable property, shares and other securities and property rights. This Decree was immediately applied against Fortum and Uniper, Finnish and German energy companies, following Finland's joining NATO and Germany moving to sell the stake of Rosneft, a Russian oil giant, in a German oil refinery. President Putin signed An Executive Order on 16 July 2023, bringing the subsidiaries of French food corporation Danone and Danish brewer Carlsberg under government control (Bradshaw and Korshunava, 2023).

In April 2024, the Kremlin announced the "temporary external management" of Russian subsidiaries of Italian water heating company Ariston and German appliance maker BSH Hausgeraet. The nationalization of the assets of these Western companies before the signing of an Executive Order by President Vladimir Putin, which revealed that the measures are "an urgent response to the United States and other countries and international organizations whose actions, unfriendly and contrary to international law, illegally deny the Russian Federation, Russian legal entities and individuals property rights and/or restrict their ownership titles" (Katanich, 2024).

JPMorgan Chase, the biggest US bank by assets, has found itself caught in a U.S-Russia sanctions war after a Russian court ordered the seizure of \$440 million in JPMorgan's Russian accounts and "movable and immovable property," including its stake in a Russian subsidiary to recoup \$439.5 million from JPMorgan Chase that VTB says the US lender froze after the

Ukraine invasion. VTB filed a suit in April 2024 in a St.

Petersburg arbitration court seeking relief to recover funds frozen in the US because JPMorgan said it would exit Russia. The order exposed JPMorgan to a nearly half-billion-dollar loss for abiding by US sanctions. It was the latest example of American banks getting caught between the demands of Western sanctions regimes and overseas interests (Son, 2024).

Effects of sanctions on Europe

The harsh economic sanctions imposed by the US and European countries on Russia have compelled Russia to diversify its trade away from the West and to deepen its economic and political integration with Asia as part of a broader Eurasian bloc. Russia, a major global exporter of oil and gas and formerly the primary supplier to Europe, has shifted its focus to the Asian market in less than two years since the sanctions were imposed and the EU ceased purchasing. This shift reflects significant and profound changes in the current world economy. Today, Russia's largest trading partners are China, India, and Turkey, with much of the trade conducted in Rubles, Russia's currency, as well as in currencies such as the Chinese Yuan and Indian Rupee, reducing the vulnerability posed by the US use of the dollar as a tool to advance its global strategic interests.

The irony today is that while China and Russia are seeking economic partnership through BRICS, the US and NATO is forging military cooperation, which has contributed to the conflict between Russia and Ukraine. Russia is a member of the BRICS economic bloc, which includes Brazil, India, China, and South Africa. Before its recent expansion at the 15th BRICS Summit held in South Africa in August 2023, these countries collectively accounted for one-third of global GDP when measured at purchasing power parity, surpassing the share of the G7 nations—the group of industrialized nations including the US, the UK, Germany, France, Italy, Canada, and Japan. The new members joining the BRICS group include Saudi Arabia, Egypt, the United Arab Emirates, Iran, and Ethiopia. Many of the world's leading oil and gas producers today are now members of the extended BRICS block.

The Western economic sanctions designed to cripple Russia's economy appear to be rebounding harshly on Europe and undermining the industrial base of EU states like Germany. A survey conducted by KPMG with 280 German companies to assess the economic impact of the Russia-Ukraine war revealed significant disruptions in supply chains with Russia and Ukraine, as well as through Russia to Asia. These disruptions have resulted in substantial price increases for raw materials, energy, intermediate products, and transportation services (KPMG, 2022). For instance, fuel prices have doubled, and gas prices have tripled. The ongoing war has created considerable uncertainty for many companies.

An article published on September 4, 2023, by the Spanish newspaper El País, titled "Germany is staring at the end of its economic model," notes that Germany, the world's fourth-largest economy and Europe's largest, is facing structural challenges that could signal the conclusion of nearly two decades of prosperity. The foundation of Germany's economic model has traditionally relied on the Chinese market, affordable Russian gas, and access to low-cost labor from Eastern Europe. However, with escalating geopolitical tensions between the West and China, exacerbated by US policies resembling a new Cold War, coupled with the proxy conflict in Ukraine and Western sanctions on Russian energy, Germany is now confronting significant deindustrialization (Norton, 2023). According to El País, the shift in geopolitical dynamics has exposed vulnerabilities inherent in Germany's economic framework, which relies on three main pillars: cost competitiveness, technological leadership in its industries, and geopolitical stability—all of which are now contributing to high inflation and an economic downturn, potentially leading Germany into stagflation (Lomba, 2023).

The J. P. Morgan News release of 2nd October 2023 of J.P. Morgan Global Manufacturing PMI™, which is a composite index produced by J. P. Morgan and S&P Global in association with ISM and IFPSM, revealed that global manufacturing output contracted for September 2023 due to weakened demand. The data further revealed

that Europe is de-industrializing much faster than any other region of the world, and countries that are de-industrializing the fastest are Germany, Austria, Czech Republic, Netherlands, Poland, France, UK, Italy, Canada, and the Euro Zone as a whole and not so coincidentally the country that is reindustrializing its industrial manufacturing capabilities the fastest is Russia. This situation was inevitable according to Borrell, Europe's foreign policy Chief, who revealed in October 2022 that the economic model in the European Union as a whole, not just in Germany, was based on cheap energy coming from Russia and access to the big China market but with the new Cold War policies of the West, the sanctions on Russia and also increasingly on China, Europe is destroying this base of its economy. Another factor contributing to the de-industrialization of Europe is the US enactment of the Inflation Reduction Act signed into law on 16 August 2022 by President Biden, which includes 430 billion dollars of spending, including massive subsidies for Industries and thus incentivized companies in Europe to relocate their factories over to the US and jeopardize Europe industrial base. An article published in December 2023 by the Financial Times titled "The West's Russia oil ban, one year on- How a shadow fleet undermined the price cap" looked at the consequences of the West's oil boycott of Russia and how it has completely failed and backfired hard against Europe. The article noted that in response to Russia's Obasan 129 invasion of Ukraine, the EU banned Russian oil, and then the G7 countries in June 2022 imposed restrictions on those wanting to ship it to other parts of the world. Under the rules, if countries outside the G7, such as India and China, wanted to buy Russian oil using G7-registered ships, trading, or insurance services to move the oil, they had to pay not more than \$60 per barrel, and the idea was to make Russia lose money from its oil sales. The measure was designed to ensure the continuous flow of Russian oil into the international market while undermining the Kremlin's ability to finance its war in Ukraine (Wilson and Cook, 2023).

The Financial Times reported that while Russian oil flows into Europe, its largest export market, have dwindled significantly, millions of barrels continue to be shipped daily from Russia's western ports, primarily to China, India, and Turkey, which have replaced Europe as major markets. An intriguing development in this reshaping of the global oil market is India's emergence as Europe's primary fuel supplier, surpassing even Saudi Arabia, one of the world's top oil producers. India refines substantial amounts of Russian crude and profits by selling it to Europe. Since February of this year, India's crude oil imports have risen from 1.5 million barrels per day to nearly 2 million barrels per day, a more than 30% increase. This volume surpasses India's combined imports from Iraq and Saudi Arabia.

India's purchase of Russian crude has resulted in estimated savings of \$7.9 billion in oil import bills during the first 11 months of their financial year, following over \$5 billion saved in the previous year. Without India's proactive stance, inflation would likely have been higher and industrial growth lower. The EU's sanctions on Russia have proven detrimental, with Europe now paying higher prices for Russian oil purchased indirectly through India, while Russia's new partners enjoy significant discounts. As highlighted by the Financial Times, enforcement challenges and Russia's success in establishing a network of vessels beyond G7 control have largely nullified the \$60 per barrel price cap imposed by the G7 countries (Wilson and Cook, 2023).

Ben Cahill, a senior fellow at the US-based Center for Strategic and International Studies, noted that "Russia has been quite successful at building up its own fleet, finding alternative insurance, and establishing a network to transport crude and products" (Wilson and Cook, 2023). The G7's price cap failed within a year, as confirmed by a report from the Kyiv School of Economics in Ukraine, which indicated that 99% of Russia's crude oil exports were sold above \$60 per barrel. Furthermore, 71% of these exports were shipped using vessels registered outside G7 countries, including the UAE, China, and Greece (Norton, 2023).

An emerging reality is that Russia has increasingly distanced itself from Western industries, including insurance and shipping, having successfully developed its own infrastructure. As of October 2023, only around 20% of

Russian oil exports continue to use shipping and service providers insured by G7 or EU countries, down from nearly 80% in April 2022. The prospects for Western companies recovering this lost business in the near future appear slim, especially considering Russia's success in circumventing sanctions, which could lead other countries to prefer non-G7 or EU-affiliated companies.

Responses of multinational enterprises to west's sanctions

Over 1,000 companies have scaled back their operations in Russia beyond the minimum required by international sanctions, with some opting to maintain a presence despite pressures to withdraw. According to a compilation by the Yale Chief Executive Leadership Institute (CELI, 2024) in 2024, 215 foreign companies from the USA, Europe, and Asia have notably chosen to defy calls to exit or reduce their activities in Russia. These include Align Technology (USA), BT and Antal (UK), Bharat Petroleum (India), Auchan-Retail (France), AUMA Riester GmbH & Co (Germany), and China Communications Construction Company (China).

Additionally, 174 companies have decided to remain operational in Russia but have postponed future investments, developments, or marketing activities. Examples include Accor (France), which has suspended new investments; AstraZeneca (UK), which halted new investment and clinical trials; Bayer (Germany), which curtailed unspecified non-essential activities; Hilton (USA), which suspended new investments and closed its corporate office; Novartis (Switzerland), which paused all new capital investments; and Huawei (China), which suspended new orders and furloughed some staff.

Furthermore, 152 companies have opted to scale back significant business operations while continuing others. This group includes companies like Goldman Sachs (USA), which reduced operations but continued to buy Russian debt; BNY Mellon (USA), which suspended new activities but maintained existing client cooperation; and JP Morgan Chase (USA), which similarly wound down operations while continuing to buy Russian debt despite projecting substantial financial losses.

Financial institutions that have suspended operations in Russia include American Express, Visa, Western Union, MasterCard, Bank of America (all US-based), Deutsche Bank (Germany), and Zurich Insurance Group (Switzerland). Other notable actions include Alphabet (USA) withdrawing all operations in Moscow, ArcelorMittal (Luxembourg) resuming steel supplies to Russia, Carlsberg (Denmark) agreeing to sell its Russian business pending finalization, and Credit Suisse (Switzerland) ceasing new business in Russia while significantly reducing its exposure by 56%.

Five hundred and five companies have temporarily suspended most or nearly all operations while keeping return options open. Among companies in this category are 3M and Amazon (US), ACCA and British Airways (UK); Austrian Airline (Austria), which has canceled all flights until July; Bank of China and Asian Infrastructure Investment Bank (China), which curtailed Russian access to capital markets, La Lorraine (Belgium) which halted its which paused all JVs in Russia and helicopter production and Uniqlo (Japan) a fast Retailing, clothing company whose CEO initially stated that the company would not suspend its operations. In the tech sector, Microsoft, Apple, Cogent, Intel, IBM, and Google are all US companies, and Ericsson (Sweden) and several others have suspended operations in Russia. In the travel and logistics sector, Marriot (US) suspended its operations in Russia in June 2022, stating that restrictions imposed by the Western governments have made it impossible to continue to operate. Most major airlines have suspended operations, likewise DHL and FedEx (US). Airbus (France) has stopped the supply of parts, maintenance, and technical support services to Russian airlines but continues to purchase substantial titanium from Russia. Five hundred and forty-three companies have wholly exited the Russian market. Among these companies are two consumer goods and retail giants: H&M (Sweden), which has closed its 170 stores, and Nike (Japan), its 116 stores in Russia. In the energy sector, the war has forced British

Petroleum (UK) into seeking to sell off its nearly 20% stake in Rosneft, a Russian state-controlled oil company. It wrote off about \$25.5 billion on its nearly 20% holding in Rosneft and other ventures in the country. Shell (UK) exited its joint ventures with the Russian natural gas giant Gazprom. This decision will cost it up to \$5 billion in the first quarter of 2023 alone and reduce its earnings by between \$4 billion and \$5 billion (Economic Times, 2022). In the finance sector, Citigroup (US), which has staff strength of 3000 employees, also exited Russia and set aside \$1.9 billion for potential loan losses related to the war in Ukraine. In the food sector, Carlsberg, the world's third-largest brewer, has divested from Russia, resulting in a charge of \$1.4 billion. Heineken followed suit at the cost of \$400 million, and McDonald's, with 850 restaurants, exited Russia and wrote off \$1.2 billion from its books.

Since the seizure of \$300 billion in Russian assets, Russia has seized businesses and assets owned by the West, valued at over \$107 billion, which Blogs (2024) helpfully decomposed as follows. British Petroleum (BP) incurred the most significant loss in its exit from Russia and wrote down \$24 billion regarding its stakes in Rosneft and two other joint ventures in Russia. The second most significant loss was incurred by the French company Total Energies, which recorded an impairment cost of \$10.7 billion, followed by Shell, the world's largest Trader of liquefied natural gas, which holds a 27.5% stake in the Sakhalin-II fields and has written off \$5 billion of investment. Exxon Mobil disclosed a write-down of \$3.4 billion. Uniper, the German international energy company that owned and operated five power plants in Russia, chose to continue operations but was nationalized and, as a result, incurred a loss of \$5 billion.

The Finnish energy company Fortum, which owned and operated seven thermal power plants and a variety of wind and solar plants in Russia, was nationalized along with Uniper and thus incurred a loss of \$2 billion. The Austrian energy company OMV took a hit of €2 billion, Equinor of Norway shut all its facilities and incurred a loss of €1.1 billion, and the Italian utility business Enel Group sold its 56% stake in Enel Russia for around €137 million thereby incurring a loss of € 1.3 billion.

French Bank, Society General, which carried the most significant exposure due to its ownership of Russian Bank, Rosbank, sold its stake to a Russian oligarch and incurred a loss of €3.2 billion on the deal. Italy's Unicredit Bank had the second most significant exposure to the Russian market and has so far recognized a loss of €1.3 billion relating to all its exposures to Russian companies and individuals.

French Bank Credit Agricole had the third largest exposure and has taken a hit of EUR 500 million. Austria's Raiffeisen Bank International has so far taken a hit of EUR 301 million, Italy's insurer Generali also had large exposure and has so far recognized a loss of EUR 138 million, American Bank, Citigroup has so far taken a hit of \$170 million relating to its exposure and Swiss banking giant UBS has so far written off \$100 million and reduced its loan exposure from \$600 million to \$400 million. McDonald's has decided to exit entirely from Russia and has sold all of its stores to a Russian business that is not allowed to use the McDonald's name. As part of that deal, McDonald's has incurred a loss of \$1.4 billion. The large Belgium brewer AB InBev has written off \$1.1 billion as part of its exit. Carlsberg of Denmark, which had eight breweries and 8,400 employees in Russia, wrote off \$1.4 billion following the decree issued by President Putin seizing all of its assets. Similar was the case of Danone, the French food manufacturer, which wrote off \$1 billion following the seizure of its assets by the Russian State.

Heineken, the world's second-largest Brewer, had seven breweries and 1,800 employees in Russia but sold these operations to a Russian business for a token value of €1, thereby incurring a loss of \$325 million. The tobacco giant Philip Morris has discontinued sales of cigarette products in Russia and has taken a hit of over \$1 billion. Hankle, the makers of several consumer products, has written off €1 billion as part of its exit from the country, while the French carmaker Renault, which had set up its own facilities in Russia and also had a majority stake in

Russia's biggest car maker Autov has now exited from the country and sold its stake incurring a loss of €867 million in the year. The Japanese car company Nissan lost \$687 million, the German carmaker Volkswagen lost €550 million, the Swedish car manufacturer Volvo wrote Obasun 131 down the full amount of its investments of around \$860 million, and Ford sold its 49% stake in the Russian-based Solar Ford joint venture, incurring a loss of \$122 million.

DISCUSSION

Western countries' view of sanctions as a denial tool for weakening the aggregate power of targeted actors flies in 50 million euro investment in Moscow and Leonardo (Italy) the face of reality when directed at a great power, as evidenced by the multiple policy challenges confronted in the case of the Russo-Ukrainian war (Drezner, 2024). The nature of the trade between Russia and Europe prevents the implementation of a total embargo because of the likelihood of Europe incurring long-term economic costs in sanctioning Russia. Denial strategy requires multilateral cooperation to ensure that all producers of targeted goods comply to ensure that the sanctioned entity cannot secure alternatives for sanctioned goods, and this cooperation can only be sustained and enforced through institutional machinery as obtainable for US-led financial sanctions that leverage the dominance of the US capital markets in global finance. The private sector has lagged in implementation and enforcement because it lacks the compliance mechanisms to enforce sanctions. While multilateral cooperation has been robust in the West, the scope of this cooperation is not global, and the degree of institutionalization could be much higher (Drezner, 2024).

There is now a convergence of opinions that sanctioning great powers has a slim chance of achieving objective because great powers most likely will "possess the strategic reserves and capacities necessary to withstand sustained economic pressure" (Drezner, 2024). When the G7 countries-imposed sanctions on Russian crude, they miscalculated a lot, assuming that the world would comply and sacrifice their economies to punish Russia. However, save the Euro Zone, most countries are practical and have continued trading with Russia because it is unwise to stop trade with a big commodity producer offering a discount (Foo, 2024). The barrage of sanctions unleashed on Russia by the West is most unlikely to compel or deter Russia from relinquishing the territories captured through the expenditure of blood. Sanctions, therefore, failed as a deterrence or compellence tool. The decision by Western powers to weaponize the Russian Central Bank's foreign reserves may cause a significant shift in international financial order as central banks outside Western countries could begin the diversification of their external reserves from assets denominated in Western currencies, principally USD and Euro, and give oxygen to de-dollarization of transactions as we have seen actively promoted by the BRICS group. Between January and April 2024, some countries in the Middle East and Africa decided to evacuate their gold reserves from the United States.

These are Saudi Arabia, the largest economy in the Middle East, Ghana, Cameroon, Senegal, Algeria, Egypt, South Africa, and Nigeria, the last three being the largest economies on the African continent. Even though the official reason was to reduce their exposure to economic risks in the United States, it also reflects a growing lack of trust in US global leadership, hence the need to stave off future confiscation of foreign reserves by the West.

Implications of unilateral imposition of financial sanctions

Arbitrariness of power

A significant concern for countries outside the West, particularly geopolitically vulnerable developing nations, is the risk of arbitrariness when host states decide to exercise control over the assets of foreign central banks to strategically incapacitate a state, as exemplified recently by the United States. In 2019, the US government transferred control over assets of the Venezuelan National Bank held in the United States to Juan Guaidó, following its recognition of Guaidó as the interim president of Venezuela over Nicolás Maduro, the incumbent

president. This action constituted an overreach where a foreign power not only intervened in the internal affairs of a sovereign state but also coerced the state to accept its preferred candidate.

After the collapse of Ashraf Ghani's US-backed government and the Taliban takeover in Afghanistan in August 2021, the \$7 billion foreign reserves of Afghanistan's central bank, Da Afghanistan Bank (DAB), held at the Federal Reserve Bank of New York, were immediately frozen by the United States government to prevent access by the Taliban-led government. Subsequently, the United States and Swiss governments established the "Fund for the Afghan People" based in Geneva, with an account at the Bank for International Settlements. They transferred half of the frozen assets, amounting to \$3.5 billion, to this fund. The fund was designed to be administered by a board consisting of the US Ambassador to Switzerland (as chair), two selected Afghan financial experts, and a Swiss official, specifically for banking, financial, and economic stabilization purposes. Notably, the funds were not directed through the Taliban administration (Byrd, 2022). The freezing of these assets contributed to economic collapse, increased unemployment, and exacerbated the humanitarian crisis in Afghanistan.

Deleveraging from western assets

The freezing of \$300 billion in Russia's foreign reserves after the invasion of Ukraine sparked fears worldwide and broke trust in the dollar system, accelerating central banks' rush to diversify to gold. Russia has been much more aggressive in selling all its Treasury securities, reducing to \$ 29 million in July 2023, the lowest in the last 15 years. US Treasury statistics revealed that China has not added to its treasuries since 2014, after the US imposition of sanctions on Russia in reaction to the takeover of Crimea (Middelkoop, 2023). Its holdings are down to less than \$780 billion, 40% down from ten years ago. In the first quarter of 2024, China sold \$53.3 billion of Treasuries and US agency bonds, a record amount highlighting its move to diversify away from American assets as trade tensions persist. One estimate calculated that China had sold \$300 billion of US Treasuries between 2021 and mid-2023 (De Mott, 2024). The West's extension of sanctions across the financial system has incentivized emerging market economies to divert their foreign holdings from dollar assets into gold. The central banks in China, India, Turkey, and beyond have dramatically increased their gold holdings. The BRICS, Brazil, Russia, India, China, and South Africa, have bought almost 5,000 tonnes of gold for their official reserves in the last 15 years, with both China and Russia adding more than 1,500 tonnes and India adding around 450 tonnes. World Gold Council revealed that since October 2022, China has bought bullion in each of the 17 months to become the biggest buyer of the past few years. Gold as a share of the country's central bank reserves increased from 3.6% in early 2022 to 4.3% by the end of last year, an increase of \$28 billion. As China, the second largest owner of Treasuries, was buying the gold, it was simultaneously dumping US Treasuries with the rationale being diversification. This move could significantly impact the global financial system. Some European Union countries have joined the gold rush, with Poland more than tripling its gold holdings from 102.8 tonnes in 2000 to 333.7 tonnes in 2023, Hungary's central bank from just 3 tonnes in 2018 to 94.5 tonnes in 2021 and, Czech has increased its holding by 37.5% in first 11 months of 2023. The purchase of gold by the central banks of emerging markets suggests countries want to diversify from the dollar since sanctions target dollar assets. The weaponization of the dollar financial system by the United States has given oxygen to the BRICS, which is becoming an alternative platform to the existing US-dominated system. The BRICS bloc, in a strategic move, is seeking to create an alternate world order to challenge Western-led global governance. The BRICS have emphasized the necessity for diversified global leadership and a greater plurality of ideas, consistently arguing for a more multipolar and democratic order. The bloc's initiatives, such as reducing reliance on the US dollar and creating new institutions, clearly diverge from the Western-led system. Forty countries expressed interest in joining the group before the 2023 summit; twenty-three made formal applications, and five new members were welcomed to the group, showcasing the bloc's growing influence.

The BRICS is working to establish a 'New Development

Bank' as an alternative to the World Bank and the IMF, whereby the Global South can foster its own development needs. The plan by the BRICS bloc to introduce a common currency has the potential to challenge dollar hegemony and provide an attractive alternative to the dollar. This new currency could accelerate the trend toward de-dollarization, cause a decline in the dollar's value, and weaken the power of the US to sanction sovereign states. However, it must first stabilize against the dollar (Pistilli, 2024). The current geopolitical landscape presents a challenge for international investors since Firms' internationalization has become more entangled by contextual political processes, and the dimension of political intervention in international business kept changing unpredictably, leading multinational enterprises to incur considerable losses, particularly in the aftermath of the sanctions imposed on Russia by the West and the countersanctions unleashed by Russia. As a proactive approach to significantly reduce risk, International investors would need to implement strategies that can improve their ability to navigate the complexities of the current geopolitical climate and minimize losses from unexpected sanctions.

The following strategies were proposed.

Risk management

Multinational corporations must improve scenario planning, developing scenarios encompassing different political interventions, including potential sanctions. Analyze how these scenarios might impact subsidiaries in different countries and plan contingency measures for each scenario, including potential divestment or restructuring operations.

International investors need to enhance their due diligence process beyond financials to include a thorough political risk assessment for any potential investment location. This assessment should consider historical trends in sanctions, political stability, and the relationship between the host country and potential sanctioning countries. More than ever, Multinational corporations need to consider diversifying their investments across different countries and economic sectors to minimize the impact of sanctions on any single location or industry. This reduces vulnerability to sanctions targeting specific regions or any single operation. Alternative markets less likely to become entangled in geopolitical disputes should be considered. International efforts for greater transparency in foreign policy decision-making, particularly regarding sanctions, should be supported. This is because predictable and well-communicated sanctions allow businesses to plan and adjust their strategies accordingly.

Flexibility and adaptability

Multinational corporations should strive for localization, increasing local sourcing and production within subsidiaries to reduce reliance on sanctioned goods and services from other countries. On an ongoing basis, alternative markets outside the sanctioned region should be identified and developed to maintain revenue streams. Also, a prudent approach is to engage in local lobbying with businesses and governments in subsidiary countries to advocate for policies that minimize disruption caused by sanctions.

Information gathering and monitoring

Early Warning Systems for monitoring geopolitical developments and potential sanctions threats should be developed, tracking relevant news sources, government pronouncements, and international relations analyses. Investing in political intelligence services that track geopolitical developments and potential sanctions risks in specific countries and developing solid relationships with government officials in both home and host countries is essential. These relationships can provide valuable insights into potential sanctions and offer opportunities to advocate for MNCs' interests.

Investment strategies

Considering the changing political landscape, international investors should prioritize long-term investments over short-term gains, as this allows for weathering short-term disruptions caused by sanctions. Investment should be made in 'sanction-proof' sectors, which are less likely to be targeted by sanctions, such as essential goods (food, medicine) or infrastructure projects. It is crucial to incorporate flexibility and adaptability into a corporate system for survival and success by developing a flexible corporate structure that allows for rapid adaptation to changing political landscapes.

This could involve diversifying product lines or shifting production locations. Lastly, it is vital to maintain open communication with investors, informing them of potential risks and the company's mitigation strategies.

While complete mitigation might not always be possible, proactive measures can significantly reduce potential losses. Implementing a combination of these strategies by international investors can build resilience against the risks associated with unexpected sanctions.

Limitations

Given the dynamic nature of the research subject, with new sanctions being imposed or lifted frequently, the research findings may need to be updated periodically. Relying solely on qualitative data may limit the generalizability of the findings. Future research could incorporate quantitative data analysis to strengthen the causal relationships between sanctions and economic disruptions.

Conclusion

The deployment of sanctions as a deterrent and compellence tool has massively increased in recent years, leading to increased uncertainty and turbulence in the global economy. This is because the U.S. foreign policy over the past decade has relied on economic sanctions above all other tools of engagement. The imposition of economic sanctions is morally fraught as it finally damages an entire population when, in most cases, the target is the government and significant influences around the government. The decision by Western powers to weaponize the Russian Central Bank's foreign reserves is already causing a significant shift in international financial order as central banks outside Western countries have commenced the diversification of their external reserves from assets denominated in Western currencies and is giving oxygen to de-dollarization of transactions. The freezing of the foreign reserve assets of the Central Bank of Russia held by other central banks is an irregular enlistment of these central banks in monetary and financial warfare. It is a move that is capable of destabilizing the economy and financial systems, violating the principle of an open market, and challenging the independence of complying central banks from the political authorities. For multinational enterprises, sanctions represent institutional changes in host and home markets that affect many aspects of their activities. They often result in reversals in developing market-supporting institutions and create barriers to cross-border economic activities. International sanctions force multinational enterprises and domestic firms to critically evaluate their businesses and make strategic decisions that have short-term and long-term consequences for the operations and organization of affected companies. In recent years, the internationalization of firms has become more entangled by contextual political processes, and the dimension of political intervention in international business has kept changing unpredictably. Sadly, the boards and management of multinational enterprises are still not yet equipped to handle the political contingencies of internationalization. Building a model for predicting political interventions and changes to be made for adaptation may take much work due to the lack of predictability in international relations in today's world, where friends can become foes very quickly. Implementing a combination of risk management, flexibility and adaptability, Information gathering and monitoring, and investment strategies by international investors can build resilience against the risks associated with unexpected sanctions.

Multinational enterprises have incurred considerable losses in the aftermath of the sanctions imposed on Russia by the West and the countersanctions unleashed by Russia. This war should never have happened; ironically, most businesses could not have predicted this outcome. The African proverb that says, 'when two elephants fight, it is the grass that suffers' applies to the growing conflict between the US-Led Western countries and Russia. When powerful forces go to war, it is not just their people who are hurt but everyone within the scope of their influence. The grass is the multinational companies and international investors caught in the crossfire of preventable crises, which must be protected to preserve the international economic system.

FUTURE RESEARCH DIRECTIONS

This research has identified areas for further investigation, such as developing alternative conflict resolution mechanisms or strategies for MNCs to adapt their operations in sanctioned environments. The research can be further expanded by conducting case studies to analyze the specific impact of sanctions on different industries or regions.

CONFLICT OF INTERESTS

The author has not declared any conflict of interests.

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