B4Ukraine

HOW GERMANY CAN HELP DEFUND AND DISARM RUSSIA'S WAR ON UKRAINE

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Summary

2024 is the year to defund Russia's war of aggression. The B4Ukraine Coalition is calling on the German government to prioritise the following areas to achieve this objective:

1. **Increase pressure on Russian fossil fuel revenues**, including leading calls for a swift and full ban on Russia's Liquified Natural Gas imports to Europe; adopting shared measures to curb Russia's "shadow" fleet to avoid a looming environmental disaster on Germany's coastline; and stopping the import of refined Russian oil products.

2. **Encourage responsible corporate exits from Russia** through issuing risk guidance for companies; and **disincentivise continued company operations** through the introduction of a 'Russian operations tariff' to support Ukraine's defence and reconstruction.

3. **Improve export controls and enforcement to disarm Russia's military industrial complex,** through boosting corporate responsibility and effective supply chain best-practice human rights and end user due diligence by demonstrating a willingness to investigate, prosecute and issue substantive fines for violations; ensuring German enforcement institutions are adequately resourced and structured for cooperation; closing export control gaps including, as a matter of urgency, those on Russia and Belarus; and tackling third-country circumvention schemes through targeted sanctions on intermediaries.

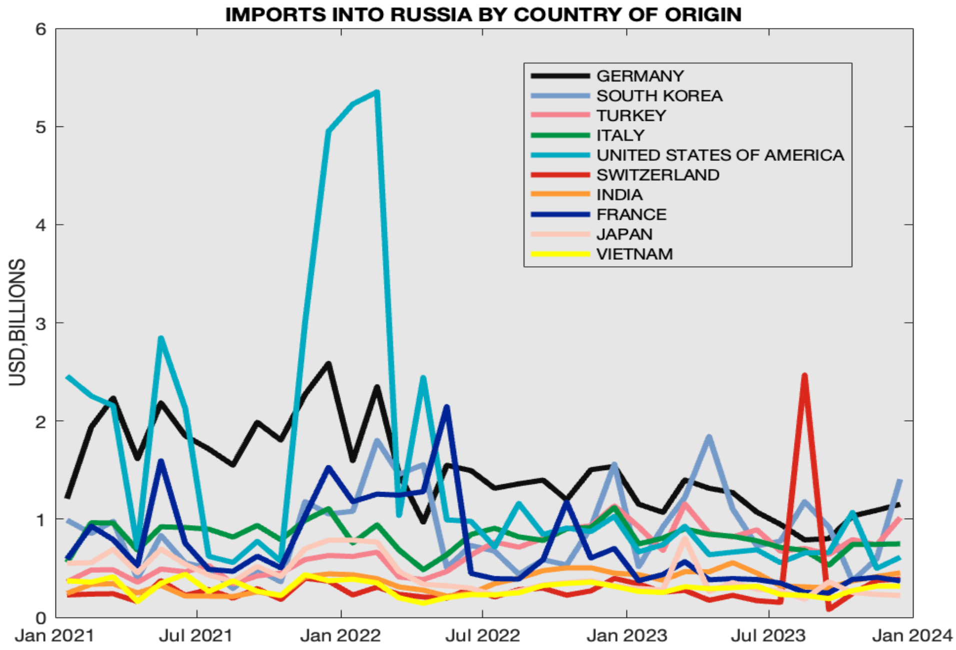
Introduction

It is now over two years since Russia's full-scale invasion, and Ukraine continues to resist as Russian attacks destroy its infrastructure, environment and human lives.

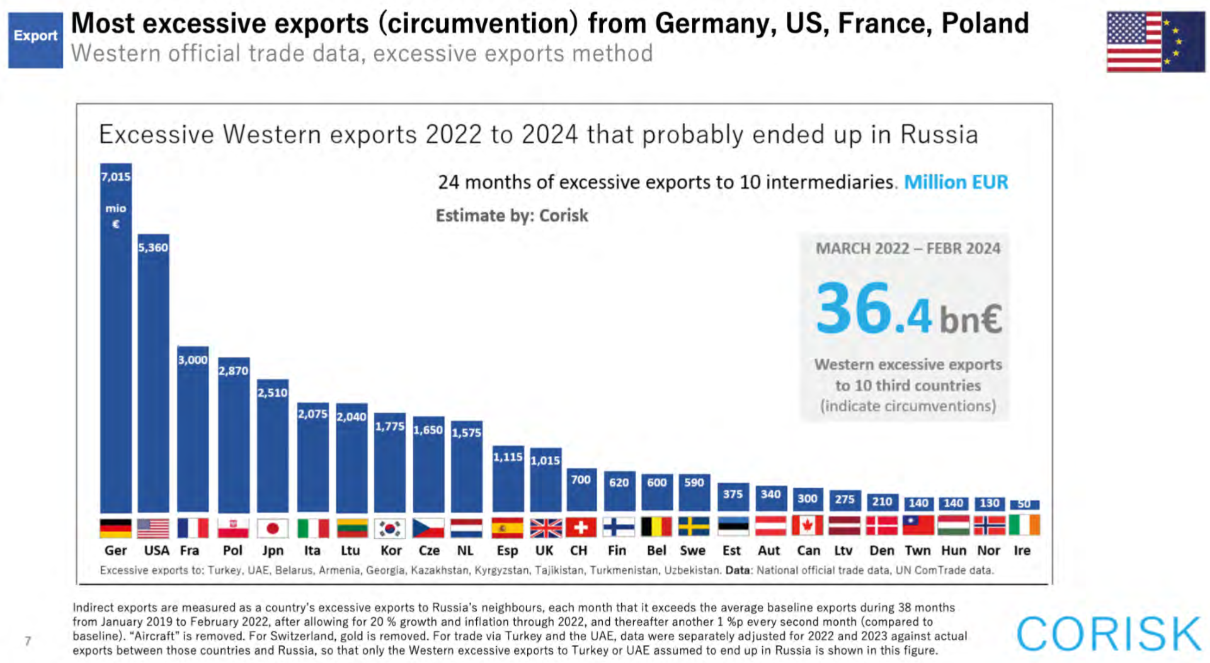
In this time, Russia's military machine has been sustained by the flow of fossil fuel revenue combined with corporate taxes paid by foreign companies and the supply of Western military technology. While the G7's unprecedented sanctions have constrained its economy, Russia has found new ways to evade and circumvent these measures. Closing the existing sanctions loopholes and tackling continued corporate presence in Russia for the non-sanctioned businesses are of utmost importance to defunding and disarming Russia's war.

Despite strong support from the German government and its people for Ukraine, data shows how German companies have continued to help sustain Russia's war of aggression through trade flows, the provision of sensitive goods, and their corporate presence in Russia.

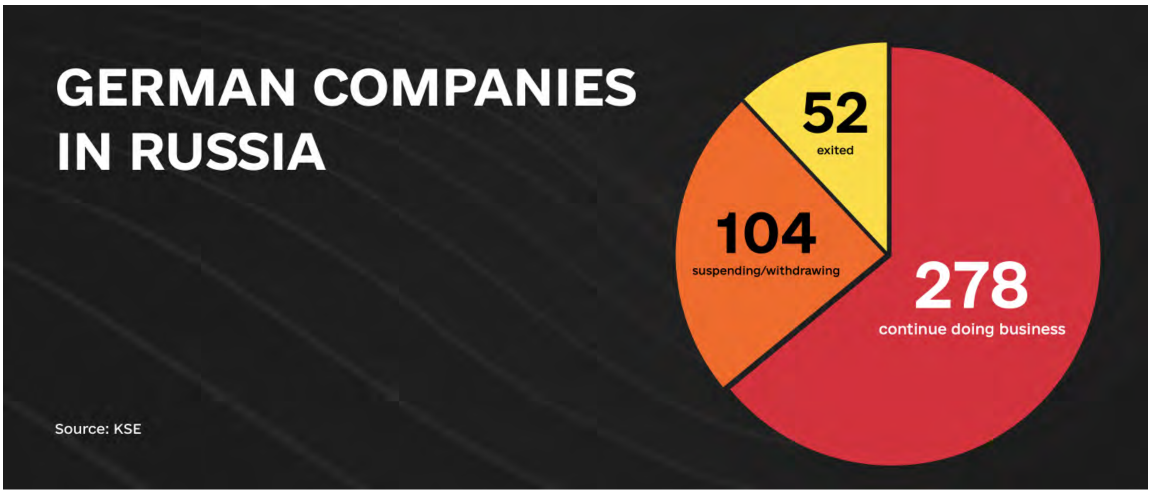
Germany is in 2nd place after China in terms of volumes of goods delivered to Russia.



Germany is the 1st in the EU for excessive exports of sensitive goods to Russia's neighbours.



Germany has the second largest number of businesses remaining in Russia, next to the US. The Kyiv School of Economics (KSE) estimates that German companies paid $1.9-2bn in tax to Russia in 2022-2023.



Further political leadership and policy interventions are needed from Germany in order to block the economic and material resources sustaining Russia's war on Ukraine. This paper draws on the work of B4Ukraine Coalition to set out a blueprint for action by the German government to defund and disarm Russia's war of aggression.

Increase Pressure on Russian Fossil Fuels

Sanctions on Russian fossil fuels have had a positive effect - but the overall impact is not enough to defund the war. Two years after the full-scale invasion of Ukraine, and Russian fossil fuel revenues are still a major cash-cow to the Kremlin, helping Russia to afford a ~70% increase in military spending in 2024 (vs. 2023).

- Measures such as the EU oil import ban and G7 price cap have had a significant impact. Russia's export earnings from oil have been cut by 14% vs. a hypothetical non-sanctions baseline, costing them €34 billion over the one year period after sanctions were implemented. Due to lower oil export earnings, Russia's external environment has deteriorated markedly: merchandise exports in 2023 were 28% lower than in 2022, the goods balance 62% smaller, and the current account surplus 79% smaller. Due to sharply reduced foreign currency inflows, the ruble has lost ~40% of its value vs. USD and EUR compared to fall 2022. Budget revenues from oil and gas have also been impacted; they came in 24% lower in 2023 vs. 2022.

- Nevertheless, since the full-scale invasion of Ukraine, the Kremlin has amassed more than €610 billion ($657 billion) in revenue from its export of fossil fuels.

- This is equivalent to nearly **27 times** the total of all the bilateral aid (€23 billion) committed to Ukraine by the German government since the full-scale invasion.

Despite reducing its reliance on Russian fossil fuels, European countries, including Germany, continue to purchase large quantities of Russian fossil fuels.

- Overall, the EU has purchased an estimated €188 billion ($203 billion) of fossil fuels from Russia since Russia's full-scale invasion of Ukraine; and the average EU citizen has paid more than Euros 400 for Russian fossil fuels since the invasion.

- Between May 2023 and May 2024, **Germany imported an estimated €182.4 million of oil products (diesel, gasoil and naphtha) made from Russian crude oil.** This diesel, gasoil and naphtha was imported into Germany from the STAR refinery in Turkey that was 61% reliant on Russian crude over the most recent 12 month period whilst the Jamnagar refinery in India was 29% reliant on Russian crude. Germany's purchases of oil products made from Russian crude in Turkey and India will have sent tens of millions of euros back to the Kremlin in tax revenues.

- Meanwhile, Russian LNG continues to reach Germany from Belgium. **The estimated share of regasified Russian LNG in total gas deliveries from Belgium to Germany in 2022 is six to eleven percent.** In 2023, the Russian gas share is likely to have been even higher, as Russia's LNG imports via the port of Zeebrugge increased by 41% to 4 billion cubic metres in 2023 compared to 2022, while Belgium's gas deliveries to Germany increased in 2023 remained roughly stable.

Gaps in EU sanctions and national policy enable this continued trade.

LOOPHOLE 1: LIQUIFIED NATURAL GAS IMPORTS

Imports of Russian Liquified Natural Gas imports need urgent attention. The EU currently has no ban on the flow of Russian pipeline gas or LNG to Europe.

- The EU has purchased more than half of all Russian LNG since the invasion - sending an estimated 12 billion euros per year back to Russia.

- This applies to Germany too. Russian LNG continues to reach Germany via imports from Belgium's Zeebrugge and other EU ports.

- Yet the EU is not dependent on Russian LNG. A ban would have a negligible effect on energy security. Imports of Russian LNG accounted for 5% of EU gas consumption, showing the bloc's relatively low reliance on it.

- Conversely, Russia is heavily dependent on the EU as a market for LNG and as a transshipment point for world markets. The flagship Yamal LNG project is particularly dependent, with 82 % of all

Yamal exports between 24 Feb '22-24 Feb '24 going to or via EU ports/waters.

- Without the current arrangement of unfettered EU access, Russia would not be able to maintain current export levels and its plans to expand its LNG income stream would be severely disrupted.
- **In the first 4 months of 2024, the EU bought 18% more Russian LNG (in volume terms) than the same 4 month period of 2023.** Without the bloc banning Russian LNG imports, EU companies will continue to buy more unsanctioned Russian LNG. If the bloc is to succeed in their RePower EU plan to end reliance on Russian fossil fuels by 2027 they must start reducing their imports of Russian LNG immediately.

LOOPHOLE 2: THE SHADOW FLEET

The continued operations of Russia's underinsured shadow fleet enables evasion of the Price Cap policy and poses a looming environmental risk in European/German waters.

- Russia's shadow fleet exists to circumvent the G7's oil price cap policy. The exact size of the shadow fleet is unknown, but the International Maritime Organisation estimates that globally it consists of between 300-600 old tankers. These lack proper insurance, have opaque ownership, and "flag hop" between different permissive ship registries, posing considerable risk to other ships and to the environment.
- Shadow fleet vessels also frequently conduct ship-to-ship transfers, which further increases the risk of incidents, for instance in Sweden's exclusive economic zone to the east of Gotland – just outside its territorial waters - and in Greek territorial waters off the coast of Kalamata.
- Older 'shadow' tankers transporting Russian oil and petroleum products across EU Member States' Exclusive Economic Zones, Territorial Waters, or various straits raise environmental and financial concerns due to their questionable insurance coverage, potentially lacking sufficient Protection & Indemnity (P&I)

insurance to cover the cost in the event of an oil spill or catastrophe. In the case of accidents and spills, it would lead to environmental disaster and EU taxpayers would foot at least some of the bill.

- From the onset of the Russian full-scale invasion until the end of March 2024, **342 unique vessels have passed through the Baltic Sea from Russia and subsequently transited through the Danish Straits close to the Northern coast of Germany.** These vessels alone exported Russian oil valued at €46 bn. 153 vessels are older than 20 years, some of them already 36 years, posing significant environmental risk.
- The clean-up cost operation and compensation resulting from just one oil spill from these 342 tankers with dubious insurance could fall on the coastal country taxpayers in the region of over a billion euros.

LOOPHOLE 3: THE 'REFINING LOOPHOLE'

A "refining loophole" in the oil sanctions has allowed Western countries, which have largely banned the import of crude oil from Russia, to import billions of euros worth of oil products from third states. Once crude has been transported outside Russia and refined into petroleum products such as gasoline or diesel by third countries such as India, Turkey or China, it is no longer considered of Russian origin, and can legally be imported to the price cap countries.

Between May 2023 and May 2024, Germany imported an estimated total of €182.4 million of oil products (diesel, gasoil and naphtha) made from Russian crude oil.

- Between mid-May 2023 and mid-May 2024, Germany imported an estimated € 81.5 million of refined oil products (naphtha) from the STAR refinery in Turkey, € 73.1 million of this was estimated as being produced from Russian crude oil. The STAR refinery was 61% reliant on Russian crude over the most recent 12 month period.

- Between mid-May 2023 and mid-May 2024, Germany imported an estimated € 372.8 million of refined oil products (diesel and gasoil) from the Jamnagar refinery in India, €109.3 million of this was estimated as being produced from Russian crude oil. The Jamnagar refinery was 29% reliant on Russian crude over the most recent 12 month period.

- Germany's purchases of oil products made from Russian crude in Turkey and India will have sent tens of millions of euros back to the Kremlin in tax revenues.

RECOMMENDATIONS

The German government should urgently adopt measures and drive European action to curb Russia's shadow fleet and address the environmental risk posed by Russia's under-insured shadow fleet in German waters.

- Require 'shadow' tankers transporting Russian oil through German territorial waters to provide documentation showing adequate maritime insurance. Adequately capitalised and independently credit-rated P&I insurance is readily available through so-called 'P&I clubs' and roughly 95% of the global tanker fleets carries it. It provides cover for any spills that could affect coastal areas. Requiring proof of adequate P&I cover would limit Russia's ability to use shadow fleet tankers in key areas through which its oil exports must pass, including the Baltic Sea, Black Sea, and Mediterranean. Failure to provide proof of P&I coverage would reliably identify shadow fleet vessels and could expose them to enforcement action (i.e., designations).

- Identify and sanction all vessels, their owners, operators and lead crew members that engage in the transport and/or ship-to-ship operations of Russian crude oil and oil products sold above the price cap.
- Ban ship-to-ship transfers of Russian crude, oil products and LNG in German territorial waters and exclusive economic zones.
- Ban ancillary maritime and other services to ship-to-ship transfer operations taking place in German territorial waters.
- Identify and sanction third country service providers (maritime or otherwise) that engage with the transport and/or ship-to-ship or ship-to-shore operations of Russian crude oil and oil products sold above the price cap (e.g.: insurers, brokers, port and logistics companies, financial services…etc.)

The German government can also use its position and influence within the EU and G7 to defund the war by plugging the gaps and strengthening enforcement of the existing EU sanctions.

- **Lead calls to fully ban liquefied natural gas (LNG) imports from Russia and its transshipment in European ports for exports to other countries, setting a clear and swift implementation date.**
- Near-term, the EU should designate the 15 specialist icebreaker tankers which are capable of transporting Russian LNG from arctic waters to world markets. Sanctioning these vessels would seriously disrupt the trade.
- Longer term the EU should make good on its promise to wean itself off Russian fossil fuels by also eliminating Russian pipeline gas imports.
- **Close the “refining loophole”**, which allows EU countries to import oil products – mainly diesel, jet fuel and gasoline – produced from Russian oil at refineries in third countries like India, Turkey or UAE. The most effective step would be to ban the importation of oil products produced from Russian crude oil. This would enhance the impact of the sanctions by disincentivizing third countries from importing large amounts of Russian crude and help cut Russian revenues. The price cap coalition’s relatively low reliance (3%) on

oil products produced from Russian crude means that a ban on these imports would have no significant inflationary pressure on domestic oil prices.

- **Lower and fully enforce the price cap on Russian crude oil and oil products.** This action will not drive up global oil prices for two reasons: First, Russia's oil production costs are low enough ($10-15/bbl) to make sure that the incentive to supply is maintained even at a much lower cap level. Second, Russia is too dependent on oil export earnings and budget revenues to weaponize its exports in the same way it did with gas.

  Proper price cap enforcement will also require addressing critical weaknesses in the attestation regime. Research has shown that price cap compliance is very low if not entirely absent due to the oil trader/brokers falsifying pricing information. At the heart of the issue lies the fact that this information is coming from intermediaries that are either subsidiaries of Russian oil companies or entities suspected to be linked to Russia.

Encourage responsible corporate exits from Russia and disincentivise continued operations

In the days following Russia's invasion of Ukraine, global companies by and large condemned Russia's actions and rushed to ensure the safety and wellbeing of affected employees. Hundreds withdrew or suspended operations and investment in Russia – or announced their intention to do so. Several major companies went further, providing support and needed services to Ukrainian refugees and their families.

Yet two years after Russia's invasion, more than 2100 multinational companies, including many western household names, continue doing business in Russia. Their presence helps sustain the war on Ukraine and undermines the rules-based international system. Since the full-scale invasion of Ukraine, only a tiny number of foreign firms (358) have completed a full exit from the Russian market through sale or liquidation.

The Kyiv School of Economics estimates the amount of taxes paid by all foreign companies operating in Russia in 2022-2023 at $20 billion (€18.6 billion). This undercuts the significant bilateral humanitarian, financial and military aid provided by G7 and allied countries. For every $7 G7 governments declared in bilateral aid to Ukraine in 2022, its companies paid $1 in taxes to the Russian state.

German corporate presence in Russia

The global picture is reflected when we look at the data for German-headquartered companies. At the time of writing, 268 German companies (or 63%) continue operating to some extent in Russia. A further 103 have suspended or are withdrawing operations. Only 52 have completed their exit.

German firms were the 2nd biggest contributors to the Kremlin's coffers through taxes on profit, paying $402m (€370m) in profit tax to the Russian government in 2022. **KSE conservatively estimates the total for overall German tax to Russia in 2022 to be $1.9-2bn (€1.75-**

1.84) annually in 2022.

Why is this a problem?

Firstly, German companies operating in Russia are prolonging the war through their tax contributions to the Russian state. Their presence also undermines Germany government support to Ukraine, with €23 billion in funding committed since the full-scale invasion.

Secondly, companies operating in Russia are required by Russian law to help conscript employees into the Russian army as well as providing other resources when asked. This makes them potentially directly complicit in over 125,000 war crimes committed by the Russian Armed Forces in Ukraine. Financial institutions, for instance, are also required by the regulator to provide payment holidays to members of the Russian military.

Lastly, their presence is now hindering Ukrainian funding by blocking the use of frozen Russian assets, amounting to around €300 billion. The threat of retaliation from Russia, such as the expropriation and nationalisation of foreign companies, is one of the primary reasons for foreign businesses to pressure their respective governments against the confiscation of Russian sovereign assets.

Thus, foreign firms that choose to stay in Russia hold both Ukraine and Western governments hostage to their decisions. This situation places the entire financial burden of defending Ukraine on these governments, while the companies themselves continue to profit in Russia and indirectly finance the war.

The burden of financing military assistance and reconstruction of Ukraine must be placed on the aggressor state and the companies that fund the aggression, not the Ukrainian and German taxpayers.

The case for a responsible exit

In the last two years since the start of the full-scale war against Ukraine, through a series of legislative initiatives the Russian government has gradually — but predictably — tightened restrictions for foreign companies willing to leave their market. For instance, foreign businesses willing to exit are obliged to sell at a 50% discount while also paying at least a 10% in “exit tax” to the Kremlin, in addition to obtaining a special government permit for any large-scale exit deal.

On top of these barriers to exit, the Russian government has begun to expropriate western businesses, gifting lucrative assets to the Kremlin supporters.

While we acknowledge the real challenges faced by companies willing to leave the Russian market, B4Ukraine challenges the recent media narrative that companies have become hostages of the Kremlin. This ignores the fact that companies have made a choice to turn a blind eye to red-flag warning signs from the invasion of Crimea in 2014 onwards and chose to remain even as competitors made the call to exit. We continue to emphasise the agency that businesses did and continue to have in making responsible decisions, in line with their obligations under the UN business and human rights framework.

Under conditions of lawlessness, the Russian government de facto already controls the assets of businesses that remain in Russia. That is why these companies must pursue an exit strategy. In situations where no credible sale option exists, and in the face of clear direct contributions to mass human harm, companies should write down the loss and/ or take the case to international arbitration or seek other legal remedies.

RECOMMENDATIONS

- **The German government should support responsible business conduct by informing German businesses of risks associated with continued business operations in the aggressor state and setting out options for a responsible exit.**
- As a leading G7 government, Germany has a responsibility to define expectations for businesses that are currently not subject to sanctions. The United States has led the way here with a business Risk Advisory for Russia.
- To support responsible investment, Germany should also require all publicly listed companies to disclose their exposure to Russia, including the full taxes paid to the Russian government from 2022.
- **At the same time, the German government should disincentivise**

continued corporate presence in Russia through introducing a 'Russian Operations Tariff' for corporations who have chosen to remain in Russia to contribute to Ukrainian defence and reconstruction. Their continued presence supports the Russian budget and war effort and hinders the confiscation of Russian assets, making this measure necessary until they exit the Russian market. Up until that point, for every €1 in corporate taxes paid to the Russian budget, €2 should be allocated to Ukraine.

- Ukraine's 2024 budget allocates nearly €37 billion — roughly half of its total expenses — to defence. This is three times less than the Russian defence budget, but ironically estimated to be the same as Western companies paid to the Russian one since the full scale invasion. Imposing these measures may not only equalise the power of the parties but also, in the long run, reduce Russia's resources for continuing the war while increasing Ukraine's resources for effective defence.

Improve export controls and enforcement to disarm Russia's military industrial complex

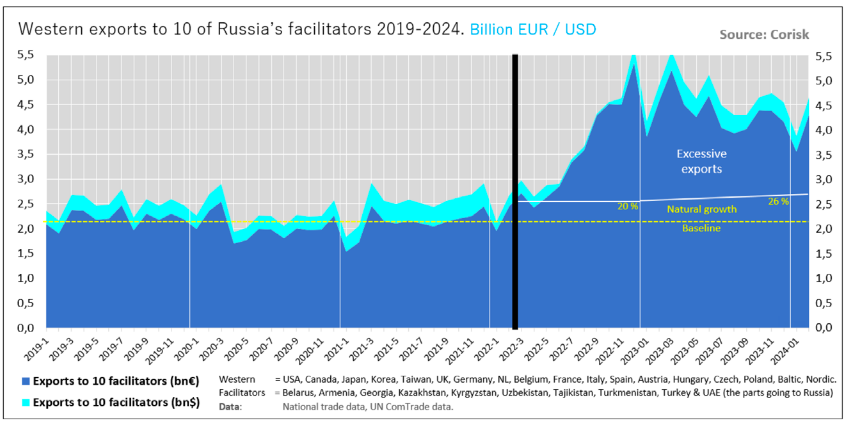
Despite the introduction of export controls, Russia continues to import large quantities of western items critical to Russian weapons systems and its military development. In the first ten months of 2023, it received $8.8 billion (€8.2 billion) worth of the so-called "common high-priority (CHP) items (also known as "battlefield goods"), according to a recent Kyiv School of Economics (KSE) report. Roughly 44% of these imports came from companies headquartered in countries that have imposed export controls on Russia, illustrating that Russia continues to rely heavily on Western components for its military industry. 3.2% of the imports in value terms were accounted for by German companies.

Third country circumvention

Since the imposition of restrictions, supply chains have adapted and many sensitive goods now reach Russia via intermediaries in third countries. Many of the producers from coalition countries whose products are repeatedly found in Russian weapons on the battlefield continue to trade with Russia via third-country intermediaries.

Data shows that Germany is no exception. While direct exports to Russia of all goods have dropped, indirect exports (measured as excessive exports to Russia's neighbours each month after it exceeds the average baseline exports during 38 months from January 2019 to February 2022) have increased.

Starting point: Western excessive exports via 10 third-countries
Western official trade data, excessive exports method

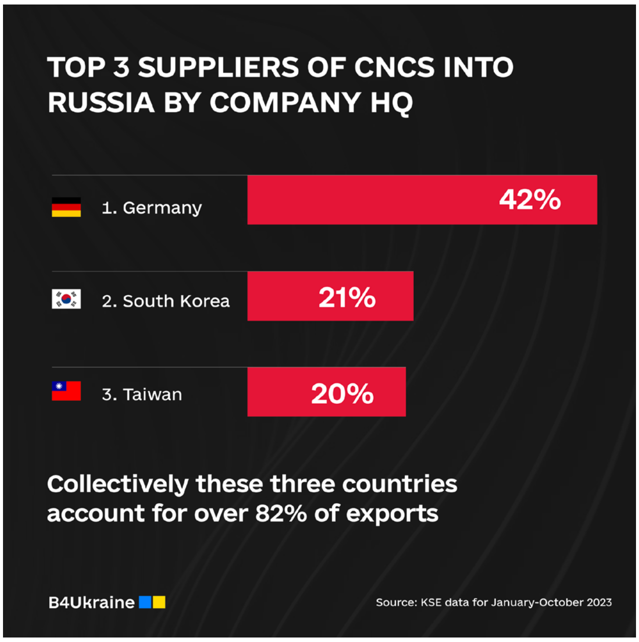


Indirect exports are measured as a country's excessive exports to Russia's neighbours, each month that it exceeds the average baseline exports during 38 months from January 2019 to February 2022, after allowing for 20 % growth and inflation through 2022, and thereafter another 1 %p every second month (compared to baseline). "Aircraft" is removed. For Switzerland, gold is removed. For trade via Turkey and the UAE, data were separately adjusted for 2022 and 2023 against actual exports between those countries and Russia, so that only the Western excessive exports to Turkey or UAE assumed to end up in Russia is shown in this figure.

CORISK

Computer Numerical Control (CNC) machines

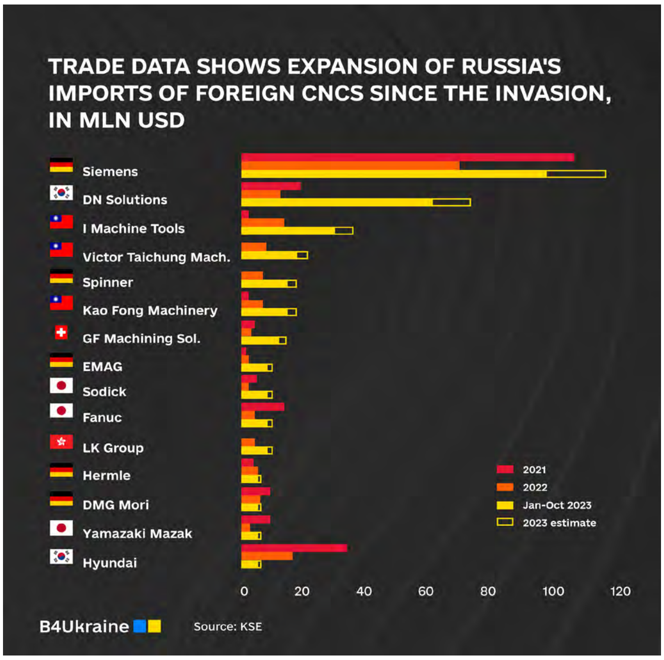
Germany plays a central role in the production of [CNC machine tools](), which remain the backbone of Russia's military production. Every single Russian tank or plane has parts made with foreign-made CNC machines. Between January-October 2023, Russian imports of CNC machinery surged to $292 million (€270 million), representing a staggering 33% increase relative to the previous year. The top suppliers of Germany (42.3%), South Korea (20.7%), Taiwan (19.5%), collectively account for over 82%.



The production of these items is also overwhelmingly located in coalition countries—76.7% in January-October 2023—with Germany (28.0%), Taiwan (20.4%), and South Korea (15.9%) playing the biggest roles.

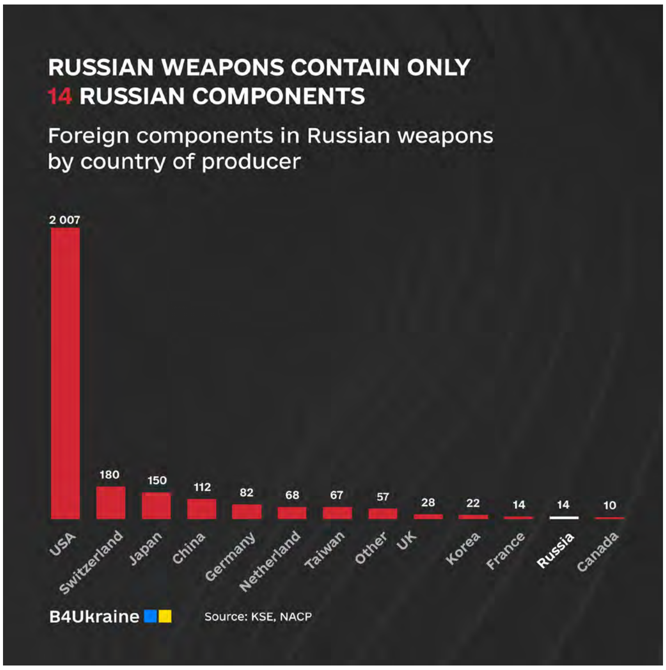
Most CNC machine sales and shipments to Russia come from China, Hong Kong, and Turkey. However, there are still some direct shipments from the EU (8.6%), South Korea (7.5%), and Taiwan (5.5%). Within the EU, the largest shares belong to Finland, Poland, Germany, Lithuania, and Latvia. NATO member Turkey has been a standout accomplice in terms of shipments of CNC machines and spare parts.

CNC machinery made by key producers has continued to reach Russia since the full-scale invasion from some top producers, including those headquartered in Germany. In some cases, [trade has increased]().



Components

A staggering 95% of all foreign parts found in Russian weapons on the battlefield were sourced from producers in the coalition helping defend Ukraine, with 72% accounted for by US-based companies alone. German producers accounted for 3% of foreign parts.



The fact that Russia still acquires advanced technology from the West signals its inability to do so domestically or with the help of China. This provides the coalition countries with significant leverage if existing export control loopholes are closed.

RECOMMENDATIONS

Germany can reduce its substantial shadow trade:

- **Bolster corporate responsibility.** Private sector buy-in is the first line of defence for export controls enforcement as dual-use goods are often extremely difficult to trace once they have been sold by the original producer. Robust and effective compliance procedures based on best-practice human rights and end user due diligence by the German private sector is critical and can be incentivised through German authorities demonstrating a willingness and ability to investigate and impose meaningful fines in the case of violations. In the absence of a higher risk of discovery and higher penalties, the risk assessment of the companies in question is unlikely to change.

- **Strengthen enforcement institutions and cooperation.** Enforcement agencies in sanctions coalition countries need to be adequately equipped to implement and enforce comprehensive export controls. The European Union lacks unified enforcement structures altogether, as member states remain responsible for the implementation of restrictive measures, including those imposed on the EU level. In the area of export controls, it is critical for countries, including Germany, to identify which government agency is responsible when goods from companies headquartered there are produced offshore and never physically pass through their jurisdictions.

- **Close export control policy gaps.** Significant inconsistencies continue to exist within the Russia export controls regime. These stymie effective enforcement and enable circumvention. Restrictions need to be harmonised across coalition jurisdictions. A clear example of this is the need to align export controls on Russia and Belarus. As many of the goods in question are produced on behalf of coalition-based companies in third countries, it is also important to ensure that export controls in all jurisdictions apply extraterritorially the way U.S. ones do under the Foreign Direct Product Rule.

- **Target third-country circumvention.** Coalition authorities need to address the role of third-country intermediaries in export control circumvention schemes, including those in China, Turkey, and the UAE. A first step is to impose sanctions on entities found to facilitate export control violations which involve companies or individuals from coalition countries. This has to be done comprehensively (i.e., targeting not only a small number of entities), consistently (i.e., across sanctions coalition jurisdictions), and regularly (i.e., adapting to Russian attempts to rework its circumvention networks).

- **Leverage the role of financial institutions.** Banks should be tasked to play a role in the monitoring of the trade with export-controlled goods and impeding illicit transactions, building on their experience with due diligence in areas such as anti-money laundering (AML) and countering financing of terrorism (CFT). They must be enabled to play this role by aligning access to critical information with what is available in the AML/CFT spheres. Banks also require additional data about the goods reflected in financial transactions to be able to identify export controls-related red flags.

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