SWIFT SYSTEM TURNS INTO ECONOMIC SANCTIONS INSTRUMENT

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Shortly after the Russia's forces started a "special military operation" against Ukraine on the evening of 24 February 2022, in essence a full-scale invasion of Ukraine, the leaders of the European (Union) Commission held an emergency meeting to discuss the punitive sanctions that could be put in place against Russia to deter her from military aggression. The reports on the matter point out that at the meeting, specific financial measures European Union (EU) member states may take against Russia were discussed. It is noted in this respect that one of the controversial options discussed at the meeting was the exclusion of Russian financial institutions from the global messaging system for financial transactions, which is called the Society for Worldwide Interbank Financial Telecommunications (SWIFT). It is claimed in the reports that many EU leaders, including German Chancellor Olaf Scholz and French Finance Minister Bruno Le Maire, advocated the view of being extremely cautious. In fact, it is also claimed that the French Finance Minister Bruno Le Maire considered the SWIFT ban as a last resort and characterized such a sanction as a "financial nuclear weapon."[1] Additionally, it is mentioned in the reports that Italy, Hungary, and the Greek Cypriot Administration of Southern Cyprus have also expressed their concerns at the EU meeting regarding the SWIFT ban.[2]

What is SWIFT and Why is Important for International Financial Transactions?

Conventional wisdom considers SWIFT as the cornerstone of global financial transactions.[3] Before SWIFT came into existence, international interbank telecommunication was managed through Telex-Messages. After the decline of the telex message system, SWIFT was founded on 3 May 1973 as a non-profit cooperative organization to create a shared worldwide data processing and communication link. Furthermore, it was headquartered in Brussels as a diplomatic alternative to the intense rivalry between New York and London.[4] At its founding, SWIFT membership amounted to 239 banks from fifteen Western countries. Its main task was to create common standards for the transmission of financial information. A year later, SWIFT connected to Asian countries. By 1987, SWIFT's user base began to expand with the participation of broker-dealers, exchanges, central depositories, and clearing institutions. According to its website, SWIFT's 2020 strategy envisages a strong focus on core objectives like building its financial crime compliance portfolio and expanding its market infrastructure.[5]

Brief History of Using SWIFT as an Economic Sanction Instrument

As can be understood from the information given above, SWIFT is designed to make international payments quickly and efficiently as per its establishment purpose. However, past examples show that SWIFT can also be used as a weapon, even though it is nominally independent. For example, in 2012, SWIFT, under pressure from the United States (US) and the EU, agreed that Iran's membership violated American and European sanctions and, as a result, sanctioned Iranian banks were dis-

connected from the system. SWIFT announced this decision with the following explanation:

> "The new European Council decision, as confirmed by the Belgian Treasury, prohibits companies such as SWIFT to continue to provide specialised financial messaging services to EU-sanctioned Iranian banks. SWIFT is incorporated under Belgian law and has to comply with this decision as confirmed by its home country government. This EU decision forces SWIFT to take action. Disconnecting banks is an extraordinary and unprecedented step for SWIFT. It is a direct result of international and multilateral action to intensify financial sanctions against Iran. SWIFT has been and remains in full compliance with all applicable sanctions regulations of the multiple jurisdictions in which it operates and has received confirmation of this from the competent regulatory authorities. As a global provider of secure messaging services, SWIFT is not involved in or control over the underlying financial transactions that are contained in the messages of its member banks."[6]

On the other hand, known for its numerous resolutions threatening non-EU countries with sanctions on various issues, the European (Union) Parliament has adopted resolutions proposing to remove Russia from SWIFT. For example, the Parliament resolution of 29 April 2021 on Russia regarding "the case of Alexei Navalny, the military build-up on Ukraine's border and Russian attacks in the Czech Republic" underscored that "Russia should be excluded from the SWIFT payment system."[7] Furthermore, according to an another resolution adopted on 16 December 2021 regarding "the situation at the Ukrainian border and in Russian-occupied territories of Ukraine", the Parliament once again threatened Russia with exclusion "from the SWIFT payment system, thereby excluding Russian companies from the international financial market."[8] As per the press release of the Parliament, the resolution was adopted by 548 votes in favour, 69 against, and 54 abstentions. In addition to these threats of the European Parliament, according to the US White House press release of 7 December 2021, regarding US President Joe Biden's video call with Russian President Vladimir Putin, Biden voiced the deep concerns of the US and its European allies to Putin about Russia's escalation of forces surrounding Ukraine and made it clear that "the U.S. and its Allies would respond with strong economic and other measures in the event of military escalation. "

It is worth mentioning at this juncture that Russia, back in 2014, considering these threats from Western countries regarding expulsion from SWIFT system, started to develop a domestic financial-communications platform called as the System for Transfer of Financial Messages (SPFS). The system was developed by the Bank of Russia and is considered by some as a "Russian analogue to SWIFT."[9] It is noted that the Russian platform had more than four hundred member banks -including

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two dozen from former Soviet states- and managed one-fifth of all domestic financial communications by the end of 2020. Meanwhile, the growing Chinese Cross-border Interbank Payment System (CIPS) should also be considered. Like SPFS, CIPS is tiny compared to SWIFT. However, CIPS already has users in over a hundred countries; it is reported that 1280 financial institutions in 103 countries and regions have connected to the system.[10] Backed by the People's Bank of China (PBOC), CIPS' clearing and settlement services system initiated in 2015 is being used to internationalize the Chinese yuan.[11] CIPS is likely to be pleased to expand its reach and be seen as an alternative to the US and EU-driven Western banking systems.

EU Statements and Decisions on Removing Key Russian Banks from SWIFT System

In the statement made by the European Commission on 26 February 2022, under the heading of "Joint Statement on further restrictive economic measures", the European Commission and the leaders of France, Germany, the United Kingdom (UK), Italy, Canada and the US (the G-7 countries minus Japan) announced the following commitments regarding financial and economic sanctions against Russia:

> We, the leaders of the European Commission, France, Germany, Italy, the United Kingdom, Canada, and the United States condemn Putin's war of choice and attacks on the sovereign nation and people of Ukraine. We stand with the Ukrainian government and the Ukrainian people in their heroic efforts to resist Russia's invasion. Russia's war represents an assault on fundamental international rules and norms that have prevailed since the Second World War, which we are committed to defending. We will hold Russia to account and collectively ensure that this war is a strategic failure for Putin...
>
> Specifically, we commit to undertake the following measures:
>
> First, we commit to ensuring that selected Russian banks are removed from the SWIFT messaging system. This will ensure that these banks are disconnected from the international financial system and harm their ability to operate globally.
>
> Second, we commit to imposing restrictive measures that will prevent the Russian Central Bank from deploying its international reserves in ways that undermine the impact of our sanctions...[12]

Subsequently, the EU on 2 March 2022 announced that the Union "agreed to exclude key Russian banks from the SWIFT system, the world's dominant financial messaging system."[13] The European (Union) Council regulation on this decision was promulgated in the Official Journal of the EU on 2 March 2022.[14] The names of the Russian banks to be sanctioned are included in the annex of the Decision. These banks are: Bank Otkritie, Novikombank, Promsvyazbank, Bank Rossiy, Sovcombank, VNESHECONOMBANK (VEB), and VTB BANK, and "any legal person, entity or body established in Russia whose proprietary rights are directly or indirectly owned for more than 50 % by these entities."[15] The regulation prohibits "to sell, supply, transfer or export euro denominated banknotes to Russia or to any natural or legal person, entity or body in Russia, including the government and the Central Bank of Russia, or for use in Russia."[16] The EU statement mentions that the banks targeted by measure were chosen as these banks are already subject to sanctions by the EU and the G7 countries. Furthermore, it is stressed that the decision would take effect as of 12 March 2022 to give SWIFT and other operators a brief transition period to implement the measure, thereby mitigating any possible negative impacts for EU businesses and financial markets.

SWIFT announced the EU's decision to remove Russian banks from the system with the following statement, which is similar to the statement on Iran sanctions:

> Diplomatic decisions taken by the European Union, in consultation with the United Kingdom, Canada and the United States, bring SWIFT into efforts to end this crisis by requiring us to disconnect selected banks from our financial messaging services. As previously stated, we will fully comply with applicable sanctions laws. To this end, in compliance with the legal instructions in EU Council Regulation (EU) 2022/345 of 1 March 2022 we disconnected seven designated Russian entities (and their designated Russia-based subsidiaries) from the SWIFT network on 12 March 2022. Additionally, in compliance with EU Council Regulation (EU) 2022/398 of 9 March 2022, we will disconnect three Belarusian entities

> (and their designated Belarus-based subsidiaries) on 20 March 2022. The SWIFT community will be kept regularly updated across multiple channels, including in the customer section on swift.com. SWIFT underpins the flow of value around the world, across more than two hundred countries, and demonstrates what can be achieved when people come together for common good. We will continue to support economic stability, resiliency, and prosperity across the global financial system, to support long term resolution and recovery as well as support politically neutral humanitarian organisations through our corporate social responsibility programmes.[17]

As can be seen from the SWIFT announcement, three Belarusian entities (and their designated Belarus-based subsidiaries) have also been excluded from the system in reaction to Belarus' involvement in Russia's invasion of Ukraine.

Conclusion

It is possible to say that sanctions, especially those economic in nature, are one of the most controversial tools used in international diplomacy. While rooted in the earliest international practices, particularly in times of war, economic sanctions now take many forms in times of peace. They can be directed against states or against persons belonging or close to governments, or opposed to them, as is the case with terrorists and their supporters. The intention of these sanctions is to "inflict commercial, financial or monetary damages on the target State or persons in order to pressure them to act in a certain way."[18] Certain scholars, while explaining the history of economic sanctions, refer to the description by the then US President of Woodrow Wilson of sanctions in 1919 as "the economic weapon." In this context of the designation of economic sanction as a weapon by Wilson, scholars point to the practices of Allied and Associated Powers led by the UK and France in the First World War during which they launched an "unprecedented economic war against the German, Austro-Hungarian, and Ottoman empires."[19] As such, there have been various historic examples for sanctions being used as a tool for economic war beyond the cases of Iran and now Russia.

In recent years, there has been a significant increase in the economic-financial sanctions applied by both the EU and the US to impose their will on other countries. Being in the same alliance in such an overzealous sanctioning mood is no longer sufficient to warrant exclusion from sanctions. Such sanctions have at times turned into an exercise of "teaching lessons" to some allies. There have been cases in the past where this course of action has reached a level where it has shaken even the strongest alliances.

On the other hand, economic sanctions are sometimes imposed in response to violations of international norms of behavior. The most recent example of this is, as discussed throughout this paper, the sanction for the removal of leading Russian banks from the SWIFT system. In terms of its effects, it will not be surprising that this sanction has a greater impact on the international scale than in the past. In this context, it should be noted that the French Finance Minister's aforementioned characterization of the key Russian banks' expulsion from SWIFT as a "financial nuclear bomb" has merits. It would be a prudent approach not to exclude the possibility that this sanction, which aims to push Russia into a corner economically, will cause tectonic shifts on the global financial system in the near future. The case of destructive economic sanctions targeting Russia may cause many countries outside the Western world to seriously consider the option of being included in existing or newly developed systems that may be an alternative to SWIFT in the coming period. These developments give us the strong signals that there may be radical structural changes in the international political and economic system created after the Second World War.

Endnotes

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