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Article

The banking system of Ukraine as a factor of social stability in the war

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Abstract: Before the collapse of the USSR, Ukraine was one of the 15 socialist republics. Along with Belarus, the Russian Federation, and the USSR, Ukraine is one of the founders of the United Nations. Ukraine has gone through transformations from a command-administrative to a market system in 30 years. The driving force behind this development was the national democratic forces, the leaders of which were former dissidents of the USSR. One of the main factors of market transformations in Ukraine is the national private banking business. In the conditions of Russia's direct military aggression against Ukraine in 2022, the banking business of Ukraine has shown its institutional capacity and is one of the stabilizing factors of society. Thanks to the integration of Ukraine's banking business into the global financial system, millions of Ukrainian refugees have the opportunity to use their accumulated funds in the national currency abroad. The purpose of this article is to analyze the impact of the banking sector of Ukraine on the country's democratic development and the contribution of the banking system to countering Russian aggression. The article considers further ways of development of the banking system of Ukraine in the post-war period.

Keywords: Russia's military aggression against Ukraine; banking system of Ukraine; banks with foreign capital in Ukraine; monetary policy; transformation from a command-administrative to a market economy
JEL Classification: E30; E31; E32; E37

1. Introduction

Russian military aggression against Ukraine after 2022 divided the modern world into three major camps: countries with an authoritarian type of government that support Russia in its aggression, democratic countries that support Ukraine with resources, and countries that support neutrality and want to be in the camp of the winners but also try to have their profit from the war. The support of partners allows Ukraine, which is 4 times smaller in terms of population and 8 times smaller in terms of GDP than the aggressor, to successfully resist on a front with a length of more than 1200 km in 2022–2023. The declared goal of Ukraine in the war is to oust the aggressor from its territory. Due to the military and financial support of more than 50 countries in the world, Ukraine received the next resources: $90.5 billion in military aid, $12.3 billion in humanitarian aid, and $130.1 billion in financial injections to cover the budget deficit based on "The Ukraine Support Tracker" from February 2022 to July 2023 [1]. In total, aid to Ukraine for this period exceeds the annual level of GDP for 2021.

As a result of internal political processes in the United States of America, in the first quarter of 2024, military and resource support to Ukraine from this country almost stopped.

After the collapse of the USSR in the 1990s, the doctrine of empire development was formed by Russian intellectuals. Moscow can remain an equal center of influence on world politics and economy and be a separate civilization under the following main conditions: first, if it shapes the outlook and ideology of the community of no less than 300 million people. Second, if it remains the leading military power with nuclear weapons. Third, if it holds a leading position in the world energy supply markets. According to the developed doctrine of conducting a hybrid war, Russia has several regional conflicts in the countries of the former USSR. Russia created and financially supported pro-Russian political forces in all neighboring states. Russia created a global information system of mass media to influence the electorate of democratic countries [2].

Ukraine, with a population of more than 42 million people and with the largest territory in Europe, was constantly at the center of political, informational, and economic aggression of the Moscow Empire. Civil society and corresponding political parties were formed in Ukraine in 30 years, despite the long-term cultural and information dominance of Russian information resources in the mass media of Ukraine, powerful pro-Russian political parties, energy dependence on Russia, and the government corrupted by the Russians. Leaders of civil society were well-known from USSR dissidents. They were supported by the Ukrainian diaspora from the US and Canada. These forces are fighting for a place among European democratic countries for Ukraine and are opposing Russian expansion. In 2004 and 2013, there were two national democratic revolutions. These revolutions completely changed the political agenda that had been shaped by Moscow's imperial forces.

The purpose of this article is to analyze the impact of the banking sector in Ukraine on the country's democratic development and the contribution of the banking system to countering Russian aggression.

After the collapse of the USSR, each of the 15 republics was looking for its own model of development [3]. The Baltic countries, which had a relatively small population and formed a pro-European political elite, joined the European Union and NATO. The economic system of Belarus has remained centrally planned for 30 years. The concentration of political and economic power in Belarus took place in the hands of an unchanged president, who became completely controlled by Russia. In Georgia and Moldova, national democratic and Russian pro-imperialist political forces are in constant conflict. Ukraine, which transferred the third-largest nuclear arsenal to Russia in the early 1990s, had tried to remain a neutral country, in 2014 balancing between the Western and Eastern vectors of development before the Russian military aggression.

Ukraine had a powerful military-oriented state industry, good electricity generation, transport infrastructure, and developed agriculture at the beginning of the 1990s. At the beginning of the 1990s, Ukraine had a powerful military-oriented state industry, good electricity generation, transport infrastructure, and developed agriculture. However, the Ukrainian military industry was part of the industrial complex of the USSR. The cycle of the final production of weapons was located in Russia. After the collapse of the USSR, this part of Ukraine's economy lost sales markets. Ukraine's economy relied on the cheap energy resources of the USSR and had outdated energy-intensive technologies.

Russia's aggression against Ukraine in the financial field began in 1991. Russia refused to share gold and currency assets and foreign economic assets with the countries of the former USSR. According to the agreements at the time of the creation of the Commonwealth of Independent States, Ukraine accounted for 16.4% of this property according to previous agreements. The National Bank of Ukraine began its work with zero foreign exchange reserves and no assets in 1992. The funds of the population of Ukraine, which were in the accounts of "Sberbank of the USSR" at the end of 1991, were transferred to the benefit of the Russian economy due to the instructions of the central Moscow office. In 1992, the order of settlements between enterprises and banks of Russia and Ukraine was changed by the decision of the Russian government. Payments between enterprises began to be made only via correspondent accounts of central banks. The Ukrainian enterprises were thrown out of the Russian ruble currency zone by this decision. There were "huge blood clots" in the calculations between corporations. There were huge blood clots in the calculations between corporations. Later, according to interstate agreements, these accumulated debts between enterprises were formalized as the state debt of Ukraine. In 1992–1993 Ukraine agreed to place Russian military bases in Crimea for 10 years to repay this debt. Ukraine experienced hyperinflation. The savings of the population depreciated. It was necessary to carry out an unprepared monetary reform urgently in these conditions. The inflation rate in 1992 exceeded 10,000% [4].

2. The development of the private banking business in Ukraine

It was the dynamic development of private banking businesses for independent Ukraine that became one of the main drivers of the growth of private business activity. The banking business was the locomotive of changes in the country in the conditions of the collapse of the USSR economy, hyperinflation, and shortages of money, goods, and services.

The birth of the Ukrainian private banking business should be attributed to the end of the 80s, to the period of Gorbachev's reconstruction of the USSR within the framework of the planned economy. At that time, all industrial enterprises had state ownership and were subject to centralized management. However, to activate private initiative at that time in the USSR, the decision was made to demonopolize the centralized banking system; enterprises were allowed to invest funds in the creation of new banks at the expense of profits. Private commercial banks began to develop.

The banking business in the USSR was centralized. In the USSR, there were five large banking structures that had central Moscow offices and republican, regional, and district offices. This is how "Sberbank of the USSR" worked with citizens' funds. The state "Oschadbank of Ukraine" was created on its basis. "Promstroybank USSR" served industry and construction. The bank was corporatized by employees and continued to operate as Prominvestbank in the 1990s. "Sotskombank USSR" served trade and social security. The bank was corporatized and operated as "Ukrsotsbank". The Export-Import Bank of the USSR served foreign trade operations. On its basis, the state "Ukreximbank" was created. "Agromprombank USSR" served agricultural enterprises. The bank was corporatized by employees and continued to operate as Agroprombank "Ukraine".

With the beginning of Ukraine's independence, the National Bank of Ukraine started registering new banks with private and mixed capital. By the end of 1992, there were 133 banks in Ukraine. The increase in legal entities occurred due to the registration of new ones and the re-registration of Russian branches into Ukrainian legal entities. The requirements for the initial capital were minimal because of the hyperinflation of that period. In 1995, 230 legal entity banks were already operating. Banks began to actively develop their own network of branches and finance small private businesses and privatized enterprises. Managers of the middle management of Soviet banks had the opportunity to start their own business.

Ukraine became a member of the IMF in 1992. In 1994, it received the first tranche of 250 million SDRs from the IMF for carrying out structural reforms. Already in September 1996, at the highest legislative level, Article VIII of the Agreement with the IMF on ensuring the convertibility of the hryvnia for current trade transactions was ratified. This clear solution, at first sight, could not be put into full practice for a long period because international reserves were minimal and the country was dependent on the supply of gas, oil products, coal, and nuclear fuel from four nuclear power plants.

The economic reforms regarding the transition from a state form of enterprise management to a market one were very difficult and inconsistent under the leadership of the IMF. There was opposition from the deep Soviet bureaucracy. Privatization of enterprises in some sectors of the economy led to the formation of industrial and financial groups, which quickly turned into private monopolies and began to influence the legislative and executive branches of the government. The banks and stock market institutions were used as a tool for property redistribution in this period.

The banking business was developing mainly at the expense of private investments and was a flagship in carrying out market reforms for the first 20 years. New banks were registered, bankruptcies with various scandals occurred, and financial market infrastructure and banking business tools were developed. The banking supervision procedures were developed according to Basel requirements. In the first edition of the Laws "On Banks and Banking Activity" and "On the National Bank of Ukraine", the legislative field was regulated according to the Basel principles. The provisions were laid down in the laws, which did not allow turning the banking regulator into an organization with unlimited raiding capabilities. Banks had the opportunity to appeal regulatory decisions of the NBU in court. After legislative changes in 2015, banks lost this opportunity.

In the 1990s, the private banking business that served the accounts of its industrial financial group was also a tool for protecting the property rights of this group. Private banks protected the confidential information of majority owners. In addition, the banking business was a tool of anonymous concentration of assets for high-ranking government officials who converted power into industrial and financial assets during this period. In addition, during this period, banking Russian capital played a significant role in the privatization processes of the 1990s in Ukraine [5].

The integration of Ukraine into the global financial system took place gradually. The first bank with 100% foreign capital was registered by the French banking group CreditLyonnais. Credit Lione Ukraine Bank began operating in 1993.

One of the most successful projects that started from scratch was "ING Bank Ukraine" of the Dutch financial group ING Bank, which entered the market in December 1997.

In 1998, one of the most successful foreign projects, Raiffeisen Bank Ukraine, of the Austrian financial group Raiffeisen International, entered the Ukrainian market.

Citigroup opened “Citibank Ukraine”, which focused on servicing subsidiaries of multinational companies in Ukraine and trade financing of export-import flows.

“ProCreditbank” of the German ProCreditHolding started work from scratch at the beginning of 2001. It was focused on the niche of lending to small and medium-sized businesses, and it had one of the fastest development models on the Ukrainian market, as life has shown.

The expansion of the largest Russian banks into the Ukrainian market in the early 2000s, which bought the business of already existing structures, should be noted.

After the “Orange” revolution of 2004, the financial sector of Ukraine was widely opened to the entry of international financial groups, which bought the shares of already operating private banks and offered the market new banking products in the period from 2005 to 2008. It was a period of powerful integration of the financial system of Ukraine into the international space.

On the eve of the global financial crisis of 2008, 13 of the 20 largest financial groups in the markets of Central and Eastern Europe operated in Ukraine. It were such groups, as: Austria (Raiffeisen International Holding AG, Erste Bank, Volksbanken International), Hungary (OTR-bank), Germany (ProCredit Holding, Commerzbank), Greece (Piraeus Bank), Georgia (Bank of Georgia), Israel (Bank Hapoalim), Italy (UniCredit Bank), Kazakhstan (Tyuram Alem Bank), Cyprus (Marfin Popular Bank, Sharp Arrow Holdings, Bank of Cyprus Group, IMB Group), Luxembourg (EFG Private Bank), the Netherlands (ING-Bank, TVIF Financial Services, Houm CreditGroup, Credit Europe Bank), Poland (PKO Polska, GetinHolding), USA (Citigroup), France (BNP Paribas, Credit Agricole, Calyon Global Banking, Societe Generale), Czech Republic (Houm Credit Group), Sweden (SEB, Swedbank). In addition, more than ten banks with Russian capital, which were six of the seven largest ones, operated on the Ukrainian market. Ukrainian businesses attracted from banks with foreign capital only in foreign currency total credit resource with the equivalent of up to $70 billion in the period from 2005–2008. The rapid dollarization of the credit market of individuals laid a slow-acting mine in relation to the risk of a sharp change in the exchange rate of the hryvnia. Another approximately $30 billion was received by national businesses in the form of direct investments, which were used for investments in agriculture and the processing industry.

The global financial crisis began in Ukraine in the second half of 2008. The crisis was deepened by the banking financial crisis and the devaluation of the national currency by 60%. Ukraine’s GDP fell by 15.4% in 2009. As a result of the crisis, three dozen banks lost their liquidity and went bankrupt. To minimize the consequences of the crisis, the state nationalized three systemically important banks with budget funds. As a result of this economic crisis, pro-Russian political parties and the pro-Russian president came to power in the 2010 elections. They changed the vector of political development of the country.

The conflict between civil society and the authorities intensified as a result of the Ukrainian government’s refusal to sign the association agreement with the European Union at the end of 2013. In 2014, a deep political crisis ended with a “revolution of dignity” and a change of power. After the escape of the president to Russia, early elections of the president and Verkhovna Rada, as well as local authorities, were held. Russia took advantage of the internal political instability in Ukraine. Russia's military aggression began. Russia annexed Crimea and launched an active military operation in eastern Ukraine in February 2014.

The main creditor of Ukraine during this period was the IMF. The terms of lending to Ukraine by the International Monetary Fund since 2014 have been standard ones, despite the ongoing military aggression. To receive money, Ukraine had to make a transition to inflation targeting and introduce a floating exchange rate in its monetary policy. In addition, the government had to carry out structural reforms in management and strengthen the fight against corruption. State procurement, state-owned enterprises, and private banks were considered channels of corruption. With the financial support of the IMF, the National Bank of Ukraine withdrew more than 100 private banks from the market and nationalized the largest private bank, PrivatBank, in the period from 2014 to 2016. During this crisis, the hryvnia devalued from UAH 8 to 25/USD. The Executive Management Body model (as classified by the IMF) actually began to operate in the field of monetary policy formation as a result of the reforms in Ukraine. This model envisages the concentration of authority for policymaking and its implementation in a single body. Decisions of the NBU board were removed from the control of the judicial branch of government. At the same time, it should be noted that the concentration of significant powers in one management unit without a proper system of checks and balances increases the risks of inefficient activities and abuses [6].

In the conditions of devaluation of the national currency in 2014–2017, the regulator increased the capital requirements of banks. The NBU systematically strengthened the requirements for the formation of reserves for active bank operations. The NBU implemented measures to reveal the ultimate owners of banks and also increased the requirements for the transparency of borrowers' capital. Under these conditions, the banking system showed a high level of negatively classified assets. Banks significantly reduced lending, and investment lending stopped. Banks began to work more with government securities.

Ukraine's economy was still under the stress of the global pandemic crisis of COVID-19 when Russia's large-scale military aggression against Ukraine began in February 2022. The Ukrainian military withstood this insidious blow. There was a consolidation of society to counter aggression. In these conditions, the financial system of Ukraine showed its institutional capacity. Despite the scale of the aggression, there was no panic in the banking segment of the market. People's trust in the banking system was proved, and the liabilities of banks increased month by month. The NBU switched to a fixed exchange rate policy and sharply increased the discount rate. State banks were operating even when the fighting was taking place in Kyiv, unlike a number of banks with foreign capital.

The quality of the monetary authority's administrative measures was more effective in comparison to the events of 2014–2015. Ukrainian banks have shown their integration into the European financial space. All displaced persons in the country and refugees in European countries were able to use their accounts in the banking system of Ukraine freely, as well as receive pensions and social benefits even abroad. After the start of the aggression in 2022, the National Bank of Ukraine withdrew from the market all Russian banks with state Russian capital. The National Bank of Ukraine also nationalized one of the largest private banks that had belonged to Russian oligarchs and got under international financial sanctions.

The tight monetary policy of the Central Bank of Ukraine in 2022–2024 kept the financial market in a stable state. The policy of a positive discount rate at a fixed exchange rate in conditions of reduced demand led to a rapid slowdown of inflationary processes (**Figure 1**).

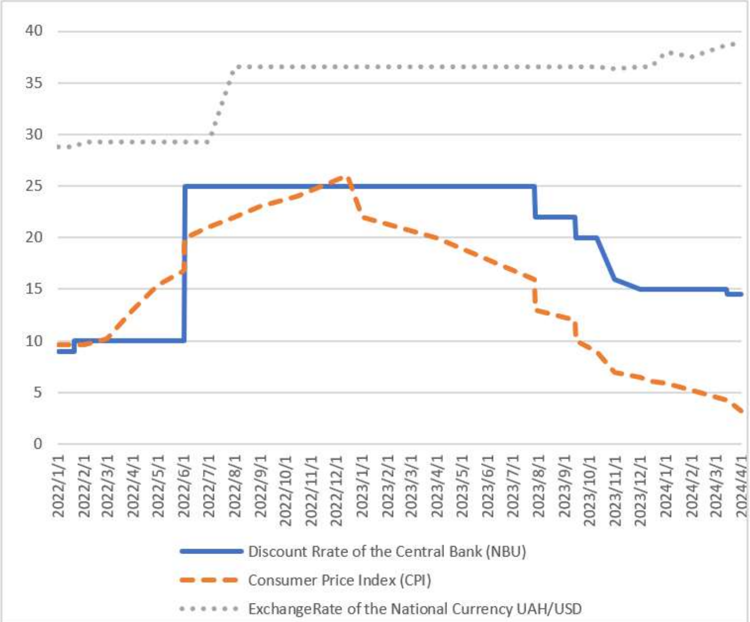

Figure 1. Dynamics of the NBU discount rate (%), exchange rate of the national currency hryvnia (UAH/USD), consumer price index (%) in 2022–2024 [4].

After the Russian aggression in 2014, the National Bank of Ukraine reduced the number of banks operating on the market to 63 legal entities due to strict regulatory policy. As of 2023, banks with 100% capital of international financial groups control 37.8% of the banking business. Less than 10% remained for the private sector of banking business. Over thirty years, the banking system was bureaucratizing. The banks have begun to perform inappropriate fiscal functions. Financial monitoring requirements have increased. Banks are trying to impose environmental control over clients' business. The banking business has lost its business attractiveness for private capital as of 2023. Not a single new legal entity has been registered in the banking sector in Ukraine since 2014. In Ukraine, the banking business is losing its role as a driver of market changes in the country. Calculations indicate that the systemic financial crises of 2008–2009, 2014–2015, and 2022–2023 reduced the impact of bank credit on the economy. The ratio of banks' loan portfolio to GDP decreased from 74% in 2007 to 16.2% in 2023 [7]. The resource boost that the Ukrainian economy received from foreign financial investments in the banking business in the period 2005–2008 was leveled by subsequent crises and war.

The banking system ensured stable money circulation in wartime conditions. In the period from 1 March 2022 to 1 March 2024 (this is a two-year term since the beginning of the escalation of the war), household account balances increased by 52%, and corporate client account balances increased by 79%. The total loan portfolio of households and corporate clients decreased by 14%. Banks invested the liquidity received from clients in government and NBU securities (an increase of 111%), as well as in correspondent accounts with foreign banks (an increase of $4.1 billion) (**Figure 2**).

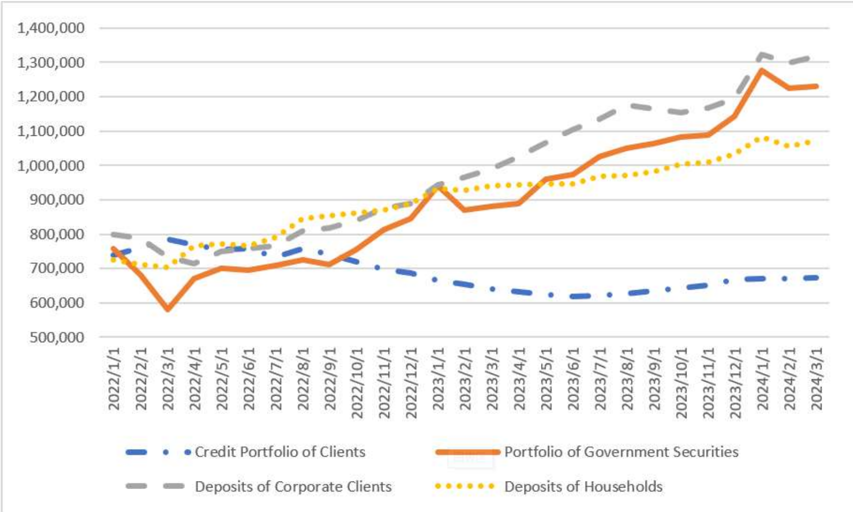

Figure 2. Dynamics of portfolios of deposits of corporate clients, households, loans and government securities in 2022–2024 (million UAH) [4].

3. Conclusions

The development of the private banking system in Ukraine became the main tool that ensured the transition from a command-administrative system to a market one after the collapse of the USSR. The banking system developed at the expense of private investment and grew along with the growth of national private capital.

The state-owned two banks had a market share of no more than 10% in terms of net assets in the 1990s. Having gone through several financial crises at the expense of significant budget expenditures for the nationalization of large banks, as of the beginning of 2023, the concentration of the banking business under the auspices of the state took place. The share of state banks in the market is 53.5%. According to the strategy for the development of the state banking sector, which had been developed before the war, the concentration of the state banking business was supposed to decrease to 25% in 2025 due to the sale of nationalized banks to foreign investors.

The countries of the Western world have supported Ukraine with both military and financial resources in 2022–2023.Ukraine received an international resource and survived the war with Russia. The banking system has shown institutional capacity and integration into the international financial systems. The banking system during the war has ensured smooth money circulation, improved the quality of electronic settlement services, prevented panic among clients, and ensured a high reserve of liquidity.

In the war conditions, the further ways of developing the financial system became clear. Today, it is clear that for investments in the development of its own military industry, Ukraine needs to create a national reconstruction and development bank.

Enterprises that export high-tech products need system support. It is necessary to create conditions for entering the market of regional municipal banks or programs that will support the recovery of regions after the end of the war. It is necessary to create a centralized bank that will work with the assets of banks that are devalued as a result of military actions.

The high NBU discount rate in 2022–2023 inhibited lending. In fact, the NBU completely canceled the refinancing of banks in 2023. During the war, banks have earned surplus profits by buying certificates of deposit from the National Bank at a high discount rate and government securities. The legislative initiative to increase the tax rate to 50% on bank profits in 2023–2026 will not contribute to capitalization and increase the attractiveness of banking business in Ukraine. The government is killing one of the drivers of its market development by unconsciously copying ideas from developed economies.

The strategic goal of Russian aggression is the destruction of Ukrainian statehood and the reconstruction of the Soviet Union in a new version. As well as the return of the world political order that existed during the Cold War. Ukraine has gone through the difficult path of building its own statehood and governance institutions in the thirty-two years since the collapse of the USSR. There is no proven theory of the transition from command-administrative methods of management to market ones. There is a political consensus in Ukraine regarding joining the EU and NATO. The development of the national banking business is an important component of this path. Ukraine is going through a difficult path of protecting its statehood, creating an efficient economy, and developing the banking business, which should be a driving force on Ukraine's path to Western civilization.

Conflict of interest: The author declares no conflict of interest.

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