Bloomberg View

Can This Man Save Ukraine's Economy?

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January 6, 2015

Aivaras Abromavicius has managed money-losing funds for years, but he never presided over anything as hopeless as the Ukrainian economy. Still, the recently appointed economy minister is full of good cheer and certain he and his colleagues in the new cabinet can turn things around. It all depends on whether international lenders give Ukraine enough time to reform itself at the pace the government is setting.

Strictly speaking, Abromavicius should never have become a government official in Ukraine. The 38-year-old asset manager is Lithuanian by birth. He moved to Kiev six years ago after marrying a Ukrainian, the chief executive of an agricultural company in which a private equity fund run by Abromavicius's employer, the Swedish investment firm East Capital, took a stake. He only gave up his Lithuanian citizenship after accepting the ministerial post.

Two more foreigners -- U.S. citizen Natalie Jaresko and Georgian Oleksandr Kvitashvili -- accepted Ukrainian citizenship at the same time, to become finance and health ministers, respectively.

I asked Abromavicius why he was picked over all the other fund managers and investment bankers in the world -- surely there are some with ties to Ukraine at least as strong as his own? He replied, simply: "I guess there was no one bigger than me in Kiev." East Capital, he says, manages a $5 billion portfolio, and he's a partner (according to data compiled by Bloomberg, his share in East Capital Explorer AB is worth $372,000).

That isn't much by Western standards, but it's enough. Abromavicius's salary at the ministry is a few hundred dollars a month -- he doesn't even know how much exactly -- and Ukraine needs people with means of their own in the cabinet, to help ensure they enter government for the right reasons. His Ukrainian passport is about a month old, and he admits to understanding about 85 percent of what he hears in government meetings held in Ukrainian, which he doesn't speak. Still, he describes himself as a patriot.

The two biggest funds Abromavicius managed were East Capital Russian Fund, with a five-year total return of minus 46 percent, and East Capital Eastern European Fund, with a five-year total return of minus 30 percent. The last time the entities saw any noticeable growth was in 2011. That's not really Abromavicius's fault: Eastern European equities, especially Russian ones, haven't performed well in recent years. Ukraine, for its part, doesn't even have a stock market to speak of. It's an economic wasteland.

At the beginning of December, the nation's foreign reserves dropped below $10 billion. The country is eating through them at an alarming rate: November saw them drop by $2.6 billion, only slightly less than the $3 billion Ukraine hopes to get from the International Monetary Fund this month. If the hryvnia was not propped up by limits on hard currency trading, things would be even worse. Ukrainian citizens aren't allowed to trade more than 3,000 hryvnia ($189 at the official rate) a day for foreign currency. There's a lively black market for those who need more, but the exchange rate there is at least 20 percent higher than the official one.

The economy got steadily worse after President Viktor Yanukovych was overthrown in late February. Russia annexed Crimea and fomented a separatist rebellion in Ukraine's eastern industrial regions, which took a toll. The provisional government could have tried to boost economic activity by dismantling the dysfunctional, convoluted tax and regulatory system that only oligarchs could successfully navigate with the help of corrupt officials, but it did nothing all year. No wonder Ukrainian 2017 bonds are trading at 60 cents per dollar, down from above par a year ago. Andrei Illarionov, a former economic adviser to Russian President Vladimir Putin now at the Cato Institute think tank in Washington, says a default is "practically unavoidable" by next month -- unless Ukraine's government cuts spending sharply and reforms the pension system and the state oil and gas monopoly, through which energy subsidies are channeled.

Abromavicius says that's exactly what the new cabinet will do, now that it's filled with solid private sector professionals like himself and backed by a parliament with a clear pro-European majority. "We have a strong team spirit," he says.

Late last year, parliament passed a 2015 budget that was quickly signed by President Petro Poroshenko. It was, however, published without the actual spending and revenue tables. I asked Abromavicius why the numbers haven't been released yet. "It's the holidays," he replied, referring to the New Year's and Orthodox Christmas break, which stops most activity in Ukraine and neighboring Russia for the first 10 days of January. In reality, the government is still working on the budget.

The day after tomorrow, an IMF mission will arrive in Kiev. It will probably be the first to see a relatively coherent spending and revenue collection plan. Abromavicius says government spending as a percentage of gross domestic product will increase from this year's 53 percent, although he won't say by how much. Former finance minister Viktor Pinzenyk has estimated the new share at 67 percent.

Abromavicius says he believes in radical spending cuts. His own ministry has 1,300 staffers in 24 departments, paid an average of 5,000 hryvnia ($316). The new minister plans to cut staff by 20 percent, retaining only 15 departments. "I hope my colleagues will follow my example," Abromavicius says: The government as a whole has only pledged a 10 percent staff cut.

I asked him why he needed even 1,040 economy ministry employees. After all, his predecessor, the economist Pavlo Sheremeta resigned in disgust in September, saying that Ukraine's bureaucracy stifled all meaningful activity. And Abromavicius already relies on volunteer advisers more than on ministry staff: He has invited a former Estonian official to work with him on e-government and a Lithuanian to sift through the numerous technical aid offers Ukraine is now receiving from its European allies.

Abromavicius says he is in touch with Sheremeta: "He did not simplify the management system...I'm getting his advice on that." The new minister also says there is lots of work to do in reforming Ukraine's 3,500 state corporations (the plan is to install independent directors, make the companies transparent, extract dividends from them -- now they pay almost none -- and then sell them off) and overhauling the $10 billion a year state purchasing system, where greater transparency could save at least $2 billion a year.

Abromavicius promises the first meaningful reforms within a month. Sometimes these are simple solutions: Kvitashvili, the Georgian health minister, has convinced the cabinet to abolish the certification of medications already approved in the European Union, the U.S., Canada and Australia. The ministers are talking about giving all regulatory agencies a year to prove to a special commission that they're of use to business and government. The government is also serious about cutting payroll taxes to just 16 percent -- close to the U.S. level for the lowest income bracket -- from 41 percent, although that's only expected to happen in stages over the next year. And soon, natural gas prices for households will begin to rise further: This month, the government expects to work out a schedule for phasing out subsidies.

All of these are moves in the right direction. "We shouldn't waste this crisis," Abromavicius says. "It's a unique chance for reforms." That's what he and the cabinet's other English-speaking, Western-educated professionals will be telling the IMF and other foreign donors in the coming weeks.

The West cannot allow Ukraine to fail now, because that would prove Russian President Vladimir Putin right about the insincerity and inefficacy of Western aid. So the IMF will probably release the next portion of the already approved $17 billion package to keep the government in Kiev afloat for now. Ukraine, however, needs an additional $15 billion to survive this year, according to European Commission President Jean-Claude Juncker. This money should be made contingent on the country making quicker changes than even the most committed reformers, such as Abromavicius, believe are possible now. Stretching out essential structural changes over a year or two should not be an option: That's a sure way to waste the crisis, to use Abromavicius's phrase.