

GEORGE SOROS

December 23, 2014

His Excellency Petro Poroshenko
President of Ukraine
Kyiv
UKRAINE

His Excellency Arseniy Yatsenyuk
Prime Minister of Ukraine
Kyiv
UKRAINE

Mr. President, Mr. Prime Minister, My Dear Friends,

I want to appeal to you to unite behind the reformers in your government and give your wholehearted support to a radical, “big bang” type of approach. That is to say, administrative controls would be removed and the economy would move to market prices rapidly rather than gradually.

As you know, I have left no stone unturned trying to drum up support for a larger financial package at the European Summit dinner on December 18. You could see from the communique that I did not have much success, although the comments by Presidents Tusk and Juncker were helpful. There was a widespread feeling that the Ukrainian government has not got its act together and is not really committed to radical reforms. Yesterday morning I spoke to Christine Lagarde who has been most supportive of my arguments and she has expressed similar views.

This puts the “new” Ukraine, that is adamantly opposed to the “old” Ukraine with its endemic corruption and ineffective government, into jeopardy. The public is willing to put up with a certain amount of sacrifices for the sake of a new Ukraine, but Ukraine needs a larger financial package than the \$15 billion currently contemplated to keep the drop in living standards to a tolerable level. In order to justify a larger package the government needs to present a convincing budget with significant savings. The civil service headcount needs to be cut by much more than 10% and Naftogaz needs to be reorganized with a big bang replacing the hidden subsidies provided by Naftogaz with direct subsidies for the needy. As Yuriy Vitrenko explained to me this could be made to work by assuring people that their request for subsidy will be granted for the first year whether they are entitled to it or not (using social pressure to discourage unjustified

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requests) and not requiring them to pay more than the year before. That would give the authorities a year to organize an orderly transition from hidden to explicit subsidies. That is why I urge you to endorse the big bang approach.

You are fortunate to have appointed three “new Ukrainian” ministers and several natives who are committed to this approach. They could reorganize their own ministries, cutting the headcount to a fraction of its current size but raising the salaries of the remaining staff. This could provide an example for the other ministers to follow. The ministers who undertook radical reforms could be held responsible if they failed, but they must be given a chance to succeed by allowing them to choose their own deputies.

When I asked President Juncker’s diplomatic advisor what he had in mind when he spoke about the lack of progress, surprisingly he emphasized constitutional reforms. Indeed, Ukraine is at a unique moment when the public is passionately interested in constitutional issues and this moment should not be missed. Civil society needs to be actively engaged in the discussions. This raises the role of the National Reform Council which I hope you will clarify between the two of you.

As you know, I asked Andrés Velasco, a prominent economist who was Chile’s very successful minister of finance from 2006-2010 to visit Kyiv where he met the Prime Minister; the President was in Warsaw at the time. Velasco came back with a dire view of the financial situation. The National Bank of Ukraine has practically no hard currency reserves. That means that the hryvnia has no anchor. If a panic occurred and the currency collapsed as it did in Russia, the National Bank could not stabilize the exchange rate even if only temporarily as Russia did by injecting \$90 billion.

Your first priority must be to regain control over the financial markets—bank deposits and exchange rates. Unless you do, you will have no way to embark on deeper reforms. I believe the situation could be stabilized by getting the European Council to make a commitment in principle that they will pull together the new \$15 billion package that the IMF requires in order to release the next tranche of its original package at the end of January 2015. Based on that commitment the Federal Reserve could be asked to extend a \$15 billion three months swap arrangement with the National Bank of Ukraine. That would reassure the markets and avoid a panic.

I believe the communique from Brussels and the comments by Presidents Tusk and Juncker are having a calming effect on the market. It is for you to decide whether you consider the danger of a financial panic real enough to take preventive measures. If you do, you would have to call Chancellor Merkel to ask for a commitment in principle on a

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\$15 billion package. I am ready to call Jack Lew of the US Treasury to sound him out about the swap agreement.

I have to leave for Asia on December 27th and I would like to discuss this issue with you by phone or preferably by Skype before I leave. I shall have to reduce the intensity of my involvement in Ukraine for the next three weeks. I plan to visit Kyiv after Davos. My deputy Chris Canavan is ready to visit earlier if necessary.

With continued best wishes,

A handwritten signature in black ink, appearing to read 'Arsenyuk', written in a cursive style.