The Death Of Ivan Ilyich And The Portuguese State Budget For 2013

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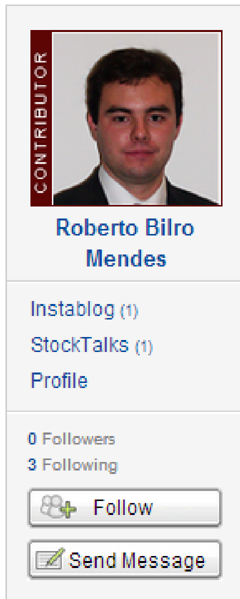

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Living what seemed to be a good life, Ivan Ilyich Golovin, the fictional character invented by the brilliant Leo Tolstoy, injured his side while hanging up curtains in a new apartment intended to reflect his family's superior status in society.

That character may well be today's Portugal, trying desperately not to lose its core balance while attempting to show everybody that it has a good life and still holds some kind of status (although one cannot say a "superior" status, that's for sure). That is what Portugal is, and has been all about, since the first time we needed a bailout, back in the eighties.

Much like Ivan Ilyich who, after his fall, developed in only a pair of weeks, a strange taste in his mouth and an excruciating pain that refused to disappear, Portugal has taken a fall, and no doubt about it, got up with serious injuries. And again, like Tolstoy chose to explore in his novella, not even the doctors could explain or treat his character's condition, much like the government together with the International Monetary Fund cannot explain nor treat Portugal. Ivan Ilyich was dying, and so is my country.

It's amazing how the two plots converge, especially during the second half of the novella, in which Tolstoy records Ivan Ilyich's terror as he battles with the idea of his own death. "I have been here. Now I am going there. Where? ... No, I won't have it!" Oppressed by the length of the process, his wife, daughter, colleagues, and even the physicians, decide in the end not to speak of it, but advise him to stay calm and follow doctors' orders, much like the government is asking all the Portuguese people, "follow the FMI orders," "follow our orders" even though they leave us to wrestle with how this terrible thing could befall a man, excuse me, a country, who apparently had lived so well.

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The Portuguese State Budget for 2013, presented yesterday to the Parliament by the Finance Minister Víctor Gaspar, can be compared to the three days spent by Ivan Ilyich screaming, as he realized he was "done for, that there was no way back, the end was here, the absolute end."

The State Budget proposal includes the toughest tax hikes yet under the country's bailout programme, which can amount to up to three months' wages for middle-income workers.

Let's have a look at the most important measures the Portuguese Government, on its death bed, has proposed in its State Budget for 2013, shall we?

- Reducing public-sector jobs by 2%.
- Suspension of promotions, and elimination of the Christmas bonus for employees earning more than € 1,100 a month.
- Pensions above €1,350 a month will be cut by between 3.5% and 10%.
- Tax brackets will be reduced from eight to five.
- A 4% "extraordinary tax" will be introduced on 2013 earnings exceeding the national minimum wage;
- Individuals earning above €80,000 a year (highest level of income tax bracket) will continue to pay an additional 2.5%.
- Deductions at source will be massively increased from 21.5% to 25%.
- Average income tax rate will increase from the current 9.8% to 13.2%.
- Flat rates will be increased from 25% to 28% for the majority of capital gains.

The deductions at source applicable to non-residents in Portuguese territory will be increased from 15% to 25% when it comes to income derived from intellectual and industrial property as well as when it comes to income from immovable property, income from intermediation in the celebration of contracts.

One of the most important measures to be taken in the light of the proposed state budget for 2013 is the introduction in the Portuguese Tax System of a Financial Transaction Tax (FTT).

The key information about the scope of this FTT is yet to be developed and disclosed. As far as we can understand from the proposal for the Parliament to authorize the government to legislate on the introduction of a Financial Transaction Tax (the "FTT"), within the draft for the State Budget of 2013, it appears that the Portuguese Government is following the proposal of the European Commission (the "EU") of 28 September 2011 for the introduction of a FTT in the 27 Member States of the EU.

The proposal states that the maximum allowed rates are:

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- up to 0.3% as a general rate;
- up to 0.1% for high frequency trading; and
- up to 0.3% for financial derivatives.

The fact is, such maximum tax rates are a lot higher than the EU proposal rates. The maximum percentages for an EU FTT are:

- up to 0.1% as a general rate; and
- up to 0.01% for financial derivatives.

Here are some of the questions on everybody's lips:

Why would Portugal impose such a drastic FTT if the country needs to regain full market access by the end of the second half of next year?

What's the reason behind such a tough State Budget, that will most likely risk worsening the recession that is already hitting the Portuguese economy?

Comparing these troubling times with Lev Tolstoy's masterpiece, "The Death of Ivan Ilyich," can help us understand the answers to those questions. It is only now that the government has completely understood the serious situation Portugal faces, like Ivan Ilyich. The fact is that, when facing immediate death, one tries desperately to hold on to life. In my humble opinion, this draft State Budget for 2013 is to be interpreted as a desperate act of the Portuguese government in order to regain the trust of the markets, however, it is a high gamble that will most likely fail and, as a result, Portugal will have to ask for an extension of its funding programme.

There is a serious risk that both the Portuguese and the European economy will underperform next year and, given the increase in the deductions at source applicable to non-residents in Portuguese territory and the extremely high FTT maximum rates, our opinion is that you should avoid investments in Portugal and, especially, investments on Portuguese yields, that will most likely be trending up after the approval of the definitive Portuguese State Budget for 2013.

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