

Problem Set – Social Targets

Professor: Marcelo Neri

TA: Tiago Bonomo

Comment, agreeing totally, partially or not. Justify the following propositions in three or four lines (if possible, present a formula or graphic in capsular form to illustrate your answer):

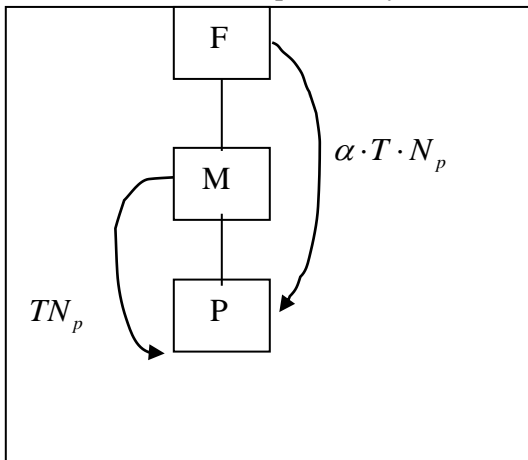
- 1) The consequence of establishing a system in which the greater the poverty, the greater the investment of the federal government in a region, without any kind of counterpart in the results, is that the local final investment ends up being the same as in an autarchy.
- 2) The fact that young people are underrepresented in the electoral market make social spending for this age group less attractive to politicians.
- 3) Besides the introduction of incomplete information, the poor under a government with poverty aversion are as well as they would be with complete information. However, the poor under a government less concerned about this social issue are worse off.
- 4) If the federal government makes unconditional transfers to the municipal government, the situation of the poor does not change, regardless of the utility functions assumed for the federal government or the municipalities.
- 5) Decentralization of social spending is fundamental to finance social actions where they are most needed and resources are scarcer.
- 6) Conditioning the social budget with the evaluation of social advances tends to be regressive due to the greater inefficiency of the poor.
- 7) A system of *a posteriori* social targets should be suggested in the presence of aggregate shocks.
- 8) Even in a situation where the municipality does not have the money to deal with its social problems, a system of Social Targets can be implemented.
- 9) The structure of incentives provided by contracts of social targets clashes with the structure of incentives of conditional income transfer programs such as the school scholarship.
- 10) If we adopt the social goal based on the Poverty Indicator known as the Mean Poverty Gap (P1), we will implicitly assume that priority is given first to the poorest of the poor.

Social Targets

5) Partnership (P) → Government knows the type θ of the municipality

Let us now turn to a case in which the government acts concomitantly with the municipality in the transfer of income, just as in the case of the minimum income program. In addition, this action will take place without setting goals. The difference is that the transfer of government will be linked to the social investment of the municipality. If this reduces its investment, so does the government, and the opposite, as it was compelled to do in the program of minimum income in cases of reduction of municipal investment.

What we have, therefore, is the establishment of a partnership between the government and the municipality. Since improvement in social conditions is an externality to both, a natural solution is for the two to share responsibility for social investments.



Suppose that for each T transferred by the municipality, the government contributes with a percentage α , that is, with αT .

- 1) Assemble the problem
- 2) Compare the results with the solution for autarchy
- 3) Make sensitivity analysis for several alphas (i.e. ($\alpha > 0$))
- 4) While in the situation of unconditional transfer the income remained the same even with the transfer of the government, in the case of partnership we have a worsening in the situation of the poor.

Find an explicit solution for the income of the poor from the following utility function:

$$v(Y_p) = \sqrt{Y_p},$$

Rules versus Discretion:

A) Derive step by step the model of Persons and Tabellini with Credibility. What is the effect of increasing the relative weight attributed by the government to unemployment in its social loss function on the effects of adverse supply shocks on output and inflation levels. Explain the result commenting how the possibility of commitment increases the level of social well-being in the case without commitment.

B) Based on the final equations of the models with and without commitment present in the previous question, comment, agreeing or not, the following propositions:

- i) The fact that the government determines the rate of inflation after the private sector fixes its inflationary expectations gives the government a privileged position in the fight against inflation
- ii) In many cases the government must tie its own hands to signal low inflation expectations for the rest of the economy
- iii) Independently of the existence of interest conflict between the private sector government and the private sector commitment always reduces the expected inflation rate
- iv) The effects of the supply shock on the product level depend fundamentally on the form of the social loss function of the government and not on the availability of compromising technologies
- v) The establishment of an independent central bank headed by a conservative economist can reduce the level of inflation and increase the level of employment in the economy
- vi) In the dynamic versions of the Phillips curve less unemployment today would buy more inflation not only today, but also in the future.