Translation of **"*Responsabilidade Fiscal e Motivação Social*"**

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Law of Fiscal Responsibility and Social Incentives

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"Fiscal responsibility strengthens social responsibility, particularly when goals, monitoring and suitable motivations are existent."

The Law of Fiscal Responsibility (LFR) represents a milestone in the new public finances regime at the different levels of the state (refer to www.bndes.gov.br). It constitutes a key element in the accomplishment of enduring stability. The LFR restricts expenses to the budget obtained that same year. We explore the link between the credit rationing imposed by the LFR and the coordination of social, decentralized actions. We discuss the existence of an alternative channel—within the arguments confined in the law—through which fiscal responsibility leads to the broadening of social responsibility.

Initially, let us study the back7ground justifications for the implementation of the LFR. The law plays a pedagogical role in the transition of a managerial culture—created in an inflationary period—towards a new mentality, unified by stability, transparency and planning. Some of the fundamental causes of fiscal irresponsibility are found in the difficulties of controls inherent to the public sphere. As opposed to private enterprises, which are closely monitored by their respective owners. Open capital enterprises are monitored, on a daily basis, in the stock market. The control of a public entity, on the contrary, is performed in a diffused manner through the electoral market.

Another difference between public and private administration is that the latter has defined intervals of duration. This brings about perverse incentives so that the increasing debts are passed on from one public manager to the next. By softening the financial conditions between successive mandates, the LFR oversees the equality of opportunities among public managers of the same entity.

In conceptual terms, the LFR corresponds to the imposition of a liquidity restriction to public management. The budget constraint must coincide on a yearly basis, and not in accordance to a longer deadline. The LFR removes liquidity from the system of public management, acting to prevent financial insolvency and political populism.

Joseph Stiglitz, the preacher of credit rationing, discusses in various works the concept and successful experiences of selective credit constraints, that is, public choices that direct private actions towards preferable public targets. The policy operates in two stages: a) the general contention of credit through artificial means; and b) the creation of special credit lines designed for strategic segments. Stiglitz's point is that the first step empowers the effects of the second. This means that sector policies pertaining to credits are more effective in an environment of general credit rationing. When obtaining credit is a rare circumstance, the sensibility of those demanding it for incentive schemes increases.

We will not discuss whether it is worthwhile (or not) to impose restrictions on credit. We will solely point out the fact that the LFR has already done so. The LFR introduces a variant of the first stage—mentioned above—applied to the case of public administration for the reasons mentioned prior. Our point is to use the post-LFR environment, so as to strengthen the efficiency of the transfers occurring between the different levels of government. These mechanisms establish the heart and veins of current Brazilian social policies.

The LFR does not only soften financial instabilities detrimental to sustainable human development, but it also increases the coordination capacity of decentralized social actions. What we have today is the possibility of implementing an incentives' system more powerful than before.

The management of Brazilian social policy has become more complex and challenging than ever. In the interior realm, the decentralization of public actions allied to the growing involvement of NGOs and private firms creates a widespread diversity of simultaneous actions. On the other hand, the internationalization process of economies, concomitant with contagious macroeconomic instabilities, broadens the scope of opportunities to the realization of transfers of resources and social technology between countries.

The question interesting us is: how should we increase the returns obtained by society from this myriad of actions? It is up to the diverse levels of public activity (multilateral entities, several levels of the state, and civil society) to act simultaneously towards the same goal. These involve the coordination of diffused efforts through the settlement of targets and the design of mechanisms providing the incentives to achieve them.

The Millennium declaration, recently promulgated, mediates not only social indicators, as well as values and deadlines to be pursued at the global level. Our proposal is that specific locations—in particular, those at the sub-national level—announce a commitment to the global targets as they have been specified. In practice, this would involve that states and municipalities, other than nations, challenge their respective populace to reach the proposed auspicious targets. An example: state A, or district B, would adhere to the target of reducing by one half the proportion of its population with income per capita below US$1.00 daily at PPP, by the year 2015. The recent Brazilian experience with inflationary targets and electrical energy rationing targets enlightens the strength of tangible objectives.

Now why should we only adhere to the Millennium goals and not others? a) The proposed indicators have already been formulated, monitored and benefit from inherent credibility. b) The uniformity of the goals may contribute to the convergence of social efforts at the global scale, by guaranteeing a positive externality. c) The fact that the deadline for the global goals outlasts the mandate of a single government inhibits discontinuity of actions between political mandates; external goals tend to establish temporal consistency in decisions. The goals should belong to society and its citizens, as such being perceived as independent from the idiosyncrasies of specific governments.

Aside from the coordinating and mobilizing characteristics of the social targets, the conditioning of the financial aspect to the observed social outcome—be that considering individuals or levels of government—is an interesting principal. The same spirit of Bolsa-Escola of rewarding poor families whose children attend school can be applied to the annual reallocation of the social budget at numerous administrative levels. The process of rewarding, with additional resources, those units progressing swiftly, may be applied towards the lower levels of government: from the federal to the state realm, from the state to their respective municipalities and from the latter to their respective administrative regions. The IBGE Census provides recent information constituting the stepping-stone for these various geographical levels.

Following this line of reasoning, the magnitude of the external debt forgiven for heavily indebted poor countries (HIPC), currently in place, should also consider the future path of these nations' social indices. Those attaining financing from lost funds tend to lose their motivation. On many occasions, the best remedy against poverty is not charity, but credit instead. There is no doubt that the core of social action should be upon the poorest, but nonetheless, those moving towards the emancipation of their wanting should be rewarded. The main comparative advantage of being poor is the relative capacity of prospering. Future success should also be rewarded, instead of only compensating for past failures.

The social target's main problem is related particularly to the short run, given the presence of shocks. The result obtained by the social protagonist depends on factors beyond his reach, as the outcome does not depend solely on his efforts or skill. Thus the importance of using a relative evaluation schemes is made clear. The selection of a system capable of international comparisons allows us to place each country within the international norm. The system of incentives should be announced a priori and the relative performance should be evaluated a posteriori. Everything functions as a system of credit in which the financial debt from social projects can be reduced in view of social advancements. The advantage of the social credit apparatus is, if well designed, to attract better social actors and induce them to undertake the best practices.

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