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Flypaper Effect in Decentralized Economies

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ABSTRACT

First generation theories of intergovernmental transfers mostly focus on ‘flypaper effect’. It simply argues whether the impact of lump-sum grants to a locality can be equal to the effects of lump-sum funds given local residents or not. Some empirical work shows that the impact of lump-sum grants to local public expenditure is higher than the effect of equal increases in private income. In this study, flypaper effect is investigated in a fiscally decentralized economy from a theoretical point of view. There are two cases: in the first one, lump-sum grant is given to local government in order to be used as public expenditure; in the second case, it is directly given to citizen in order to be used in their consumption. Welfare levels of these two different cases are compared.

KEYWORDS Flypaper; Decentralization; Welfare

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