

The Flypaper Effect and the Municipal Participation Fund in the Brazilian Public Sector

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Abstract : The fiscal decentralization driven by the 1988 Constitution was responsible for granting greater autonomy to Brazilian subnational entities, as states and municipalities were entrusted with greater responsibilities to provide local public goods and services. However, the revenues necessary to implement the new attributions are largely received through intergovernmental transfers and not by local tax collection. The literature points out that public spending increases more by receiving unconditional and nonmatching (lump sum) intergovernmental grants than by an increase in taxpayers' income. This effect, called the flypaper effect, happens because the funds received could be used to reduce local taxes, meaning an increase in the citizen's private income. However, they are applied in the public sector in the form of expenses. The present work investigates the existence of the flypaper effect in Brazilian municipalities during the first two decades of the 21st century. The research uses the Municipal Participation Fund (FPM) as a grant proxy from 2000 to 2019 through econometrics of cross-section and panel data for all 5,568 municipalities. The results indicate the flypaper effect in Brazilian municipalities, as well as the proportional relationship between the receipt of constitutional transfers and the increase in public expenditure.

Keywords : flypaper effect, intergovernmental transfers, municipal participation fund, fiscal federalism

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