
The impact of local government size on the flypaper effect: evidence from the 2008 fiscal reform in Italy

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Abstract

We investigate the impact on expenditure of tax on principal dwellings before 2008 and the impact on expenditure of the grant which, after 2008, during the Berlusconi government, compensated for the abolition of the tax on principal dwellings. We setup a theoretical model in which the introduction of a political bias against taxation gives rise to the flypaper effect. If the public good is very important with respect to private consumption then an increase in the municipal size implies a decrease in the extent of the flypaper effect; the opposite happens if the public good is not important with respect to private consumption. We then test the hypotheses coming from the model by using data on Italian municipalities, focusing on two groups of expenditure: principal expenditures, which are those important to guarantee the minimum standard daily life of a municipality and the rest, defined as residual expenditures. We find that the flypaper effect holds for both kinds of expenditure, but decreases with respect to population in the case of principal expenditure and increases with respect to population in the case of residual expenditure.

Keywords: both

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