

# Municipal Finance and Labor Mobility by

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Discussion by  
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# Broad Motivation: Provision of public goods

- Samuelson(1954): “No market type solution exists to determine the level of expenditures on ***public goods***” Tiebout 1956 (emphasis added)
- Tiebout: “... the consumer voter moves to that community whose local government best satisfies his set of preferences.”



**Mobility is critical to the allocation of public goods.**

# Fundamental Question- research landscape: How does Mobility Affect Debt Financing of Public Goods?

- Illustration: Detroit's 2013 bankruptcy filing:
  - Population/tax base fell by 26% from 2000
  - Tax revenues down 20% in Five years, Tax rate highest in Michigan
  - 78,000 vacant buildings
  - Police down 40%, crime at 5 times national average, 40% of streetlights did not work!

Questions:

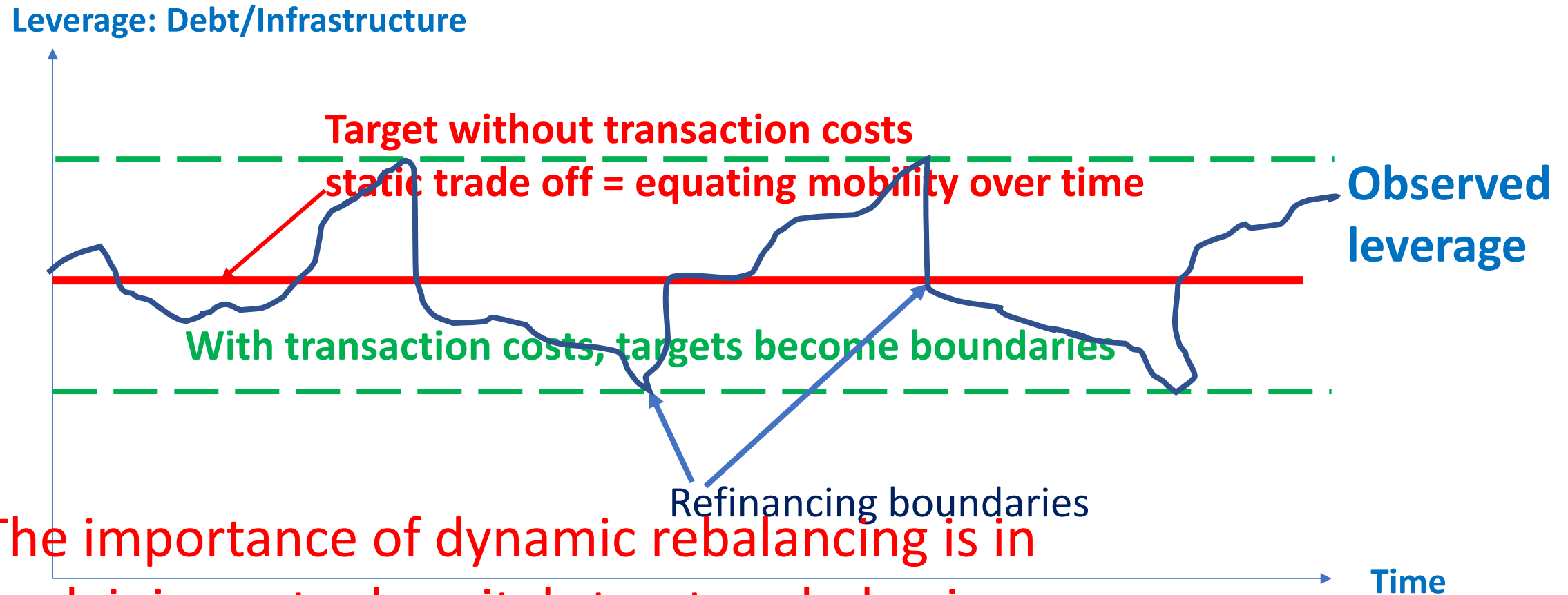
1. Did Detroit Borrow Too Much Ex Ante?
2. Does Potential Mobility explain degree of Debt Financing?
3. Is mobility responsible for dead weight financial distress costs?
4. Why were the costs not avoided prior to 2013?
5. How should Detroit respond to loss of population?

**Where does this paper fit?**

Suggestion: this is a dynamic capital structure study.

- Main Contribution is Empirical
- Main question:
  - How much Should Detroit have borrowed
  - How does that depend on population mobility
  - How should Detroit respond after, while population moves

# Dynamic Capital Structure Models:



The importance of dynamic rebalancing is in explaining actual capital structure behavior:  
The static model does not explain the data

# Gao and Gao: A Muni Dynamic Capital Structure Paper –Focused on mobility

- Most extensive data collection to date.
- Application to a Dynamic Capital structure model of a municipality
- Discovers that ‘labor mobility’ theoretically and empirically can explain the use of debt finance:
  - The more mobile the labor force, the greater the use of Debt to avoid taxes

Excellent first step! But several concerns to address

# Areas for improvement

- Shorten and Simplify
- Clarify the motivation and purpose
- Is this a test of the underlying tradeoff or Muni's response
  - E.g. Detroit set in 2009 seems to be a focus on response
  - Writing suggests both
- Why Labor Mobility? Tiebout is about population preferences
- Transplanting private corporation capital structure to municipal requires more work
  - Hennessey and Whited is private corp – infinitely lived corporation.
  - This paper is about transient population and Public Goods

# Areas for Improvement:

- The model focuses on transfers to and from citizens that **are not taxes**  
Citizens move because of taxes but not because of transfers –Why?
  - Detroit prescription is difficult to understand
- Main empirical measures need more motivation
  - Leverage = Debt/**personal income**,
    - Short term cash flow, not long term sustainability
    - Cash management not capital structure
  - Taxes = **mill rate** ??
- Risky Debt and Bankruptcy Law



# Conclusions

- This is an important topic
- Early days for Empirical and Theoretical Work - important start
- Main Suggestion: Clarify purpose, simplify analysis, develop measures that best match the analysis.
- I look forward to future versions and ultimate publication