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Paying Down the Federal Debt: A Discussion of Methods

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Summary

Beginning with fiscal year 1998, the federal government began running budget surpluses; that is, the flow of revenue into the Treasury exceeded the outflow of expenditures. The Treasury has been lowering the amount of outstanding publicly-held debt by reducing new debt issuance as existing federal debt issues mature. In addition, on March 9, 2000, the Treasury conducted its first buyback operation of outstanding Treasury securities before maturity. As of March 16, 2001, the Treasury had re-purchased outstanding Treasury securities with a total par value of $36.25 billion. This report examines these two methods of paying down the publicly-held debt and discusses estimates of the publicly-held debt that cannot be retired by the end of FY2011. This report will be updated as developments warrant.

Beginning with fiscal year 1998, the federal government began running budget surpluses; that is, the flow of revenue into the Treasury has exceeded the outflow of expenditures. Consequently, the U.S. Treasury has been reducing the amount of outstanding publicly-held debt.[1] This report examines methods of paying down the publicly-held debt.[2]

The Congressional Budget Office (CBO) reports that the budget surplus was $236 billion in fiscal year 2000. CBO's baseline projections of the budget show rising budget surpluses through fiscal year 2011; consequently, the publicly-held debt is projected to

[1] The sum of publicly-held federal debt and federal debt held in government accounts equals total federal debt. For an explanation of the relationship between budget surpluses (and deficits) and different concepts of federal debt, see CRS Report RS20767, *How Budget Surpluses Change Federal Debt*, by Philip D. Winters.

[2] For an examination of some economic consequences of eliminating the publicly-held debt, see CRS Report RL30614, *What if the National Debt Were Eliminated? Some Economic Consequences*, by Marc Labonte.

decline in nominal dollars through fiscal year 2011.[3] In January 2001, CBO's baseline projections indicate that the publicly-held debt will decline from year-to-year as follows: $3,410 billion (FY2000 actual), $3,148 billion (FY2001), $2,848 billion (FY2002), $2,509 billion (FY2003), $2,131 billion (FY2004), $1,714 billion (FY2005), and $1,251 billion (FY2006).[4] After FY2006, CBO's projected surpluses will result in the Treasury's cash on hand exceeding its ability to retire debt held by the public. Hence, CBO's projections of the amount of publicly-held debt "simply assume that the Treasury will accumulate all funds exceeding the amounts needed to retire available debt."[5]

Methods of Paying Down the Debt

When the government first began running surpluses in FY1998, the Treasury used only one method to pay down the debt–reducing new debt issuance. Today, the Treasury has another method–buying back outstanding debt.[6]

Reduction and Elimination of New Debt Issuance.

All publicly-held debt eventually matures. To reduce the debt outstanding, the Treasury has been issuing smaller replacement issues, issuing securities less frequently, and discontinuing the issuance of particular maturities. For example, on May 6, 1998, the Treasury announced that it would stop issuing three-year notes after May 1998, and the auctions of five-year notes would be changed to quarterly auctions from monthly auctions.[7] The dollar volume of new debt issued has been less than the dollar volume of maturing debt; consequently, the dollar volume of outstanding publicly-held debt has declined.

Buybacks of Outstanding Debt.

On August 4, 1999, the U.S. Treasury published for comment proposed rules for permitting it to buy back outstanding debt securities before maturity.

Lawrence H. Summers, the Secretary of the Treasury, stated that buybacks of debt would offer the following three advantages:

> First, by prepaying the debt we would be able to maintain larger auction sizes than would otherwise be possible. Enhancing the liquidity of Treasury's

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[3] For an examination of the accuracy of budget projections, see CRS Report RL30854, *Uncertainty in Budget Projections,* by Philip D. Winters.

[4] U.S. Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2002 - 2011* (Washington: GPO, Jan. 2001), p. 15.

[5] *Ibid.,* pp. 15-16.

[6] For an overview of federal debt management, see CRS Report 98-370 E, *Federal Debt Management: An Overview of Concepts and Policy Options,* by James M. Bickley.

[7] Berry, John M., "Treasury To Reduce Sales of Securities", *The Washington Post*, May 7, 1998. p. E4.

> benchmark securities should lower the government's interest costs over time and promote overall market liquidity.
>
> Second, by paying off debt that has substantial remaining maturity, we would be able to prevent what would otherwise be a potentially costly and unjustified increase in the average maturity of our debt: from just over five years to more than seven years on the current trajectory.
>
> Third, by paying off debt, we can absorb excess cash at times of the year when tax revenues exceed immediate spending needs. This kind of absorption is an important part of sound debt management.[8]

On January 13, 2000, the Treasury Department announced that during calendar year 2000 it would purchase outstanding Treasury securities before maturity worth as much as $30 billion.[9] On January 19, 2000, the Treasury published its final rules which adopted the proposed rules without significant changes. Under the final rules, redemption prices would be determined through a process in which market participants would submit competitive offers to sell particular Treasury securities back to the Treasury.[10] On March 9, 2000, the Treasury bought back $1 billion in Treasury bonds in its first debt buyback in calendar year 2000.[11, 12]

As of March 16, 2001, the Treasury had conducted 24 buyback operations of outstanding Treasury securities with a total par value of $36.25 billion.[13] From March 21, 2001, through June 25, 2001, the Treasury has scheduled six buybacks of Treasury securities.[14]

Through fiscal year 2011, the magnitude of the maximum possible reduction in the publicly-held debt is controversial. Non-retireable debt can be classified as marketable

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[8] U.S. Treasury. *Treasury News*. Statement of Lawrence H. Summers, Secretary of the Treasury. Washington, Aug. 4, 1999. p. 2.

[9] Dreazen, Yochi J. and Gregory Zuckerman, "Treasury Announces Its Plan To Buy Back Debt of as Much as $30 Billion, Above Expectations," *The Wall Street Journal*, v. 235, no. 11, Jan. 14, 2000. p. C19.

[10] For a presentation of the final rules, see: U.S. Dept. of the Treasury, Fiscal Service, "Marketable Treasury Securities Redemption Operations," *Federal Register*, v. 65, no. 12, Jan. 19, 2000, pp. 3,114-3,118.

[11] "Treasury Announces Debt Buyback Operation," *Treasury News*, Department of the Treasury, March 7, 2000. p. 1.

[12] The Treasury last repurchased debt during the Hoover Administration in 1930 as reported in the following source: Zuckerman, Jacob M. and Jacob M. Schlesinger, "Treasury Unveils Anticipated Buyback Plan as Bond Prices Finish with Only Small Gains," *The Wall Street Journal*, v. 235, no. 48, March 8, 2000. p. C24.

[13] For a summary of Treasury buyback operations, see: [http://www.publicdebt.treas.gov/of/ofbuybaksum.htm].

[14] Treasury Borrowing Advisory Committee of the Bond Market Association. *Report to the Secretary of the Treasury*. Jan. 30, 2001. pp. 4-5. [http://www.treas.gov/domfin/report.htm].

debt and non-marketable debt. Marketable debt can be readily purchased or sold on financial markets. For example, Treasury coupon bonds are actively traded. Non-marketable debt cannot be sold on financial markets. For example, savings bonds and state and local government series debt (used to house bond issue money temporarily) are non-marketable.

Projections of Non-Retireable Publicly-Held Debt.

Projections vary concerning the amount on publicly-held debt that cannot be retired by the end of FY2011 because of different assumptions. For example assumptions differ about the willingness of owners of Treasury bonds to sell their bonds back to the federal government without being paid an "unacceptably high" premium.

The Bush Administration maintains that $1,158 billion is non-retireable by the end of FY2011.[15] The $790 billion in non-retireable marketable debt consists of $677 in coupon issues (non-matured 10 and 30 year bonds) and $113 billion in inflation-indexed issues (non-matured 10 and 30 year bonds).[16]

> OMB estimates that it would cost between $50-$150 billion in bonus payments to entice these holders to give up their bonds. It makes more sense to let this debt mature naturally, leaving the Nation on a glide path to zero debt after 2011.[17]

The $368 billion non-marketable debt that is non-retireable over the next 10 years consists of savings bonds ($170 billion), state and local government series ($86 billion), bonds backing up emerging market Brady bonds maturing between 2019-2023 ($19 billion), bonds issued as part of the S&L clean-up maturing between 2019-2030 ($30 billion), and "other" debt ($63 billion).[18]

The Congressional Budget Office projects that $818 billion is non-retireable by the end of FY2011.[19] CBO assumes that after 2002 the magnitude of the Treasury's debt buyback effort will decline because most holders of outstanding 30-year bonds will not "... sell them at prices that the government is willing to pay."[20] CBO assumes that nonmarketable debt (for example, savings bonds or securities issued to state and local governments) that serves other purposes besides financing government activities will

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[15] U.S. Executive Office of the President, Office of Management and Budget, *A Blueprint for New Beginnings, A Responsible Budget for America's Priorities*, Washington, U.S. Govt. Print. Off., 2001, p. 31.

[16] *Ibid.*

[17] *Ibid.*, p. 30.

[18] *Ibid*., p. 31.

[19] Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2002 - 2011*, Washington, U.S. Govt. Print. Off., Jan. 2001, p. 13-15.

[20] *Ibid*., p. 15.

continue to be issued.[21] Lastly, CBO makes the assumption that "no debt with a maturity of five years or more will be issued after 2002."[22]

On March 2, 2001, Alan Greenspan, Chairman of the Federal Reserve Board of Governors, testified before the House Budget Committee that

> As of January 1, ... there was in excess of three quarters of a trillion dollars in outstanding nonmarketable securities, such as savings bonds and state and local series issues, and marketable securities (excluding those held by the Federal Reserve) that do not mature and could not be called before 2011. Some holders of long-term Treasury securities may be reluctant to give them up, especially those who highly value the risk-free status of those issues. Inducing such holders, including foreign holders, to willingly offer to sell their securities prior to maturity could require paying premiums that far exceed any realistic value of retiring the debt before maturity.[23]

But, Gary Gensler, former Treasury Undersecretary for Domestic Finance during the Clinton Administration, states that

> close to $3.0 trillion of the currently outstanding 3.4 trillion in publicly held debt could be paid off, leaving outstanding between $410 and $500 billion in debt at the end of ten years. I believe that Treasury can achieve this in the future, by: (1) allowing the vast majority of this debt to mature as it comes due; (2) making various changes to debt management policies over time; and (3) smoothly repurchasing over time the majority of Treasury's long term debt at market level prices.[24]

He maintains that the Treasury could discontinue issuance of any new longer-term debt, continue to buy back long-term debt, and begin exchanging short-term debt for long-term outstanding debt.[25] Furthermore, he states the Treasury could discontinue issuing special non-marketable securities for state and local government which then would invest in alternative debt instruments.[26] Lastly, he asserts that the Thrift Savings Plan for federal employees (equivalent to a 401K program) could replace its Treasury securities' fund option with a new private bond fund.[27]

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[21] *Ibid*.

[22] *Ibid.*

[23] Testimony of Alan Greenspan, Chairman of the Federal Reserve Board of Governors, before the House Budget Committee on March 2, 2001.

[24] Letter from Gary Gensler, former Treasury Undersecretary for Domestic Finance in the Clinton Administration, to Representative John Spratt on Feb. 27, 2001.

[25] *Ibid.*

[26] *Ibid.*

[27] *Ibid.*