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Paying Down the Federal Debt: A Discussion of Methods

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Summary

The federal government has begun running budget surpluses; that is, the flow of revenue into the Treasury has been exceeding 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. On January 13, 2000, the Treasury announced that during calendar year 2000, it would buy back outstanding Treasury securities worth as much as $30 billion. This report examines these two methods of paying down the publicly held debt and will be updated as developments warrant.

The federal government has been 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.

The Congressional Budget Office (CBO) reports that the budget surplus was $124 billion in fiscal year 1999. CBO's baseline estimates of the budget, under the assumption that discretionary spending grows at the rate of inflation after fiscal year 2000, shows rising budget surpluses through fiscal year 2005; consequently, the publicly held debt will decline at an increasing rate in nominal dollars.[2] In July 2000, CBO's baseline projections, under the

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[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: U.S. Library of Congress, Congressional Research Service, *Surpluses and Federal Debt,* by Philip D. Winters, CRS Report RS20065 (Washington: March 1, 1999), 6 p.

[2]These forecasts are based on positive assumptions about control of discretionary spending and are examined in the following source: U.S. Library of Congress, Congressional Research Service,
(continued...)

assumption that discretionary spending grows at the rate of inflation after fiscal year 2000, indicate that the publicly held debt will decline from year-to-year as follows: $3,633 billion (FY1999 actual), $3,409 billion (FY2000), $3,158 billion (FY2001), $2,854 billion (FY2002), $2,522 billion (FY2003), $2,165 billion (FY2004), and $1,774 billion (FY2005).[3]

Methods of Paying Down the Debt

When the government first began running surpluses in FY1988, 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.[4]

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.[5] 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 benchmark securities should lower the government's interest costs over time and promote overall market liquidity.

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[2](...continued)
Budget Surpluses or Deficits under Alternative Discretionary Spending Assumptions, by Philip D. Winters, CRS Report RS20283 (Washington: July 30, 1999), 4 p.

[3]U.S. Congressional Budget Office, *The Budget and Economic Outlook: An Update* (Washington: GPO, July 2000), p. 3.

[4]For an overview of federal debt management, see: U.S. Library of Congress, Congressional Research Service, *Federal Debt Management: An Overview of Concepts and Policy Options,* by James M. Bickley, CRS Report 98-370 E (Washington: April 15, 1998), 28 p.

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

> 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.[6]

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.[7] 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.[8] On March 9, 2000, the Treasury bought back $1 billion in Treasury bonds in its first debt buyback in calendar year 2000.[9, 10]

On August 2, 2000, Gary Gensler, Under Secretary of the Treasury for Domestic Finance, stated that the Treasury had conducted 10 buyback operations resulting in the redemption of securities with a total par value of $17.5 billion.[11] Furthermore, Mr. Gensler indicated that the Treasury was on schedule to buy back $30 billion in Treasury securities in calendar year 2000.[12]

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

[7]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, January 14, 2000. p. C19.

[8]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, January 19, 2000, pp. 3114-3118.

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

[10]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.

[11]"Under Secretary of the Treasury for Domestic Finance Gary Gensler Remarks at the August 2000 Treasury Quarterly Refunding," *Treasury News*, Department of the Treasury, August 2, 2000. p. 2.

[12]*Ibid.*