Debt Management

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Introduction

Deficit

- Expenditures exceeding revenues in a given time period

Debt

- Accumulation of deficits
- Money and funds owned by someone else

Examples at the federal, state, and local level but also the household and firm level

- Federal debt, credit card debt, mortgages, corporate bonds, etc.

Government debt as a result of covering deficits, financing capital projects, or short periods within a fiscal year when expenditures are higher than revenues

Federal Debt vs. State and Local Debt

Reasons for debt at the federal level

- Stabilization of economy (e.g., after a recession)
- Deficits

Reasons for debt at the state and local level

- Long-term financing of capital items

GAO: What is the Federal Debt?

Debt Held by the Public at the Federal Level

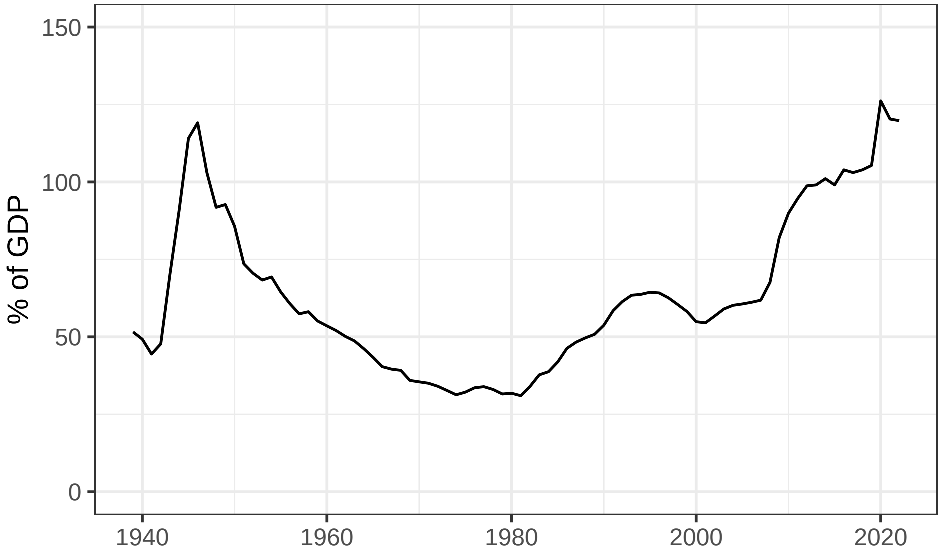
Debt held by the public

- *"The Debt Held by the Public is all federal debt held by individuals, corporations, state or local governments, Federal Reserve Banks, foreign governments, and other entities outside the United States Government less Federal Financing Bank securities. Types of securities held by the public include, but are not limited to, Treasury Bills, Notes, Bonds, TIPS, United States Savings Bonds, and State and Local Government Series securities."*

Sources

- TreasuryDirect: FAQs About the Public Debt
- Treasury: What is the national debt

Federal Debt as Percent of GDP



Federal Surplus or Deficit as Percent of GDP

Deficit and Debt

Violation of fiscal sustainability standard and transfer of cost to future generations

- Restricted ability to provide government services in the future given debt service
- Restricted ability to respond to problems through deficit financing, e.g., recession, COVID-19
- Transfer of cost associated with debt to future generation

Restriction of economic growth potential

- Higher deficit $\Rightarrow$ More borrowing and potentially higher interest rates on debt
- Crowding out of private capital resulting in lower investment and growth

Debt held by foreigners

- Servicing implies greater leakage from the economy

Reduction of Deficit and Debt

Methods

- Increasing tax revenues by either higher rates or broader base
- Lower expenditures (e.g., mandatory and/or discretionary spending)

Debt limit:

- *"The debt limit does not authorize new spending commitments. It simply allows the government to finance existing legal obligations that Congresses and presidents of both parties have made in the past."*

U.S. Department of the Treasury on failing to raise debt limit:

- *"Failing to increase the debt limit would have catastrophic economic consequences. It would cause the government to default on its legal obligations—an unprecedented event in American history."*

Introduction to Bonds

Definition

- Obligation to pay a specified sum of money (face value/principal amount) at a specified date or dates in the future–maturity date(s)–together with periodic interest (usually annually or semi-annually) at a specified rate (coupon rate).

Bond types

- General obligation
- Revenue (or non-guaranteed) bond

General Obligation

Collateral for principal and interest payments: All available taxes (i.e., unrestricted tax revenues) and taxing authority (i.e., ability to raise additional tax revenue)

- Common use for non-revenue generating projects
- Interest exempt from federal tax
- Low risk and thus, lower interest rates therefore cheaper

Requirement of voter approval before issuance at local (and sometimes state) level

- Disclosure fund usage
- Confirmation of public approval associated with project(s)

Bonds can only be issued if the government has not exceeded its statutory debt limit

- Total debt as a % of assessed property values
- Debt service as a % of revenues (often general fund revenues)
- Debt service = Principal payments + interest

Revenue (or non-guaranteed) bond

Issued by government-owned enterprise units (e.g., water and sewer, electric utility) or on behalf of private entities with a public purpose (e.g., hospitals, museums)

- Commonly issued for revenue generating projects
- Not subject to debt limitations
- Interest not exempted from federal tax
- Higher risk $\Rightarrow$ Higher interest rates on debt

Secured by revenues of the issuer not the government

- User charges and fees, tolls, and gasoline tax

Revenue debt as an obligation to issuer and not government

- Exempt from debt limit
- No effect on government's credit rating/quality and no voter approval required

Credit Rating

Three big firms:

- Moody's, Standard and Poor's, and Fitch

Functions

- Certification of credit quality of issuer and probability of full and timely repayment
- Higher credit rating $\Rightarrow$ Lower borrowing cost (interest/coupon rate)
- Purchase of rating from rating agency
- Issuers are required to comply with disclosure requirements
- Report to rating agency and investors of material events that may affect their ability to meet payments on time and in full

Some state ratings