

RESEARCH REPORT

Federal financing and the allocation of private capital

Federal borrowing and tax design can exert opposing pressures on private investment. A dated Treasury refunding, official model evidence, and transparent user-cost calculations separate financing, asset choice, timing, and the policy counterfactual.

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Federal borrowing and tax design affect private investment through several channels whose direction and timing can differ. Borrowing changes the supply of securities and the demand for financing. Tax provisions change the return required for an asset to be worthwhile. Public spending can alter demand, infrastructure, and productive inputs. The resulting investment response is not determined by the deficit alone.

This report separates the financing transaction from the fiscal policy that creates it. Treasury’s August 2026 refunding illustrates the difference between gross issuance and new cash. CBO’s February 2026 analysis provides a dated example of investment incentives and financing effects operating together. A simplified, reproducible user-cost calculation then shows why a tax change can reduce the cost of one asset even while market financing becomes more expensive. The calculation is illustrative and does not estimate the effect of a current provision.

Gross issuance is not new borrowing

Treasury’s [August 5, 2026 refunding statement](#) announced \$125 billion of securities to refund approximately \$96.3 billion of privately held notes and bonds maturing in mid-August, raising about \$28.7 billion of new cash. The offered securities comprised three-, ten-, and thirty-year maturities. This single operation demonstrates why its gross issue size cannot be treated as an equal withdrawal of new financing from private investment.

Announced refunding component	Amount
Three-year note	\$58 billion
Ten-year note	\$42 billion

Announced refunding component	Amount
Thirty-year bond	\$25 billion
Total offered	\$125 billion
Privately held securities being refunded	Approximately \$96.3 billion
New cash raised	Approximately \$28.7 billion

The final line is the difference between the preceding totals. Investors receiving principal from maturing securities can reinvest it, purchase other assets, or change cash holdings. Those portfolio decisions still matter for market pricing, but the full gross auction amount is not a new reduction in the resources available to businesses. Refinancing changes maturity and ownership even when it does not finance an equal new deficit.

Treasury’s [August borrowing estimates](#) also explain how cash-balance assumptions affect net marketable borrowing. A larger Treasury account balance can require more issuance without an equivalent contemporaneous increase in public purchases. Conversely, drawing down cash can finance expenditure without new issuance of the same size in that period. The deficit, cash requirement, and securities issued are connected but distinct measurements.

The saving channel depends on the policy package

At the level of the economy, government borrowing can compete with private uses of saving. The adjustment can involve interest rates, private saving, foreign capital, exchange rates, and investment. There is no fixed rule that each additional dollar of government borrowing removes exactly one dollar of domestic private capital formation. The response depends on behavior and the international setting.

Households can change saving when taxes and public expenditure change, but the extent depends on income, expectations, liquidity, and the distribution of the policy. A transfer to a constrained household can produce a different near-term demand response from an equivalent tax reduction for a household with substantial wealth. The resulting pressure on resources and monetary policy can therefore differ even when the immediate deficit effect is the same.

Foreign capital can finance part of the adjustment. That can limit the reduction in domestic investment relative to a closed-economy case, while changing external liabilities and income flows. The fact that investment remains strong does not establish that borrowing has no cost. It can mean that the cost appears partly through the external position, future income payments, or the exchange rate rather than an immediate one-for-one reduction in capital spending.

The time horizon is essential. An economy with unused capacity can respond to stronger demand by increasing output and hours. Over a longer period, the accumulation of debt and the response of financing conditions can become more important. A short-run increase in investment and a long-run crowding-out channel can

therefore coexist. An assessment should state the horizon rather than treat the two observations as contradictory.

A dated official example of offsetting effects

CBO's [February 2026 Budget and Economic Outlook](#), in its analysis of the 2025 reconciliation act, distinguishes incentives, changes in economic activity, and crowding out. It projects higher business fixed investment but lower residential investment relative to its specified earlier baseline. These are model-based estimates under the report's policy and economic assumptions, not realized outcomes or an independent forecast produced here.

The source is useful because it makes the composition explicit. A package can improve the tax treatment of some business assets while raising the financing cost faced by a broader set of borrowers. Different asset lives and tax provisions then produce different net effects. An aggregate statement that fiscal policy either supports or reduces investment can conceal those offsets.

Its baseline also matters. The reported policy effects are relative to a defined alternative, not a comparison with investment observed before enactment. Actual investment can rise more or less than projected for many other reasons. Evaluating the estimate requires the baseline, assumptions, and subsequent evidence to remain identifiable. A model's attribution should not be restated as a measured causal result from the national accounts.

Maturity changes the transmission of federal financing

The stock of government debt contains securities that reprice or mature at different times. A change in market yields affects the cost of new issuance immediately but passes into the average interest cost of the outstanding stock gradually. The same distinction applies to private borrowers with fixed-rate bonds, floating-rate loans, and different refinancing dates.

Issuance composition can affect the duration and liquidity held by investors. A bill and a thirty-year bond offer different exposure to interest-rate changes and serve different portfolio purposes. Their demand is not perfectly interchangeable. The market effect of a financing program therefore depends on maturity, expected future supply, and investor preferences, as well as the amount of net borrowing.

This is a portfolio channel, not an assumption that every maturity decision permanently changes the real cost of capital. Investors can substitute across securities and hedge risks. Monetary expectations and the economic outlook also move yields. Identifying an issuance effect requires a counterfactual that separates these factors. A yield increase on an auction day does not establish the causal contribution of that auction.

Refinancing risk creates another distinction. Shorter maturities can lower costs under some yield configurations while exposing the borrower to more frequent repricing. Longer maturities can provide budget certainty at a different cost. The economic question is the trade-off under uncertain future rates, not simply which security has the lowest current coupon.

The private cost of capital has several layers

An enterprise's financing cost begins with a benchmark opportunity cost but includes credit risk, liquidity, maturity, and transaction costs. Banks can change collateral and covenants even when the benchmark rate is stable. A company with access to long-term bond markets can respond differently from a smaller business relying on a short bank facility.

The expected return on the asset also matters. A business can face lower interest rates and still postpone investment if demand deteriorates. Another can invest despite higher rates because a large improvement in expected sales raises the return. Financing and demand should therefore be modeled separately before their combined effect is assessed.

Tax treatment changes the hurdle in a further way. A deduction's value depends on when it is taken and whether the taxpayer can use it. A credit can operate differently from a deduction, and limits, losses, or interactions can affect the realized benefit. A headline statutory percentage does not establish the effective marginal incentive facing every business.

The distinction between new investment and existing capital is important here. A policy can raise the after-tax value of an existing asset without providing an equal incentive to create a new one. An asset-price increase can benefit current owners while the effect on new capital formation remains modest. An assessment should identify which decision margin the provision changes.

A simplified user-cost calculation

The following exercise is hypothetical. It considers a fully taxable, equity-financed investment with an asset price of one, no inflation or capital gains, no adjustment costs, and a constant required return and depreciation rate. It ignores credits, state taxes, loss limitations, interest deductibility, and other interactions. Its purpose is to isolate deduction timing and the financing return, not to reproduce the U.S. tax code.

Let r denote the required financing return, δ economic depreciation, τ the tax rate on the asset's operating return, and z the present value of depreciation deductions per unit of investment. Under these assumptions, a simplified annual pretax user cost is:

$$c = (r + \delta) \times (1 - \tau z) / (1 - \tau).$$

The term $1 - \tau z$ is the acquisition cost after the value of deductions. Dividing by $1 - \tau$ accounts for tax on the operating return. The return and depreciation term represents the annual resource cost of holding the capital under the simplified conditions. All rates in the formula use a common basis.

Set τ to 25% and δ to 10%. Compare $z = 0.60$ with immediate expensing, $z = 1.00$, at required returns of 5% and 6%.

Required return r	Deduction present value z	Simplified user cost c
5%	0.60	17.0000%
5%	1.00	15.0000%
6%	0.60	18.1333%
6%	1.00	16.0000%

For the first row, $(0.05 + 0.10) \times (1 - 0.25 \times 0.60) / 0.75 = 0.17$. With immediate expensing, the tax factor equals one under the stated assumptions, giving 0.15. Raising the required return by one percentage point then increases that user cost to 0.16. The combination of better deduction timing and a higher required return can therefore leave the user cost below its initial 0.17 level.

This is a conditional comparison. In practice, z itself can change with the discount rate when deductions occur in the future. Holding it fixed isolates a partial effect. A complete calculation would specify the deduction schedule and recompute its present value at each financing rate. A taxpayer unable to use deductions immediately would also require another treatment.

Asset lives change sensitivity

The same financing-rate increase has a different proportional effect on an asset with a lower economic depreciation rate. Under immediate expensing in the simplified example, an asset with $\delta = 2\%$ has user costs of 7% and 8% when r moves from 5% to 6%. The increase is about 14.29% of the initial cost. For $\delta = 10\%$, the increase from 15% to 16% is about 6.67%.

These figures do not estimate investment elasticities. They show why the financing component can be a larger share of the cost of long-lived capital. The eventual quantity response depends on demand, alternatives, tax rules, and adjustment costs. A more rate-sensitive cost is not automatically a larger percentage change in investment.

This distinction helps explain why the composition of private capital can change under one fiscal package. Structures, equipment, intellectual property, and housing face different depreciation, financing, and tax arrangements. An incentive targeted at one category can offset its financing pressure while other categories receive less relief. Aggregate private investment can then conceal substantial reallocation.

The timing of a temporary incentive adds another layer. Firms may bring purchases forward before a scheduled expiration, producing a near-term increase followed by slower spending. That can support current output without a proportionate permanent increase in the capital stock. Evaluation needs a horizon long enough to distinguish an acceleration from additional investment over the asset's life.

Recompute deduction timing rather than fixing its value

The partial comparison can be extended without adding a behavioral forecast. Suppose a hypothetical asset receives equal deductions at the end of years one, two, and three. Its deduction present value is $z = (1/3) \times [(1 + r)^{-1} + (1 + r)^{-2} + (1 + r)^{-3}]$. This schedule is an illustration, not a description of a U.S. depreciation class.

At a 5% discount rate, z is approximately 0.907749. At 6%, it is approximately 0.891004. Using the same 25% tax rate and 10% economic depreciation as before gives user costs of approximately 15.4613% and 16.5813%, respectively. The financing-rate increase now raises cost through both the direct required return and the lower present value of delayed deductions.

The calculation clarifies what must be held constant in a tax comparison. If one analyst fixes the deduction present value while another recomputes it with the interest rate, their results answer different questions. Neither should be compared as though the discrepancy were an arithmetic error. The assumptions about timing, tax capacity, and the discount rate must accompany the result.

A company with tax losses needs another extension. If the deduction cannot reduce current tax, its value depends on when the business can use the associated tax position and on the governing rules. An investment incentive can consequently have a smaller immediate cash effect for the firm with the greatest financing need. The availability of finance and the usability of tax relief are separate constraints, even when they interact in the same project.

The location of investment and the ownership of returns

Capital inflows can support domestic investment while part of the resulting income accrues to nonresident owners. Domestic production and national income therefore need not change by the same amount. A factory operating in the United States contributes to domestic output according to its production, while the distribution of its investment income depends on ownership and financing.

This distinction prevents two opposite mistakes. Foreign financing does not imply that the domestic asset has no benefit: workers, suppliers, customers, and the public finances can be affected. But preserving domestic investment through external finance is not equivalent to financing it entirely from additional domestic saving. Future income flows and the external balance remain part of the assessment.

Tax design can also affect the location of activity without changing a multinational group's total investment to the same degree. A facility may be moved, expanded, or reorganized in response to differences in after-tax costs. The domestic outcome can be important even where the global total changes little. An evaluation should identify whether its objective and denominator concern U.S. investment, worldwide investment, or the domestic income generated by the investment.

The same caution applies to the purchase of an existing company. The transaction can change ownership and financing without immediately creating new fixed capital. It may later affect management, integration, and investment decisions, but the acquisition price itself should not be counted as newly produced equipment or

structures. Financial transactions and capital formation need to be reconciled before an apparent inflow is interpreted as new capacity.

Costs are distributed across borrowers

A common benchmark yield change does not create a uniform incidence. A household seeking a long mortgage, a business refinancing a short facility, and a company holding cash face different exposure. Existing fixed contracts delay part of the adjustment. Newly financed projects face the marginal terms immediately. An aggregate investment response should therefore be connected to refinancing schedules and the composition of prospective investment.

Distribution also affects demand. Higher interest income can support some savers while higher debt service reduces resources for some borrowers. Their spending responses need not offset one another. The fiscal and monetary interaction should retain these balance-sheet differences rather than infer the demand effect from the total interest paid. This is a further reason that a single deficit-to-investment coefficient cannot describe every policy package.

A financing-channel map

Channel	Immediate observation	Investment margin	Necessary distinction
Net public borrowing	Funds raised after refinancing and cash effects	Economy-wide financing conditions	Gross auctions are not all new borrowing
Maturity and portfolio supply	Duration and liquidity supplied to investors	Benchmark yields and hedging costs	Issuance effects versus policy expectations
Tax deductions and credits	Change in after-tax cost	Asset choice, timing, location, and scale	Statutory benefit versus usable marginal incentive
Public purchases and transfers	Change in demand and income	Expected sales and utilization	Short-run demand versus durable capacity
Public infrastructure	Services supporting production	Complementary private investment	Budget allocation versus operating service

Channel	Immediate observation	Investment margin	Necessary distinction
Fiscal uncertainty	Distribution of possible future rules	Option to wait and required return	Announced intentions versus enacted durable rules

The map is a way to organize evidence, not an additive forecasting model. Several channels interact. A tax change can alter both borrowing needs and the incentive to invest; stronger output can raise tax receipts and reduce the financing requirement; monetary policy can respond to aggregate demand. A calculation that holds every other channel fixed should be described as a partial comparison.

Public capital can complement private investment

Borrowing used to finance a useful network can raise the return on private assets that depend on it. A reliable power connection, transport improvement, or public research facility can expand feasible business activity. The potential complementarity does not remove the financing cost; it introduces a benefit that should be assessed alongside it.

The relevant comparison is the quality and timing of the public asset. A delayed connection may provide little help to a private facility that needs to operate earlier. A poorly used asset can leave debt service without the expected productivity benefit. Public capital should therefore enter the analysis through delivered services and realistic utilization, rather than its capital-budget label.

Private investment can also respond before the public asset is complete if the commitment is credible. That response creates coordination risk: each party may rely on the other’s schedule. A robust assessment tests what happens if one part is delayed or scaled down. The combined program should remain feasible under plausible variation in cost and demand.

This is why the composition of federal expenditure matters for investment even when borrowing is identical. A transfer, a purchase of current services, a financial investment, and a network project have different immediate and future effects. The deficit records the financing outcome; it does not summarize the production consequences.

Uncertainty, expectations, and irreversible commitments

Investment is often partly irreversible. Once a specialized facility is built, resale or conversion may recover only a fraction of its cost. Uncertainty about taxes, demand, or financing can therefore make waiting valuable. A policy that improves the expected return can still have a limited immediate effect if uncertainty about its persistence remains high.

A stable rule can reduce one source of uncertainty, but stability alone is not proof of a good incentive. A permanent distortion can direct capital toward low-return activity. The economic evaluation should distinguish predictability, efficiency, and distribution. They are related objectives but not substitutes.

Expected future fiscal adjustment also affects the calculation. Businesses can anticipate higher taxes, lower public demand, or changes in infrastructure services. The extent to which those expectations affect current investment depends on credibility and the firm's exposure. It should not be assumed that every borrower fully anticipates and offsets a future tax liability, or that expectations have no effect at all.

For this reason, a forecast should present the key assumptions and sensitivities. A point estimate can be useful, but it should not conceal uncertainty about interest-rate responses, private saving, capital inflows, and investment elasticities. The model's policy counterfactual is part of the result.

What evidence would identify the effect?

An empirical assessment needs to separate common macroeconomic conditions from the financing and tax changes of interest. Businesses most exposed to a provision may differ systematically from those least exposed. Timing can reflect anticipation. A rise in investment after enactment is therefore not sufficient evidence that the whole increase was caused by the law.

A stronger design identifies the affected assets or taxpayers, the relevant change in the marginal incentive, and a credible comparison. It tests whether expenditure was accelerated, shifted among assets, relocated, or increased over a longer horizon. Financing conditions and demand should be included where they affect the comparison rather than relegated to a general background paragraph.

For Treasury-market effects, the corresponding task is to identify an unexpected change in supply or composition and distinguish it from information about the economy. Announcements can reveal financing needs as well as issuance decisions. Investors can react to both. A market movement around an announcement should not be attributed to the securities quantity without considering that information content.

All hypothetical user-cost results are annual rates per unit of asset value. Table entries are rounded after calculation. The deduction schedule example uses end-of-year payments and the same rate for discounting and the required financing return; changing either convention requires recalculation.

A practical comparison of financing alternatives

The financing channel can be tested more precisely by holding the public project constant while changing the funding arrangement. Debt finance, current taxation, and expenditure reallocation impose costs on different groups and dates. The comparison should include the resources displaced today and the liabilities carried forward, rather than treat one arrangement as costless because it avoids an immediate tax increase. The economic effect also depends on whether the project expands capacity or primarily transfers purchasing power.

The relevant private response can vary with the recipient of the public spending. A payment to a liquidity-constrained contractor may affect near-term cash availability differently from a transfer to a household with substantial savings. Neither response can be inferred simply from the size of gross borrowing. Distributional information helps connect the fiscal transaction to saving and investment without assuming that the accounting counterpart itself identifies causation.

In a corporate financing exercise, the public-finance scenario should be translated into a complete yield and tax path. A higher short-term reference rate, an unchanged long-term rate, and a wider borrower spread are different assumptions from a parallel shift in all yields. Combining them without disclosure can make a user-cost estimate appear more precise than the underlying scenario. Separating the components permits the investment decision to be tested against the risk that is actually relevant.

Conclusion

Federal financing affects private capital through saving, portfolio supply, demand, public assets, and expectations. Tax design changes the required return at particular investment margins. These channels can offset or reinforce one another, and they can redistribute investment across assets even when the aggregate response is modest.

The August refunding shows why gross issuance and new cash are different. CBO's dated analysis shows why a policy package can contain positive investment incentives and crowding-out effects simultaneously. The hypothetical user-cost calculation demonstrates the underlying arithmetic without asserting a current-policy effect. Together, they support an assessment based on instrument, asset, horizon, and counterfactual rather than the deficit headline alone.

For the reporting of fiscal cost, see [Tax expenditure estimates and the cost of investment incentives](#). For the separate interpretation of central bank assets and rate control, see [Balance-sheet policy and the interpretation of monetary restraint](#).

Source addresses

The links below retain the source addresses cited in the analysis. References should be read within their stated periods and scope.

<https://home.treasury.gov/news/press-releases/sb0590>

<https://home.treasury.gov/news/press-releases/sb0584>

<https://www.cbo.gov/publication/62105>