

29. NET INTEREST

Table 29-1. NET INTEREST

(In millions of dollars)

Function 900	1997 Actual	Estimate					
		1998	1999	2000	2001	2002	2003
Spending:							
Mandatory Outlays:							
Existing law	244,013	242,694	241,750	236,489	233,541	227,116	220,575
Proposed legislation			4	7	15	20	26
Tax Expenditures:							
Existing law	915	965	1,015	1,065	1,115	1,175	1,235

The Federal Government pays large amounts of interest to the public, mainly on the securities it sold to finance the budget deficits in past years.

The Government also pays interest from one budget account to another, mainly because it invests its various trust fund balances in Treasury securities. Net interest—which does not include these internal payments—closely measures Federal interest transactions with the public. In 1999, Federal outlays for net interest will total an estimated \$241.8 billion.

The Interest Burden

As noted above, the amount of net interest depends on the amount of debt held by the public, as well as on the interest rates on the Treasury securities that comprise that debt. In essence, debt held by the public is the total of all deficits that have accumulated in the past—minus the amount offset by budget surpluses. Recent large deficits sharply increased the ratio of debt held by the public to the Gross Domestic Product (GDP)—from 26.1 percent in 1980 to 50.2 percent in 1993. Partly due to the huge rise in debt, interest rates on Treasury securities also rose sharply. The combination of much more debt and higher interest rates caused Federal net interest costs to mushroom—from 1.9 to 3.3 percent of GDP between 1980 and 1991 (see Chart 29-1).

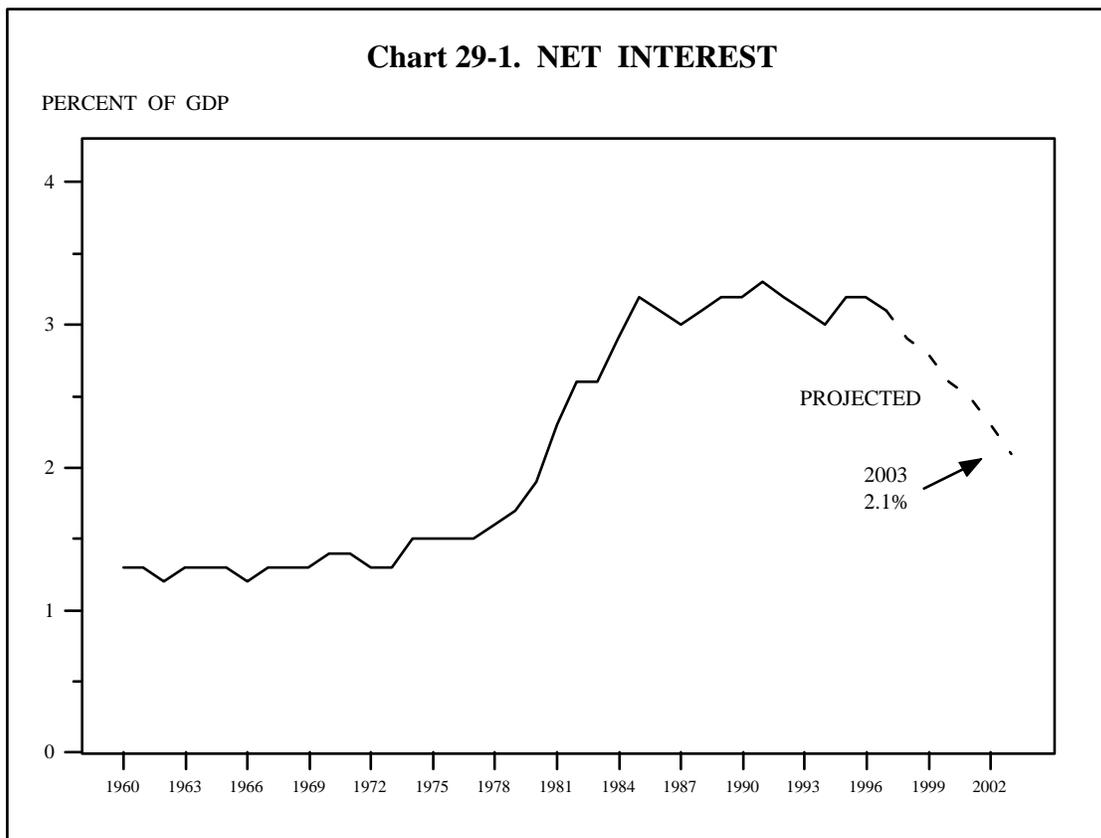
Now that budget deficits have fallen dramatically, the ratio of net interest to GDP has begun to fall as well, from 3.3 percent in 1991 to 3.1 percent in 1997. The combination of the 1997 Balanced Budget Act, the prospect of a balanced budget, low interest rates, and forecasts of lower rates in the future reduce the projected ratio further, to an estimated 2.1 percent in 2003.

Components of Net Interest

Net interest is defined as gross interest on the public debt minus the interest received by on-budget and off-budget trust funds and minus all activities that fall under “other interest” (discussed later in this chapter).

Gross Interest on the Public Debt: Gross interest on the public debt will total an estimated \$366.6 billion in 1999 and \$378.9 billion in 2003. At the end of 1997, the gross debt totaled \$5.370 trillion, of which \$3.771 trillion was held by the public. The debt held by the public accounted for about a quarter of the total credit-market debt owed by the non-financial sector.

The Treasury Department’s management of the debt, including its decisions about how much to borrow in securities with different maturities, may substantially influence Federal interest payments. Since 1993, the average maturity of marketable, privately held public debt has shrunk from five years



and 10 months to five years and four months, cutting total interest outlays by an estimated \$9.6 billion from 1994 to 1998. In 1997, the Treasury began issuing five- and 10-year notes indexed to the Consumer Price Index. The principal, payable at maturity, is adjusted each month for inflation, while interest, paid semiannually, is computed on the inflation-adjusted principal.

Interest Received by On-Budget Trust Funds: On-budget trust funds will earn an estimated \$67.4 billion in interest in 1999, and \$74.5 billion in 2003. The civil service retirement and disability fund will receive almost half of it, while the military retirement fund will receive about a fifth. The Medicare Hospital Insurance (HI) trust fund will receive over \$8 billion in 1999.

Interest Received by Off-Budget Trust Funds: Under current law, the receipts and disbursements of Social Security's old-age and survivors insurance (OASI) trust fund and disability insurance (DI) trust fund are excluded from the budget. Social Security, however, is

a Federal program. Thus, net interest includes the off-budget interest earnings. Because Social Security will accumulate large surpluses over the next several years, interest earnings of all the off-budget trust funds will rise from an estimated \$51.6 billion in 1999 to \$76.3 billion in 2003.

Other Interest: Other interest includes both interest payments and interest collections—much of it consisting of intra-governmental payments and collections that arise from Federal revolving funds. These funds borrow from the Treasury to carry out lending or other business-type activities.

Budgetary Effect, including the Federal Reserve

The Federal Reserve System buys and sells Treasury securities in the open market to implement monetary policy. The interest that Treasury pays on the securities owned by the Federal Reserve is included in net interest as a cost, but virtually all of it comes back to the Treasury as "deposits

of earnings of the Federal Reserve System.” \$24.6 billion in 1999 and \$26.9 billion in
These budget receipts will total an estimated 2003.