

28. NET INTEREST

Table 28-1. Net Interest

(In millions of dollars)

Function 900	1999 Actual	Estimate					
		2000	2001	2002	2003	2004	2005
Spending:							
Mandatory Outlays:							
Existing law	229,735	220,314	208,308	198,605	189,244	177,445	163,634
Proposed legislation			4	21	57	85	134
Tax Expenditures:							
Existing law	965	1,015	1,065	1,115	1,175	1,235	1,295

The Federal Government pays large amounts of interest to the public, mainly on the debt it incurred to finance the excess of past budget deficits over surpluses. Net interest closely measures these Federal interest transactions with the public.

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 does not include these internal payments.

In 2001, Federal outlays for net interest will total an estimated \$208.3 billion, declining to \$163.6 billion in 2005. The amounts shown for the mandatory outlay effects of proposed legislation in the table at the beginning of this chapter are interest payments to Government revolving funds, and therefore have no net effect on the Government finances.

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. Debt held by the public is the total of all deficits that have accumulated in the past—minus the amount offset by budget surpluses. Large deficits in the 1980s and early 1990s sharply increased the ratio of debt held by the public to the Gross Domestic Product (GDP)—from 26.1 percent

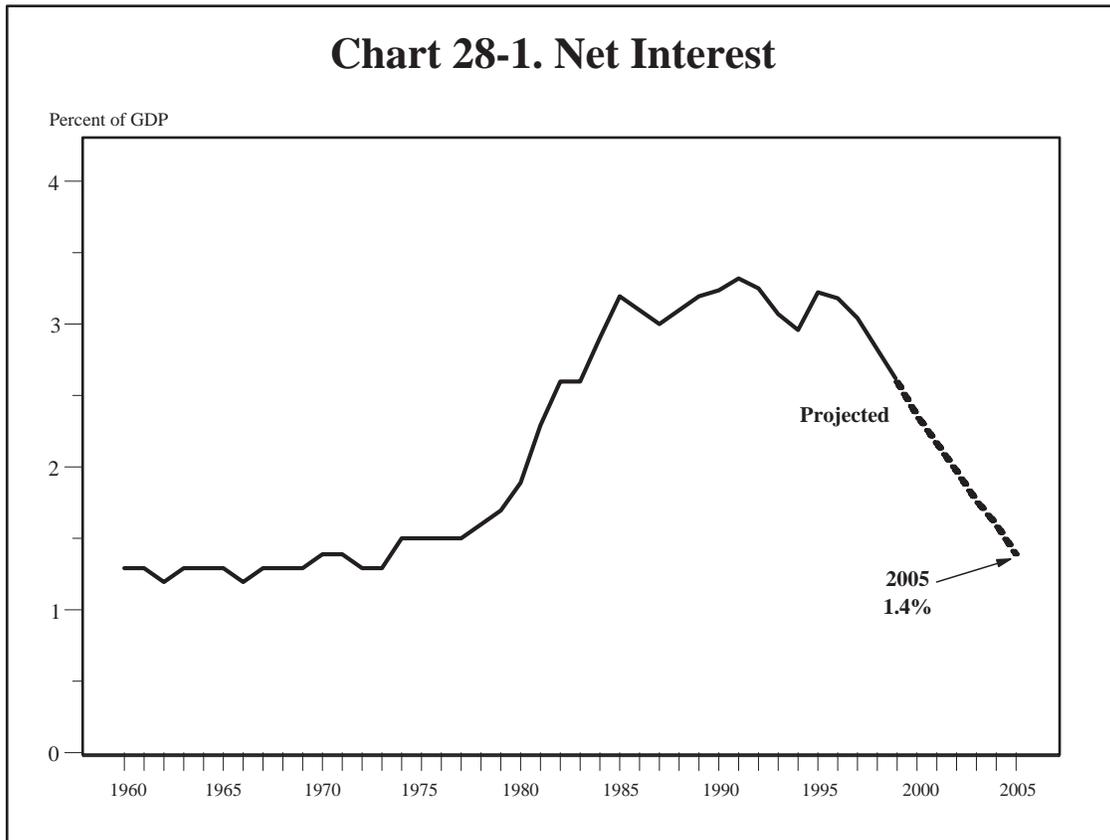
in 1980 to 49.5 percent in 1993. Partly due to the huge rise in debt, interest rates on Treasury securities also rose sharply. The combination of much more debt and higher interest rates caused a substantial increase in Federal interest costs—from 1.9 percent to 3.3 percent of GDP between 1980 and 1991 (see Chart 28-1).

As budget deficits were gradually eliminated, and as interest rates declined, the ratio of net interest to GDP fell from 3.3 percent in 1991 to 2.5 percent in 1999. The combination of budget surpluses starting in 1998, and continued moderate interest rates, is projected to reduce the ratio further, to an estimated 1.4 percent in 2005. Thus, the interest burden is projected to fall by one-half in just over a decade. As shown in the table above, net interest started to decline in 1999.

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 \$360.0 billion in 2001 and \$372.4 billion in 2005. At the end of 1999, the gross Federal debt totaled \$5.606 trillion, of which \$3.633



trillion was held by the public. The debt held by the public accounted for 21.7 percent of the total credit-market debt owed by the non-financial sector of the U.S. economy. This proportion peaked at 26.7 percent in 1994 and has trended down over the last few years, as Federal Government borrowing diminished with the declining deficits and recent surpluses (see Table 12-1 in *Analytical Perspectives*).

The Treasury Department plans to buy back outstanding U.S. notes and bonds as part of its efforts to manage efficiently the reduction of the publicly held debt. The budgetary treatment of the premiums and discounts on these repurchases is discussed in detail in Chapter 24 of *Analytical Perspectives*, "Budget System and Concepts and Glossary".

Interest Received by Trust Funds: Under current law, the receipts and disbursements of Social Security's old-age and survivors insurance (OASI) trust fund and disability insur-

ance (DI) trust fund are excluded from the budget. Social Security, however, is a Federal program. Thus, the net interest of the Federal Government as a whole includes the off-budget interest earnings. Because Social Security will accumulate large surpluses over the next several years, its interest earnings will rise from an estimated \$68.1 billion in 2001 to \$110.5 billion in 2005.

The other trust funds are on-budget. The interest earnings of the civil service retirement and disability fund will rise from an estimated \$35.8 billion in 2001 to \$40.1 billion in 2005, and the interest of the military retirement fund will rise from \$13.0 billion to \$14.0 billion. The Medicare Hospital Insurance (HI) trust fund will receive \$12.5 billion in 2001. Together with Social Security, these account for most of the interest received by trust funds.

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.” These budget receipts will total an estimated \$29.5 billion in 2001 and \$33.8 billion in 2005.