29. NET INTEREST

Table 29–1. NET INTEREST
(In millions of dollars)

Function 900	1996 Actual	Estimate 1997	1998	1999	2000	2001	2002
Spending:							
Mandatory Outlays:							
Existing law	241,090	247,539	249,840	251,792	248,126	244,857	238,623
Proposed legislation	....	–157	19	51	77	106	139
Tax Expenditures:							
Existing law	1,300	1,290	1,285	1,270	1,215	1,170	1,155

The Federal Government pays large amounts of interest to the public, mainly on the securities it sells to finance the budget deficit.

The Government also pays interest from one account to another, mainly due to the Government's investing of trust fund balances in Treasury securities. These payments move money from one budget account to another. Thus, net interest—which does not include these payments—closely measures Federal interest transactions with the public. In 1998, Federal outlays for net interest will total an estimated $249.9 billion.

The Interest Burden

As noted above, net interest directly relates to debt held by the public. It also relates to 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 as a percentage of Gross Domestic Product (GDP)—from 26.8 percent in 1980 to 51.9 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 2.0 to 3.4 percent of GDP between 1980 and 1993 (see Chart 29–1).

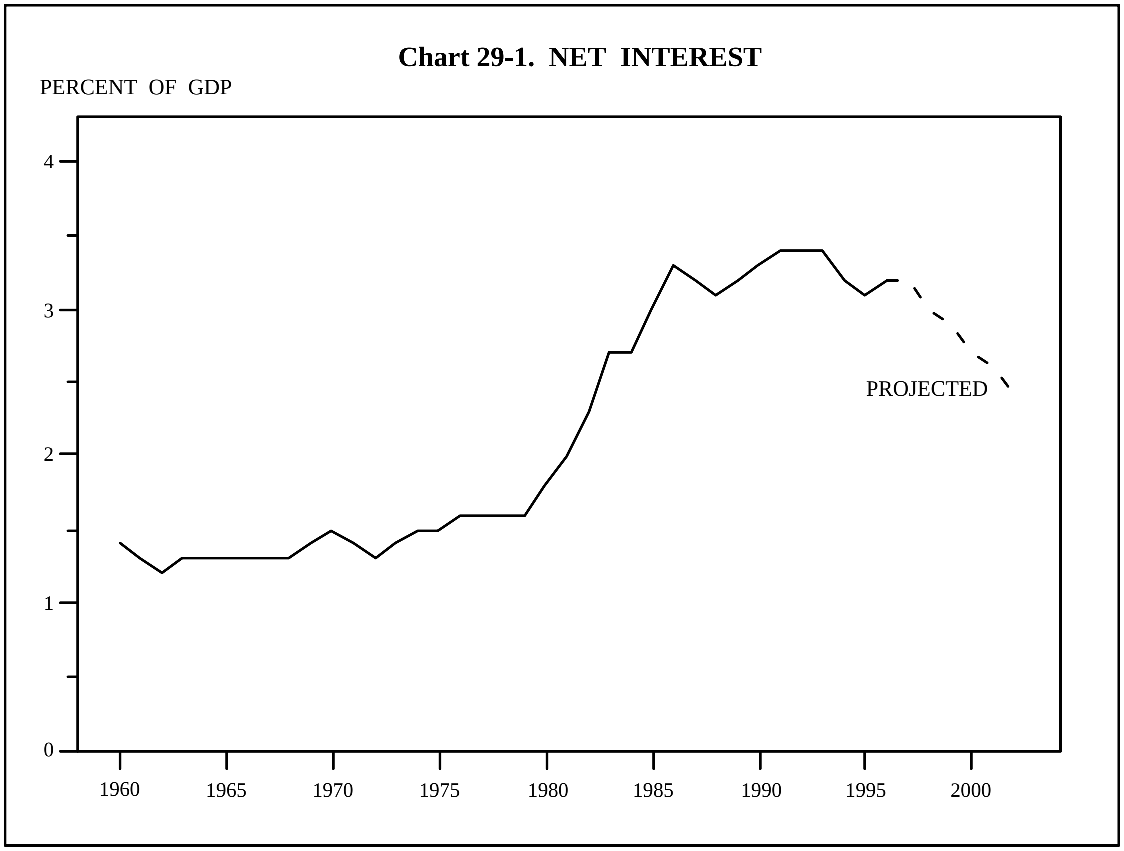
Now that the budget deficits have fallen, the ratio of net interest to GDP has begun to fall as well, from 3.4 percent in 1990 to 3.2 percent in 1996. The President's plan to balance the budget by 2002 would further reduce the ratio, to 2.4 percent by 2002, reflecting not just the gradually falling deficits but also lower interest rates on Treasury securities—both in the recent past and projected for the future.

Components of Net Interest

Net interest is gross interest on the public debt minus interest received by on-budget and off-budget trust funds and minus all of the activities that fall in the category of "other interest" (discussed later in this chapter).

Gross Interest on the Public Debt: Gross interest on the public debt will total an estimated $366.1 billion in 1998 and $376.8 billion in 2002. At the end of 1996, the gross debt totaled $5.147 trillion, of which $3.698 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 invest in securities with different



maturities, may substantially influence Federal interest payments. Since 1993, the average maturity of marketable, privately held public debt shrunk from five years and ten months to five years and two months, cutting total interest outlays by an estimated $9.6 billion in 1994–1998. In 1997, Treasury plans to issue 10-year notes indexed to the Consumer Price Index. The principal, paid at maturity, is adjusted each month for inflation while interest, paid semiannually, is computed on the inflation-adjusted principal. Indexed bonds may have a lower yield than fixed-rate securities of similar maturity because the holder faces less risk from inflation.

Interest Received by On-Budget Trust Funds: On-budget trust funds will earn, in interest, an estimated $63.7 billion in 1998 and $67.4 billion in 2002. The civil service retirement and disability fund will receive almost half of it, while the military retirement fund will receive a fifth. The Medicare Hospital Insurance (HI) trust fund will receive over $10 billion in 1998. Without changes in policy, the interest receipts of that fund will approach zero as it sells its Treasury securities to offset a growing deficit.

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 the off-budget trust funds will rise from an estimated $45.2 billion in 1998 to $61.6 billion in 2002.

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 trades Treasury securities in the open market to implement monetary policy. The interest that Treasury then pays on the securities falls within net interest, 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 $23.0 billion in 1998 and $24.2 billion in 2002.