19. NET INTEREST

Table 19–1. Net Interest
(In millions of dollars)

Function 900	2000 Actual	Estimate					
		2001	2002	2003	2004	2005	2006
Spending:							
Mandatory Outlays:							
Existing law	223,218	206,369	188,126	175,223	161,456	144,626	127,132
Proposed legislation	....	....	5	21	37	53	68
Tax Expenditures:							
Existing law	470	490	520	540	570	600	630

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 the Government invests its various trust fund balances in Treasury securities. Net interest does not include these internal payments.

A Falling Interest Burden

Largely as a result of the strong economic performance over the past several years, and policy actions to reduce the deficits, the long upward trend for net interest has ended. Since 1998, the budget surpluses have led to a reduction in debt and interest costs. This trend will accelerate over the next several years.

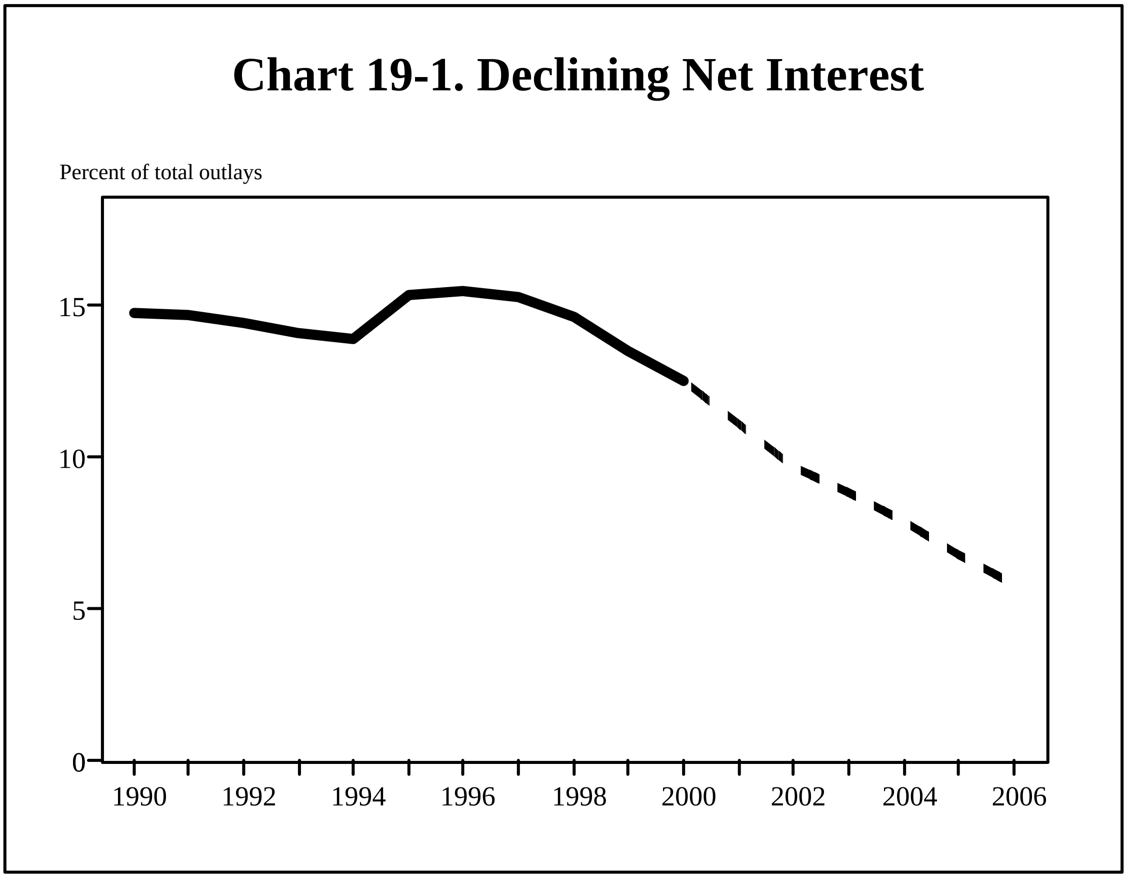
The amount of net interest depends on the amount of debt held by the public, as well as on the interest rates on the Treasury securities that comprise the debt. Net interest grew from 1.4 percent of GDP in 1970 to a peak of 3.3 percent of GDP in 1991 as a consequence of growing budget deficits. In dollar terms, net interest began to decline in 1998 with the first budget surplus in recent years. In 2006, net interest is projected to be $127.2 billion, about $116.8 billion below its 1997 peak. As a percentage of GDP, net interest will fall to an estimated 1.0 percent in 2006. And the interest burden as a percent of total outlays will plunge from a peak of 15.4 percent in 1996 to 5.8 percent in 2006. (See Chart 19–1.)

With the prospect of continuing surpluses, the Administration plans to reduce debt held by the public, and thus net interest will continue to decline rapidly over the next few years. The reduction in the debt burden will help to increase the resources for private sector investment, lower interest rates, and raise productivity growth.

Components of Net Interest

Net interest is defined as interest on Treasury debt securities (gross), minus the interest received by on-budget and off-budget trust funds, and adjusted for the receipts and outlays that are recorded as "other interest" (discussed later in this chapter).

An important part of the net interest function is to bring together the payment and receipt of interest from one Government account to another. The largest portion of these transactions involves the payment of interest to trust funds, which have invested their cash surpluses in Treasury securities. Within the interest function, the payments of interest to trust funds are included in



interest on Treasury debt securities (gross) and the receipts of interest by trust funds are shown, as negative amounts, in interest received by trust funds. A similar treatment is given to several special funds, such as the Nuclear Waste Disposal Fund and Abandoned Mine Reclamation Fund. For these special funds, payments of interest are included in interest on Treasury debt securities (gross) and the receipts of interest are shown, as negative amounts, in "other interest." A smaller category of intragovernmental interest payment occurs primarily in connection with Federal credit programs, when certain Government accounts borrow from the Treasury, which, in turn, must borrow from the public. In these instances, the payment of interest on the Treasury's borrowing from the public is shown as interest on Treasury debt securities (gross) and Treasury's receipt of interest from the borrowing agency is shown as "other interest."

Thus, the net interest total includes, where possible, both the paying side and receiving side of intragovernmental interest payments. The exception to this practice occurs where only the paying side is included in the interest function, as happens with payments of interest to revolving funds, such as the Bank Insurance Fund, Exchange Stabilization Fund, or Employee Life Insurance Fund. The payments to these funds are shown as interest on Treasury debt securities (gross), but the receipts by these funds are reported as offsetting collections within the fund, rather than offsetting receipts in the interest function. This practice leaves net interest as a close, though not precise, measure of the interest paid to the public.

In 2008 through 2011, the surplus exceeds the amount of maturing debt. When this happens, excess balances begin to accumulate and reach $1,288 billion by the end of 2011. These balances are assumed to earn interest. Because no institutional arrangements are assumed regarding how or where the excess balances might be deposited, these interest earnings on excess balances are included, as offsetting receipts, in “interest on Treasury debt securities (gross).” The relationships among the surplus, debt held the public, and excess balances are discussed further in Chapter 12, “Federal Borrowing and Debt” in *Analytical Perspectives.*

Interest on Treasury Debt Securities (gross): Interest on Treasury debt securities (gross) is estimated to increase slightly from $351.0 billion in 2002 to $352.7 billion in 2006. The underlying debt includes the rising amount of trust fund balances in on-budget and off-budget Government accounts. At the end of 2000, the gross Federal debt totaled $5.6 trillion, compared to $4.0 trillion at the end of 1992. However, most of the growth in the gross Federal debt occurred by 1998; during the last two years, gross debt has increased only slightly. It will continue to increase through 2006 as the increase in trust fund balances exceeds the decline in debt held by the public.

Interest Received by Trust Funds: As was noted earlier, interest received by trust funds is deducted from the interest on Treasury debt securities (gross) to determine net interest. Total trust fund interest receipts are estimated to rise from $152.4 billion in 2002 to $213.4 billion in 2006.

The receipts of Social Security’s Old-Age and Survivors Insurance and Disability Insurance (OASDI) trust funds are the largest of all the trust funds (and are excluded from the budget, and thus shown as “off-budget,” under current law). OASDI trust fund interest is estimated to increase from $76.1 billion in 2002 to $120.1 billion in 2006. The other large trust funds which earn interest (and which are on-budget) include the civil service retirement and disability fund (whose interest is expect to rise from $36.5 billion in 2002 to $41.6 billion in 2006); the military retirement fund (whose interest is expected to rise from $12.6 billion in 2002 to $13.6 billion in 2006); and the Medicare Hospital Insurance (HI) trust fund (whose interest is expected to rise from an estimated $13.7 billion in 2002 to $22.6 billion in 2006).

Other Interest: Other interest includes both interest payments and interest collections. Receipts of interest are included for credit liquidating accounts and the Federal Financing Bank (which borrowed from the Treasury, mostly to support certain Federal credit programs). Receipts of interest are also included for special funds, as described above. Payments of interest include IRS payments on certain refunds, and payments to credit financing accounts that have deposited cash balances with the Treasury.

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 $31.8 billion in 2002, rising to $36.7 billion in 2006.