19. NET INTEREST

Table 19–1. Net Interest
(Dollar amounts in millions)

Function 900	1993 Actual	2001 Estimate	Percent Change: 1993–2001
Spending:			
Mandatory outlays	198,736	210,234	6%
Tax expenditures	1,130	490	–57%

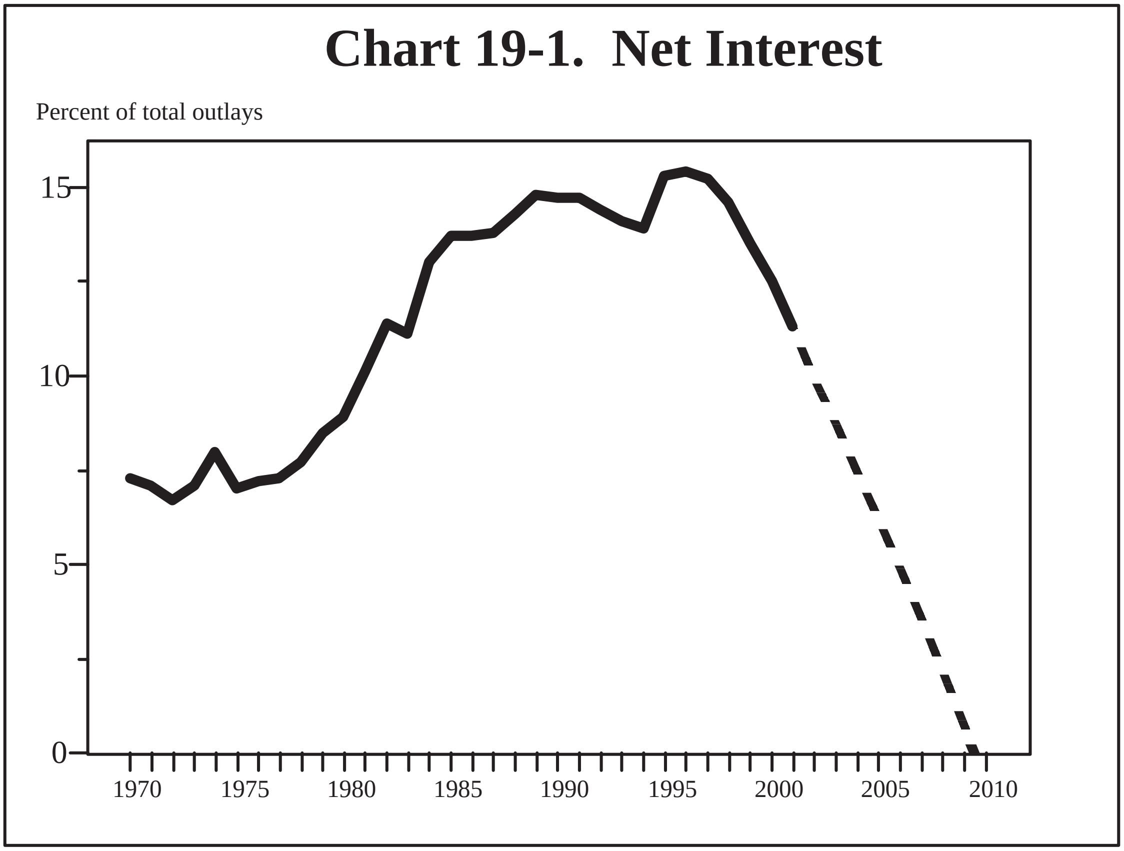
The Federal Government pays large amounts of interest to the public, mainly on the debt it incurred to finance the excess of past budget deficits over surpluses. Net interest closely measures these Federal interest transactions with the public.

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.

Falling Interest Burden

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. In 1993, the Administration inherited a large and growing debt, coupled with the prospect of large and growing budget deficits for many years into the future. Net interest had grown from $14.4 billion (or 1.4 percent of GDP) in 1970 to $198.7 billion (or 3.0 percent of GDP) in 1993, and was projected to grow still further without a change in policy. Over the same period, net interest had increased from 7.3 percent of total outlays to 14.1 percent. Largely as a result of fiscal policy actions under the Clinton-Gore Administration, and the strong economic performance over the past eight years, the unified budget deficit of $290 billion in 1993 became an estimated surplus of $256 billion in 2001; thus, the long, upward trend for net interest has ended. In dollar terms, net interest began to decline in 1998 with the first budget surplus in recent years. By 2001, net interest is projected to be $210.2 billion, about $34 billion below its 1997 peak (though still about $11 billion above the level of 1993). As a percentage of GDP, net interest will fall from 3.0 percent in 1993 to an estimated 2.0 percent in 2001. As a percentage of total outlays, it will fall from 14.1 percent in 1993 to an estimated 11.3 percent in 2001, freeing resources for other purposes (see Chart 19–1).

The projection at the start of the Administration was that net interest would continue to increase in dollars and as a percentage of GDP for the foreseeable future, thereby leaving less budgetary resources available for programs, and threatening the long-term sustainability of the budget. This trend for net interest has improved radically, however, largely as a result of fiscal policy actions and the strong economic performance over the past eight years. The Omnibus Budget Reconciliation Act of 1993 and the Balanced Budget Act of 1997 reduced the size of the projected deficits. Actual budget performance exceeded expectations, as the economy grew more strongly than expected; receipts grew faster, and outlays slower, than expected. The unified budget turned to surplus in 1998, and the surpluses grew larger in 1999 and 2000. As a consequence, the debt held by the public fell from $3.8 trillion at the



end of 1997 to $3.4 trillion at the end of 2000.

The swing to surplus in the unified budget increased national saving and enhanced economic growth. The prospect of continuing surpluses implies that net interest will continue to fall toward zero over the next few years. This improvement is one of the most important reasons for the projected long-term stability of the budget, and is a vital foundation for the Nation's preparation for the aging of the population, including the impending retirement of the baby-boom generation.

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 the 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.

Interest on Treasury Debt Securities (Gross): Interest on Treasury debt securities (gross) rose from $292.5 billion in 1993 to an estimated $361.2 billion in 2001. 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 $4.1 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, as the decrease in debt held by the public has been approximately matched by an increase in trust fund balances. For the period 1993–2001, the increase in debt held by trust funds was greater than the increase in total Treasury debt securities (gross).

Interest Received by Trust Funds: As noted earlier in this chapter, interest received by trust funds is deducted from the interest on Treasury debt securities (gross) to determine net interest. Total trust fund interest receipts were $82.3 billion in 1993, increasing to an estimated $142.1 billion in 2001.

The receipts of Social Security's Old-Age and Survivors Insurance and Disability Insurance 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). Because Social Security accumulated large surpluses between 1993 and 2001, its interest earnings rose from $26.8 billion in 1993 to an estimated $69.0 billion in 2001. The other large trust funds which earn interest (which are on-budget) include the civil service retirement and disability fund (whose interest rose from $25.7 billion in 1993 to an estimated $35.3 billion in 2001); the military retirement fund (whose interest increased from $9.8 billion to $12.6 billion); and, the Medicare Hospital Insurance trust fund (whose interest declined from $10.6 billion in 1993 to $9.2 billion in 1998, as that program generated small deficits between 1995 and 1997; however, reforms enacted in 1997 and slower-than-expected cost increases have resulted in an increase in the fund balance and an increase in interest received to an estimated $12.2 billion in 2001).

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 earlier. 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 $27.9 billion in 2001.