

PROFESSOR OFFERS DEBT SAVINGS RECIPE

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TEXT:

NEW YORK (AP) - Add a dash of short-term Treasury notes. Pare some 30-year bonds. Save \$12 billion a year.

That, oversimplified, is one finance professor's recipe for how the federal government can maximize its savings from some of the lowest short-term interest rates in a generation.

Similar suggestions from academia and economic circles have been kicked around for years. But lately this idea is attracting more attention amid a dramatic growth in the difference between short-and long-term interest rates.

While both long- and short-term yields have declined in the last few years, short-term rates have dropped much faster.

The Treasury sells securities of various maturities to pay interest on existing debt and to cover the ballooning federal deficit. Of total debt issued in the last year (excluding Treasury bills), the Treasury sold roughly 35 percent in short-term notes, 38 percent in intermediate bonds and 26 percent in long-term bonds.

By tilting the Treasury's mix toward lower-interest securities, the government should see a noticeable decline in its annual interest payments, said Campbell Harvey, the associate professor from Duke University's Fuqua School of Business in Durham, N.C.

The government spent \$238 billion, or nearly one-quarter the total federal budget, on payments to bond investors in fiscal year 1992.

"You don't have to tilt the maturity structure much to save \$12 billion," said Harvey.

Harvey estimates the Treasury, if current policy doesn't change, will float about \$700 billion in bills and \$620 billion in notes and bonds over the next year.

Instead, he suggests, the Treasury should increase its bill issuance to \$850 billion, reducing sales of one- and two-year notes to \$250 billion and longer-term notes and bonds to \$220 billion.

In addition to lower interest payments, Harvey points to other potential benefits. He said reducing the supply of long-term debt in the market would raise the value of available securities, thus pushing down long-term yields. This could nudge important consumer and business loan rates lower, spurring more borrowing and speeding the nation's economic recovery.

So if the idea is so simple, why hasn't the Treasury jumped on it?

One problem, in the physics of the debt markets, is that what comes

down must go up.

Critics say today's rock-bottom short-term rates seem poised to rise, which could make the Treasury's job of financing the federal deficit suddenly more expensive.

Long-term rates, while not as low as shorter-term yields, are still at the lowest levels in nearly 20 years.

If the Treasury opts to issue less long-term debt, it will fail to lock in those low long-term rates for many years to come. Because the Treasury must "roll over" or refinance short-term debt in the near future, it could end up paying sharply higher interest to investors.

"Over the long term you pay for it," said Bob Banon, a senior bond strategist with IDEA, a New York financial advisory firm. "When rates start heading up, you're not locked into anything at all. The government's debt doesn't go away."

Harvey acknowledges in his economic model there is the risk of rising short-term rates. But, he said, "a shifting of the offerings to short maturities would suggest the risk is low. . . ."