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Duke professor sees large US savings in issuing variable-rate debt

Knight-Ridder

New York---Mar 5--A Duke University professor said the US government could save billions of dollars in interest costs by issuing variable-rate securities.

"There has been a lot of talk about reducing the maturity of the government's debt, but it seems like there are other options," Campbell Harvey, associate professor of finance at Duke's Fuqua School of Business, told Knight-Ridder Financial News.

His suggestion is to issue, for example, 30-year bonds with a floating coupon tied to the weighted average rate of the last 6 months' worth of US bill auctions.

The benefits would be manifold, he said.

First, it would reduce the amount of fixed-coupon, long-term debt which the government would issue, pushing long term yields down.

Second, it would not increase the amount of short-term debt which the government would issue, as would happen if it simply were to substitute the issuance of short-term for long-term debt, as has been considered by the government.

And third, it would send an important message to the financial markets, Harvey said.

"If you're selling bonds at 6.8 pct (the approximate bond yield currently), you're telling the market that you expect inflation to rise so you want to lock in these low rates now," he said.

"If you go to short maturities, you're telling the market that long-term rates are too high and you're expecting low inflation."

With floating-rate debt, the message is the same as shortening the maturity mix, but it also includes a mechanism that penalizes the government if it decides to reinflate.

"With a floating-rate instrument, if you have any temptation to monetize the debt, you have to pay a penalty," Harvey said.

"If the government policy is low inflation, they should be issuing instruments like this," he said.

Harvey said his studies show that the 30-year bond yield could be below 6 pct if variable-rate debt were issued, which would be an important element in sustaining the economic expansion.

"The key variable in a recovery is for long-term rates to come down some more," he said. End

(By Kevin Donovan, Knight-Ridder Financial News)

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