DSG

SPECIAL REPORT

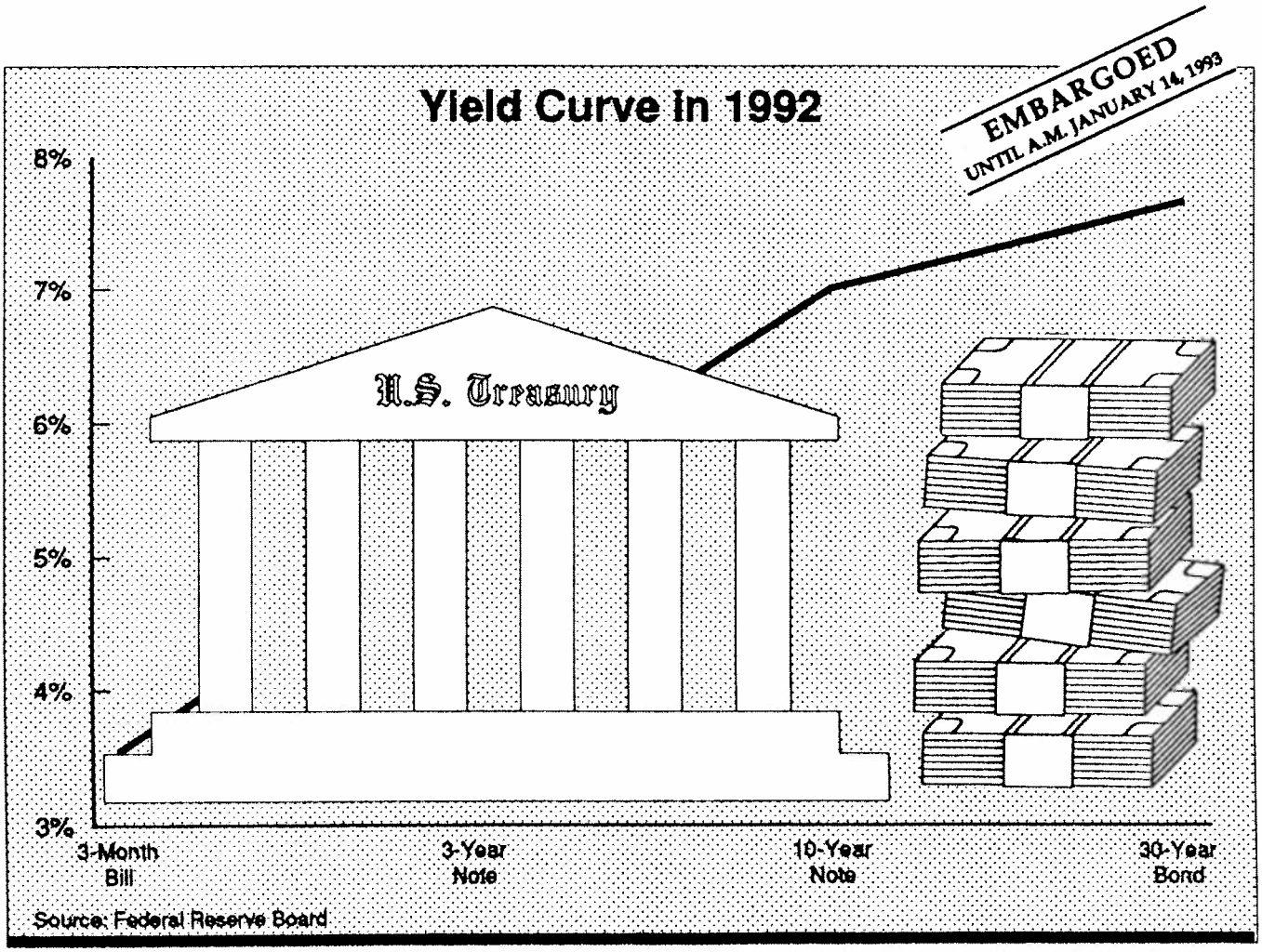
January 14, 1993 No. 103-1

HON. BOB WISE (W. Va.) — Chairman

SCOTT LILLY — Executive Director

Can One Policy Produce Both Budget Savings and Economic Stimulus?

(A New Policy for U.S. Treasury Debt Management Can Save the Taxpayer Billions and Increase the Rate of Economic Growth)



Democratic Study Group • U.S. House of Representatives

1422 Longworth House Office Building; Washington, D.C. 20515 — Tel: (202) 225-5858

A NEW DEBT MANAGEMENT POLICY

DSG Contact: Randall Dodd

Policies to spur and sustain an economic recovery seem far more difficult to devise during the current downturn than during past periods of weak economic performance. At present there are two major impediments to strong growth, with each appearing to demand not only different remedies but ones which would work at cross purposes with one another.

The gross imbalance in fiscal policy over the past decade has created a level of government borrowing which places severe pressure on credit markets and reduces the capacity of businesses to get capital and create jobs. At the same time, the lack of sustained strength or vitality in any major sector of the economy indicates a need for the government to stimulate growth through expanded government purchases and increased borrowing.

The following analysis discusses a policy option which may permit simultaneous progress on both reducing government borrowing (i.e., the federal deficit) and stimulating growth.

MANAGING THE FEDERAL DEBT

In order to finance the federal debt, the Treasury issues three types of marketable securities: Treasury bills (short-term securities that mature in 3, 6, or 12 months); Treasury notes (intermediate-term securities that mature in 2 to 10 years); and Treasury bonds (long-term securities that mature in more than 10 years).[1]

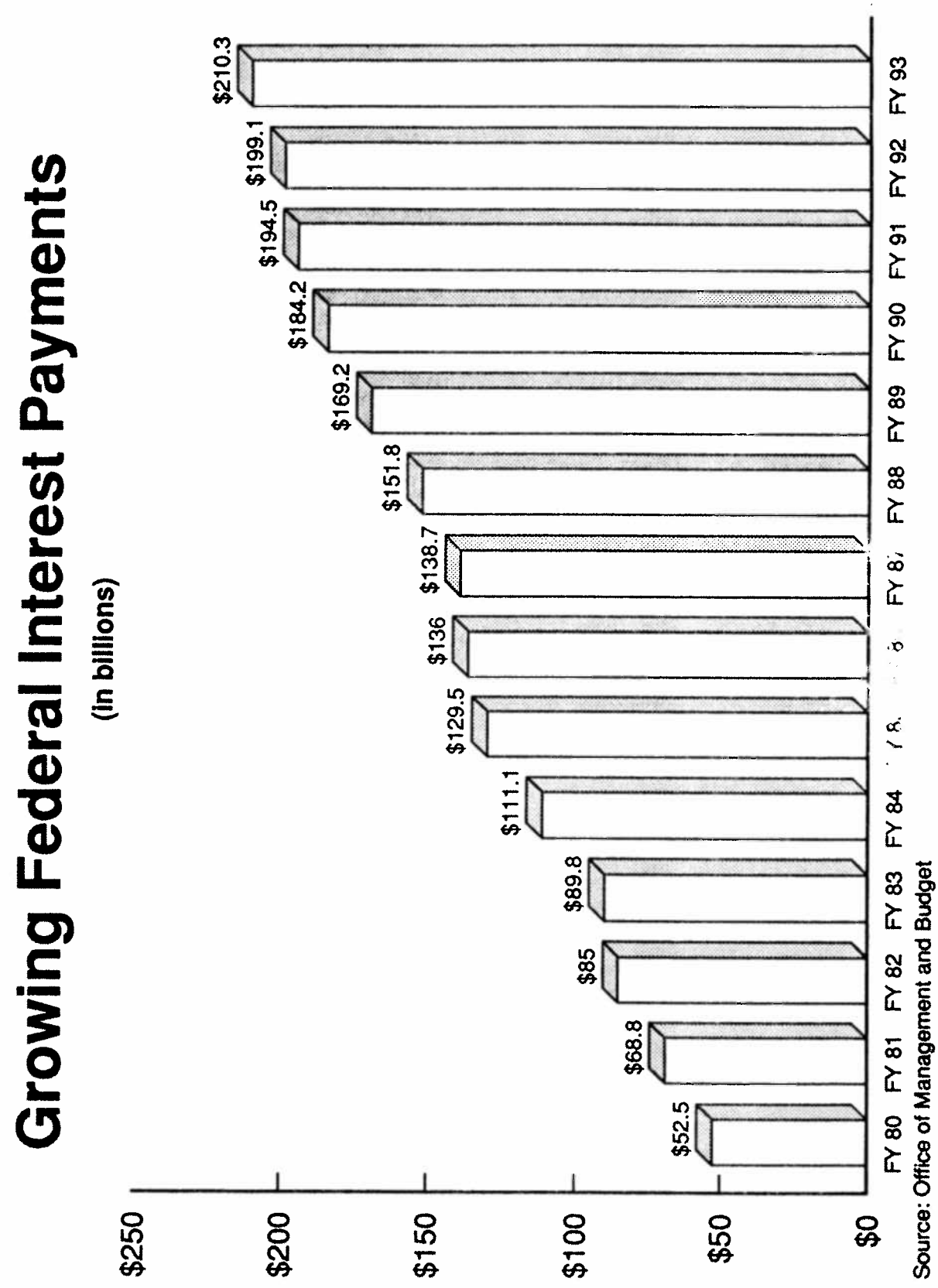
The Treasury is free to use any combination of these instruments to raise the cash that the government needs to continue operations. Under certain market conditions, these decisions can have a very significant but not widely recognized impact on both the cost of financing the federal deficit and the strength of the nation's economic performance.

DEBT MANAGEMENT AND THE DEFICIT

The cost of servicing the net public debt[2] has been the fastest growing item in the federal budget over the last decade. As the net public debt has swollen from $709 billion at the end of FY 1980 to more than $3 trillion by the end of FY 1992, the interest payments required to finance that debt have grown from $52 billion in FY 1980 to $210 billion estimated for FY 1993. This has resulted in the crowding out of other spending priorities and the frustration of efforts to hold down federal deficits. Debt service, which accounted for less than 9% of federal spending in FY 1980, will make up 14% of federal spending in FY 1993 and, according to President Bush's own FY 1993 budget, will reach 16% by FY 1995.

Among the factors which determine how much interest the federal government must pay in a given year is the extent to which the Treasury decides to finance debt on a short- or longer-term basis.

As was noted above, the Treasury issues a mix of short-term bills, intermediate-term notes, and long-term bonds to finance the debt. The mix is important because short-term interest rates are normally lower than longer-term interest rates. Thus, the Treasury usually pays more in interest on notes, which mature in two to ten years, than bills, which mature in 3 months to a year. Similarly, the Treasury pays the most for bonds, with maturities of up to thirty years.

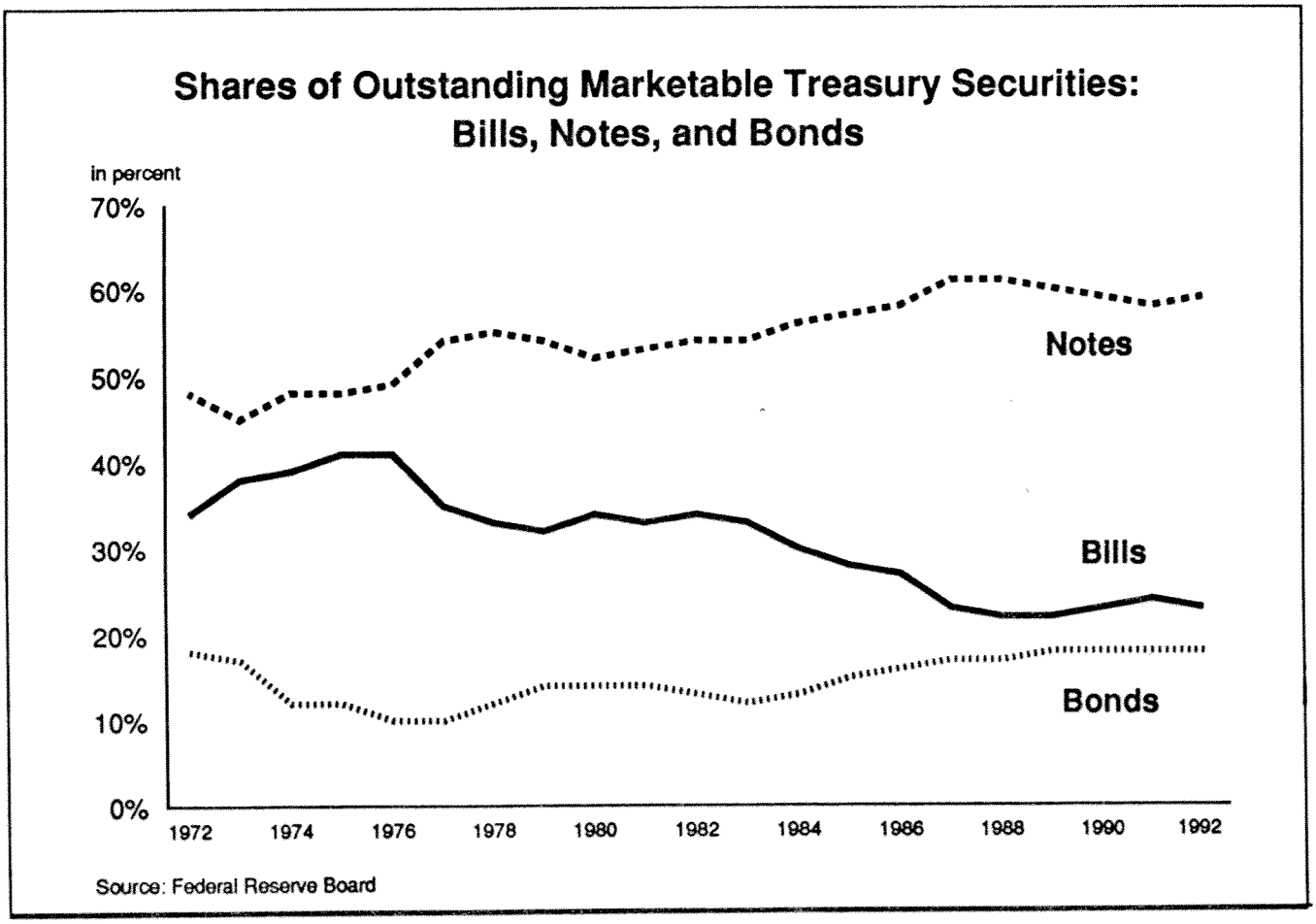

Growing Federal Interest Payments
(In billions)
$250
$200
$150
$100
$50
$0
$52.5
$68.8
$85
$89.8
$111.1
$129.5
$136
$138.7
$151.8
$169.2
$184.2
$194.5
$199.1
$210.3
FY 80
FY 81
FY 82
FY 83
FY 84
FY 88
FY 89
FY 90
FY 91
FY 92
FY 93
Source: Office of Management and Budget

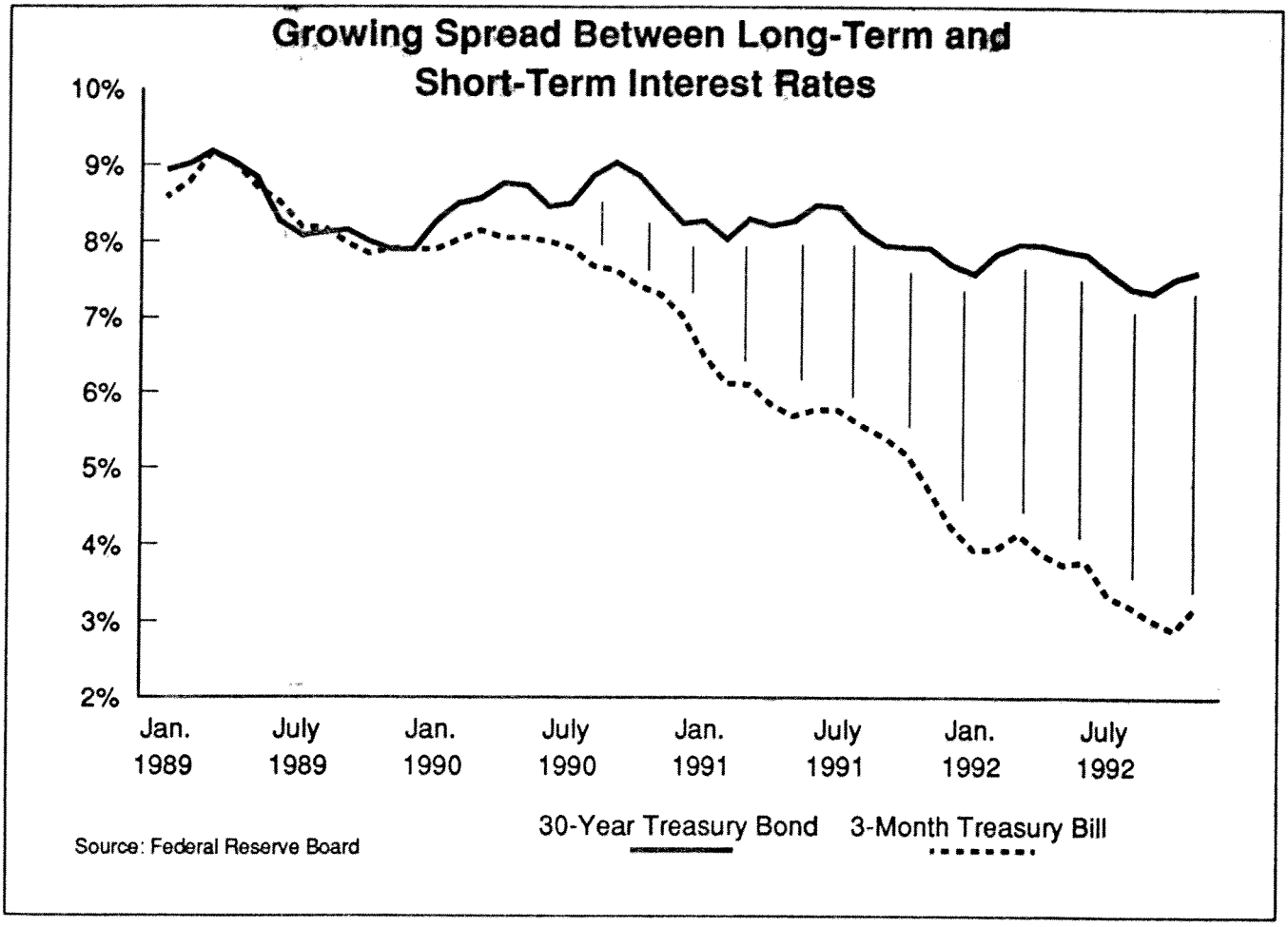
The Treasury's mix of bills, notes, and bonds has remained fairly stable over the past two decades. During this period, the share of outstanding Treasury securities has been 20% to 40% short-term bills, 45% to 60% intermediate-term notes, and 10% to 20% long-term bonds. (Within these ranges, there has been some movement out of short-term borrowing in the last ten years. Whereas short-term bills represented an average of 36% share of securities from 1972 to 1981, they represented only an average of 26% from 1982 to 1992.)

The added expense of financing a portion of the debt intermediate and long-term has been justified by the rationale that it stabilizes interest costs over time. That is, with longer-term borrowing, the Treasury locks in the interest it pays so that an increase in short-term rates does not bring about a commensurate increase in interest payments on the entire federal debt.

When the spread between long- and short-term rates is small or moderate, this Treasury policy of borrowing longer-term can be more easily defended. The premium for borrowing longer-term is small and the goal of stabilizing interest costs over time is worth the price of this small premium.

However, the practice of financing a large portion of the debt with intermediate-term notes and long-term bonds is far more difficult to justify when the differential between longer-term and short-term rates is very large, as it has been over the last couple of years. Whereas private borrowers adjust to even small changes in credit market interest rates, the Treasury Department under President Bush simply failed to respond to dramatically changed circumstances.

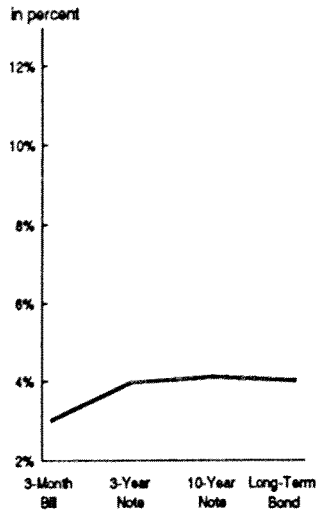




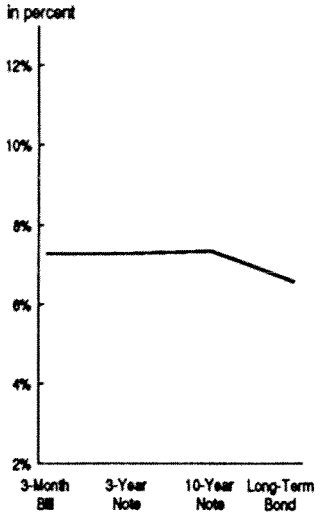
The interest rate on 3-month Treasury bills ("T-bills"), which was 7.90% in January 1990, fell to 3.94% by the first of 1992 and to 3.21% by November 1992. Meanwhile, the 30-year Treasury bond rate, which was 8.26% at the beginning of 1990, fell to 7.58% by the first of 1992 and then rose slightly to 7.61% by November 1992. That amounts to a drop in the interest rate on Treasury bills of 4.69 percentage points in less than three years, while the rate on the bonds fell by only 0.65 percentage points. Thus, in early 1990, it cost the Treasury only 4.5% more to finance the debt with 30-year bonds than with T-bills. By November of 1992, the Treasury had to pay 137% more for financing with 30-year bonds than with T-bills. (See Appendix Table 1 for a complete list of interest rates for 3-month T-bills, 3-year notes, 10-year notes, and 30-year bonds since 1954. In addition, page 5 shows the "yield curve"[3] for various years.)

The current spread between interest paid on T-bills and 30-year bonds is unprecedented in the postwar era. Unfortunately, this situation exists not only with regard to the 30-year bond but the 10-year note and other intermediate-term instruments as well. On average, it cost the Treasury about 18% more in first-year interest payments to use 10-year rather than 3-month financing during the 28 years prior to 1992.[4] In no year prior to 1992 did the interest the Treasury was required to pay on 10-year notes exceed the interest paid on 3-month T-bills by as much as 50%. But during the first 11 months of 1992, the Treasury paid an average of 7.0% interest on 10-year notes — twice what it was paying for 3-month money during this period.

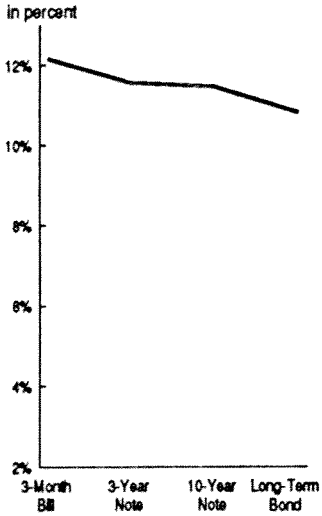
Yield Curve in 1960



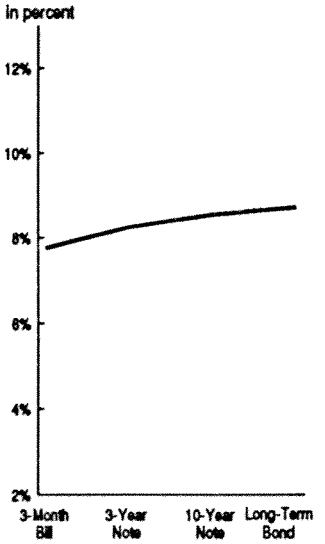
Yield Curve in 1970



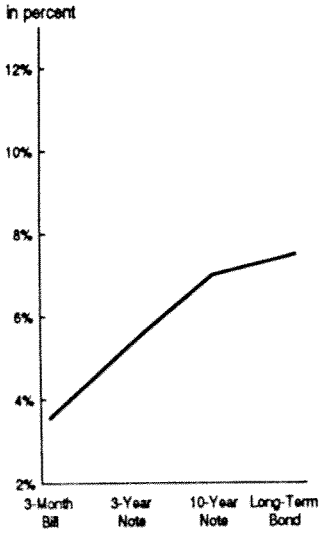
Yield Curve in 1980



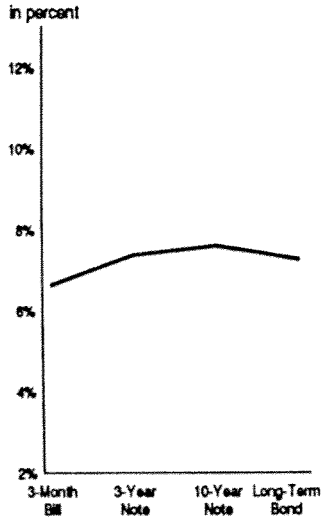
Yield Curve in 1990



Yield Curve in 1992



Average Yield Curve
1960-1990



Source: Federal Reserve Board

Other intermediate-term notes have also been very expensive relative to T-bills. The interest rate on 3-year notes had only fallen to 5.14% by November 1992, making them 60% more costly than 3-month T-bills.

WHAT HAS LONGER-TERM BORROWING COST US?

DSG has attempted to determine how much the Treasury's decision to continue financing the debt with roughly the same ratio of short to long-term borrowing has added to federal outlays. Specifically, we examined how much federal interest payments could have been cut between August 1991 to July 1992 if all federal borrowing had been short-term. We also projected how much interest payments could be cut if this policy continued for an additional 12 months (August 1992 to July 1993). It was assumed for purposes of analysis that short-term rates would not be markedly affected by this change in debt management strategy.

DSG used the Treasury's monthly report on outstanding public debt and the quarterly Treasury Bulletin to determine the amount and the effective interest rate of all note and bond auctions for the 12 months beginning August 1991.

In the 12 months between August 1991 and July 1992, the Treasury issued about $520 billion in notes and bonds to finance new deficits and to refinance past debt that had come due. Of this, $44 billion was in 30-year bonds, $47 billion in 10-year notes, $41 billion in 7-year notes, and about $390 billion in 2-, 3-, and 5-year notes.

DSG calculations found that, if the Treasury had issued 3-month Treasury bills instead of these bonds and notes over the course of those 12 months, it could have saved $5.3 billion. (See Appendix Table 2 for the DSG calculations used to arrive at this estimate.)

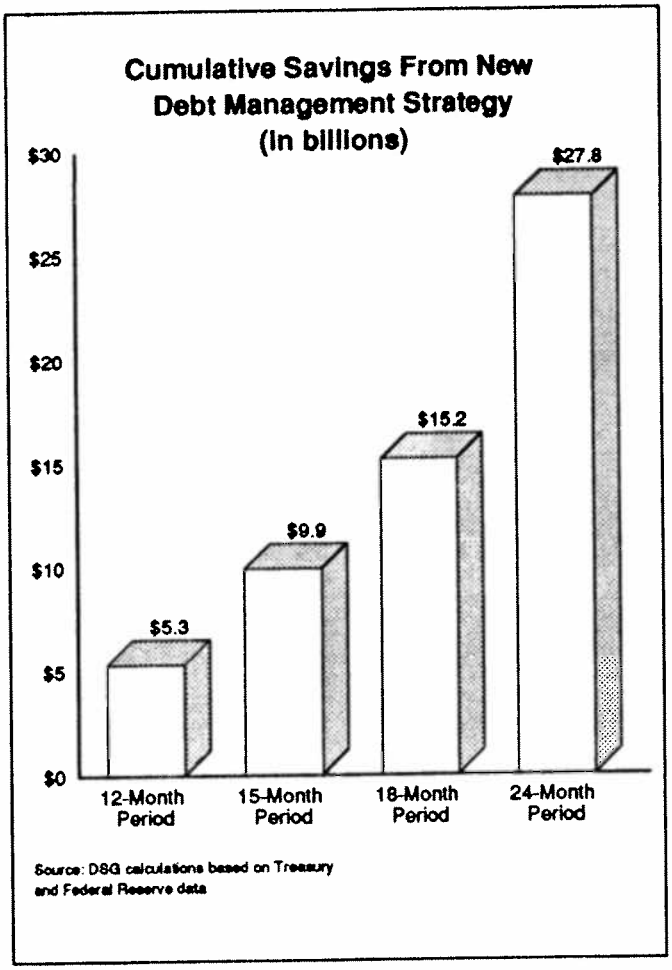
The first-year benefits of this policy underrepresent the savings that would come in the second and future years. The savings are small in the first months of the policy as the first note and bond issues are replaced by T-bill auctions. The amount of debt shifted into short-term securities then accumulates through the year with each monthly and quarterly auction. In totaling the first-year interest savings, only those securities auctioned in the first month would accrue savings for the entire year and those securities auctioned in the following months would accrue savings for only a fraction of the year.

In the second year of the policy, the savings would mushroom. All of the first-year debt financed through T-bills would save the difference between the T-bill interest rate and longer-term rates for the entire second year. In addition, new amounts would be shifted from longer-term into shorter-term debt with each monthly auction in the second year. Together these factors make the savings grow larger and larger each year.

Thus, if we extend our example for an additional three months, the cumulative savings over the 15-month period would rise from $5.3 billion to $9.9 billion. Assuming that current interest rates remain unchanged, then the savings over 18 months would rise to $15.2 billion.

Finally, if we extend the example for a full two years and assume that rates remain at current levels through July 1993, the two-year savings would rise to $27.8 billion. (See Appendix Table 2.)

Assuming the normal relationship between long- and short-term interest rates is reestablished at some future date and the Treasury returns to its old pattern of distributing debt between long- and short-term securities, the Treasury would still accrue savings from its



temporary move toward shorter-term debt financing. This would happen for two reasons.

First, benefits would be derived from the fact that the policy (as we shall see in the next section) is likely to bring down long-term rates. A future $10 billion issue of 30-year bonds (approximately the amount offered at a normal quarterly auction) might well be expected to sell at a one-half point lower interest rate, saving the Treasury $50 million a year — or $1.5 billion over the 30-year life of the securities. Further savings could be expected on the sale of intermediate-term securities, whose rates would fall as well.

Secondly, despite the prospect that short-term interest rates might rise as the economy picks up steam in the next few years, they are unlikely to approach current note and bond rates — based on the current widespread weakness across all sectors of the economy and the lack of evidence that expected growth rates will put any significant upward pressure on prices.

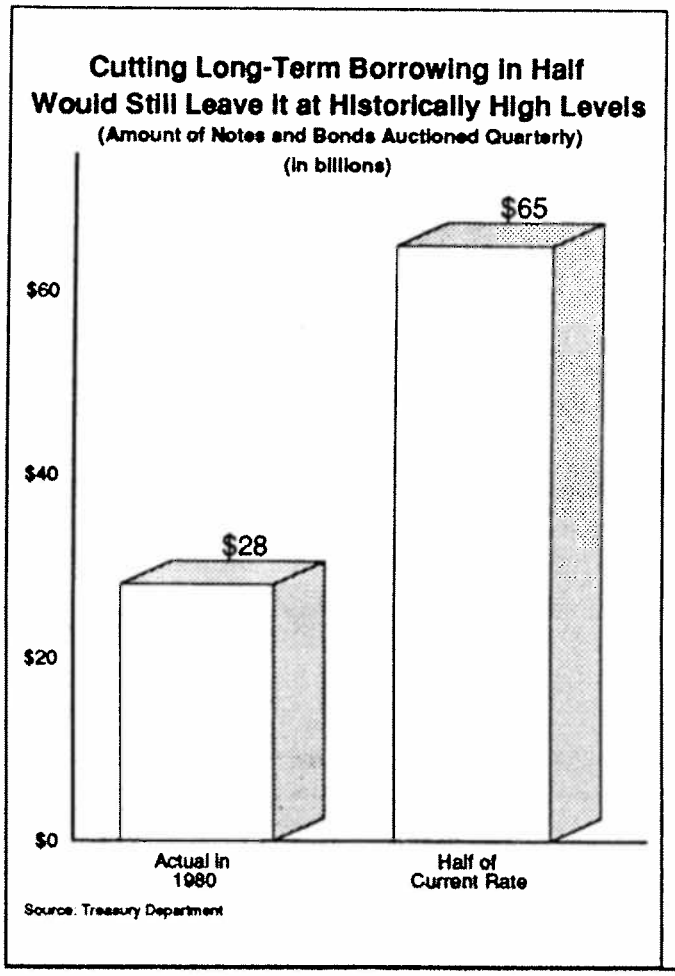
If we assume that 3-month T-bills rise by 50% over the next 18 months and that the proposed movement toward shorter-term financing will force the Treasury to refinance debt at those higher rates (that would have otherwise been locked in at current long-term rates), we would still see a substantial savings. Instead of paying 7.6% interest, the Treasury would be paying 4.8%.

It should also be pointed out that all of the forecasts, including the President's own most recent midterm budget review, indicate that short-term rates will not rise by anything approaching 50%. The White House forecasts a 20% rise in short-term rates for 1993 and the consensus of private forecasts projects no increase at all.[5] Further, virtually all short and longer-term economic forecasts project no appreciable increase in the inflation rate — the principal source of pressure for pushing short-term rates higher.

A policy of shifting completely out of notes and bonds and into bills would not be popular in certain quarters. It would affect financial industries involved in trading these instruments, as well as those that base financial contracts on the interest rates which the Treasury auctions produce. It would force insurance companies and pension funds to find other long-term investments in the private sector to match their long-term actuarial liabilities. It would also significantly cut profits for virtually all banks and savings institutions, which have benefited enormously from the opportunity which current policies have provided over the past year — to borrow at cheap short-term rates and loan at high long-term rates by offering home mortgages and car loans or simply by buying notes and bonds from the Treasury.[6]

These problems would be moderated if the Treasury were to continue longer-term issues, but at a significantly reduced volume. If the Treasury were, for instance, to shift only half of the debt auctioned as notes and bonds into bills, the savings would be half that of a complete shift. That would amount to savings of $2.7 billion in the first year or a total of $13.9 billion over the two-year period. Still, under this scenario, the Treasury would auction $65 billion in notes and bonds quarterly, providing investors with significantly more government long-term debt to purchase than was available in 1980.

It can be argued that these cost-saving figures are overstated because a large transfer of demand out of long-term borrowing and into short-term might significantly force up short-term rates. The upward pressure which such a policy would place on short-term rates would not, however, be great and with cooperation from the Federal Reserve, that pressure could be neglible. First, the transfer would place less pressure on short-term credit markets than one might expect because short-term markets are so large. While the Treasury auctions play a major role in the long-term credit markets, they play a modest one in the short-term market. Secondly, and of greater importance, the Federal Reserve has enormous power to keep short-term rates low. The Fed, through its ability to create money and lend it to banks through the discount window, can overwhelm short-term credit markets and hold short-term rates at desired levels.

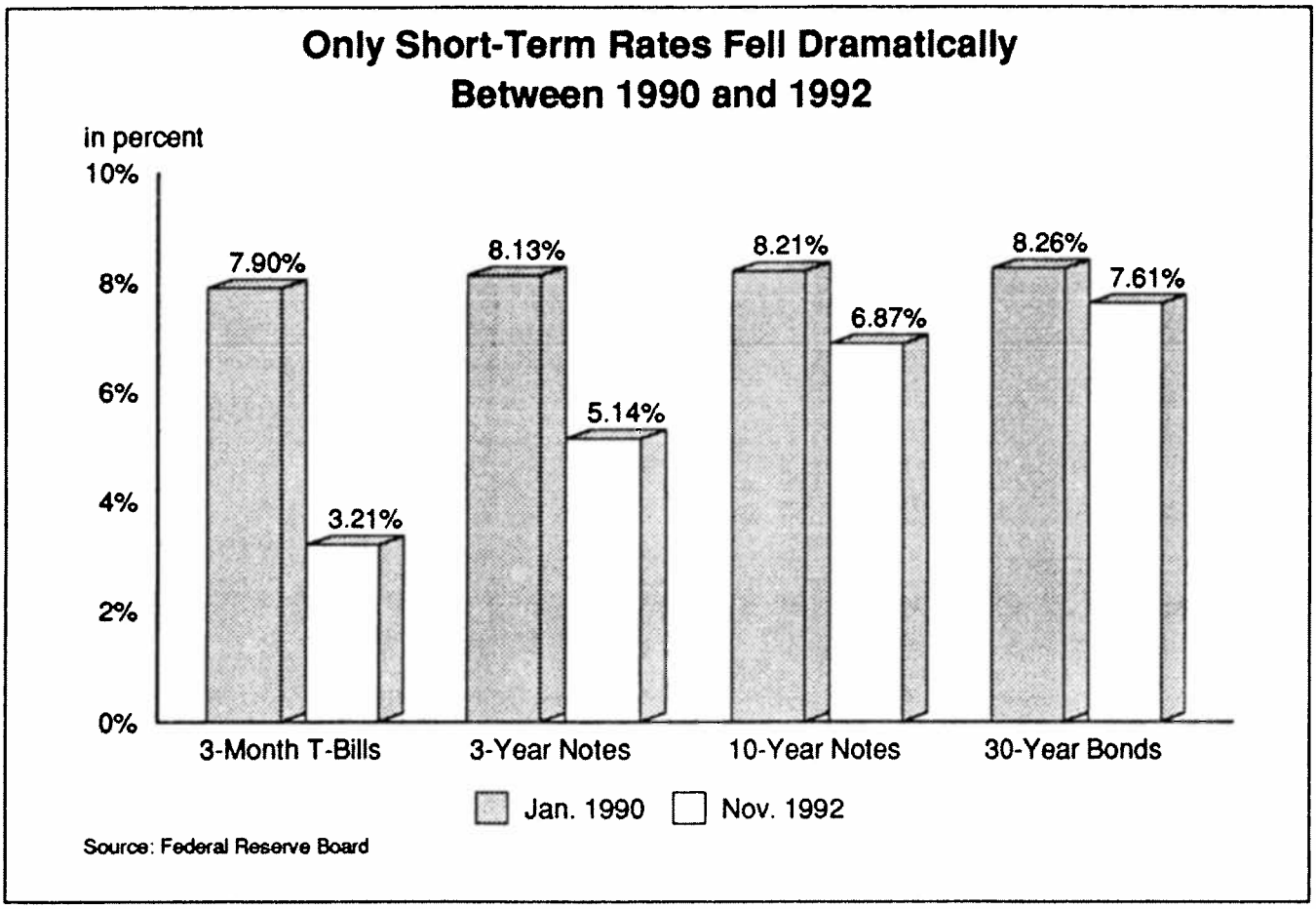


LONG-TERM RATES AND ECONOMIC GROWTH

The Bush Administration shunned a variety of traditional strategies for dealing with the recession which began in August of 1990. The President and his economic team argued that the most effective means of restoring growth would be through lowering interest rates. As the previous discussion on Treasury yields indicates, however, that effort resulted in changes at only one end of the yield curve. Between January 1990 and November 1992, the interest rates dropped 59% on 3-month T-bills, but only 16% on 10-year notes, and less that 10% on 30-year bonds.

The lack of attention paid to long-term rates in the Bush anti-recession policies is curious since it is clearly long-term rates that provide the real leverage on the pace of economic expansion.

Few consumers borrow short-term other than with their credit cards, and as most are painfully aware, those rates are not adjusted to allow for fluctuations in short-term rates. The decline in short-term rates did help some con-

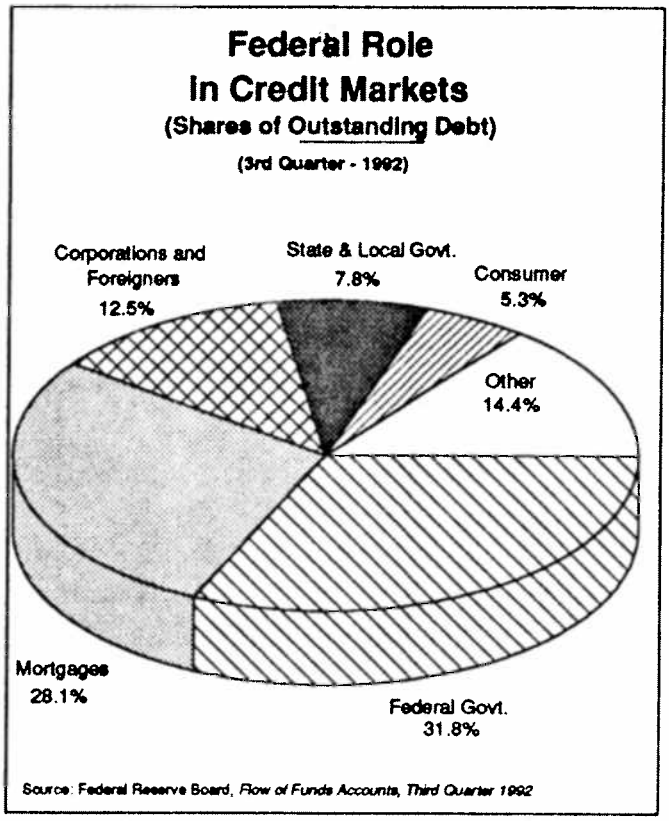


sumers—most notably homeowners with adjustable rate mortgages. But the benefit they received was largely offset by the precipitous drop in income of other consumers, principally the elderly, who derive a large share of their income from savings accounts, money market funds, and CDs—all based on short-term rates. The net impact of lower short-term rates was probably very small on both aggregate demand and the pace of economic growth.

Long-term interest rates, on the other hand, have a very direct and powerful effect on a variety of key activities. These include personal and commercial real estate, new home construction and improvement, automobile and other durable goods purchases, and investment in new plant and equipment.

While supporters of the Bush policies might argue that only the Federal Reserve controls interest rates and then only at the short end, there is considerable evidence to the contrary. The key to the Bush strategy of using interest rates as a lever to bring about economic recovery lay in the hands of his own Treasury Department.

By virtue of the explosion of the public debt over the course of the last decade, the federal government is a dominating player in national and world credit markets. By the third quarter of 1992, the Federal Reserve reported in their flow of funds data that the Federal Government accounted for $4.7 trillion of the $14.7 trillion in total outstanding debt in this country. State and local government accounted for only $1.1 trillion and corporate and foreigner debt amounted to a mere $1.8 trillion. Even when home and commercial mortgages were combined, they amounted to only about 90% of the debt of the federal government.

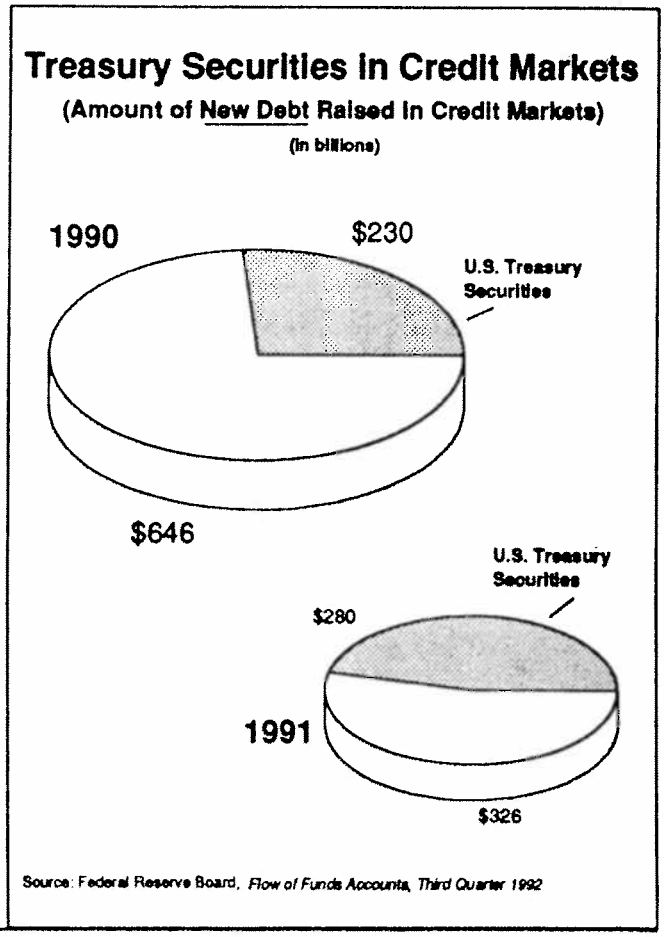


In 1990, Treasury securities represented more than one-quarter of the total $876 billion in new debt raised in U.S. credit markets. As the recession took hold, the role of the government in credit markets became even more dominant. In 1991, Treasury securities accounted for 46.2% — nearly one-half — of the shrinking demand for new credit.

It is difficult to predict with precision how a market as large and complex as U.S. credit markets might react to a shift in the pattern of Treasury borrowing from longer- to shorter-term borrowing. It is clear beyond any reasonable doubt, however, that a key factor in keeping long-term rates high through this period of very weak demand on the part of other borrowers has been the high level of government long-term borrowing. It is remarkable to note that in the face of the highest differential in history between long and short-term rates, the Treasury actually slightly increased its issues of notes and bonds and decreased its issues of bills during 1992.[7]

DSG contacted a wide array of forecasting and econometric modeling concerns in academia, business, and government to seek estimates on the impact which a shift in the pattern of Treasury borrowing would have on long-term rates and what effect a decline in long-term rates might in turn have on the economy. While there was general agreement that such a policy would lower long-term rates, have at most a modest impact on short-term rates, and provide some stimulus, no one we spoke with was able to make a precise estimate as to the magnitude of these effects based on recent analysis.

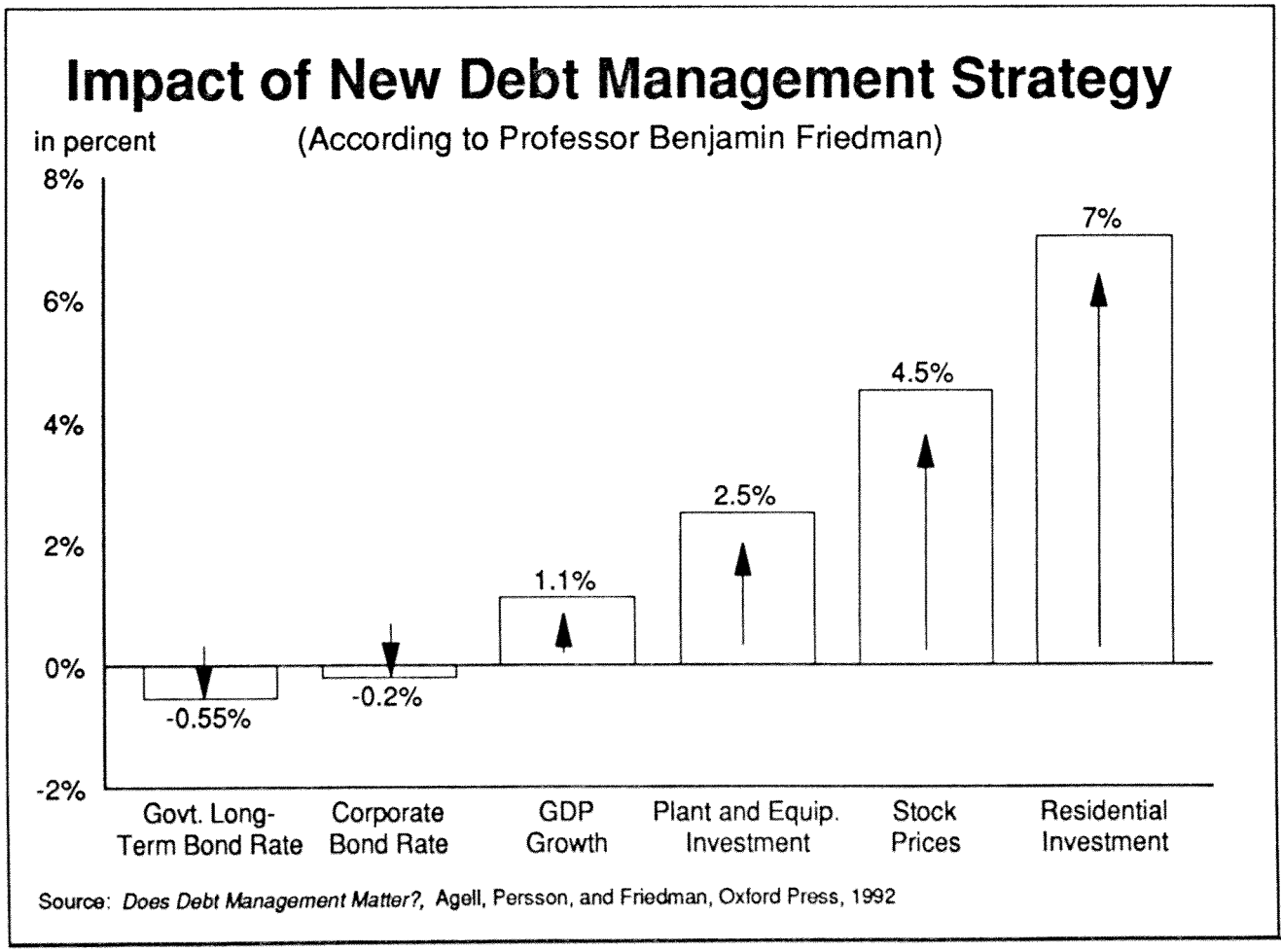
A detailed econometric study using data from the mid-1970s was conducted on this issue by Professor Benjamin Friedman of Harvard. The study estimated the cost of shifting $12 billion (measured in 1991 dollars) of long-term bonds and notes into short-term bills in one year. (That would have



amounted to shifting about 25% of the long-term bonds and notes issued in that period into short-term bills.) He estimated that the result would be a lowering of the interest rate on long-term securities (defined as 10 years or more) by 0.55%. In turn, corporate bond rates would fall 0.20% and stock prices would rise 4.5%. The impact of this lowering of the long-term rate was significant with respect to overall economic performance. In Professor Friedman's study, real GDP increased by 1.1%, plant and equipment investment grew by an additional 2.5% or more, and residential investment grew by an additional 7%.

The following numbers help explain how changes in long-term rates can affect the pool of eligible homebuyers. If long-term rates were to decline by one-half of one percent, bringing the 30-year bond down from 7.6% to 7.1%, it would have a commensurate effect on mortgage rates. One might expect the standard 30-year home mortgage to drop from about 8.25% where it is today to about 7.75%. Payments on a $70,000 starter home would drop by about $300 per year. Based on Fannie Mae's requirement that payments cannot exceed 28% of gross income, that would shift the minimum qualifying income from $22,500 to $21,500. According to Census Bureau statistics, more than a million families fell into that income range during 1991. This is a rough estimate of how many additional families would qualify to buy a starter home if long-term interest rates were to fall by just 0.5%.

A similar example could be constructed for a small business seeking to expand operations. There is clearly a range of opportunities open to American businesses to make and sell more products even under current economic condi-



tions if the marginal cost of manufacturing new or additional products leaves a reasonable margin for profit. One factor which keeps such costs high is the continued high rate of interest charged for loans which allow plant expansion and equipment purchases. As long-term interest rates decline, the number of options which become viable increases and the number of businesses that qualify for such credit expands.

Yet another way in which lower long-term interest rates can help stimulate the economy is by allowing existing homeowners to refinance their mortgages at lower rates. The research department of the Federal Reserve Board has recently estimated that mortgage refinancing plus the automatic adjustment that accrues with adjustable rate mortgages has added $25 billion a year to consumers' purchasing power.[8] That is equal to adding 1/2% growth to GDP.

CONCLUSION

The large difference which presently exists between short-term and long-term interest rates in the United States is unprecedented. Continued high interest rates on long-term debt is a major part of the explanation for why the economy has not responded more vigorously to Federal Reserve easing of the money supply. U.S. Treasury debt management policy, which has continued to rely heavily on longer-term securities to finance the public debt, is a key reason for continued high long-term rates.

If there is a silver lining to bad policy, it is that reversal of such policy produces good results. Reversing the current Treasury debt management policy of relying on high levels of long-term debt issues when that form of financing is relatively far more expensive should produce two very desirable results. It should provide both immediate and long-term budget savings in the area of interest payments on the federal debt, the fastest growing portion of the budget. It should also push down long-term rates and provide a significant portion of the stimulus needed to put the U.S. economy back on track.

NOTES

[1] In addition to marketable securities, the Treasury also uses instruments which are not sold in open credit markets to finance the debt. These include savings bonds, foreign government and public series, and government account series. Such non-market instruments have accounted for between one-quarter to one-third of total debt financing over time.

[2] There are two measures of public debt. The gross debt (sometimes referred to as the debt subject to limit) measures the total borrowing of the government from all sources, including the federal government's own trust funds. The net debt excludes intergovernmental borrowing and measures only that portion of the debt owed to lenders other than the government itself.

[3] A yield curve shows how interest rates change as the maturity of the security changes.

[4] We chose the period of 1964 to the present for a comparison of rates because that was the period for which comparable data was available on both 3-month Treasury bills and 10-year notes.

[5] Office of Management and Budget, *Mid-Season Review: The President's Budget and Economic Growth Agenda*, p. 6, and *Blue Chip Economic Indicators*, December 10, 1992, pp. 2 and 3.

[6] See *Barron's*, January 11, 1993, p. 14: "The Federal Reserve continued to ease credit, which allowed banks to continue to reap huge profits by simply borrowing money at 3% and investing in government and mortgage securities paying double that rate...Industry profits...[in 1992] should total a record high $33 billion-$34 billion."

[7] In 1991, the share of new funds raised through T-bills was 29%. During 1992, it fell to 24%. Notes and bonds made up the difference.

[8] Conversations with economists at Federal Reserve Board.

Appendix Table 1

Trends in Interest Rates on Treasury Securities

	3 -Month T-bills	*3-Year Notes*	*10-Year Notes*	*30-Year Bonds*
1954	0.97%	1.63%	2.40%	n/a
1955	1.78	2.47	2.82	n/a
1956	2.71	3.19	3.18	n/a
1957	3.34	3.69	3.65	n/a
1958	1.87	2.84	3.32	n/a
1959	3.49	4.46	4.33	n/a
1960	3.01	3.98	4.12	n/a
1961	2.42	3.54	3.88	n/a
1962	2.84	3.47	3.95	n/a
1963	3.23	3.67	4.00	n/a
1964	3.63	4.03	4.19	n/a
1965	4.04	4.22	4.28	n/a
1966	5.01	5.23	4.92	n/a
1967	4.44	5.04	5.07	n/a
1968	5.49	5.68	5.65	n/a
1969	6.90	7.02	6.67	n/a
1970	6.64	7.29	7.35	n/a
1971	4.45	5.65	6.16	n/a
1972	4.17	5.72	6.21	n/a
1973	7.25	6.96	6.84	n/a
1974	8.14	7.82	7.56	n/a
1975	5.99	7.49	7.99	n/a
1976	5.13	6.77	7.61	n/a
1977	5.41	6.69	7.42	n/a
1978	7.46	8.29	8.41	8.49%
1979	10.45	9.72	9.44	9.29
1980	12.15	11.55	11.46	11.30
1981	14.81	14.44	13.91	13.44
1982	11.19	12.92	13.00	12.76
1983	8.93	10.45	11.11	11.18
1984	9.95	11.89	12.44	12.39
1985	7.74	9.64	10.62	10.79
1986	6.15	7.06	7.68	7.80
1987	6.01	7.67	8.38	8.58
1988	6.88	8.26	8.85	8.96
1989	8.40	8.56	8.50	8.45
1990	7.76	8.25	8.55	8.61
1991	5.57	6.81	7.86	8.14
1992 Jan.	3.94	5.40	7.03	7.58
Feb.	3.95	5.72	7.34	7.85
Mar.	4.15	6.18	7.54	7.97
Apr.	3.90	5.93	7.48	7.96
May	3.75	5.81	7.39	7.89
Jun.	3.79	5.60	7.26	7.84
Jul.	3.35	4.91	6.84	7.60
Aug.	3.21	4.72	6.59	7.39
Sep.	3.03	4.42	6.42	7.34
Oct.	2.90	4.64	6.59	7.53
Nov.	3.21	5.14	6.87	7.61

Source: Federal Reserve Board

Appendix Table 2

Calculations of Savings from New Debt Management Policy

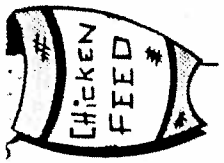
Actual Auctions of Treasury Notes and Bonds, 8/91-7/92						Savings from Shifting to Treasury Bills			
Date of Issue	Maturity (in years)	Amount (in millions)	Yield on Notes and Bonds	Fraction of Year	First-Year Treasury Payment (in millions)	Yield on 3-Month T-Bills*	First-Year Trea. Payment (in millions)	First-Year Savings (in millions)	Second-Year Savings (in millions)
Aug-91	2	$14,087	6.46%	all	$910	5.56%	$783	$127	$458
Aug-91	3	17,165	6.92	all	1,188	5.56	954	233	637
Aug-91	5	9,825	7.37	all	724	5.56	546	178	409
Aug-91	10	12,339	7.94	all	980	5.56	686	294	584
Aug-91	30	12,163	8.17	all	994	5.56	676	317	603
Sep-91	2	15,373	6.14	11/12	865	5.41	762	103	450
Sep-91	5	10,088	7.05	11/12	652	5.41	500	152	387
Oct-91	2	15,716	6.01	10/12	787	5.18	678	109	440
Oct-91	5	9,348	6.94	10/12	541	5.18	404	137	349
Oct-91	7	10,268	7.20	10/12	616	5.18	443	173	410
Nov-91	2	15,629	5.51	9/12	646	4.73	554	91	359
Nov-91	3	16,808	6.00	9/12	756	4.73	596	160	469
Nov-91	5	9,871	6.54	9/12	484	4.73	350	134	329
Nov-91	10	12,000	7.29	9/12	656	4.73	426	230	490
Nov-91	30	12,000	8.00	9/12	720	4.73	426	294	575
Dec-91	2	16,539	5.12	8/12	565	4.24	468	97	316
Dec-91	5	9,635	6.24	8/12	401	4.24	272	128	292
Jan-92	2	15,132	4.99	7/12	440	3.94	348	93	269
Jan-92	5	9,464	6.28	7/12	347	3.94	218	129	291
Jan-92	7	10,559	6.40	7/12	394	3.94	243	152	337
Feb-92	2	15,952	5.40	6/12	431	3.95	315	116	349
Feb-92	3	17,774	5.54	6/12	492	3.95	351	141	414
Feb-92	5	9,948	6.75	6/12	336	3.95	196	139	352
Feb-92	10	11,000	7.29	6/12	401	3.95	217	184	449
Feb-92	30	10,000	7.91	6/12	396	3.95	198	198	470
Mar-92	2	17,817	5.85	5/12	434	4.15	308	126	470
Mar-92	5	11,302	6.94	5/12	327	4.15	195	131	422
Apr-92	2	16,396	5.43	4/12	297	3.90	213	84	364
Apr-92	5	11,441	6.93	4/12	264	3.90	149	116	426
Apr-92	7	10,178	7.11	4/12	241	3.90	132	109	397
May-92	2	15,803	5.13	3/12	203	3.75	148	55	303
May-92	3	19,152	5.96	3/12	285	3.75	180	106	527
May-92	5	11,049	6.75	3/12	186	3.75	104	83	391
May-92	10	11,714	7.50	3/12	220	3.75	110	110	503
May-92	30	10,000	8.00	3/12	200	3.75	94	106	479
Jun-92	2	17,256	5.11	2/12	147	3.79	109	38	328
Jun-92	5	11,054	6.43	2/12	118	3.79	70	49	356
Jul-92	2	16,917	4.29	1/12	60	3.35	47	13	183
Jul-92	5	12,104	5.56	1/12	56	3.35	34	22	284
Jul-92	7	10,006	6.44	1/12	54	3.35	28	26	323
Total		**$520,872**	**6.47%**		**$18,814**	**4.36%**	**$13,532**	**$5,282**	**$16,242**

*Average rate of financing and refinancing in T-bills through end of period.

	(in millions)
First-Year Savings from Shifting to Treasury Bills, 8/91-7/92	$5,282
Second-Year Savings from Shifting to Treasury Bills, 8/91-7/92	$16,242
Second-Year Savings from Financing New Debt with Treasury Bills, 8/92-7/93	$6,240
Total Two-Year Savings	$27,764

air in the future.
IS J. MURRAY Jr.
, Jan. 21

York State Energy Office.



son and his accomplishments
shington" (Jan. 17). Howev-
hour including fringe bene-
nany jobs in such a poor
that this is a generous rate of
out to somewhere above
line when the cost of all
$8 an hour rate.
s doing nothing more than

D BALKAN
wood Park, Queens, Jan. 17

N

mn on Jan. 10, about the
l a V-8 engine for the Indian-
city. Its displacement is 2.65

ers. Letters for publication should
lephone number. Letters should
ss Section, The New York Times,
6. We regret that because of the
ible to acknowledge or to return

Cultural Values Shape Economic and Political Success."

population has grown more rapidly, and why worker productivity has grown more slowly, than in needs of our poor, not on the failure of other nations to meet the needs of their people. ■

The Monetary Path to Full Recovery

By HENRY KAUFMAN

THE Clinton Administration is essentially faced with two competing approaches to economic policy: fiscal and monetary activism.

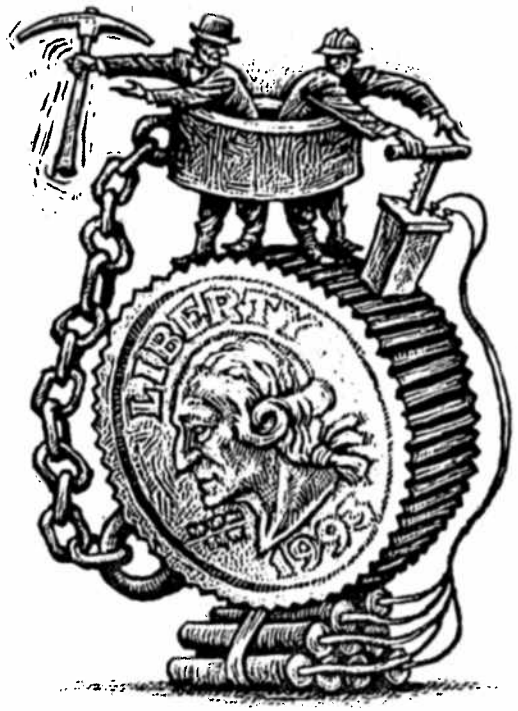
The first boils down to a sizable immediate fiscal stimulus to prime a business expansion, through middle-class tax cuts and greater Government expenditures on infrastructure, coupled with a package of standby revenue and spending measures that several years later would bring down the Federal budget deficit.

This option carries considerable risk. The main danger is that financial markets will rebel, sensing that after the short-term stimulus is legislated, the commitment to long-term deficit reduction will be abandoned. A negative market reaction could provoke a decline in bond prices. This would impede any further improvement in the financial condition of the private sector, which is necessary for a durable economic revival.

The rise in interest rates would also weigh on the stock market, discouraging the issuance of new shares and thus stunting the recent trend for corporations to cut back on the excessive debt built up in the 1980's.

The other approach — the one I recommend — is to limit the fiscal stimulus to $20 billion to $25 billion over 12 months and to rely mainly on a number of incremental steps to improve monetary and credit conditions. Monetary activism, because it is reversible, is a more dependable way of laying a foundation for sustainable growth. This approach should have at least four elements:

First, the Administration should take the lead in reviving the policy coordination process among leading industrial countries to negotiate a de-escalation of official interest rates. This entails exceptional statesmanship. But economic circumstances are now ripe for a monetary consensus.



Today, the other big industrial countries are contending with the prospect of little or no economic growth — or worse. Apart from Japan, no other major industrial country is in a good position to adopt fiscal stimulus. Thus, all will be more receptive to additional monetary accommodation. If that is done in concert, the odds are that financial markets will react quite favorably, greatly improving the chances for a global acceleration in business activity.

Second, I recommend semiannual meetings at which the President sits down behind closed doors with Federal Reserve officials for a candid appraisal of economic and financial prospects and a better understanding of policy constraints. This would follow up on the useful introductory meeting Alan Greenspan and President Clinton held on Thursday. These sessions would not be for the purpose of invading the central bank's independence but to give the Administration a clear understanding of how much growth can reasonably be financed from a monetary perspective.

Third, Treasury officials have an exceptional opportunity to shift to a more flexible debt-management policy without taking significant risks. By substantially reducing the amount of newly issued longer-term obligations, including 10-year notes and 30-year bonds, this policy shift would provide significant benefits.

- It would lower long-term rates, thereby stimulating long-term commitments in the private sector, without exerting appreciable upward pressure on short-term rates.
- It would increase the access that private-sector and state and local government borrowers would have to the long-term bond market, helping them achieve a useful lengthening in the maturity of their debt, which has become progressively shorter over the last decade. Accordingly, this would reduce the financial vulnerability of those in the private sector who are least able to absorb risk and will shift that risk onto the Government, which is able to bear a greater share.
- It would also help to sustain and perhaps lift stock prices.

Fourth, a thorough reorganization of financial regulation is an important ingredient in repairing the financial fabric of the United States. A parallel regulatory reform initiative in the international arena would help in easing financial strains in several other major countries as well.

These efforts could play a vital part in getting a satisfactory business expansion going without any budgetary expenditure whatsoever, a not inconsiderable advantage. ■

Henry Kaufman is president of Henry Kaufman & Company, a money management and financial consulting firm.