

GOVT. DEBT REPAYMENT



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These days, the world over, governments are borrowing more and more money from the market. You may have wondered how governments always manage to create a mountain of debt for themselves.



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But ever wondered how governments ultimately repay their debts?

There are several ways by which a government actually repays its debts. I will try to explain some of them one by one...



**Understanding
Govt. Debt Repayment
– By Prof. *Simply Simple*™**



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Well, borrowing money is obviously not a problem for any government.

After all, a government's promise to repay does not require any collateral.

But we need to understand a little bit about how governments manage their finances first before moving on to the repayment of their debts.



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To start with...

- Just like individuals, a government has to constantly balance income and expenditure.
- Governments have only limited sources of income, which look like peanuts when we look at the mountain of expenditure.
- So, before planning anything, the government does need to find some extra money.
- But where is this extra money going to come from?



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Now...

- Although default by a government is not common, we can't say that it is completely improbable.
- Sometimes governments too default in the repayment of their debts.
- But you would hear about a government defaulting only in extreme situations.
- By & large, the track record of governments repaying debts appears as clean as a whistle.
- There are several ways by which a government actually repays its debts...



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First and foremost...

- ❑ For actually repaying its debt, a government needs to develop a fiscal surplus that can be used to buy back existing government securities.
- ❑ A fiscal surplus can arise only if the government's income exceeds its expenditure.
- ❑ To make that happen, a government would need to improve its income and reduce its expenses.
- ❑ Unfortunately, there is no fixed formula of how to reduce expenses, but when it comes to improving income, all governments have to use their famous weapon: *taxes*.



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Here's how...

- ❑ **More taxes, both indirect and direct, help governments mobilize more resources, part of which can be used for the repayment of debts.**
- ❑ **But taxes in themselves may not be enough to repay all debts.**
- ❑ **Taxes are very helpful in meeting the yearly payments of interest, but to actually retire the mountain of debts, the government may need to think of other strategies.**



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What other strategies can the government follow?

- The government can use public sector companies to its advantage.**
- This can be done in two ways.**
- First option:**
 - **The government can choose to keep the public sector companies with itself and use their yearly dividends to repay debts.**
 - **This will produce slow but steady results.**
 - **Every year, a part of the debt would get repaid, provided the government is not planning to use dividends for any other purpose.**



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Otherwise...

- ❑ **Second option:**
 - **The government can choose to divest its holding in public sector companies at the best available opportunity and use the proceeds for repayment of debts.**
 - **Disinvestment produces immediate results.**
 - **A mountain of money received from disinvestment can be used to retire a mountain of debt in one shot.**
 - **Most governments around the world that are now putting their money to bail out private enterprises expect to repay their debt by profitably divesting their holdings when the right time comes.**



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But what if nothing works?

- ❑ When nothing works, governments can resort to their least popular choice: Borrow money to repay existing debt.
- ❑ But that's not all. When borrowing becomes difficult, governments may even resort to printing notes.
- ❑ Such a course of action may lead to hyperinflation, which indicates that the government has gone bankrupt.
- ❑ So even if you get your money back, it is a worthless piece of paper. Luckily, we have many sensible central banks to prevent things from coming to such a pass.



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To Sum Up

- ❑ **What: Governments repay their debts in several ways.**
- ❑ **When: To actually repay its debt, a government needs to develop a fiscal surplus, but sometimes that may not be possible.**
- ❑ **How: Taxes, Public Sector Companies & borrowing programmes may be used. In the worst case, a government may resort to printing more notes to repay existing debt.**



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Hope you have now understood the
concept of Govt. Debt Repayment

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