

[Working Papers](#)

Financing vs. Forgiving a Debt Overhang

Paul R. Krugman

SHARE   

WORKING PAPER 2486

DOI 10.3386/w2486

ISSUE DATE January 1988

This paper examines the tradeoffs facing creditors of a country whose debt is large enough that the country cannot attract voluntary new lending. If the country is unable to meet its debt service requirements out of current income, the creditors have two choices. They can finance the country, lending at an expected loss in the hope that the country will eventually be able to repay its debt after all; or they can forgive, reducing the debt level to one that the country can repay. The post-1983 debt strategy of the IMF and the US has relied on financing, but many current calls for debt reform call for forgiveness instead. The paper shows that the choice between financing and forgiveness represents a tradeoff. Financing gives the creditors an option value: if the country turns out to do relatively well, creditors will not have written down their claims unnecessarily. However, the burden of debt distorts the country's incentives, since the benefits of good performance go largely to creditors rather than itself. The paper also shows that the tradeoff itself can be improved if both financing and forgiveness are made contingent on states of nature that the country cannot affect, such as oil prices, world interest rates, etc.

Download a PDF

[Information on access](#)


Acknowledgements and Disclosures



Download Citation



Published Versions

[Journal of Development Economics](#), Vol. 29, pp. 253-268, (1988). citation courtesy of 

Related

TOPICS

International Economics

PROGRAMS

International Trade and Investment

International Finance and Macroeconomics

More from NBER



In addition to [working papers](#), the NBER disseminates affiliates' latest findings through a range of free periodicals — the [NBER Reporter](#), the [NBER Digest](#), the [Bulletin on Retirement and Disability](#), the [Bulletin on Health](#), and the [Bulletin on Entrepreneurship](#) — as well as online conference reports, [video lectures](#), and [interviews](#).



15th Annual Martin Feldstein Lecture:

**The Next Flight of the Bumblebee:
The Path to Common Fiscal Policy
in the Eurozone**

Mario Draghi, former President, European
Central Bank and former Prime Minister, Italy
Summer Institute, 2023

2023, 15th Annual Feldstein Lecture, Mario Draghi, "The Next Flight of the Bumblebee: The Path to Common Fiscal Policy in the Eurozone"

LECTURE

Dr. Mario Draghi, who served as President of the European Central Bank and Prime Minister of Italy, presented the 2023...



Methods Lecture:

Linear Panel Event Studies

Jesse M. Shapiro, Harvard University and NBER

Liyang Sun, CEMFI

July 28, 2023

2023 Methods Lectures, Jesse Shapiro and Liyang (Sophie) Sun, "Linear Panel Event Studies"

LECTURE

Overview: Linear panel event studies are increasingly used to estimate and plot causal effects of changes in policies...



Panel Discussion:

Long-Term Dynamics of the Employment-to-Population Ratio

Karen Glenn, Social Security Administration

Stephen Goss, Social Security Administration

Nicole Maestas, Harvard University and NBER

Julie Topoleski, Congressional Budget Office

July 26, 2023



2023, SI Economics of Social Security, Panel, "Long-Term Dynamics of the Employment-to-Population Ratio"

Supported by the Alfred P. Sloan Foundation, the National Science Foundation, and the Lynde and Harry Bradley...

National Bureau of Economic Research

Contact Us

1050 Massachusetts Avenue
Cambridge, MA 02138
617-868-3900
info@nber.org
webaccessibility@nber.org

HOME PAGE

Accessibility Policy

Diversity Policy

Privacy Policy

FOLLOW

