

[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

Acknowledgements and Disclosures



Citation and Citation Data



Published Versions

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

Related

TOPICS

[International Economics](#)

PROGRAMS

[International Trade and Investment](#)

[International Finance and Macroeconomics](#)

More from the 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 Health](#), and the [Bulletin on Entrepreneurship](#) — as well as online [conference reports](#), [video lectures](#), and [interviews](#).



Martin Feldstein Lecture, Summer Institute 2025
The Fiscal Future

N. Gregory Mankiw, Harvard University and NBER
July 10, 2025

2025, 17th Annual Feldstein Lecture, N. Gregory Mankiw, "The Fiscal Future"

FELDSTEIN LECTURE

PRESENTER: [N. GREGORY MANKIW](#)

N. Gregory Mankiw, Robert M. Beren Professor of Economics at Harvard University, presented the 2025 Martin Feldstein...



Methods Lecture, Summer Institute 2025
**Uncovering Causal Mechanisms:
Mediation Analysis and
Surrogate Indices**

Raj Chetty, Harvard University and NBER
Kosuke Imai, Harvard University
July 24, 2025



2025, Methods Lecture, Raj Chetty and Kosuke Imai, "Uncovering Causal Mechanisms: Mediation Analysis and Surrogate Indices"

PRESENTERS: [RAJ CHETTY](#) & [KOSUKE IMAI](#)

SlidesBackground materials on mediationImai, Kosuke, Dustin Tingley, and Teppei Yamamoto. (2013). "Experimental Designs...



2025, International Trade and Macroeconomics, "Panel on The Future of the Global Economy"

PANEL DISCUSSION

PRESENTERS: [OLEG ITSKHOKI](#), [PAUL R. KRUGMAN](#) & [LINDA TESAR](#)

Supported by the Alfred P. Sloan Foundation grant #G-2023-19633, the Lynde and Harry Bradley Foundation grant #20251294...

National Bureau of Economic Research

[Contact Us](#)

1050 Massachusetts Avenue

Cambridge, MA 02138

[617-868-3900](#)

info@nber.org

webaccessibility@nber.org

[HOMEPAGE](#)

[Accessibility Policy](#)

[Diversity Policy](#)

[Privacy Policy](#)

FOLLOW



© 2026 NATIONAL BUREAU OF ECONOMIC RESEARCH. ALL RIGHTS RESERVED.