International Lender of Last Resort: General Discussion

In the general discussion, **Jeffrey Sachs** responded to Frankel's references to crony capitalism and other symptoms of homegrown problems by arguing that "fundamentals" could not explain capital inflows to emerging markets of $121 billion in 1996 and outflows of $95 billion in 1998. Thereafter, the discussion turned to the difficulty of disciplining governments that could repay their debts by raising taxes but choose not to do so. Sachs argued that the U.S. Chapter 9 does not allow creditors to force increased taxation and that bankruptcy is not about reform but about dealing with financial distress and associated collective action problems in an orderly way. **Takatoshi Ito** observed that in domestic crises, regulators shut insolvent institutions; he questioned whether an ILLR should lend into debt overhangs. **Sachs** replied that debtor-in-possession finance is for cases when the return warrants the investment, whether or not the debtor is solvent. **David Wyss** pointed out that credit ratings encourage fiscal discipline in states; such ratings could play a similar disciplinary role in the interbank market.

Catherine Mann suggested that the return on loans to the emerging markets was too low to cover the risk that total lending would exceed what a given debtor country could support. In such cases, a gap between the private and social rate of return develops. Should the private sector create an instrument to cover this gap (that is, default insurance) or must an international financial institution cover it? **William Cline** pointed out that after four of six international rescues, the debtor was able to regain access to the private markets quite promptly. While he favored such voluntary arrangements, he also feared that, in the face of a systemic threat, it would prove impossible to restore confidence "on the cheap," without large rescue packages. **Uri Dadush** claimed that the basic motivation for an ILLR was to control systemic risk and suggested keeping humanitarian aid separate; the markets need to know whether the goal is controlling systemic risk or politics. **Hausmann** asked whether providing LLR loans in tranches might cause capital flight and whether enforced roll-overs and bail-ins might be destabilizing. Finally, **Agustin Carstens** observed that, absent the Mexican bailout, holders of Tesobonos (primarily U.S. mutual funds without access to the Fed) might have required LLR assistance. He ended the session by suggesting that every financial system needs a lender of last resort.