Referee Report on "An Idealized view of Financial Intermediation", by Carolyn Sissoko

Overall, the author did a good job in addressing the issues raised in my first report. I only have some additional comments below.

1. In order to address an important objection raised in the report of the other referee, the author modifies her model so that goods become perishable and barter cannot occur in the second sub-period of each date. The problem with this mechanism is that now an agent cannot consume his/her own endowment and, as a result, he/she faces no cost in simply giving his/her endowment away. As a result, we can build equilibrium with gift giving. Moreover, this equilibrium, differently from the equilibrium with fiat money and the equilibrium with financial intermediation, may support the first-best in a scenario where the social planner gives the same weight to each agent but there is an unequal distribution of endowments (wealth). Its drawback is that it is supported under weak incentives, i.e., as long as there exists an infinitesimal transaction cost in the exchange of goods, this equilibrium disappears. However, this fragility does not imply that the author should simply dismiss the gift-giving equilibrium. There must be some discussion about it at some point in the paper, possibly in the conclusion.

There is also another issue related to the mechanism used by the author to solve the referee's critique. Consider, for example, the following scheme with fiat money. Assume that fiat money is indivisible and at the beginning of each period, after the uncertainty as to the set of buyers and sellers is resolved, the policy maker proceeds as follows: (i) if the agents that were sellers in the second sub-period of the last period become buyers in the first sub-period of the current period, there is no injection of money; (ii) if the agents that were buyers in the second sub-period of the last period become buyers in the first sub-period of the current period, the stock of "old" money in the economy loses its value and one unit of "new" money is given to each current buyer. Under this scheme, since each buyer holds the same amount of money, they consume the same amount of goods, irrespective of his/her endowment. Note that the key for this scheme to be an equilibrium is that sellers are not willing to consume their own good and that goods are perishable. If either assumption is dropped, this exchange pattern also breaks down since a seller would now condition the offer of goods on the amount of money held by the buyer. Note also that this equilibrium is supported under strict incentives.

My point is simply that the reformulation made in the paper brings in some disadvantages that the author needs to take into account, or at least provide some discussion about them.

2. A better job could still be done in addressing issues related to the robustness of the model. The main result of the paper states that in the presence of default-free intermediaries, there is no default on the equilibrium path. This result is supported by a grim trigger strategy that forces an agent into autarky if he/she ever defaults. However, one could have default happening on the equilibrium path. This can occur, for example, if we fix the discount factor and assume that in some periods the endowment realization for some agents is so high that it may induce the agent to default. If this happens, the

intermediary punishes the agent for some length of time but allows him/her to get back to the credit system after this punishment phase.

In another direction, this paper can be seen as an interesting application of a folk theorem type of result in an environment with perfect observability, i.e., where agent's endowments are observable by the intermediary. There is however a large literature on folk theorems in environments with imperfect public and private monitoring that would allow for the study of financial intermediation in broader contexts than the one considered in this article. For example, one could think of an environment where endowments are non-observable and information about the economy goes through public signals. In this environment, sometimes an agent may default on the expectation that other agents will also default. This is another instance where default can happen along the equilibrium path. Finally, it would be interesting to discuss how the results would change if we have coexistence between financial intermediaries and fiat money since, in this case, an agent could use money to make transactions after a default. An implication of this coexistence is that parameters such as the inflation rate would induce an endogenous bound on the agent's decision to default.

In synthesis, given the claim that this model is a nice benchmark to study financial intermediation, it would be interesting to know what does the author thinks about these types of extensions, i.e., whether she expects that her model can deal with them in a tractable way.

However, I also understand that this discussion can take the paper into a route longer than the one defined by its initial plan. For this reason, and even though I think that the above possibilities are worth exploring, I would leave them at this stage simply as a recommendation.

3. This is a minor comment. I do not see why it is necessary to talk about histories when defining the Pareto optimal allocations. This is not a model where histories affect preferences or technology.