Dear Sebastian Schich,

I recommend that your article, "Expansion of Deposit Insurance Coverage During Fall 2008: Selected Challenges," be published in the e-journal Economics as policy paper.

I also recommend one small change in your paper. You dismiss the danger of moral hazard too lightly. In the executive summary you write, "Clearly, in the midst of a crisis, one should not be overly concerned with moral hazard, as the immediate task is to restore confidence, and guarantees can be helpful in that respect." But one of the worst aspects of the current and past crises is that zombie banks use deposit insurance to gather funds that are subsequently used to gamble to avoid the inevitable bankruptcy. This is a very real moral hazard problem that drains money from deposit insurance funds and the treasury. This form of moral hazard should be an immediate concern to policymakers during a crisis. It would be interesting to have data to show how much the OTC market for credit default swaps grew after the crisis started (Say after the Bear Stearns failure in March 2008). This form of moral hazard bankrupted the FSLIC during the savings and loan crisis in the United States in the 1980s.

It is one thing to deemphasize moral hazard in your discussion, but you should not say that it is OK for policymakers to ignore moral hazard in the middle of a crisis.

Regards,

Bill Gavin
Associate Editor