
This paper presents a series of assertions with little or no analysis of their foundation, and no framework for understanding the current financial crisis.

For instance, he makes some observations on pages 2 and 3 about foreign exchange swap agreements. He does not describe these arrangements among central banks and does not indicate why they are a problem. The only information that he provides is that they have been large recently.

On pages 4 and 5, he discusses an increase in the total assets of the Federal Reserve since August 2007. Actually, the large increase has occurred since August 2008. He does not discuss the implications of this rise in Fed assets or the implications of changes in the composition of Fed assets.

He makes the following observation on page 5: “The intellectual case for deposit insurance for small depositors is limited, at best, in societies that still have postal system savings banks.” He provides no support for this statement.

Any discussion of the history of the adoption of federal deposit insurance in the U.S. should cite: Mark Flood, “The Great Deposit Insurance Debate,” Federal Reserve Bank of St. Louis Review (July/August 1992.)

He does not provide a framework for understanding the current financial crisis. The major event was the bankruptcy of Lehman Brothers in September 2008. That event undermined what had been called modern risk management. The bankruptcy of Lehman Brothers cancelled the credit default swaps issued by Lehman Brothers, thus undermining confidence that all credit default swaps would be honored. The banking crisis in Europe began shortly after the bankruptcy of Lehman Brothers. The federal government bailed out AIG in order to stand behind the credit default swaps issued by AIG.

The bankruptcy of Lehman Brothers is relevant for the role of the Fed as lender of last resort. The Fed proved to be an unreliable lender of last resort, by arranging the bailout of Bear Stearns in March 2008, and not bailing out Lehman Brother in September 2008. With that inconsistent record, the U.S. public demanded more protection under the FDIC.

He concludes by arguing for narrow bank legislation, but he does not deal with the inadequacy of that reform to preserve financial stability. One argument against narrow banking is illustrated by U.S. experience during 2008: disruption of the financial system can come from sources outside the regulated banks: Bear Stearns, Lehman Brothers, and AIG. Second, narrow banks would tend to assume credit risk by extending daylight overdrafts to their depositors. In contrast, advocates of narrow banking assume that the narrow banks would assume no credit risk.