

# ***PERSONALLY SPEAKING***

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## **FIRES STILL SMOLDERING IN U.S. BANKING SYSTEM**

**Edward J. O'Boyle, Ph.D.**

**Mayo Research Institute**

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Last September a fire broke out in the U.S. banking system which overnight threatened to engulf not only the entire U.S. system but also banking systems elsewhere linked in a network of agreements, transactions, and mutual dependencies. An alarm was sounded and fire department personnel and equipment arrived on the scene but learned quickly they were not prepared for the kinds of combustible materials (derivatives) fueling the fire.

Containment was their immediate objective. A massive response was launched focused on combustibles (TARP first tranche with backup from FDIC) but nothing worked and the fire continued to rage out of control. Next they sprayed enormous volumes of water over the entire structure (TARP second tranche with FDIC backup) hoping that effort would suppress the flames which by then were igniting fear and anxiety around the globe. It didn't help that the senior firefighting team (Treasury) was being replaced while the fire had not yet been contained. Further heightening fear and anxiety were arsonists who enjoyed playing with fire (ponzi schemes) to enrich themselves at the expense of their investors.

Containment was achieved but the still smoldering combustible materials stubbornly resisted efforts to snuff them out forcing fire crews to remain on the scene months after the initial breakout. Managers of other structures in the system not immediately threatened by the fire was persuaded to let firefighters spray water on their structures on the premise that a little water (TARP Capital Purchase Program) would encourage them to step up their efforts to get credit flowing again.

Efforts to deal with the smoldering combustibles by hauling them away failed because no one could figure out how much to pay the haulers for removal services. Another suggestion was made to haul out of the damaged structures any and all materials of value yet untouched by the flames and to let those structures and combustible materials burn themselves out. That suggestion, however, has gotten no traction. Most recently, the damaged structures which hold those combustibles are being forced by the legal system to retrieve them, clean them up, and make them viable (mortgage cram-down) even at the risk that they may become combustible again.

Fire inspectors report that the blaze which since January 2008 has consumed 42 banks started in the sub-flooring long before it broke out in September. In spite of warnings from the fire prevention bureau, negligence on the part of senior managers eager to pocket the

fees for holding the combustible materials and by building code enforcers willing to turn a blind eye to that negligence made it easy to accept and store those materials. Ignition came suddenly and unexpectedly from large numbers of cash-strapped homeowners defaulting on their mortgages.

A few powerful persons advocate repairing the broken financial system by nationalizing the banks, putting them under direct government control. But that's like asking firefighters to remain at the site, demolish the structures, and build others in their place. Opponents object to this remedy arguing that when the fire is out, firefighters should withdraw and leave the rebuilding to competent and trustworthy financial specialists who know best how to rebuild the system. However, the few who would nationalize the system are supported by the many who are persuaded that government knows best. Today there are 252 banks on the FDIC list of "problem banks" and the issue of bank ownership and control remains unresolved.

Just as the fire prevention bureau attempts to educate the public about hazards such as overloaded electrical circuits, blocked exits, and natural gas leaks, the general public needs to be better informed about the risks involved in financial ventures especially as new financial instruments such as credit default swaps are developed. The problem is that the U.S. financial system continues to operate with a fire prevention bureau that functions on just one broken principle – *let the buyer beware*.

Negligence in storing combustible materials and in building code enforcement, not to mention arson, is a felony punishable by imprisonment. Those who were negligent, whether they are bank executives, regulators, or members of Congress on financial oversight committees, should go to jail. Removing the perpetrators is necessary in order to *reduce* the risk of a similar financial collapse in the future. Even so, there is no way to assure that a fire will not break out again even if the entire system were nationalized because the smartest and best-intentioned human beings can and do lapse into ignorance and negligence and are too easily enticed to reach for a deal that is too good to be true.

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*Edward J. O'Boyle is Senior Research Associate with Mayo Research Institute.  
He completed his doctorate in economics at Saint Louis University in 1972.*

*Mayo Research Institute  
1217 Dean Chapel Road West Monroe, Louisiana 71291  
2912 McNeese Farm Road Lake Charles, Louisiana 70607  
[www.mayoresearch.org](http://www.mayoresearch.org) 318-381-4002 [edoboyle@earthlink.net](mailto:edoboyle@earthlink.net)*

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