

TIME

Wednesday, December 17, 2008

Visitors Per Month: 4,816,767

<http://curiouscapitalist.blogs.time.com>



Were the later rounds of Bernard Madoff investors banking on a bailout?

Probably not, but it's an interesting thought:

We argue in this paper that if agents correctly believe in the possibility of a partial bailout when a gigantic Ponzi scheme collapses, and they recognize that a bailout is tantamount to a redistribution of wealth from non-participants to participants, it may be rational for agents to participate, even if they know that it is the last round.

From "The Optimal Design of Ponzi Schemes in Finite Economies," by Utpal Bhattacharya, *Journal of Financial Intermediation*, January 2003. (Available for download [here](#).) The paper is about Ponzi schemes that everybody knows are Ponzi schemes, and Bernard Madoff's investors don't seem to have had the faintest idea. Although I guess one can never be too sure about that ...

What I actually found most interesting about the paper is that Bhattacharya locates his examination of Ponzi schemes squarely in the middle of the broader academic discussion of investment bubbles. It's another indication that Ponzi schemes are part of a continuum that includes mainstream Wall Street and government finance.