

Capitalism 2.0 : Convexity.

Should not a capitalist system punish as well as reward? We saw the devastation left by Lehman when it failed and concluded that some banks are too big or too interconnected to fail. But we had a sample size of 1. Are we sure that no other banks should be allowed to fail? An unnamed bank recently hired someone and paid him pre-crisis levels of pay. They did that with government money. Because of that, I find it hard to hire the same calibre of people at lower prices which one would imagine would be the case with all the lay-offs. The Great Rescue has distorted market pricing of labor in this instance, but also has distorted the price of money and of risk, a far more important mispricing. So with the Fed unilaterally setting short rates, with Tarp and Talf and the legacy loan program in action, what is price of money, RMBS, CMBS? In a general equilibrium world, what is the price of a hamburger, given that we are uncertain about the price of credit and money?

Save the patient, has been the justification for the various bailouts. But the patient is still on life support. And at what point, and who determines that point, at which life support is no longer necessary?