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WEDNESDAY, JUNE 25, 2008

Maybe Economic Bubbles Aren't So Bad After All

Posted by: [Eric Ames](#) @ 10:52 AM

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With the popping of the housing bubble, the credit bubble and various other bubbles recently, it may be hard to believe, but some argue that these bubbles are in fact good for us. I know that is hard to believe, especially considering that we typically condemn them and governments strive to prevent them, but let's take a look at some of these arguments and see what pro-bubblers have to say.

"...in bubbles, investors' money is used to build infrastructure that can't possibly repay its upfront costs, but ends up being beneficial for companies and consumers in the long run - particularly after more-efficient companies have picked up the pieces on the cheap," according to

Daniel Gross, author of [Pop! Why Bubbles are Great for the Economy](#), as reported in [New Scientist](#). The same *New Scientist* article goes on to give several examples of this phenomenon, including the recent dot-com bubble which paved the way for today's Internet. For a more historical example, they offer the railroad bubble of the 1840s which later, even though the original investors lost everything, proved to be quite beneficial for Britain because it laid the infrastructure for the best railroad system in the world at the time.

Here is another quote from the article: "Didier Sornette, a physicist who is now a risk specialist at the Swiss Federal Institute of Technology in Zurich, argues in a paper in press at *Journal of Economic Interaction and Coordination* that it is only during the reckless abandon of bubbles that individuals and companies take the foolhardy risks needed to develop technologies with large social impacts but low financial returns."

The author of the *New Scientist* article argues that today's bubbles could also prove to be beneficial in the long run. The housing bubble has created a huge inventory of housing that is now available at a discount for buyers; borrowing money will be easier after the bubble than it was before because it fostered the creation of sophisticated risk analysis techniques; and even the oil bubble could be good because it will likely lead us to explore alternative energy.

Overall, I thought the author made some excellent points, and I can see how some bubbles--while hard to swallow in the short term--can prove to be beneficial in the long term. One thing missing from his article, though, is a comparison with bubbles that didn't turn out to have any great lasting benefit. Sure, we can see that a few bubbles throughout history have turned out well, but have there ultimately been more bubbles that resulted in good outcomes or bad outcomes? Because if most bubbles still turn out bad when all is said and done, it is hard to say that we don't need to worry about them.

Just looking at today's bubbles, I can see how the oil bubble can potentially turn out to be beneficial, but I'm having a much harder time with the housing and credit bubbles. Sure, people can seemingly buy houses at a discount, but in reality housing prices still haven't reached as low as they were prior to the bubble in many markets. Housing prices are still falling, so we may end up in better shape price-wise, but we also have to consider that around 67 percent of Americans are homeowners. With that in mind are we really better off in general, or are the 33 percent of population comprising renters the only ones better off? A case could be made either way I suppose, but I doubt that if we had the chance to do it all over again we would choose the bubble over nice steady growth. As far as the credit bubble, we can look at the infrastructure, businesses and so on that we were able create thanks to cheap credit, but again I'm not sure that those benefits are going to outweigh the costs either. I guess ultimately only time will tell.

In the end of the article, though, the author makes a great point: Ever since the tulip bubble of the 1630s we have been trying to prevent bubbles, but ultimately, we have proved unsuccessful. It seems that no matter how hard we try, human nature will fuel this bubble behavior, and thus perhaps we would do better to spend our time trying to make the best of the bust rather than trying to prevent the boom.

Labels: [economy](#), [housing bubble](#), [real estate](#)

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