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OPINION

Comment: Are economic bubbles so bad?

21 June 2008

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Sumit Paul-Choudhury

HOUSES, credit and now perhaps oil: is anything immune from the depredations of the speculators? The lives of millions have been caught up in economic bubbles that seem beyond anyone's power to control. Boom followed by bust: can anything be done to stop this vicious cycle? Perhaps not - and perhaps we shouldn't try.

Exactly what triggers a speculative bubble remains mysterious, as do the mechanisms that inflate and ultimately burst it. But put crudely, bubbles start when dissatisfied people try to shake things up by taking risks with their money, their careers and even their lives. Since human beings are both imitative and inventive, other people find ways to jump on the bandwagon, which starts rolling faster and faster - until it crashes.

That sounds like a bad thing. But in his 2007 book *Pop! Why Bubbles are Great for the Economy*, the journalist Daniel Gross argued that 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. To take a recent case, most investors in "dotcoms" lost their shirts - but their money built the software and infrastructure that runs today's internet. There are plenty of historical precedents, too: for example, a bubble in the 1840s rendered shareholders in train companies penniless but left Britain equipped with the world's best railway network.

The [social economist Carlota Perez](#) believes that bubbles inevitably precede each of the "techno-economic paradigm shifts" by which society advances. And 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. That turns into "super-exponential" growth rates - of the kind Sornette says are now [observable in the oil market](#).

As well as market-fuelled bubbles, Sornette cites a number of publicly funded [technological and scientific achievements](#) that involve bubble-like disregard for economics, including the

"A bubble is the inevitable precursor to each of the paradigm shifts by which society advances"

Human Genome Project and the [Apollo space programme](#).
Cynics say that

the \$25 billion spent on the Apollo programme brought little of enduring value other than Teflon and very expensive pens (both myths, incidentally); its defenders retort that it galvanised the US's engineering and manufacturing base for a generation.

Sornette's penchant for fitting dizzyingly broad arrays of phenomena into unifying mathematical frameworks has raised controversy before (*New Scientist*, 17 September 2001, p 30), but two aspects of his thesis - that bubbles enable the risk-taking behaviour necessary for building future infrastructure and are an intrinsic feature of society - ring true. So what about today's bubbles?

The real-estate bubble has encouraged huge development of housing - which will now be available at a discount to would-be buyers. And borrowing money may be easier once the credit crunch has passed than if it had never happened, because the preceding bubble fostered the development of sophisticated risk-scoring technology. As for the oil market, the high prices resulting from the bubble might cause investors to ignore indications that [supply is a long way from running out](#) and instead pour their resources into alternative power generation, electric cars and plastic substitutes - the kind of green technologies that would be just what the planet ordered, but have met with

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fierce resistance from some economists.

How far should we go in allowing bubbles to run their course? Policy-makers tend to be terrified of speculative bubbles, and with good reason. Bubbles by their nature represent a failure of control, which looks bad, and threaten the social order, which is worse. People who can no longer afford their houses or cars probably aren't much in the mood to listen to theoretical economic arguments about future benefits: a politician convicted in the court of public opinion of presiding over economic boom and bust might as well start drafting his memoirs.

On the other hand, attempts to prevent bubbles seem to be largely fruitless anyway. People have been trying to stop them since "tulipmania" took hold in the Netherlands in the 1630s, to little discernible effect. Banking experts were still telling me that the boom-and-bust cycle had been abolished at the start of 2007 - but it seems only to have been deferred and exacerbated by their attempts to avoid it. Perhaps rather than pretending that we can do something about bubbles, we should surrender the illusion of control - and concentrate our efforts on trying to make the best of the bust that follows the boom.

Sumit Paul-Choudhury is a technology editor at New Scientist

From issue 2661 of New Scientist magazine, 21 June 2008, page 24

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Are Economic Bubbles So Bad?

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By Douglas Mulhall

Sun Jun 22 22:42:42 BST 2008

Bubbles might signal a paradigm shift, but not always in a positive direction. A series of bubbles can also be a precursor to what has led to the downfall of civilizations and the backward march of technology: degradation of currencies through printing of money and debasement of the general population's purchasing power. Nor does the optimistic view of bubbles account for the acceleration of income discrepancies between the technological class and the middle and lower income classes that for example has occurred over the past 30 years. Nor does it account for the debasement of the rule of law when laws are ignored to promote bubbles. Those factors: currency debasement, wealth discrepancy, and degrading the rule of law are each symptoms of the current bubble era and cannot be overlooked. Regarding the comment that we should surrender the illusion of control: Unfortunately this is what was done deliberately when U.S. Legislators in 1999 effectively repealed the Glass-Steagall Act that separated banking from commerce. This Act had been passed decades ago to avoid a repeat of factors that led to the Great Depression. Now it has been undone. One could argue that the Great Depression was a good thing, but I doubt the survivors would agree. And after the Great Depression came a World War. Time will tell if that pattern is being repeated due to bubblenomics.

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Are Economic Bubbles So Bad?

By Anon

Wed Jun 25 08:50:39 BST 2008

Minor bubbles are fine and can be constructive. Major bubbles and crashes are not good. The cycles of nature are just too harsh and long for people, who need to eat every day. Economies need a sufficient management and regulation to control the furies of the natural economic cycle, and its ravages on people.

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Public Funded Bubbles

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By Tom

Tue Jun 24 15:42:50 BST 2008

So-called "public bubbles" indeed show that disregarding economics can have good results, but are different from market bubbles.

Apollo and other big projects set out to create a concrete achievement that could from the start be expected to have spin-off benefits.

The motivation during an economic bubbles is pure avarice, without the slightest regard for creating any solid real-world change. Sure, sometimes achievements are made accidentally this way, but it's an inefficient way to do it.

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Public Funded Bubbles

By Freemarket

Tue Jun 24 18:56:10 BST 2008

So what exactly is the 'efficient' way? Steal the money from unwilling taxpayers?

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Public Funded Bubbles

By Anon

Wed Jun 25 08:52:49 BST 2008

No, Steal the money from rich fat cats

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Manufactured Bubbles

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By Michael Becker

Wed Jun 25 11:36:21 BST 2008

Out of control bursting bubbles like the one we are living in are directly traceable to a democratic disconnect. The most powerful and influential components of the world have a vested interest in stifling a healthy democracy. Controls that people seem to have forgotten the reasons for are removed step by step at the behest of these special interests who have massively increased their unreasonable influence and surprise surprise when reality intrudes and a severe correction happens why is anyone surprised. If it was a semi planned scenario...it is morally the equivalent of real-estate block busting. Leveraging the power of those who are in the right position to make a financial killing at the expense of millions of losers. Smoothing out boom and bust need not hamper progress. We don't need to rely on Wars and financial havoc to advance technologically and still have a society which allows the maximum opportunity and quality of life to the maximum amount of people. What is going on is a too and fro tug of war between the Summum Bonum and more democracy and bottom line mentality Oligarchy fixated on anything that interferes in anyway with their immediate plans. This always leads to reaction swings too far in each direction that alternately energizes the extreme that is in retreat while those in the ascendancy also chafe at reasonable controls to moderate the swings. Moderates play a holding action to try and dampen the destructive extremes of the pendulum are like the peacemaker in a bar brawl. They get in the way and are demonised even more by the opposing forces who enjoy the opportunities of the bubbles while unaware that they are not sustainable. Change is good and sometimes unreasonable social inertia requires a shock to re-balance fairness and effectiveness but destabilizing financial and social earthquakes whose severity is magnified by those who are eager to profit from the loss of others are the modern equivalent of Genghis Khan or Roman expansion etc. These bubbles are explosive and hardly benign. We had to destroy the economy in order to save it.....there are other ways....they have worked well enough in the past and are better for the greatest good.

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