

## **Real Bubbles Theory**

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Asset price bubbles disrupt the economy, both as they rise, with the misallocation of capital, and after they burst, with the losses of liquidity in financial markets and confidence in financial systems. On the whole, bubbles are a transient instability that ultimately slows economic growth. Bubbles are bad for growth; that's the standard story.

According to Real Bubbles Theory, bubbles are good for long run growth because they concentrate mass attention and liquidity onto a hard investment problem. This generates increased variety that lowers the costs of experimental ventures, opening new territories of forward contracts that into which real investment may flow. A bubble is an endogenous shock that heats micro activity and diversity to the point where it conditions macro structure to absorb new ideas. Now many of these ideas will be infeasible in the short term and some may be ill-conceived. But the ideas that do seed will shape growth for some time to come, and it is here that the bubble eventually pays off. In essence, the crash is not necessarily the end of the bubble. Rather, from the long run growth perspective, and subject to institutions that are strong enough to withstand this endogenous shock, it is the fillip that energizes the evolutionary process. We propose here some ways of testing this idea.