THE BUBBLE THEORY[1]

> **"... History is always novel, which is why, in spite of any accumulated disappointments and frustrations; there is no reason to discredit the value of daily deeds. Although they may be simple and modest, they are the wheels of a new way of narrating history, creating a new life course"**
>
> ERNESTO SÁBATO ("The Resistance")

By NICOLÁS DIANA[2]

For some years, particularly after the 2001-2002 crises, macroeconomic and financial experts boasted that they had upheld that, during the 90s, Argentina had been living in a bubble. This bubble included a forced, erroneous, pegged exchange rate that devastated the national economy and industries in this period and had contributed to causing one of the worst – if not the worst - emergencies in Argentine economic, financial and social history in the 20th century.

In 2002, the bubble of the 90s was replaced by a new bubble, which –unlike the previous one– apparently isolated Argentina from other nations of the world in matters of international financing and, supported by the default on sovereign debt, reconstructed domestic economic bases, going back to a mix between the agro-exporting model and import substitution industry, which, taking advantage of the idle capacity of ten years ago and the international situation, generated the currency required for the economy's sustained growth that was difficult to conceal, at least until October of 2008. As in the 90s and throughout our whole modern history, a high exchange rate was an indispensable tool, which, in addition to other sectorial policies, favored placing

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[1] HYMAN MINSKY was the economist who predicted the current financial crisis ten years earlier in *Stabilizing an unstable economy*, through his theory of "inherent instability." Also, MINSKY referred in that book that the financial system always oscillates between robustness and fragility, because in times of prosperity creates a speculative euphoria which increases the debt until it reaches the point of the economic cycle when profits can no longer pay the interest and break the bad crisis (*Fontevecchia, Jorge*, "Por qué sube el dólar si EE.UU. está en crisis," *Perfil*, 7-III-09, http://www.perfil.com/contenidos/2009/03/07/noticia_0001.html.)
In February, 2007, NOURIEL ROUBINI, professor at the New York University, presaged the worsening situation indicating step by step, the collapse of credit and sales, bankruptcies of major institutions extend the negative impact of economic and financial effects ("The Rising Risk of a Systemic Financial Meltdown: The Twelve Steps to Financial Disaster," *RGE EconoMonitors*, 5-II-08, http://www.rgemonitor.com/blog/roubini/242290.)

[2] Spanish version of this paper was published and edited in Argentina in 2009 (*see* Res Publica Argentina, Suplemento de actualidad de RAP ediciones, Número 11, 2009, artículo "La teoría de la burbuja.")

our products in international markets increasing competitiveness and collection of export duties and liquidation of currency, in addition to increased domestic consumption and the country's general economic activity.

This new bubble, criticized left and right, has, for better or for worse, partially isolated us from the effects of the global crisis.

Now then, my question is:

Is Argentina solely responsible for creating, developing and producing economic bubbles or does the world develop economically around them?

Common sense tells us that every legal, economic and social system creates its own bubbles. In a globalized world, these bubbles are not exclusive; they are made up of the different actors that utilize the relationships within them.

In the bubbles, various subsystems co-exist and aspire to maximize interests and expectations which they have chosen to become part of either through symbiosis or as parasites.

The bubbles are made up of:

a) a physical and virtual environment (limits);
b) power relationships (economic, political, financial);
c) subjects actively developing policies or basic principles;
d) passive subjects who adapt to the impositions of c);
e) inventories;
f) formal rules accepted by the players in the bubble;
g) legal, political and economic fictions participating in f).

The complex factor when the elements in the bubble interact is simplified when b), e), and g) materialize.

This occurs because the power relationships (economic, political, financial) when inventories created within the bubble are exchanged and allotted, essentially develop into a conglomerate of legal, political and economic fictions that participate in the formal rules accepted by the players in the bubble.

So far the reader may realize that there is nothing original in this view of reality, however, including fictions within the bubble as one more element and not as an external element, may lead us to finding a possible answer for the need to avoid the least possible contamination between such fictions and the expectations for maximizing virtual results that ignore the physical aspect of the exchange of material goods, abandoning the possibility or expectation of profiting through virtuality of currency by speculating in financial investments.

The economic crisis and slowdown that emerged in the United States and Europe in 2008, especially since September, was attributed to crisis of the American and international real estate and mortgage market. Far from trying to explain whether or not this is associated with one of the several cyclical and recurrent crisis of capitalism, its effects went beyond real estate credits reaching the entire financial world. This financial world is part of a worldwide bubble as just another variable and it boasted about playing by its own formal rules and fictions, with intangible inventories, virtual currency, etc.[3]

The bubble, as we have explained, lives and reproduces itself, it grows feeding off the elements described, striking a balance, enabled by:

(i) expectations of active and passive subjects within the bubble;

(ii) the belief that the bubble is self-sufficient.

According to EASTON, a system is a self-regulated unit. The bubble is self-regulated on the basis of the rules created by active subjects, who define the value and method for goods exchange.

Bubbles can co-exist with other bubbles, but not within others and, even when they can develop on the basis of fictional (virtual) elements, the rationale for these elements to exist –and, in fact, reflect– need to emerge from the real, tangible world.

In any given system –and bubbles are systems– their existence depends on the system's ability to generate *outputs* to *inputs*, through *feedback*. Excessive demands and the system's lack of response lead to its own demise.

If we apply these ideas in the financial world bubble, it is clear that speculative financing for housing in the globalized first world, which Argentina was not part of, is one of the fictional constructions that fell as soon as there was no longer any consensus

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[3] *See*, BORDO, MICHAEL D., *An historical perspective on the crisis of 2007-2008*, National Bureau of Economic Research, Cambridge, december-2008, working paper 14569 (http://www.nber.org/papers/w14569.)

or credibility: It was no longer legitimate, in the bubble itself, in the eyes of active and passive actors.

We, therefore, reiterate that the bubble is in a physical environment that contains it. It is the same physical environment that represents the bubble in the collective imagination. If there is anything that creates bubbles, it is the fascination and ecstasy of the observer.

For example, my son, who is only one, knows that bubbles appear magically (blowing bubbles with soapy water), and they go up into the air until they collapse as a result of the fragileness of their walls or when they hit the ground, and that the ground or the material that comes into contact with the bubble will prove that the bubble was always soap and water, the rest was pure illusion and fascination. In his mind, the most important thing was that for a moment he could control what is magical and what is real; fiction and reality.

My son always knew that the bubble was ephemeral, that it could last a few or several seconds, minutes even, but, ultimately, it is condemned to going back to being soap and water.

Perhaps Argentina, having consistently failed in bubbles requiring the system's (the State's) paternal intervention when it turns back into soap and water, has concrete experience in the need to strike a balance between reality and legitimate expectations of individuals within a framework where illusion blinds us from the deception created by our fascination with unrealities.

In response to the question raised, Argentina is not solely responsible for creating, developing and producing economic bubbles, the world develops economically around them. The problem lies in thinking that bubbles are everlasting, that they are strong and stable, that they provide security, and that subjects accept domination blinded by fascination, knowing that there is no such thing as magic. Another question related with the international financial bubble crisis' expansive nature is that economic subjects (individuals and corporations) act in several scenarios simultaneously, i.e., regardless of the limits of only one bubble, or in other words, in only one global scenario. Hence, it is impossible for that subject to avoid transferring their losses to every economic environment –bubbles willing-.

In short, the bubble theory:

(a) *applies to the economic reality provided the idea of acknowledging its existence is accepted, which implies accepting that it also has an expiration date;*

(b) *is intrinsically related with the physical world (real), there is no wealth that does not arise from goods, and*

(c) *enables different bubbles to co-exist, interacting with each other and, temporarily, possibly protecting the elements that each consists of, in view of the threat created by another bubble*.