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Macro Roundup Article

Headline: Kindleberger Cycles: Method in the Madness of Crowds?

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Tweet: Randall Morck's research finds that the social return to R&D investment exceeds the private return by 4X and the social benefits of tech sector bubbles likely exceed the social costs of the subsequent crashes. Hat tip to @JimPethokoukis

Summary: Profit-maximizing firms only consider their own IRRs, [and thus] forgo much high-SRR [Social Rate of Return] R&D. Externality theory prescribes intellectual property (IP), R&D subsidies, and other interventions to boost innovators' IRRs; however, mounting evidence contests the efficacy of these responses. [A "Kindelberger cycle" often] begins with a hot new technology, sometimes a new market, with very high expected IRRs. A mania inflates stocks thought favored by the disequilibrium. The bubble bursts, and a panic, crash, and (sometimes) socially costly economic downturn ensue. Economic comparisons of these social gains and losses are remarkably rare. Lansing (2012) models tech bubbles with costly crashes and calculates that social benefits outweigh social costs if the technology's SRR exceeds 2.5 times its IRR. Figure 2 suggests that the SRR of corporate R&D exceeds the IRR by a factor of 4. Historians and marketing researchers also conclude the social benefits of bubbles exceed their social costs.

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Primary Topic: Investment

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