The economic crisis model under whirling flow of Money

—How a economic crisis happens

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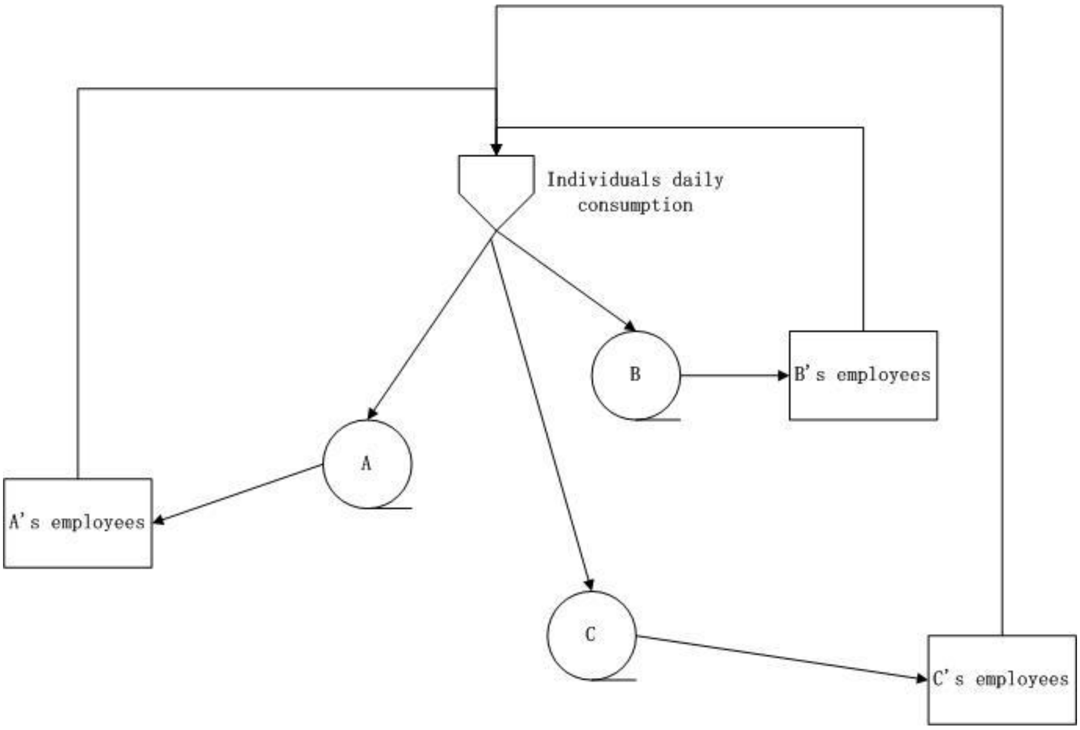
Introduction:

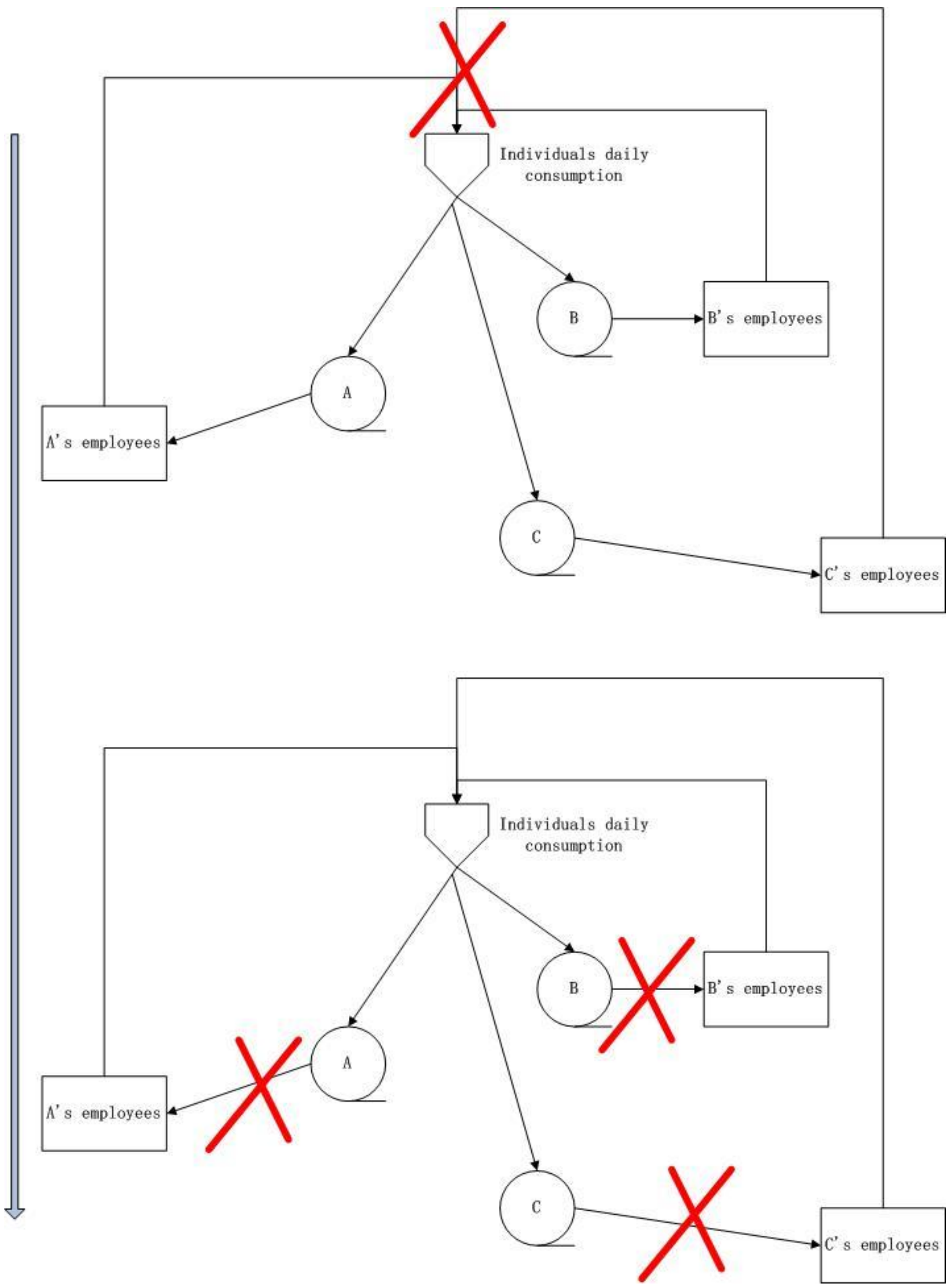
In this paper, I will briefly discuss about the formation of an economic crisis during the movement of free market. I will describe the whole process in a simple way. To make things more easy to understand, I won’t use any math models, which will only make the process more complex.

1. How an economic crisis happen

Whenever an economic crisis happens, there must be a breaking point. Like the following picture, there are some companies (A, B and C) and their employees. The employees buy commodities and services from all these companies, their consumptions are the main profit source of these large companies, and employees' money are from the salaries of these companies. In our model, to simplify the whole process, we assume there are no business activities between A, B and C.

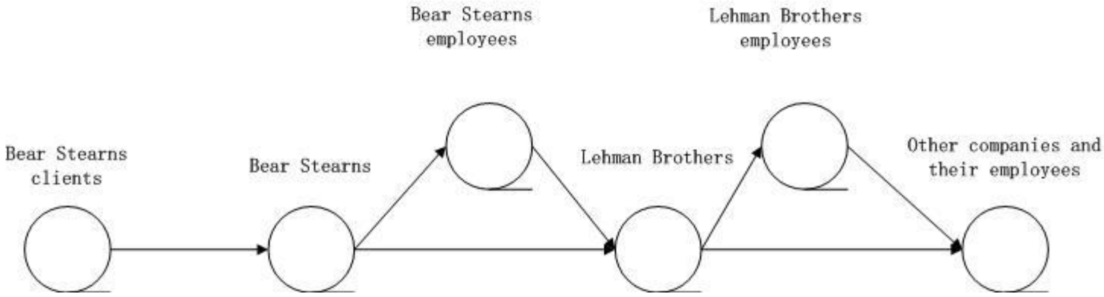


Assume these employees invest their money and they encounter a big loss, all of them lost their money. Then they don't have money to spend, so the source of all the companies will decrease, then all the companies in the market will encounter a big loss in their revenue, they are getting through a difficult time. Because these companies don't have enough income, then their employees don't have enough salary, then the employees further spend less money, then these companies further have less income, the individuals further have less salary… This would be a vicious circle, the companies finally have debit for the back pay while they have to fire more people, there are not enough job positions. The demand is not enough, the commodities which are produced could not be sold, the whole economy system goes into desperation.



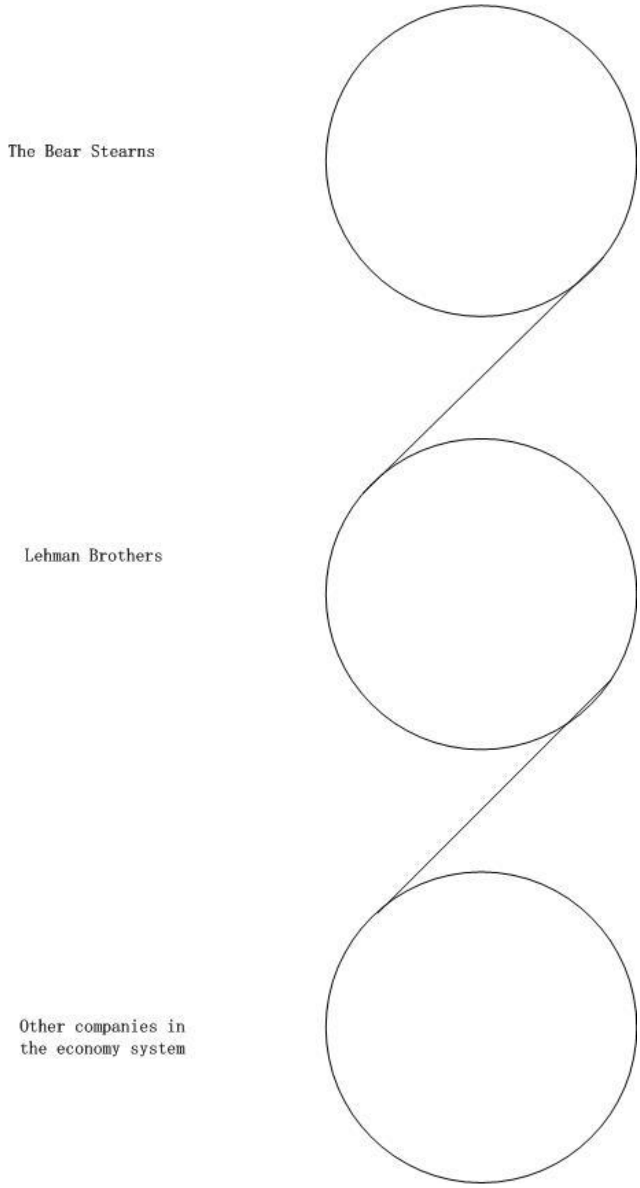
2. How 2008 economic crisis happens

In the real market, the Bear Stearns had its clients, it had its employees. The Bear Stearns also did business with other companies including the Lehman Brothers. When Bear Stearns clients could not afford their debit, the income of Bear Stearns would decrease, Bear Stearns would have less profit and even had no profit. And it could not find other income sources, as a result, finally it went bankrupt. After it went into bankrupt, because Bear Stearns was the income source of Lehman Brothers, so Lehman Brothers would have less profit or even could have big loss. During a period of time, Lehman Brothers could not enlarge its income so it would go bankrupt. And Lehman Brothers was the income source of its employees and Lehman Brothers was also income of other companies who did business with Lehman Brothers. So after Lehman Brothers went bankrupt, the incomes of other company would reduce, so other company would go bankrupt.



From the upper graph, we could see the flow of money, because the volume of the money flow from the source decreases, through this track, the destination of the money flow would also decrease. Some of them might even go bankrupt, the whole economy system was destroyed.

If we regard these three companies as the three money flow circles. We could have the flowing graph:



And the whole process is the termination of the Bear Stearns circle caused the termination of Lehman circle, then caused the termination of other circles. Because there were business activities among these companies, so this chain reaction would happen.