QUERY Economic System (SD7242)
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Posted by Jay Forrester <jforestr@MIT.EDU>

This message was in the K-12 discussion exchange, but I am resending to the system dynamics list because others may be interested.

Jay Forrester

Begin forwarded message:

First, the current crisis did not start with the burst housing bubble. It started with the excessive credit that led to the housing bubble. That excess credit resulted from the Federal Reserve holding down interest rates to less than the inflation rate in housing. This negative real interest rate (bank interest minus inflation in the housing assets) produced a powerful incentive for investment and speculation in housing. And the action of the Federal Reserve, with the increase in risk taking by banks, were a result of pressure from Congress and the public who were all enjoying the short-term rise in housing prices.

We see here one of the characteristics of a complex social system in which a policy that is good in the short run is almost always bad in the long run. Feeding the bubble with easy credit was popular in the short run but now we have the consequent day of reckoning with the collapse of the financial system.

There are a number of papers on this matter in the "System Dynamics Group Literature Collection" DVD available at:
http://systemdynamics.org/MITCollectionDVDinfo.htm

Look for the papers on the National Model. The model itself is not there, it has not yet been released, but there are many interesting discussions and computer runs on the economic long wave (also known as the Kondatrieff Wave), which I believe explain the Great Depression of the 1930s and the economic turmoil at the present time. Given the extreme degree of government financing that is now in process, the outcome may this time be different from the 1930s.

Posted by Jay Forrester <jforestr@MIT.EDU>
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