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The current economic crisis began with excessive lending (injections) (lending without proper attention to risk) in the early part of the decade, especially on houses. Banks then repackaged loans into complex derivative products (the risk rating of which was difficult to assess) and sold them on to other bodies. These complex derivatives spread throughout the financial system. At the same time, the low cost of money combined with aggressive selling by banks, resulted in consumers in many 'western' economies becoming very indebted (spending another injection and saving little – a withdrawal). Finally, the low cost of money also fuelled asset price spirals that helped drive demand (sucking in exports from emerging economies an injection into their economies but a withdrawal from the importing country economies) and drove up the prices of commodities (again an injection into commodity producing economies but a withdrawal from importing economies). There were also substantial foreign investment flows into emerging economies (an injection into those economies).

As house prices began to fall (starting in the US) so the complex derivative products began to lose value, such that their value could often not be quantified as no one was willing to buy the products. These became known as toxic assets. Suddenly the financial system could not value its assets. Credit ceased to flow. Asset prices then began to fall and thus the value of assets in the financial system fell further and the credit squeeze tightened (banks can only lend against the assets they have). Falling property prices led to dramatic cuts in the construction industry in western countries, while tighter credit cut consumer demand and led to business collapses. The circular flow was then weakened by a vicious circle of business failures, rising unemployment and declining consumer demand. This spread to emerging economies through lower imports and lower foreign investment flows to these economies (and in some cases disinvestments).

A critical requirement to halt the downward spiral of contracting economies was to fix the problems in the banking system. Governments tried to do this through injecting money into the banks (increasing their liquidity, recapitalising them and in some cases nationalising them) and attempting to deal with their toxic assets. The objective was to get credit flowing again.

In an attempt to stimulate the economy governments are using a combination of *monetary* and *fiscal policy*. *Monetary policy* should bear the main brunt of tackling booms and busts. It is based on two principal measures: i) Reducing interest rates to reduce the cost of borrowing money (which also reduces the payments being made by existing borrowers and thereby increases their disposable income, some of this will be spent –an injection into the economy) and ii) control over the money supply. By the spring of 2009 conventional policy based on interest rate reductions had virtually been exhausted and governments were beginning to use the less conventional *quantitative easing* (increasing the money supply, see Appendix 5). This is designed to inject money into the economy, although some money may leak abroad). *Fiscal* *policy* concerns tax and spending measures. Many governments have introduced substantial additional spending programmes (stimulus packages, for example based on public works programmes, an injection). In addition, governments may reduce taxes (for example, in the UK the government reduced the sales tax -VAT - from 17.5% to 15% in 2008). This again leaves people with more disposable income (some of which will be spent, an injection into the economy). Many of these measures involve a time-lag before their effects are felt and thus it is always difficult to judge when to halt the process of economic stimulation.

In countries with welfare systems (notably in Europe) the so-called *automatic stabilisers* also influence the circular flow of income, contributing to injections during downturns. For example, as unemployment rises, people pay less tax and are paid unemployment and other social security benefits (boosting their incomes but adding to government spending). At the same time the government's fiscal deficit rises.

The dangers of increased injections into an economy are that: i) more money chasing fewer goods will push up prices (inflation) and ii) higher government borrowing (Ireland, the UK and the USA are likely to have public sector deficits of over 10 per cent in the coming years and much higher levels of debt) means that there is an increasing burden placed on the citizens to repay debts in the future (through higher taxation or lower government spending). In addition, as government debt rises investors (those who buy government debt) may eventually lose confidence in the ability of governments to repay their debts (signified by the government being unable to sell its debt or having to pay an ever higher price – higher interest rate - for it). These developments could result in substantial currency depreciations. The problems spill over into emerging economies, since they own assets in US dollars and may find it more difficult to compete in the US market.