



Households are groups of people living together who sell factors of production to firms and buy the goods and services. The economy constantly flows in this cycle

Greg Zuroff

TEST YOURSELF: THE CIRCULAR FLOW



WHAT IS THE CIRCULAR FLOW MODEL?



The circular flow model is a model that shows how all the pieces of the economy fit together.



WHAT DOES THE CIRCULAR FLOW MODEL DESCRIBE?



The circular flow model describes the flow of money and products throughout the economy.



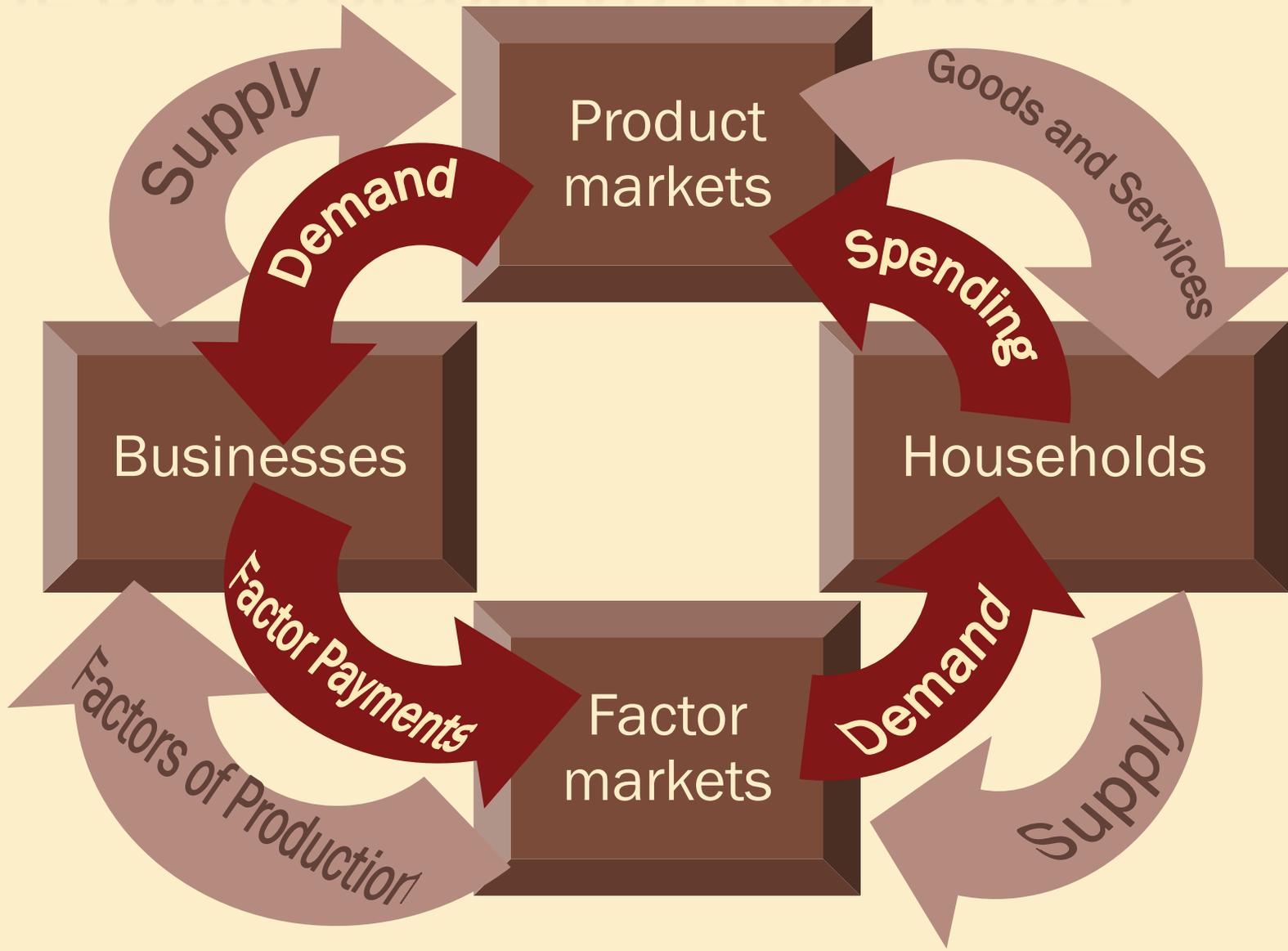
**THE TWO-SECTOR CIRCULAR FLOW
MODEL CONSISTS OF WHAT TWO
SECTORS?**



The two-sector circular flow model consists of two sectors: households and businesses.



THE BASIC CIRCULAR FLOW MODEL





**IN THE FIVE-SECTOR MODEL, THE
ECONOMY IS DIVIDED INTO WHAT FIVE
SECTORS?**



In the five-sector model, the economy is divided into five sectors, including households, firms, the financial sector, the government and the foreign sector.



A MORE COMPLEX CIRCULAR FLOW MODEL





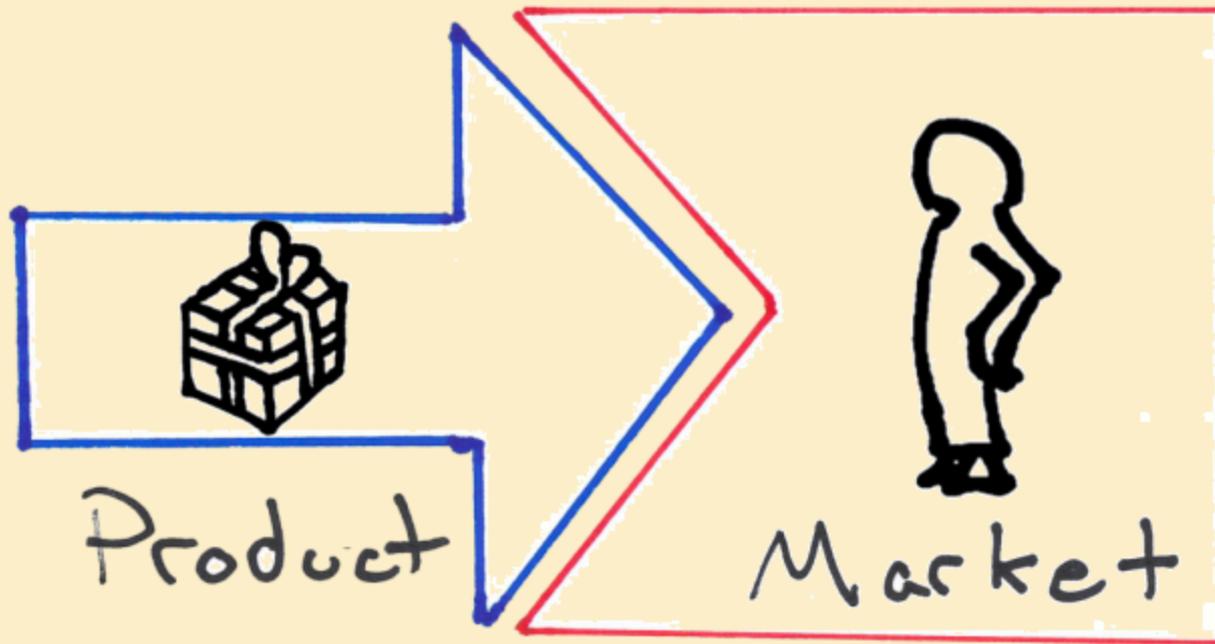
WHAT ARE PRODUCT MARKETS?



Product markets are markets for goods and services.



IN PRODUCT MARKETS, WHO ARE THE BUYERS AND WHO ARE THE SELLERS?

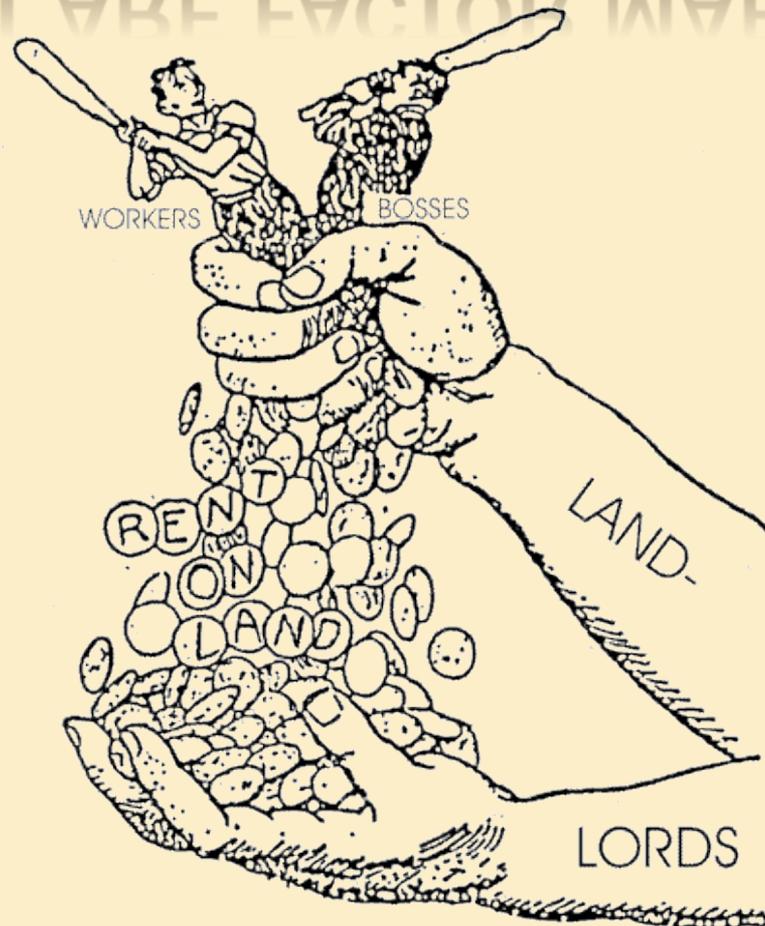




In product markets, households are the buyers and businesses are the sellers of consumer goods and services.



WHAT ARE FACTOR MARKETS?





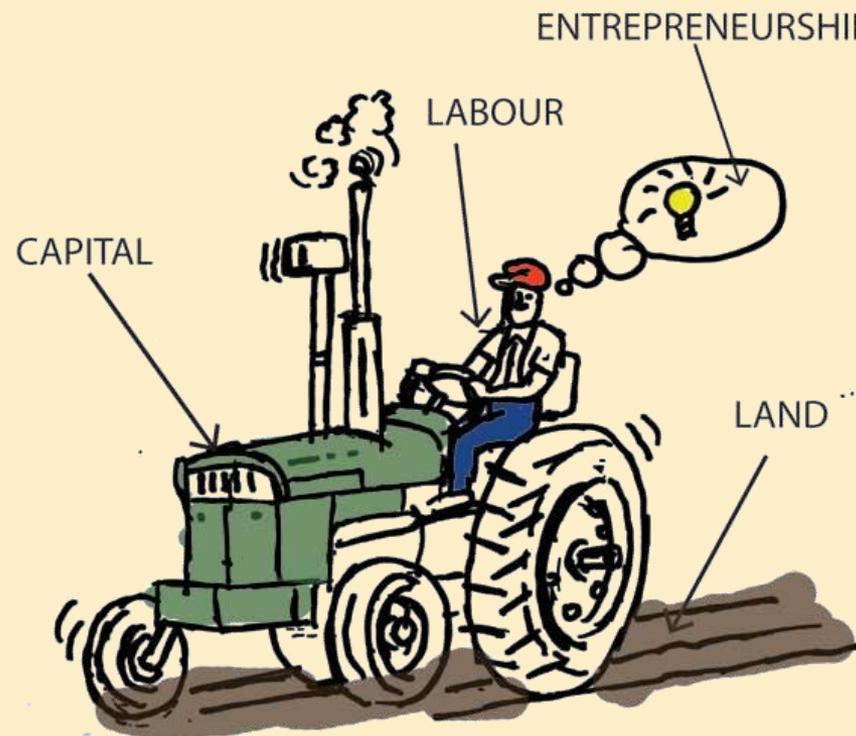
Factor markets are markets for factors
of production.



TO WHAT DOES THE TERM *FACTORS OF PRODUCTION* REFER?



The term *factors of production* refers to anything that is used by a firm in order to make a final product.





**IN FACTOR MARKETS, WHO ARE THE
BUYERS AND WHO ARE THE SELLERS?**



In factor markets, households are the sellers of resources such as labor, land, capital and entrepreneurial ability and businesses are the buyers.



WHAT IS CAPITAL?



CAPITAL RESOURCES



CAPITAL RESOURCES

are goods produced and used to make *other* goods or services.

Capital resources help increase productivity.

Capital refers to physical machinery and the funds (sometimes called financial capital) that are used to buy that machinery.



WHAT DO WE MEAN BY LEAKAGE?

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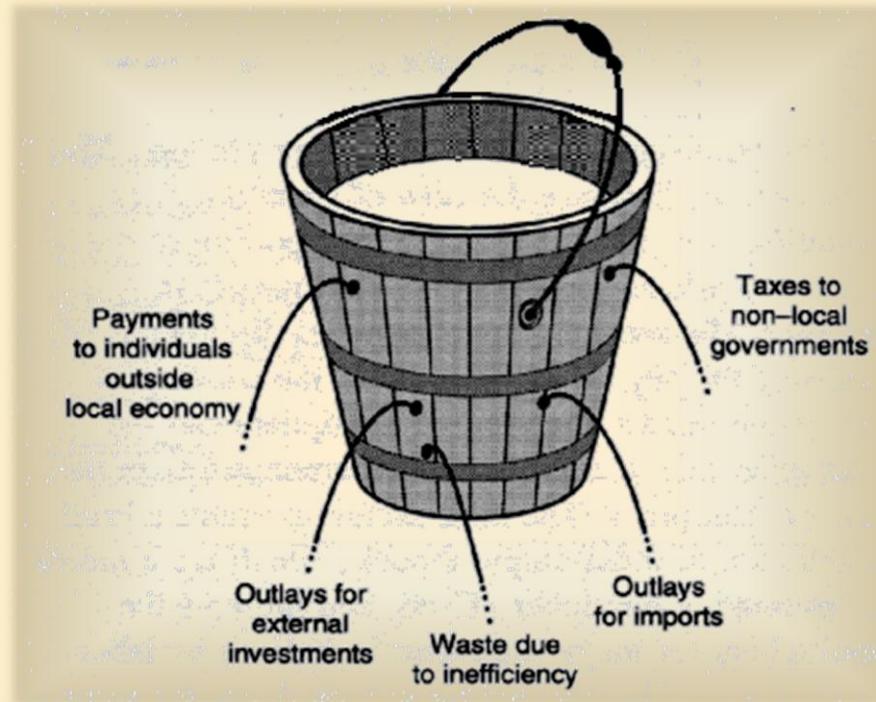
Leakage means withdrawal from the flow. When households and firms save part of their incomes it constitutes leakage. Leakages reduce the flow of income.



WHAT LEAKAGES ARE PRESENT IN A MORE COMPLEX MODEL?



Leakages are the *non-consumption* uses of income, including savings and taxes.





WHAT KIND OF LEAKAGE INVOLVES THE FOREIGN SECTOR?



Imports, the purchase of foreign goods by domestic residents, are leakages.



WHAT DO WE MEAN BY INJECTION?

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Injections are introductions of income into the flow. When households and firms borrow savings, it constitutes injections. Injections increase the flow of income.



**WHAT INJECTIONS ARE PRESENT IN A
MORE COMPLEX MODEL?**



Injections are the *non-consumption* expenditures on production. Injections present in a more complex model include investments and government spending.





WHAT KIND OF INJECTION INVOLVES THE FOREIGN SECTOR?



Exports of goods and services, which generate income for domestic exporters from overseas residents, are injections.

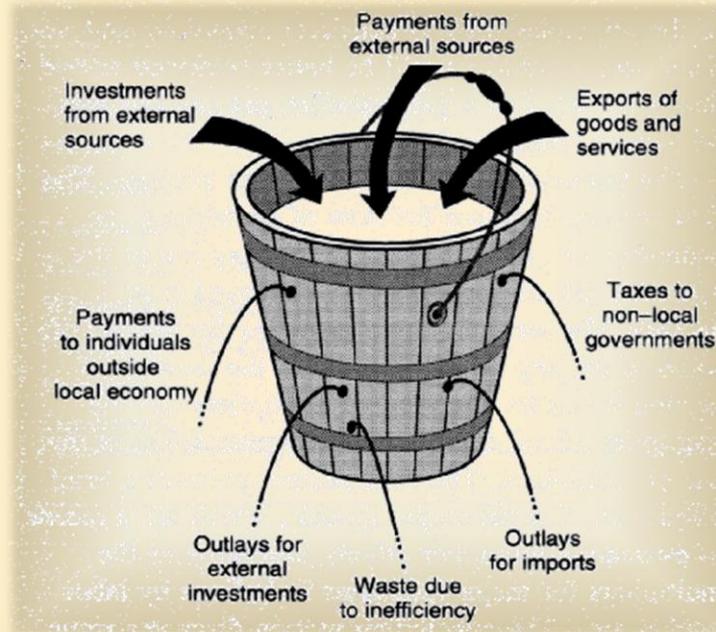


**WHAT POINT IS THE ECONOMY
TENDING TOWARD?**



The economy is tending toward a point where the dollar value of leakages equals the dollar value of injections.

As long as leakages are equal to injections the circular flow continues indefinitely.



How did you do?! If you didn't do as well as you'd like, review the margin notes and presentations and test yourself again.



THE END