

# NOTES: Markets and Circular Flow

Economics

# The Circular Flow of Goods

- Remember the 3 economic questions.
- Remember the 5 characteristics of a free enterprise system.
- Much of what characterizes a free enterprise economy has to do with the key economic sectors
  - **government, businesses, and households** and their relationships

# Three economic questions must be answered

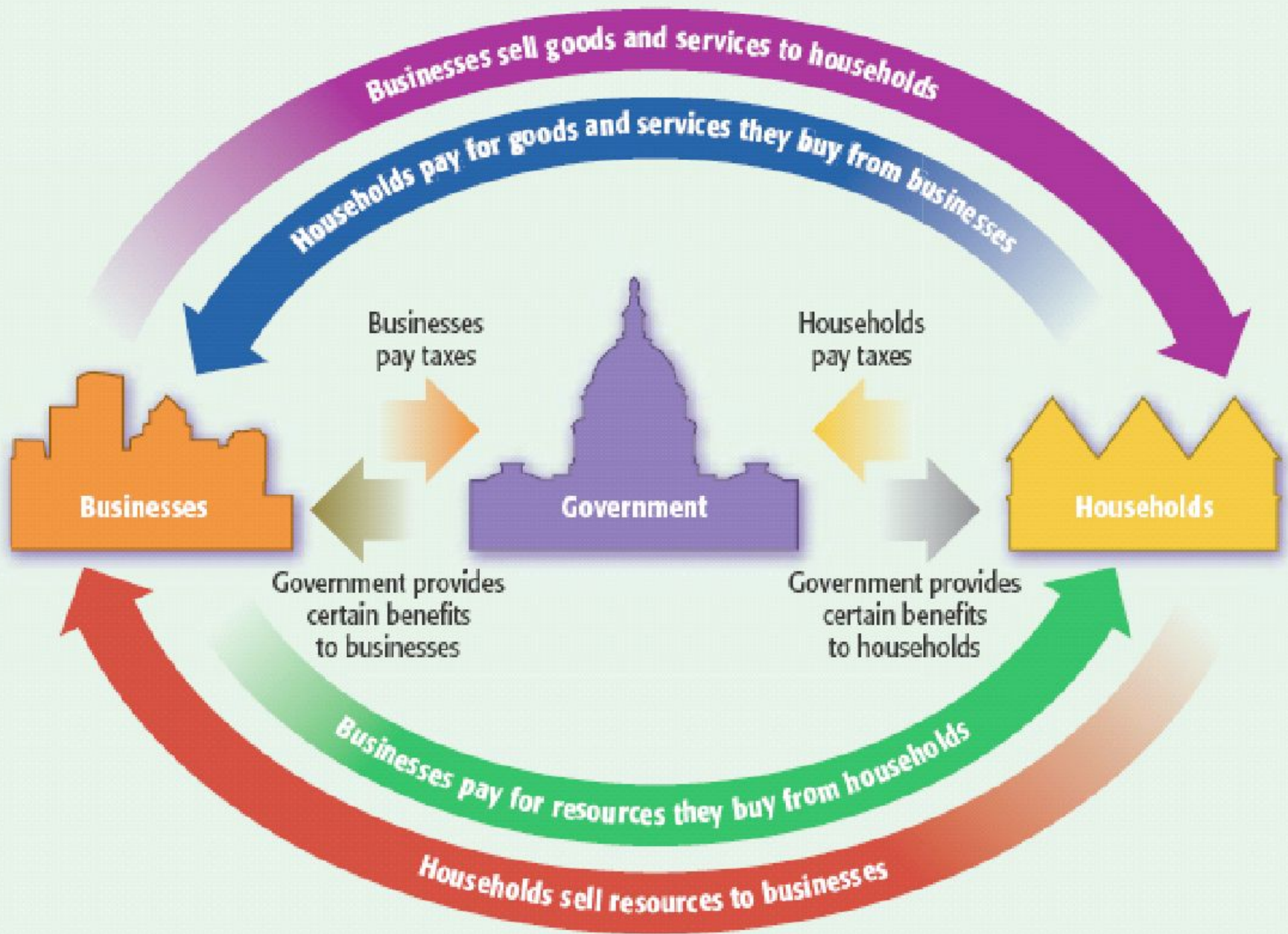
- **What** goods will be produced
  - Due to scarcity, every country must choose what to produce, therefore giving up the opportunity to produce other goods.
  - What will consumers be willing and able to buy?
  - What price and quantity will be profitable?
- **How** will the goods be produced
  - Will production decisions be made by individuals or by the government?
  - Will producers use existing technology or new technology?
  - Domestically or in foreign countries, manually or using technology?
  - The most *efficient* and reasonable way
- **For whom** will the goods be produced
  - Will the government decide? Will price decide? For those who can afford and are willing to buy them?
  - Will goods be produced for the purpose of trade with other countries?

# 5 Characteristics of a Free Enterprise (Free Market) Economy

- Private Property
- Freedom of Choice
- Voluntary Exchange
- Competition
- Economic Incentives

# The Circular Flow

- The circular flow of economic activity shows the **relationship between different economic groups**.
- The **circular diagram** is useful because it helps us see how a **change in one economic activity** (such as paying taxes) will lead to a **change somewhere else in the economy** (such as the amount households spend on goods and services produced by businesses).
  - See diagram Pg. 60 in textbook



# Elements / Sectors of the Circular Flow

- **Households** – An economic unit of one person or more that sells resources and buys goods and services.
- **Firms/Businesses** – A business unit formed by a profit seeking entrepreneur who combines resources to produce goods and services.
- **Government** – Collects taxes and provides certain benefits to both households and businesses.

# Circular flow cause and effect

- What if?
- What happens to businesses if households stop buying goods and services?
- What happens to households if businesses are not willing to pay as much for their resources? (For example – if a business cuts wages/salaries for its employees)
- What happens to the amount of resources households have to sell if the government cuts taxes?



# Purpose of Circular Flow diagram

- Explore the relationships between the economic sectors (business, government and households)
- Impact of economic activity
  - Change in one, leads to another change in economic activity