

# FOUNDATIONS OF ECONOMICS UNIT

## CIRCULAR FLOW OF INCOME MODEL

IB CORE CONCEPTS AND NOTES SPECIFICALLY RELATED TO THIS VIDEO

IB Core Concept	Standard Level and High Level Concept
Foundations of IB Economics	<ul style="list-style-type: none"> <li>Explain that economists are model builders and that they employ the assumption of “<i>ceteris paribus</i>”</li> <li>Explain and illustrate a basic model of an economy—the circular flow model</li> </ul>

Source: IB Economics Subject Guide

### The Circular Flow of Income Model

- **Households** represent the groups of individuals in the economy who perform two functions:
  - They are the **consumers** of the **goods** and **services**.
  - They are the owners and providers of the factors of production that are used to make the goods and services.
- **Firms** represent the productive units in the economy that turn the factors of production into goods and services.
  - This is the part of production in the economy that is owned by private individuals.
- **Goods** are tangible products.
  - They may be split into **durable goods** which are consumed overtime, such as cars and washing machines and **non-durable goods** which are consumed over a short period of time, such as an ice cream or a bottle of mineral water.
- **Services** are intangible products, such as a haircut or insurance, and, again, maybe consumed immediately or over time.
- This simple model ignores two important sectors of the economy: the **government** and **international trade**.
  - **Government**
    - The government has a number of roles in the economy.
    - It is normally responsible for law and order, national defense, adjusting the economy in order to achieve agreed economic games, and directly providing certain goods and services. This might include: water, public transport, electricity, or even cigarettes and some economies.
    - **The public sector:** Known as the state-owned sector of the economy that provides goods and services.

Source: Jocelyn Blink and Ian Dorton. IB Economics: Course Companion, Second Edition.