

FOUNDATIONS OF ECONOMICS UNIT

MODEL BUILDING

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"> Explain that economists are model builders and that they employ the assumption of “<i>ceteris paribus</i>” Explain and illustrate a basic model of an economy—the circular flow model

Source: IB Economics Subject Guide

Economists and Model Building

- Economists tend to build theoretical models in order to test and illustrate their theories.
- Ceteris paribus***: Latin for “*all other things being equal*”.
 - Key Concept**: When economists want to test the effect of one variable on another they need to be able to isolate the effect of the one variable by assuming that there is no change in any of the other variables.
- Economists are very famous for making assumptions, and it is always important to be aware of such assumptions.
- To illustrate the idea of model building, look at the simple model of an economy below:
- The Circular Flow of Income Model**

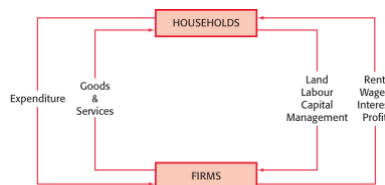


Figure 1.2 The circular flow of income

- 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 in tangible products, such as a haircut or insurance, and, again, maybe consumed immediately or over time.
- This simple model it 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, which might include things such as water, public transport, electricity, or even cigarettes and some economies.
 - **The public sector:** The state owned sector of the economy that provides goods and services is known as the public sector.

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