# The Circular Flow of Income

The **five-sector circular flow model** describes the operation of the economy and the linkages between the main sectors in the economy. The five-sector model is based on dividing the economy into five sectors. A **sector** may be defined as a part of the economy where the participants are engaged in a similar type of economy activity.

1. Individuals
2. Businesses
3. Financial institutions
4. Government
5. International Trade
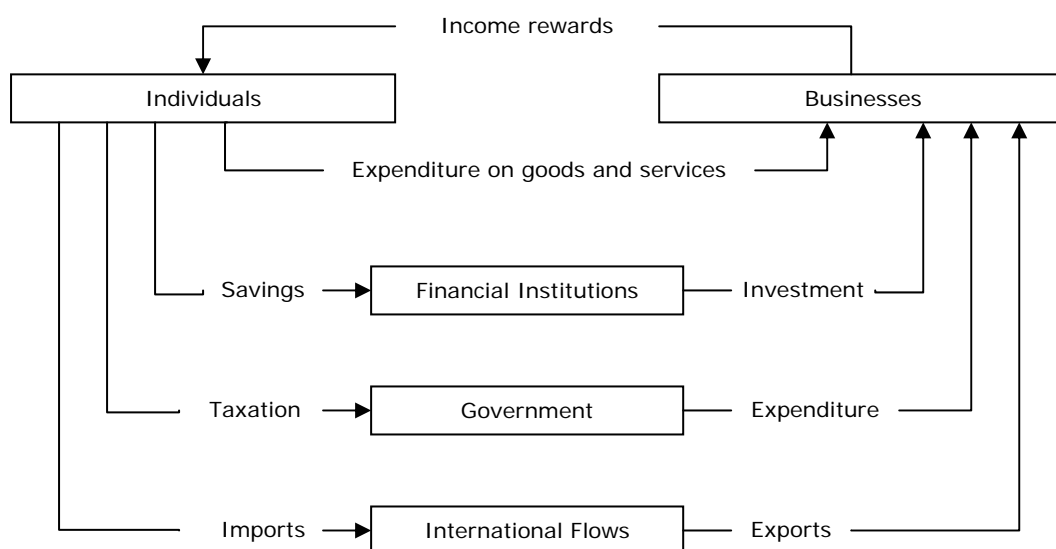
Individuals

- This sector consists of all individuals in the economy.
- These individuals are the owners of productive resources, and the consumers in our economy.
- Individuals supply factors of production (inputs) such as labour and enterprise to businesses, which they use to produce goods and services. As a reward for supply resources such as labour and enterprise to firms, individuals receive incomes – rent, wages, interest and profit.

Businesses

- This sector consists of all the business firms engaged in the production and distribution of goods and services (apart from financial services).
- It concerns all their activities involved with buying factors of production and using them to produce and sell goods and services.
- Individuals and businesses are interdependent.

Financial Institutions

- This sector consists of all those institutions that are engaged in the borrowing and lending of money, acting as the intermediaries between those who save, and borrowers of money.
- Financial institutions are needed for individuals and firms to be able to undertake saving and investment. They perform the function of mobilising savings for investment.
- Savings: *leakage*; Investment: *injection*

Government

- In Australia, this sector consists of the Commonwealth, State and local governments.
- It is involved in the satisfaction of collection (community) wants.
- It obtains the resources to do this through imposing taxes on the other sectors of the economy.
- It uses this tax revenue to undertake various government expenditures.