4.2 Introduction to the circular flow of income

Name: _____ Class: _____ Date: _____ **Total: 23 marks**

KEY WORDS circular flow of income • injections • leakages • open economy • leakages and injections

Objective

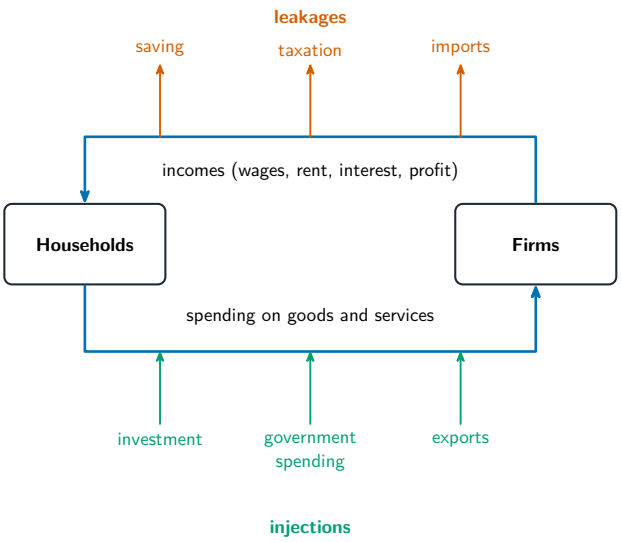
Build the skills to answer exam questions on the **circular flow of income – households and firms**, **leakages and injections**, and the equilibrium condition.

You must be able to:

- describe the circular flow between households and firms
- identify the three leakages and three injections
- explain when the flow grows, shrinks or is in equilibrium

1 Key knowledge and worked examples

Money around the economy



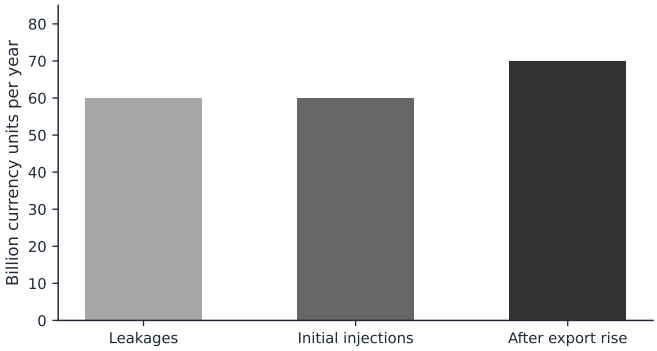
Households supply factors and spend; firms pay income and produce

- **Leakages** take money **out**: **saving** (S), **taxation** (T), **imports** (M).
- **Injections** put money **in**: **investment** (I), **government spending** (G), **exports** (X).
- **Equilibrium** when injections = leakages; if injections > leakages the economy **grows**.

Answer shapes: AO1 + AO2 + AO3 (analysis) + AO4 (judgement, for evaluate questions).

■ **Worked application: Check all leakages and injections in the same period**

For a supplied economy, $S = 30$, $T = 20$ and $M = 10$ billion currency units per year. Total leakages are $S + T + M = 60$. If $I = 25$, $G = 20$ and $X = 15$, total injections are also 60, so the measured flow is in equilibrium. If exports rise to 25 while the other entries initially stay unchanged, injections exceed leakages by 10. This creates upward pressure on income; as income changes, induced saving, tax and import flows can also change. Do not infer a permanent 10-unit income increase merely from this initial imbalance.



2 Practice

2.1 Define the term *leakage* (withdrawal) from the circular flow. [2]

2.2 State the three injections into the circular flow. [3]

2.3 State the condition for the circular flow to be in equilibrium. [1]

3 Exam-style questions

3.1 Which is a **leakage** from the circular flow of income? [1]

- ☐ **A** investment
- **B** government spending
- **C** saving
- **D** exports

3.2 Explain what happens to national income when injections are greater than leakages. [6]

3.3 Explain how a rise in exports affects the circular flow of income in an open economy. [6]

3.4 Annual leakages are $S = 20$, $T = 15$, $M = 10$, and injections are $I = 18$, $G = 20$, $X = 12$, all in the same currency units. (a) Find total leakages, total injections and their difference. [2]

(b) Predict the initial direction of income adjustment and explain why the eventual change is not necessarily equal to that difference. [2]