Exercise walk-through

Introduction to the circular flow of income ▪ 4.2

eXercise

You must be able to

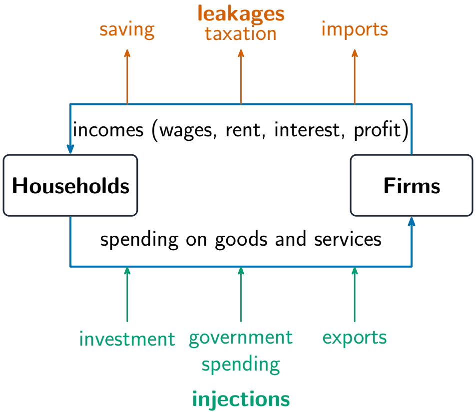
- describe the circular flow between households and firms
- identify the three leakages and three injections
- explain when the flow grows, shrinks or is in equilibrium

Method — Money around the economy

- **Leakages 漏出** take money **out**: **saving 储蓄** (S), **taxation 税收** (T), **imports 进口** (M).
- **Injections 注入** put money **in**: **investment 投资** (I), **government spending 政府支出** (G), **exports 出口** (X).
- **Equilibrium** when injections = leakages; if injections > leakages the economy **grows**.

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

Method — Money around the economy



Leakages drain the flow; injections add to it

Practice 2.1 ▪ 2 marks

Define the term *leakage* (withdrawal) from the circular flow.

Solution 2.1

Method: Money around the economy

Worked steps

money that is taken out of the circular flow rather than passed on as spending (saving, taxation or imports) (2 for a clear definition; 1 for a partial idea).

Practice 2.2 ▪ 3 marks

State the three injections into the circular flow.

Solution 2.2

Method: Money around the economy

Worked steps

investment; government spending; exports $(1 + 1 + 1)$.

Practice 2.3 ▪ 1 mark

State the condition for the circular flow to be in equilibrium.

Solution 2.3

Method: Money around the economy

Worked steps

when total injections equal total leakages (1).

Exam-style 3.1 ▪ 1 mark

Which is a **leakage** from the circular flow of income?

A investment

B government spending

C saving

D exports

Solution 3.1

Method: Money around the economy

A investment

B government spending

C saving ✓

D exports

Worked steps

C. Saving is a leakage (withdrawal) from the flow.

Exam-style 3.2 ▪ 6 marks

Explain what happens to national income when injections are greater than leakages.

Solution 3.2

Method: Money around the economy

Worked steps

[6] AO1 1 + AO3 up to 5 — when injections exceed leakages, more money enters the flow than leaves → firms receive more spending → they produce more and pay more income → national income rises until leakages rise to match injections.

Exam-style 3.3 ▪ 6 marks

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

Solution 3.3

Method: Money around the economy

Worked steps

[6] AO1 1 + AO2/AO3 up to 5 — exports are an injection, so more money enters the flow $\rightarrow$ foreign buyers' spending raises firms' revenue $\rightarrow$ firms produce more and pay more income to households $\rightarrow$ national income rises (a multiplier effect may amplify this).