

## The Circular Flow Model

### >> Key Concepts:

- ↪ The **circular flow model** illustrates the economic relationships among all players in the economy: households, firms, the factors market, the goods-and-services market, government, and foreign trade.
- ↪ In the macroeconomy, spending must always equal income.

<p><b>Components of the circular flow model</b></p> <p>Because this is a closed system, spending must equal income.</p>	<p>The <b>circular flow model</b> is a diagram illustrating the flow of spending and income in an economy.</p> <p>The counterclockwise arrows represent the flow of money. The clockwise arrows represent the flow of goods and services.</p> <p>In a <b>closed economy</b>, such as the example to the left, all the spending of households and firms must equal the income received by the factors and goods-and-services markets.</p>
<p><b>Components of the circular flow model</b></p>	<p>As households and firms pay the government net taxes, money and resources flow outside the model.</p> <p>Government spending on goods and services must equal the income received from taxes that households and firms pay to the government.</p>
<p><b>Components of the circular flow model</b></p>	<p>Foreign trade in an <b>open economy</b> also allows money and resources to leak out of the circular flow model.</p> <p>For macroeconomic equilibrium to occur, total spending must equal total income received from all players in the economy.</p>