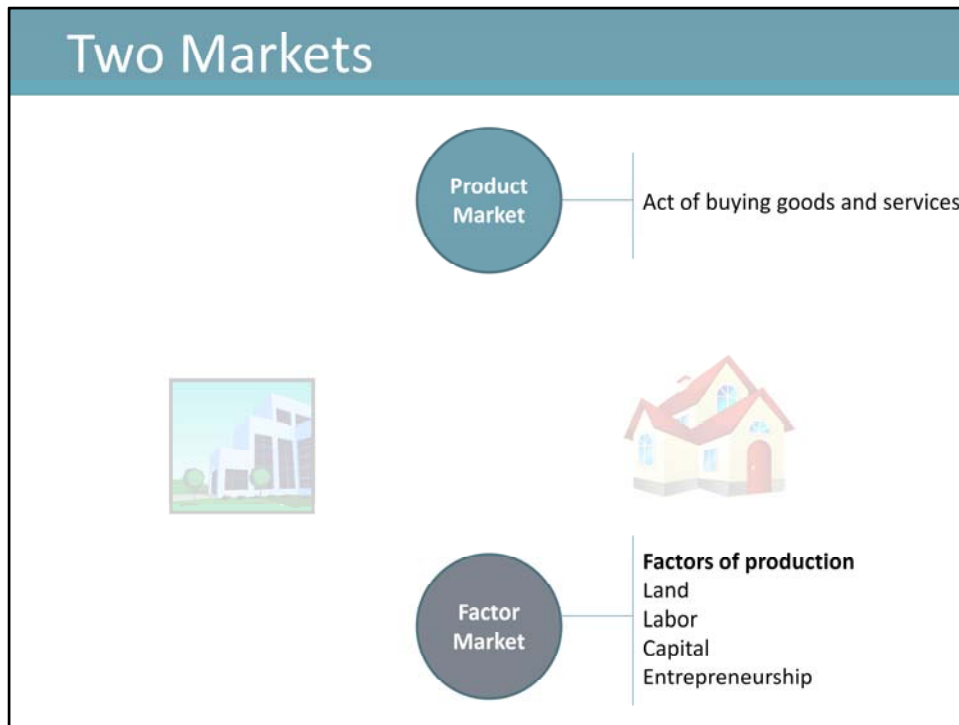


Two Main Decision Makers



Let's look at the circular flow model, which shows the relationship between the two main decision makers in our free market economy—businesses and households. Households really just means consumers. A household can be one individual or a group of individuals. These two groups appear on opposite the sides of the circle.



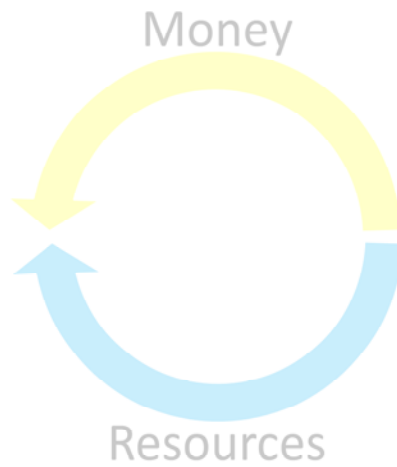
There are two markets in the circular flow model: the product market and the factor market.

The product market is not a place. It is simply the act of buying goods and services. Businesses make the products that consumers purchase and use the money they get from these sales to operate their businesses.

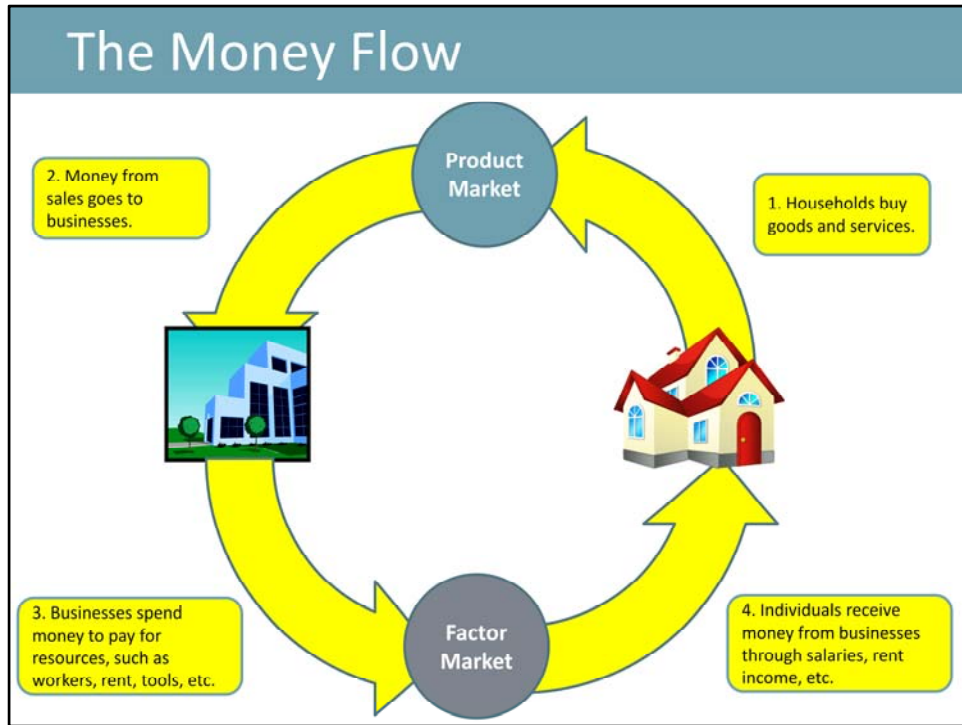
The factor market is made up of the resources that businesses use to produce their products—the factors of production. Remember that the factors of production are land, labor, capital, and entrepreneurship. Land is the space where production takes place. Labor is the human effort to produce goods and services, and capital is any man-made item, like tools or machines, that make production easier and more efficient. Entrepreneurship is the ideas and risk that individuals take and use to create and run businesses. Individuals own all of these resources.

In the factor market, individuals are the producers and businesses are the customers. For example, a restaurant pays employees to cook and serve meals. This is labor.

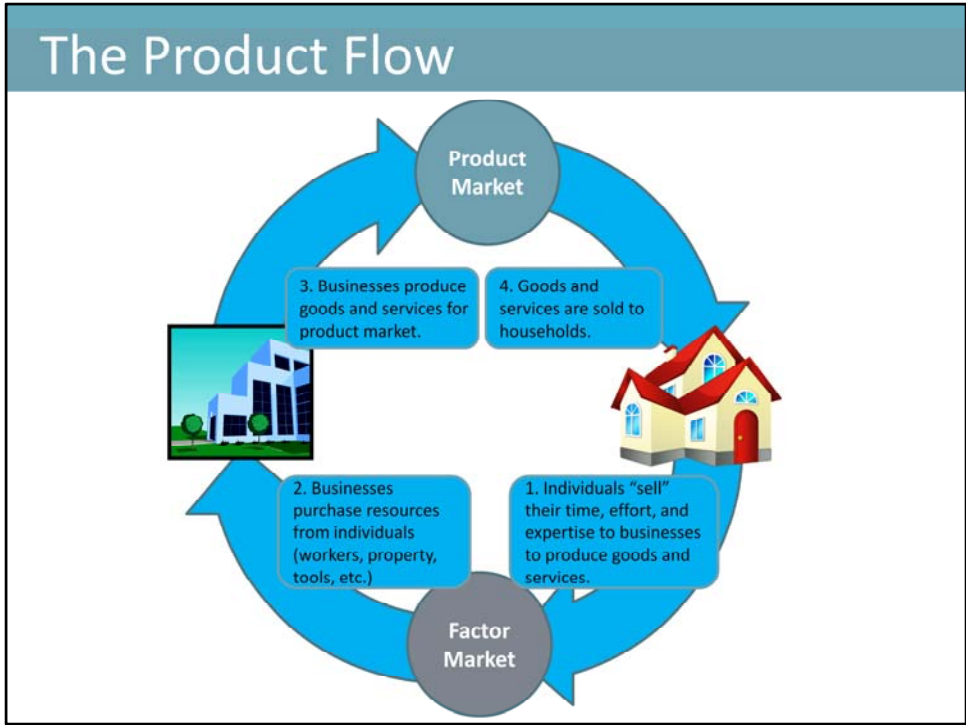
Two Arrows – Money and Resources



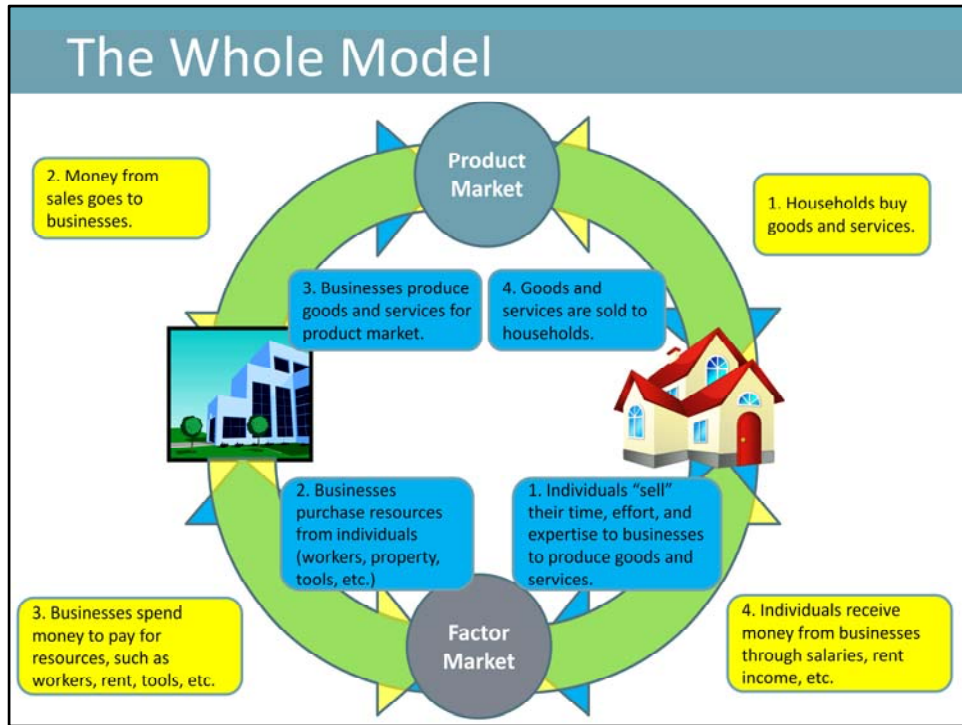
Money and resources flow in opposite directions in the model. The yellow arrow shows the flow of money, and the blue arrow the flow of resources and products.



Let's follow the money through the cycle. Starting with households, individuals spend money on goods and services in the product market. This money flows to businesses as revenue. Businesses then spend their revenue in the factor market to pay for land, labor, capital, and entrepreneurship in order to produce goods and services. This money goes to households (or the individuals) who produce the resources. With the money households receive, they are able to buy more goods and services in the product market, which keeps the cycle going!



Now let's follow the product flow which goes in the opposite direction of money. Again, starting with households, individuals sell their labor and expertise to businesses. Businesses pay for the use of these resources in order to produce goods for the product market. Households use the money they earn by selling their labor in order to purchase goods and services on the product market, which keeps the cycle going!

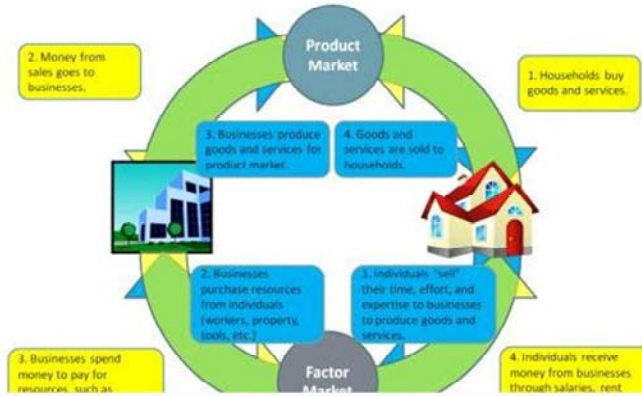


Now you can see the entire picture. Money and products flow throughout the cycle. This model shows the relationship between businesses and consumers. Note that everything starts with the individuals. We decide what we are going to purchase, which businesses then produce by using our resources. Both groups are dependent on the other to make our economy work.

The Circular Flow

Question

On the following pages, determine the market for the activity (factor or product) and its role (supply or demand).



PROPERTIES

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