What is the Economy?
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An economy is the system for deciding how scarce resources are used so that goods and services can be produced and consumed.

Resources are things like land, people (who can work or innovate through their ideas) and raw materials. They are seen as scarce because we have unlimited wants but there are not enough resources to produce the goods and services to satisfy these wants.
What is the economy?

An economy exists in a geographical area (e.g. a local area, country or the world).

The Australian economy is market-based.

Decisions to produce or consume goods and services reflect demand (what people want to buy) and supply (how much businesses can provide) in the market.
What is the economy?

Economic questions could include:

- What resources does Australia have?
- How many goods and services are being produced?
- To what extent are people borrowing or saving money?
- How might a rise in prices affect people’s decisions around spending?
- Should the Government raise or lower taxes?
What is the economy?

The economy is important to all of us.

What’s happening in the economy can affect us and the decisions we make. Our decisions can also influence how the economy is performing.

Every time you choose to buy something (or not to), you are affecting the economy.
Sectors of the economy

Here are the key sectors that make up the Australian economy.

Household sector
Firms sector
Financial sector
Government sector
Overseas sector
Household sector

This sector is made up of individuals in the economy.

- They provide their time and skills or ‘labour’ to firms in exchange for income (wages).
- They are consumers who buy goods and services from Firms.
- They may borrow from, or save money with, the Financial sector.
- They pay taxes to the Government.
Firms sector

This sector is made up of all businesses in the economy.

• They produce **output** (goods and services), which they sell to consumers and receive **revenue**.
• They may borrow money from, or save money with, the Financial sector.
• They pay **taxes** to the Government.
Financial sector

This sector is made up of banks and other financial institutions in the economy.

- They receive **savings** from Households and Firms.
- They help Households and Firms **invest** by lending them money.
Government sector

This sector is made up of all bodies in national, state and local governments.

• They receive **taxation** revenue from Households and Firms.

• They **spend** this money on public goods and services, such as roads, parks, schools and hospitals.
Overseas sector

This sector relates to Australia’s trade with other nations.

Australia *exports* (sells) goods and services, produced by businesses in Australia, to other countries.

Australia *imports* (buys) goods and services, produced by businesses in other countries.
Activity: Sectors in the Economy

Cut out the sectors in **Activity: Sectors in the Economy**. Consider how they might relate to one another. (You could arrange the sectors on a sheet of paper and draw arrows to show the connections between them.)
The Circular Flow Model

This is one way to show the flow of money and goods and services around different sectors of the economy.
Injections and leakages

In the circular flow model, money flows in and out of the economy.

Think of a bath tub with the tap on but the plug out. Water is being added by the tap but also leaking out.

It’s important to get the balance right so the water doesn’t overflow or drain out completely.
Injections and leakages

Think of all the exchanges taking place within the economy. Some are putting money into the economy. These are injections.

Some of these are taking money out of the economy – the money is not being utilised elsewhere in the economy. These are leakages.

As with filling or emptying a bath, it’s important that an economy doesn’t grow or shrink too much or too quickly.
Activity: Injections and Leakages

Read the examples in Activity: Injections and Leakages.

Decide if they are injections or leakages in Australia’s economy.

Discuss why this is, and where the examples might fit within the circular flow model.

Can you think of other examples of injections and leakages?

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**Example** | **Injection or leakage?** | **What part of the circular flow model is this?**
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An individual decides to reduce their spending and save more of their income. | Leakage | Savings
The state government has received tax revenue but has not yet decided what to spend the money on. | Leakage | Government spending
A business decides to borrow money from a bank to invest in new equipment that will increase its output. | Injection | Investment
An Australian mining company sells iron ore to a steel manufacturer in China. | Leakage | Foreign trade
An Australian electrical retailer decides to buy products from an overseas business. | Leakage | Foreign trade
The local government decides to spend money to build a skate park. | Injection | Government spending
Foreign students come to Australia to attend university paying the university for their education. | Leakage | Government spending
Injections and leakages

This shows the leakages and injections of money within the circular flow model.

**Injections:**
- Investment
- Government expenditure
- Exports

**Leakages:**
- Savings
- Taxation
- Imports
Economic growth

When injections \((I+G+X)\) are greater than leakages \((S+T+M)\), this will lead to economic growth.

Economic growth refers to an increase in the size of a country's output over a period of time.

The size of an economy is typically measured by the total production of goods and services in the economy, which is called gross domestic product (GDP).
Interdependence between sectors of the economy

The different sectors within the economy are linked together. This interdependence means that a change in one sector can affect the rest.

Discussion – How might the economy be affected if…

• the Government decided to raise taxes?
• Households decided to save more and spend less?
• Firms decided to increase their prices?
• the Financial sector made it cheaper to borrow money?
• Overseas goods and services became more expensive to import?
Example

The Financial sector plays an important role in facilitating business investment. Firms rely on banks lending them money so they can invest in things like new equipment, higher wages or additional staff, to increase production.
Activity: Complete the Circular Flow Model

Use the labels to fill in the circular flow model in Activity: Complete the Circular Flow Model.