

2.1: Economic Activity

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2.1 ECONOMIC ACTIVITY: STUDENT LEARNING ACTIVITY

Answer the questions that follow.

1. DEFINITIONS

Define the following terms:

- Income
- Factors of production
- Land entrepreneurship).
- Resources
- Land
- Labour
- Capital
- Entrepreneurship
- Public good
- Merit good
- Tax revenue
- Interest
- Interest rate
- Domestic firm
- Government expenditure
- Budget deficit
- Budget surplus
- Exports
- Export receipts
- Imports
- Import payments
- Withdrawals (leakages)
- Injections
- Current account deficit
- Current account surplus
- Circular flow model
- Real flows
- Money flows
- Financial institutions
- Transfer payments
- Subsidies
- Investment
- Savings

[10 marks]

2. SHORT-ANSWER QUESTIONS

1. Outline the types of payment associated with each of the factors of production. **[4 marks]**
2. Distinguish between the closed and open economy models of the circular flow of income. **[4 marks]**
3. Use examples to explain the relationship between real and money flows. **[4 marks]**

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4. Explain the role of the **substitution effect** and the **income effect** of a change in price in explaining the law of demand. **[4 marks]**
5. Sketch the closed economy circular flow of income, labeling all money and real flows. **[4 marks]**
6. Use the diagram in question 5 to explain how the income from the factors of production are equal to goods and services expenditure, which are both, in turn, equal to the total value of all goods and services produced in an economy. **[6 marks]**
7. Outline the withdrawals and injections into the circular flow model of income. **[4 marks]**
8. Distinguish between 'withdrawals' (leakages) and 'injections' in the circular flow model of income. **[4 marks]**
9. Outline what happens to the size of the income flows when:
 - i. Injections are greater than withdrawals
 - ii. Withdrawals are greater than injections**[4 marks]**
10. Outline how each of the following events affects the size of income flows in the circular flow model:
 - i. The government increases sales taxes
 - ii. Interest rates in an economy increase
 - iii. The currency depreciates making imports more expensive and increasing the revenues earned from exports
 - iv. Business confidence increases and investment spending increases
 - v. Income support payments such as the pension and unemployment benefits are increased
 - vi. There is a major economic recession in a country's major export market
 - vii. The government reduces spending on health and education
 - viii. Consumer confidence decreases
 - ix. Foreign imports become more price competitive within domestic markets
 - x. Retirement saving is made mandatory at five per cent of income**[10 marks]**

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3. MULTICHOICE QUESTIONS

Choose the best answer to each question.

[40 marks]

1. Capital is associated with which of the following incomes from the factors of production
 - a. Wages
 - b. Rent
 - c. Profit
 - d. Interest

2. Which of the following is an injection into the circular flow model of income?
 - a. Savings
 - b. Import payments
 - c. Export receipts
 - d. Taxation

3. Rent is the income associated with which factor of production?
 - a. Land
 - b. Labour
 - c. Capital
 - d. Enterprise

4. Labour is associated with which of the following incomes from the factors of production
 - a. Wages
 - b. Rent
 - c. Profit
 - d. Interest

5. Which of the following is an injection into the circular flow model of income?
 - a. Savings
 - b. Import payments
 - c. Investment
 - d. Taxation

6. Which of the following is an injection into the circular flow model of income?
 - a. Savings
 - b. Import payments
 - c. Government expenditure
 - d. Taxation

7. Which of the following is an injection into the circular flow model of income?
 - a. Savings
 - b. Import payments
 - c. Consumer expenditure on goods and services
 - d. Taxation

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8. Which of the following is a withdrawal (leakage) from the circular flow model of income?
 - a. Investment
 - b. Savings
 - c. Export receipts
 - d. Consumer expenditure on goods and services

9. Which of the following is not a money flow in the circular flow of income model?
 - a. Income
 - b. Investment
 - c. Factors of production
 - d. Transfer payments

10. Investment in Economics is:
 - a. Households buying shares
 - b. Households and firms buying shares
 - c. Firms buying capital goods
 - d. Savings in the form of shares or term deposits

11. Which would not be considered part of the income payments flow in the circular flow model?
 - a. Royalties
 - b. Professional fees
 - c. Sickness benefits
 - d. Wages

12. Which of the following is a real flow in the circular flow of income model?
 - a. Income
 - b. Investment
 - c. Goods and services
 - d. Taxation

13. A money flow between the government sector to the household sectors is:
 - a. Import payments
 - b. Taxation payments
 - c. Transfer payments
 - d. Subsidies

14. Which of the following is not a money flow in the circular flow of income model?
 - a. Income
 - b. Investment
 - c. Goods and services
 - d. Taxation

15. Wages is the income associated with which factor of production?

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- a. Land
 - b. Labour
 - c. Capital
 - d. Enterprise
16. Collectively, the returns for each of the four factors of production is termed:
- a. Income
 - b. Earnings
 - c. Wages
 - d. Gross domestic product
17. Which of the following is a withdrawal (leakage) from the circular flow model of income?
- a. Indirect taxation
 - b. Investment
 - c. Export receipts
 - d. Consumer expenditure on goods and services
18. Which of the following is a real flow in the circular flow of income model?
- a. Income
 - b. Investment
 - c. Goods and services
 - d. Taxation
19. Which of the following is not necessarily true in the two sector circular flow of income model?
- a. Income = goods and services expenditure
 - b. Transfers and taxation = Income
 - c. Goods and service expenditure = total value of output
 - d. Total value of output = income
20. Which of the following is a real flow in the circular flow of income model?
- a. Expenditure on goods and services
 - b. Investment
 - c. Capital goods
 - d. Taxation
21. Which of the following increases the level of economic activity?
- a. Investment and savings
 - b. Expenditure on imports
 - c. Factors of production
 - d. Government spending and exports
22. Which of the following increases the level of economic activity?
- a. Transfer payments and export receipts

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- b. Expenditure on imports
 - c. Goods and services
 - d. Transfer payments and savings
23. Profit is the income associated with which factor of production?
- a. Land
 - b. Labour
 - c. Capital
 - d. Enterprise
24. Which of the following is a withdrawal (leakage) from the circular flow model of income?
- a. Investment
 - b. Export receipts
 - c. Import payments
 - d. Consumer expenditure on goods and services
25. Land is associated with which of the following incomes from the factors of production
- a. Wages
 - b. Rent
 - c. Profit
 - d. Interest
26. Which of the following increases the level of economic activity?
- a. Expenditure on imports
 - b. Exports and savings
 - c. Factors of production
 - d. Consumer expenditure and export receipts
27. Which of the following decreases the level of economic activity?
- a. Transfer payments
 - b. Higher interest rates
 - c. Factors of production
 - d. Government spending and exports
28. Which is a money flow between the financial and firms sectors of the economy?
- a. Savings
 - b. Investment
 - c. Interest
 - d. Capital
29. Which of the following is not necessarily true in the two sector circular flow of income model?
- a. Income = goods and services expenditure
 - b. Goods and service expenditure = total value of output

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- c. Total value of output = income
 - d. Export receipts = import payments
30. Which is a money flow between the financial and household sectors of the economy?
- a. Savings
 - b. Investment
 - c. Interest
 - d. Capital
31. Enterprise is associated with which of the following incomes from the factors of production
- a. Wages
 - b. Rent
 - c. Profit
 - d. Interest
32. Interest is the income associated with which factor of production?
- a. Land
 - b. Labour
 - c. Capital
 - d. Enterprise
33. Which of the following is not necessarily true in the two sector circular flow of income model?
- a. Income = goods and services expenditure
 - b. Goods and service expenditure = total value of output
 - c. Investment = Income
 - d. Total value of output = income
34. Which is a money flow between the firms and overseas sectors of the economy?
- a. Import receipts
 - b. Foreign exchange
 - c. Export payments
 - d. Export receipts
35. Which of the following is a withdrawal (leakage) from the circular flow model of income?
- a. Investment
 - b. Import payments
 - c. Government expenditure on goods and services
 - d. Transfer payments
36. Which of the following is the money flow that corresponds to the real flow of resources?
- a. Consumption
 - b. Incomes
 - c. Factors of production

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- d. Goods and services
37. Which of the following is a real flow in the circular flow of income model?
- a. Income
 - b. Investment
 - c. Goods and services
 - d. Taxation
38. Which of the following is not a money flow in the circular flow of income model?
- a. Expenditure on goods and services
 - b. Investment
 - c. Capital goods
 - d. Taxation
39. The real flow that corresponds to the money flow of consumption is:
- a. Spending on goods and services
 - b. Resources
 - c. Incomes
 - d. Goods and services
40. Savings in Economics is:
- a. Placing money in a financial institution
 - b. Money tied up in the bank or shares
 - c. Interest bearing bank deposits
 - d. Consumption foregone

5. TRUE OR FALSE QUESTIONS

Indicate whether the following statements are true or false.

1. Investment is equal to savings in the closed economy circular flow model
True
False
2. The return from each of the four different factors of production is income
True
False
3. An injection into the circular flow decreases the level of economic activity
True
False

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4. Investment is the purchase of shares and financial instruments by households.
True
False
5. Savings and investment are both injections into the circular flow model.
True
False
6. Import payments are a withdrawal from the circular flow model.
True
False
7. A current account surplus is when tax receipts are greater than government expenditure.
True
False
8. A money flow always has a corresponding real flow in the circular flow model.
True
False
9. Savings is forgone consumption.
True
False
10. In the two sector mode: goods and service expenditure = income = total value of output
True
False

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