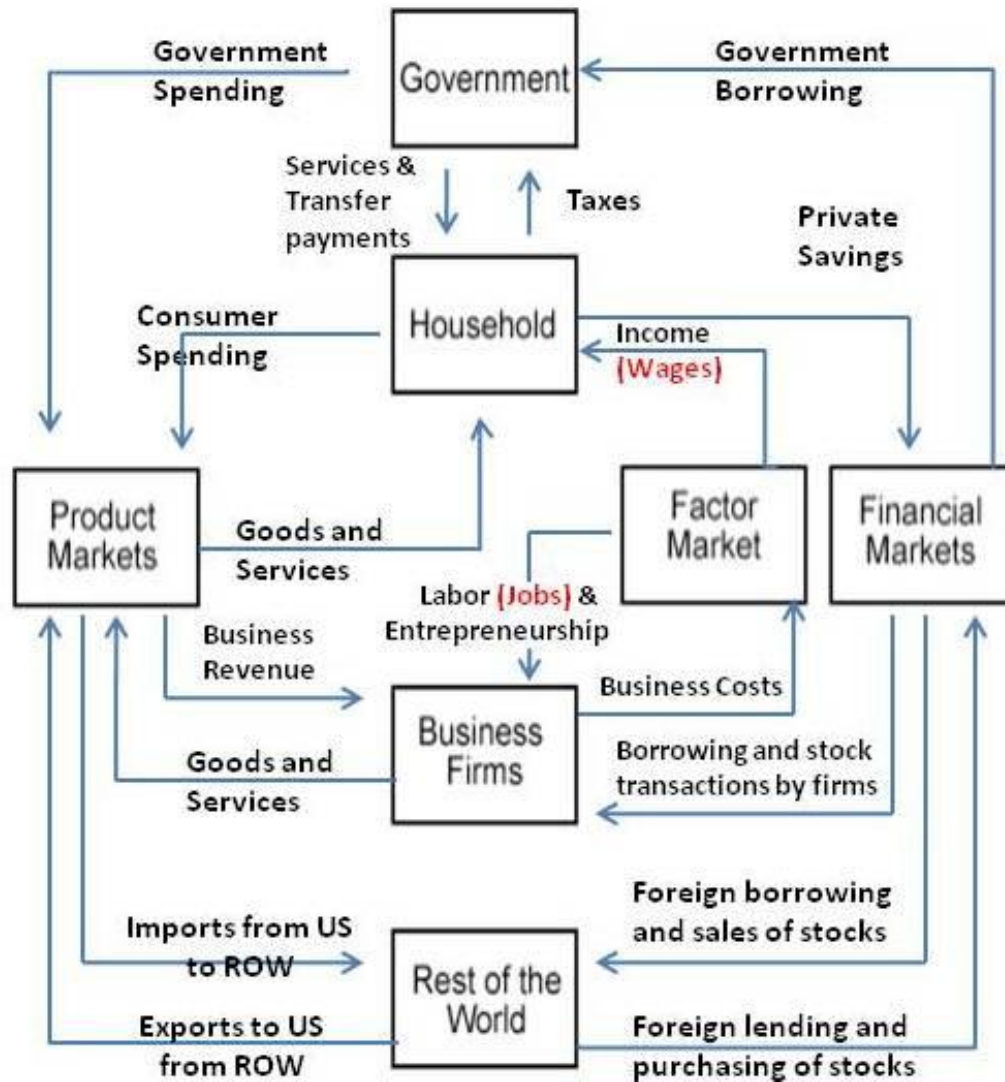


Module 6 Review Guide

Circular Flow Diagram

The flow of resources between four main players in the economy—households, businesses, the government, and the rest of the world.



The Players

- The government represents any lawmaking body (local, state, or national) that collects taxes and provides services to individuals and businesses.
- Households include individuals like you and those living in the same home.
- Businesses include any company type that earns income from the sale of goods and services.
- The rest of the world represents interaction with all those three groups in foreign countries.

Module 6 Review Guide

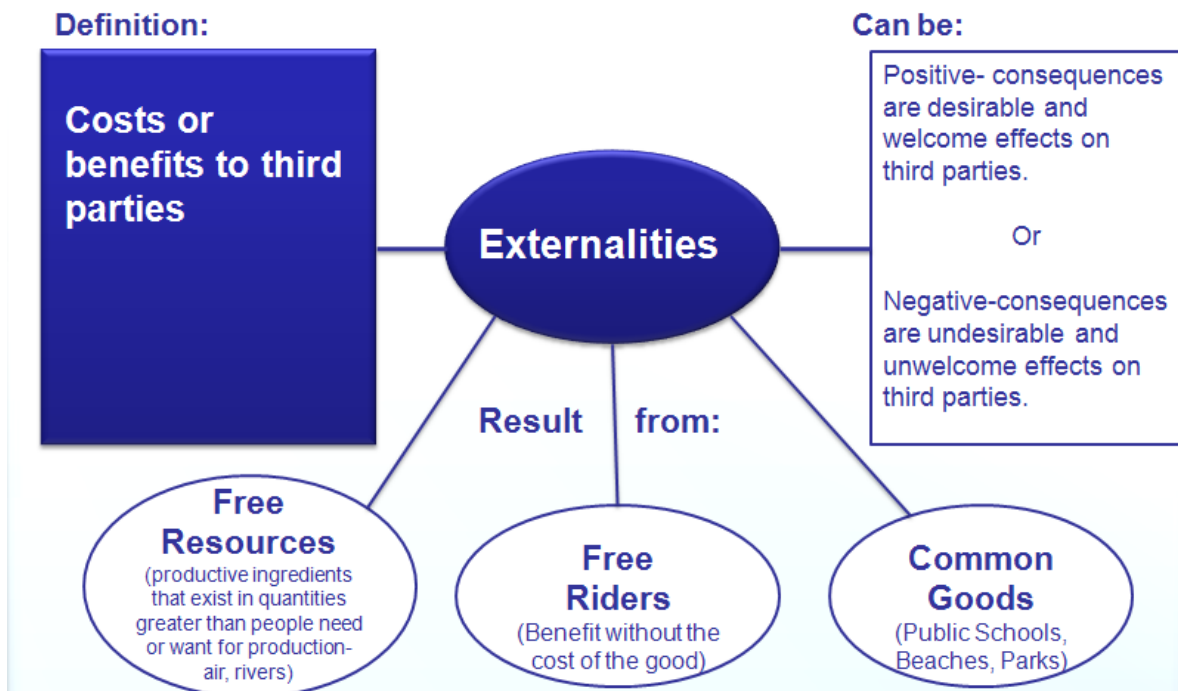
The Markets

- The four main players interact in three types of markets —factor, product, and financial.
- The product market is the buying and selling of finished goods and services, like your morning latte.
- The factor market is the exchange of the factors of production including components of land, labor, and capital, such as a coffee company purchasing equipment to process coffee beans.
- The financial market refers to the stock market and banking services, including the loans to all the other economic players use to meet their goals.

Example of Economic Relationships --- (product = cherry pies)

Government	Sets standards for food safety, taxes for production of cherry pies
Household	Purchases cherry pies
Business Firms	Grows, harvests, prepares cherrys for pies
Rest of the World	Export cherry pies to international consumers

Externalities



Module 6 Review Guide

Classifying Externalities

	Example
Commons	Graffiti on school buildings offends local residents, students, and teachers.
Commons	A sign on the highway says “\$50 fine for littering.”
Commons	Police and other government employees often have low salaries relative to other professions.
Free resources	Beach visitors leave food waste on the beach, attracting wildlife that may carry disease.
Free resources	Millions purchase new vehicles each year, the exhaust adding to pollutants in the air.
Free resources	People flush old prescription medications, contaminating the drinking water.
Free riders	Thousands pay for additional features on a blog site, while millions use the free basic version.
Free riders	A person out of work is not paying taxes, yet still benefits from services like military defense.
Free riders	A student is allergic and therefore exempt from the measles vaccine, but never gets the disease.

Module 6 Review Guide

Impact of Externalities

Banks offer **loans** in your community to help people purchase homes and start or expand businesses. Consider that a new department store, built through a bank loan, not only may generate profit for the company but also employs dozens of local residents. These employees may now be able to afford more recreation goods and services and perhaps obtain loans to buy larger homes.

Eminent domain - power of a government to pay for and take a person's property for an alternative use without consent

Externalities and the Circular Flow --- *Target builds a new store in your town*

The city repaves all the main roads with additional sales tax revenue.	Government
New daycares open that cater to Target® employees.	Business
Local students obtain Target® sponsorships to grow tutoring programs.	Individual/Household
A factory in China adds machines and workers to fill import orders.	Rest of the World

Steps in a rational decision making model

- Define the situation or problem
- Identify the important criteria for solution evaluation
- Consider all possible solutions or alternatives
- Calculate the consequences of these solutions versus satisfying the criteria
- Choose the best option