

IB Diploma: Economics

Section 2: Macroeconomics COURSE COMPANION

First Edition (2017)



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The level of overall economic activity

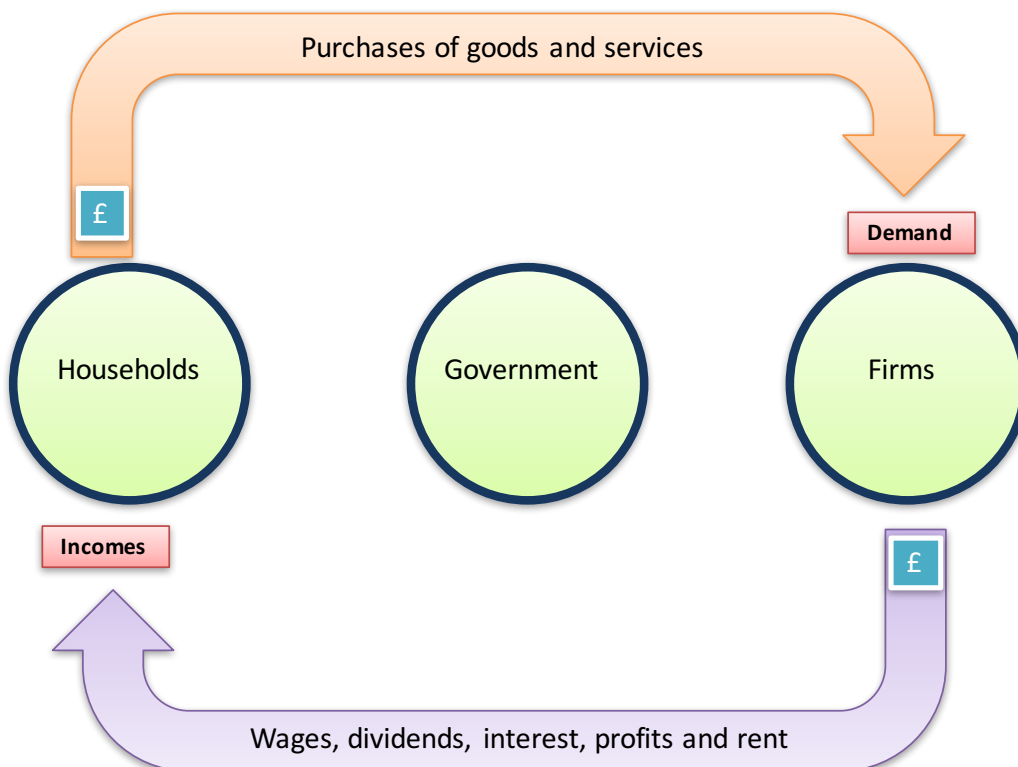
What is macroeconomics?

- National economy
 - Macroeconomics studies the behaviour of an economy in aggregate
- External factors
 - Macroeconomics studies connections between developed and developing countries in the global economy
- Macro policies
 - Macroeconomics includes looking at the effects of policies such as taxation or monetary policy interest rates
- Key topics
 - Macroeconomics involves studying inflation, growth, progress in human development, trade and globalisation

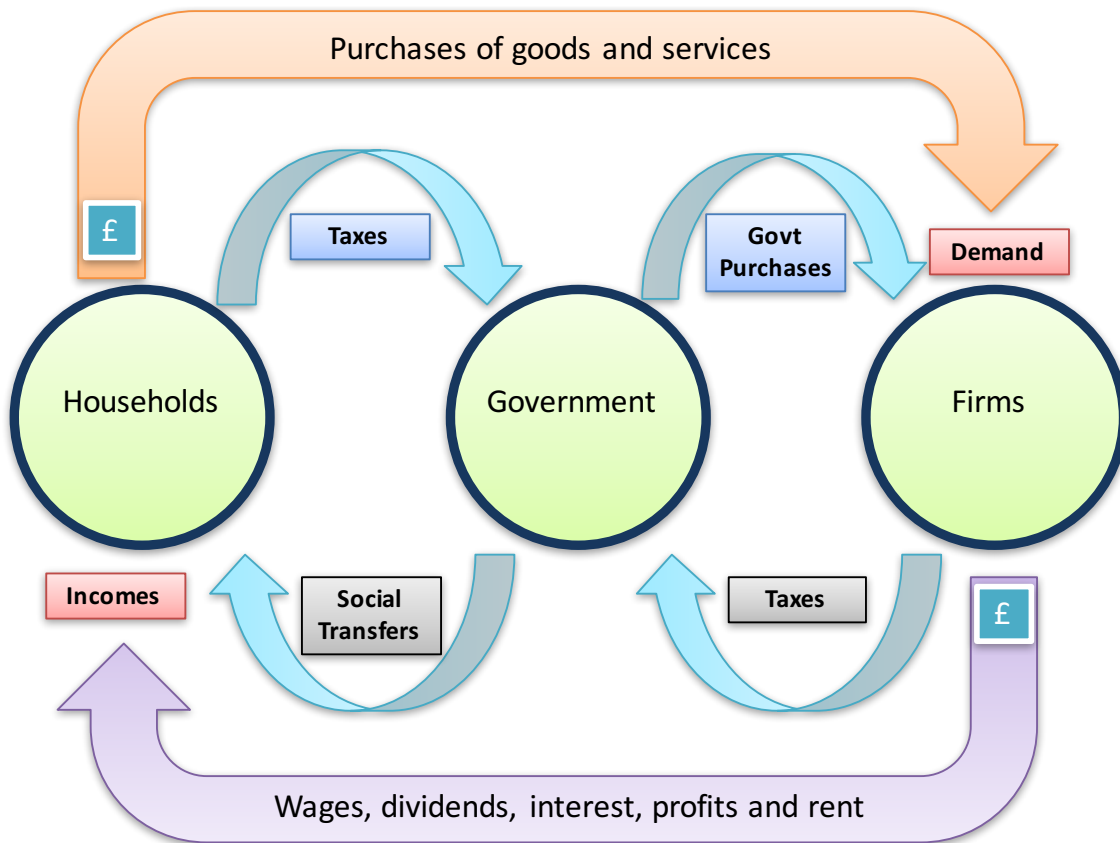
The circular flow of income model

1. Households receive income through wages and salaries from their jobs and investments and they then buy goods and services supplied by firms (consumer spending)
2. Businesses hire land, labour & capital inputs when making products for which they pay wages and rent. Firms receive payment from consumers (creating revenues and profits)
3. Government collects taxes (T) to fund spending on public services e.g. education, healthcare and defence and welfare assistance. State spending is labelled as G
4. The UK buys imports from other countries, (M) and overseas businesses and consumers buy UK products – known as exports (X)

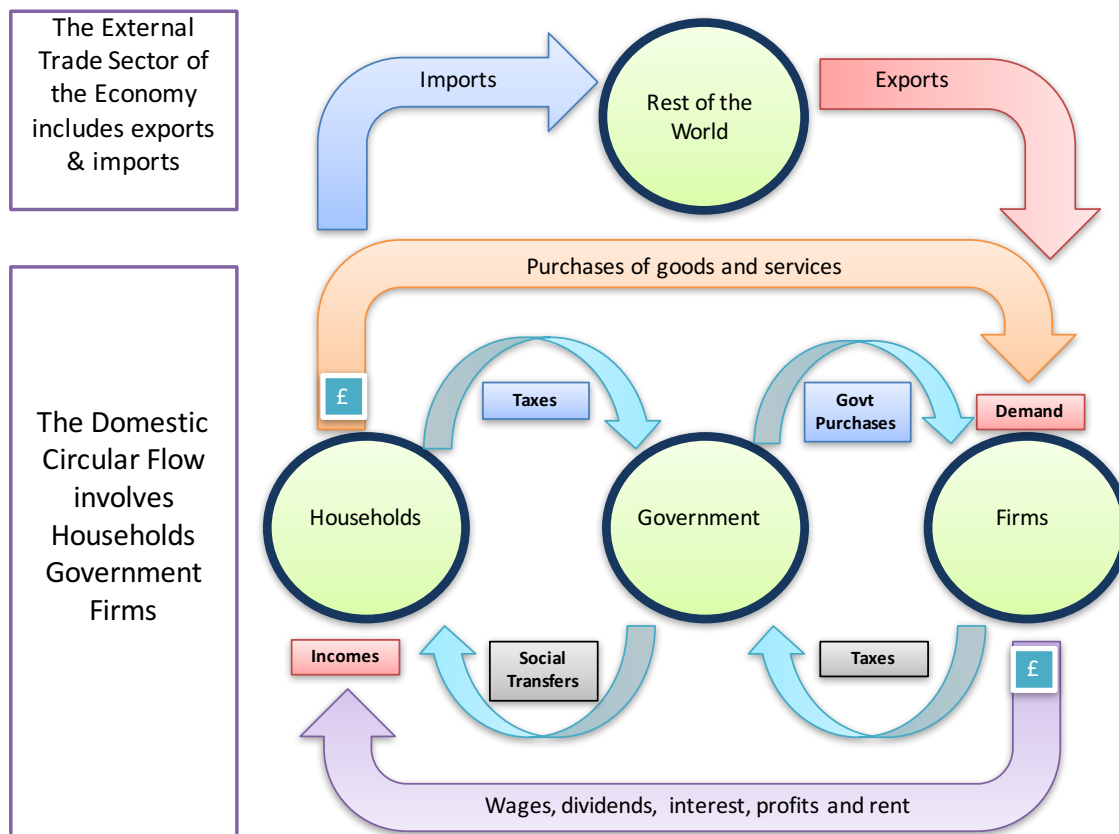
The Basic Circular Flow Model



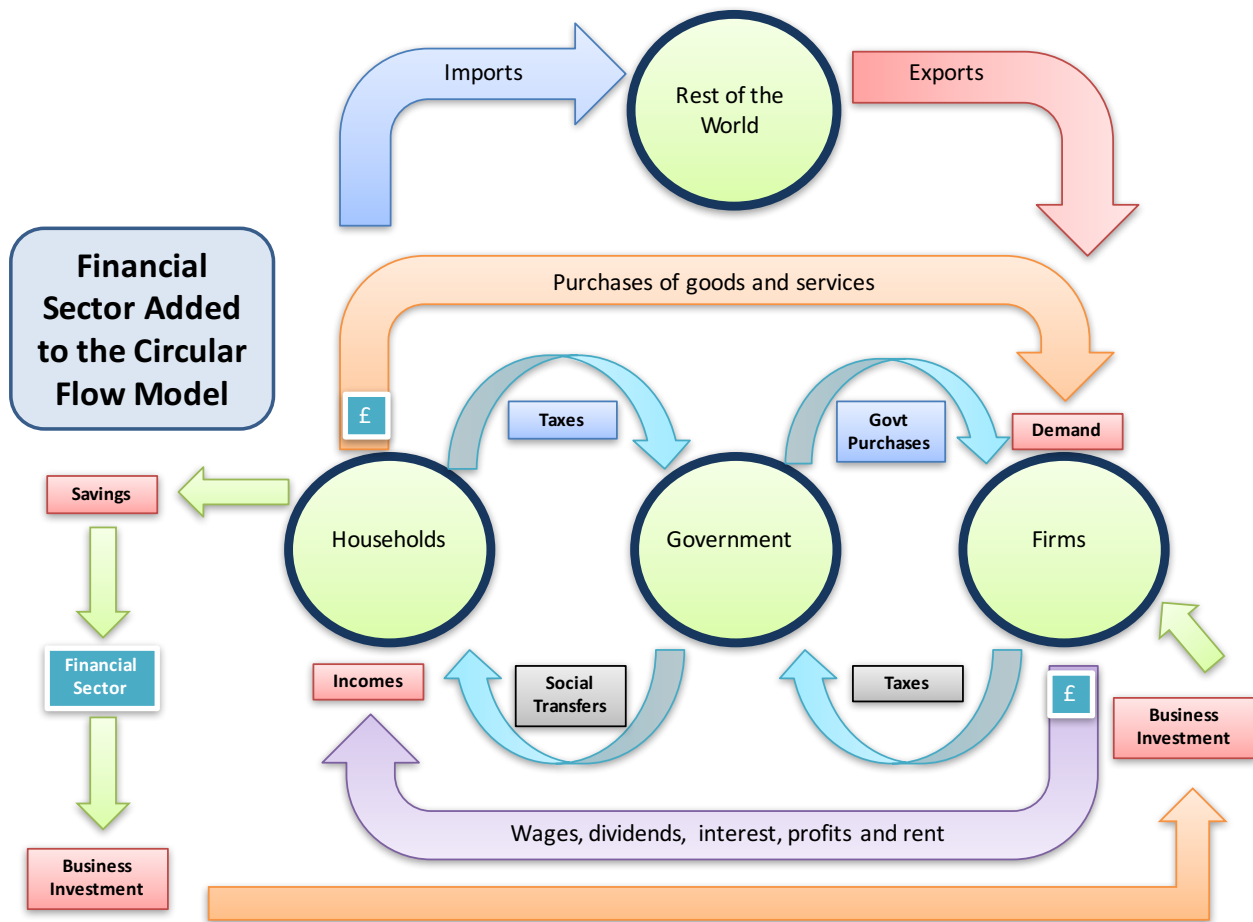
Circular Flow with the Impact of Government Included



Circular flow with an external trade sector



Circular flow with a financial sector added



Injectors and Withdrawals from the Circular Flow

- **Injectors**
 - Investment in capital goods
 - Exports of goods and services
 - Government spending
- **Leakages**
 - Saving
 - Imports of goods and services
 - Taxation

Changes in Net Injectors & Leakages

- When the level of injectors = the level of withdrawals (i.e. $I+G+X = S+M+T$) then the circular flow is in balance
- If $I+G+X > S+M+T$ then the level of national income will rise
- If $I+G+X < S+M+T$ then the level of national income will contract

Measuring Gross Domestic Product

Gross domestic product (GDP) measures the total value of national output of goods & services produced in a given time period

There are three ways of calculating GDP: National Output = National Expenditure (Aggregate Demand) = National Income

GDP (Expenditure)	GDP (Factor Incomes)	GDP (Value of Output)
<ul style="list-style-type: none"> • Consumption • Government spending • Investment spending • Change in value of stocks • Exports • (minus) Imports • = GDP (also known as aggregate demand or AD) • $AD = C + I + G + X - M$ 	<ul style="list-style-type: none"> • Incomes for people in jobs and in self-employment from their wages and salaries) • Profits of private and public sector businesses • Rental income from the ownership of land • (Transfer payments are excluded) 	<ul style="list-style-type: none"> • Value added from each of the main economic sectors • These sectors are <ul style="list-style-type: none"> • Primary (e.g. farming & mining) • Construction • Manufacturing • Tertiary (e.g. tourism) • Quaternary (e.g. business consultancy)

The importance of value added

- Value added is the increase in the market value of goods or services during production
- Value added = Value of production - Value of intermediate inputs used in supplying a good

Low Value Added Industries	High Value Added Industries
<ul style="list-style-type: none"> • Textiles • Mass processed foods • Farming • Manufacturing assembly • Social care • Contract cleaning services • Security businesses 	<ul style="list-style-type: none"> • Information technology • Renewable energy • Precision engineering • Life sciences • Aerospace • Bio-technology • High class restaurants

Manufacturing

- The process or business of producing goods in factories
- The part of a company that is concerned with making goods, rather than designing or selling them
- The manufacturing sector accounted for 10% of UK output (Gross Value Added) in 2012
- In 2013 there were 2.6 million jobs in the manufacturing sector, this was 8% of all jobs in the UK economy. Manufacturing in the UK has been declining for several decades – this is known as a process of de-industrialisation
- In other countries such as China, South Korea, Mexico and Germany, manufacturing industries account for a higher percentage of their countries' national income

Services

- Services are part of the tertiary sector of the economy
- There are many service industries – some focusing on business-to-business and others business-to-consumer products