

Closed and open macro-economy systems

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Closed And Open macro-economy Systems Todd Gray ECON224-1204A-04
Macroeconomics American Intercontinental University- Online In today's business world it is important to understand the difference between an open and closed Macroeconomic system. Each time you go out to purchase a good or service you need to be aware of how your hard earned money is being distributed across the economic system. There are two types of systems that I will discuss an open system and a closed system. Closed System:

In a closed system the money is caught up in a circular flow and is considered to be a closed system. When looking at the closed system you will notice right off that only the domestic exchanges are counted and the foreign agents are not counted within the closed system. In a closed system there should not be any leaks due to the fact that there are no foreign agents, government, or a system of savings or investments. Furthermore in a closed system there are no taxes, savings, or import expenditures that are not returned to the economy.

When look at examples of a closed economy you don't have to look very far to find a good example is the Amish they produce all of what they need and only do business within their community there is no form of savings or taxes within the economic system. The goods and services are made of home grown materials and there is no imported materials used within the closed system. This is a very small system but a good example of the closed system at work. The inner flow in a closed system functions in the following way.

Goods and services are delivered from the factories to the consumer and the land labor and capital is provided by the consumers to the factories. The outer flow in a closed system functions in the following way. Consumers
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provide the money to the factories and the factories provide the wages and rentals to the consumer. Open system: In an open economic system the good and services are counted that are exchanged both domestically and between nations. One major difference is the introduction of leaks which can inject money into the open system.

The money comes from the government, households and firms from the foreign countries that are traded with. Another type of Leak is the goods and services that the government purchases like building materials and office goods for example. The final type of leak is the money that households save it can be in the form of checking accounts or saved within the stock market and reinvested to increase the value of the money. In an open system there are a few ways that an injection of cash can happen and they are as follows.

When foreign firms send wages to the United States firms and send rent payments for foreign workers staying in the United States this creates an injection within the system. The next type of injection occurs when foreign households purchase goods and services from the United States that have been produced by the American companies. In an open system the outer flow is as follows: The factories pay the employees the wages that they use to pay the rentals then the people that buy the products produced by the factories the factories then use those funds to stay in production.

The inner flow of the open system works as follows: The people buy the goods and services and the factories use the money to purchase land to build more factories in order to provide for the people who are purchasing the products produced. In this same inner circle the government collects taxes from the people and the factories which is then injected back into the

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economy. Public services are provided to the people and the factories in exchange for the cash.

A personal example of a leakage would be for myself to take the wages paid to me by my place of employment and places those wages into a savings account and not use them to purchase goods and services. A personal example of an injection would be providing a rental apartment to a foreign worker who is receiving the rent money from the foreign country. When I use this money to buy goods and services provided in the United States it injects that money back into the economy.

References <http://www.wisegeek.com/what-is-a-closed-economy.htm>