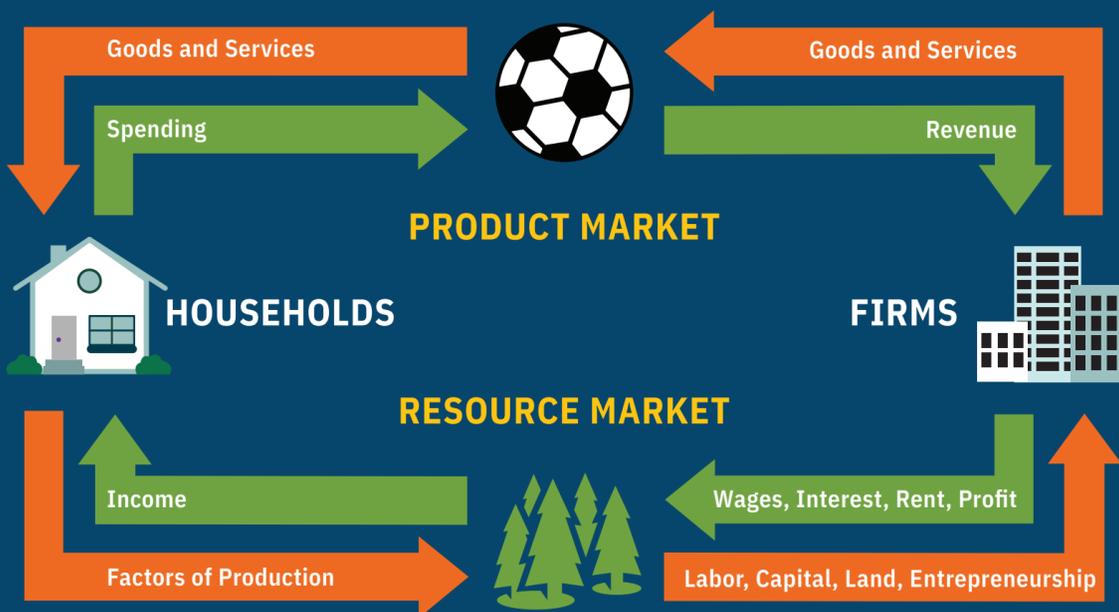


# Circular Flow

What roles do households, firms, and government play in markets?  
MICROECONOMICS

## The Circular Flow Model

In the **PRODUCT MARKET**, firms are the sellers (supply) and households are the buyers (demand).



In the **RESOURCE MARKET**, households are the sellers (supply) and firms are the buyers (demand).

### Resource Market

#### Factors of Production

##### Land

Land includes all production inputs provided by nature (natural resources).



##### Labor

Labor is the work of employees possessing human capital.



##### Capital

Capital includes all human-made goods used in the production of other goods and services.



##### Entrepreneurship

Entrepreneurs take risks and organize the factors of production to start a business.



### Product Market

#### Goods and Services

##### Goods

Goods are items we buy that are tangible. Soccer balls and cell phones are tangibles.



##### Services

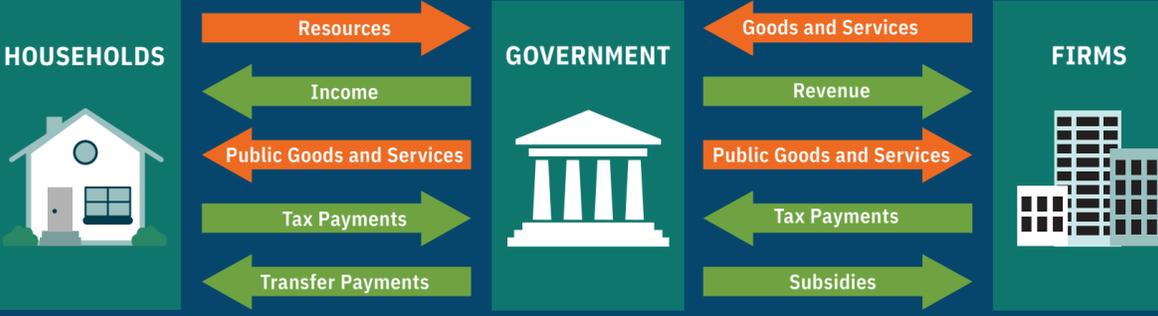
Services are intangible and usually involve paying a firm to do something for you.

Attending a soccer match and having cell phone service are intangibles.



## Government in the Circular Flow

In a three-sector circular flow diagram, government is a buyer (demand) in both the product and resource markets. Government provides public goods, public services, and transfer payments to households and firms in exchange for tax payments.



### Money Flows

#### Wages/Salaries

Payments to households (income) in the resource market for selling labor



#### Interest

Payments to households (income) in the resource market for lending money for capital purchases



#### Rent

Payments to households (income) in the resource market for the use of land



#### Profit

Payments to households (income) in the resource market to entrepreneurs whose business revenue exceeds costs



#### Revenue

Money received by firms in the product market in exchange for goods and services



### Flows to and from Government

#### Taxes

Payment to government in exchange for public goods and services



#### Transfer Payments

Payments, excluded from GDP, from government to households without a reciprocal exchange of resources



#### Public Goods and Services

Goods and services like bridges and schools financed by tax dollars on behalf of society



#### Subsidies

Payments, excluded from GDP, from government to firms without a reciprocal exchange of goods or services



## Measuring the Economy Using the Circular Flow

### Product Market Calculation

$$\text{Gross Domestic Product} = C + I + G + NX$$

Personal Consumption      Private Investment      Government Expenditures      Net Exports

### Resource Market Calculation

$$\text{National Income Accounting} = W + I + R + P$$

Wages      Interest      Rents      Profits