

**CIRCULAR FLOW OF INCOME**

**CIRCULAR FLOW OF INCOME:** It refers to continuous flow of goods & services and money income among different sectors in the economy. It is circular in nature. It has neither any end and nor any beginning point.

The circular flow of income in two sector economy is as follows:

**Households:** These provide factor services (land, labour, capital & entrepreneur) to firm.

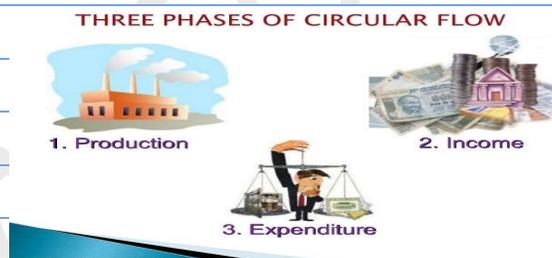
**Firms:** These provide factor payments (rent, wages, interest & profits) to households and produce goods and services with the help of factor services provided by households. Households spend Their income on purchase of these goods and services.

**PHASES OF CIRCULAR FLOW:** There are 3 types of phases of Circular flow.

1. **Production Phase:** It deals with the production of goods and services by the producer sector.

2. **Distribution Phase:** It means the flow of income in the form of factor payment (rent, interest, wages and profit) paid by producer sector to the household sector.

3. **Disposition Phase:** This phase deals with expenditure on the purchase of goods and services by household and other sectors.



**Leakage:** It is the amount of money which is WITHDRAWN from circular flow of income. It reduces aggregate demand and the level of income. E.g. Taxes, Savings and Import.

**Injection:** It is the amount of money which is ADDED to the circular flow of income. For e.g. Govt. Exp., investment and exports. It increases the aggregate demand and the level of income.

**TYPES OF CIRCULAR FLOW:**

<u>Real Flow</u>	<u>Money Flow</u>
1. Flow of Goods & services between firms and households.	1. Flow of money between firms and households.
2. It does not involve monetary component.	2. It involves monetary component.
3. It is also called physical flow.	3. It is also called nominal flow.
4. It involves barter system.	4. It does not involve barter system.

**DIFFERENCE BETWEEN STOCK AND FLOW:**

<u>Stock</u>	<u>Flow</u>
1. It is measured at a particular Point of time.	1. It is measured over a period of time.
2. It is static in nature.	2. It is dynamic in nature.
3. It does not have any dimension.	3. It has two dimensions.
4. E.g. Wealth, Capital etc.	4. E.g. National Income, Budget, Sales Revenue

**Factor Services:** Those services which are helps in production activity.

Land	Labour	Capital	Entrepreneurship
			
<b>Rent</b>	<b>Wages</b>	<b>Interest</b>	<b>Profit</b>
 <b>Factor Payment</b>			

**DIFFERENCE BETWEEN FACTOR INCOME AND TRANSFER INCOME:**

<u>Factor income</u>	<u>Transfer income</u>
1. Income received for rendering factor services.	1. Income received for not rendering factor services.
2. Include in National & Domestic Income.	2. Exclude in National & Domestic Income.
3. It is an earning concept.	3. It is a receipt concept.
4. Rent, Wages, Interest and Profit.	4. Old age pension, donation, grants etc.

S.No	Past year's exam Question	Marks	Year
1.	Define Stock.	1	2016
2.	Define Flow.	1	2016
3.	Give two examples of Flow.	1	2019
4.	Distinguish between stock or Flow variables with suitable examples.	3	2017, 2018
5.	Explain the circular flow of income. Use diagram.	4	2013, 2012C