10 The Circular-Flow Diagram and the National Accounts
The National Accounts

• Most countries calculate a set of numbers known as the national income and product accounts.

• The national income and product accounts keep track of the flows of money between different parts of the economy.

• The flows can be illustrated by a circular-flow diagram.
The Circular-Flow Diagram

Households

Money

Factors

Goods and services

Markets for goods and services

Firms

Money

Factors

Goods and services
The National Accounts

- **Product markets** are where goods and services are bought and sold.
- **Factor markets** are where resources like capital and labor are bought and sold.
- **Consumer spending** is household spending on goods and services.
- A **stock** is a share in the ownership of a company.
- A **bond** is a loan in the form of an IOU that pays interest.
The National Accounts

• Households engage in **consumer spending**.

• Households own the factors of production. They sell these factors to firms, receiving **rent**, **wages**, interest on **bonds**, **dividends** on **stocks**.

• In addition, households receive **government transfers**.

• **Disposable income**, total household income minus taxes, is available to spend on consumption or to save.
The National Accounts

- **Private savings**, equal to disposable income minus consumer spending, is disposable income that is not spent on consumption.

- The **financial markets** channel private savings and foreign lending into investment spending, government borrowing, and foreign borrowing.
The NationalAccounts

• **Government purchases of goods and services (G)** is paid for by tax receipts as well as by government borrowing.

• **Exports (X)** generate an inflow of funds into the country from the rest of the world, while **imports (IM)** lead to an outflow of funds to the rest of the world.
The National Accounts

- **Inventories** are stocks of goods and raw materials held to facilitate business operations.

- **Investment** is spending on productive physical capital, such as machinery and construction of structures, and on changes to inventories.