

Answer on Question #74681 - Economics / Macroeconomics

In a circular flow of income and spending

- a) the flow of income is in the same direction as the flow of spending.
- b) the firms' spending represents the expenditure of the households.
- c) the firms supply goods in the factor market and households buy these goods in the goods market.

[1] None of the above statements

[2] a

[3] b

[4] c

[5] All the statements are correct

ANSWERS

The right answer should be “None of the above statements” [1]. To find out the explanations to the answer [1], we need to discuss the circular flow in details.

The first statement claims that the flow of income and spending have the same direction. Let's consider it is true. What does it mean? For example, it means that if purchases of goods and services or so called expenditures goes to firms, than the wages, dividends, interest, profits and rent again goes to the firm. However, according to the flow of income and spending, when households buy goods and services this money goes to the firms and part of this income is being shared with the means of production. This is to say that money returns to households as their income.

The second statement is wrong too. The firms' all spending may not represent households' expenditure. May be there are some expenditures which goes to another economic agents.

The third structure of the process is wrong too. The right process is like this: firms go to factor markets like raw materials, labour market and so on to buy these factors to start the production. The produced items then go to the market, where the demand side buys them. So, after this when producers form their income, they will start to share some of it with people, the owners of the factors of production.

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