Circular Flow Chart and Macroeconomic Performance

Asst. Prof. Dr. Serdar AYAN
LEETURE TOPICS

- What, How, and For Whom?
- Circular Flows
- Macroeconomic Performance
What Do We Produce?

In macroeconomics, we divide the vast array of goods and services produced into: (1) **Final** goods

- Consumption goods and services
- Investment goods
- Government goods and services
- Exports of goods and services

And (2) **Intermediate** goods, i.e. those goods and services wholly used up producing other goods and services.
Consumption goods and services
Goods and services that are bought by individuals and used to provide personal enjoyment and contribute to a person’s standard of living. For example, food, clothing, movies, haircuts etc...

Investment goods
Goods that are *durable* [will last more than a year] and are bought by businesses to increase their productive capacity. For example, computers, cranes, and trucks. **Intermediate** goods are also bought by businesses for production, but are not durable and are used up in the production process [e.g. gasoline, electricity, flour to make bread, stationery and supplies, cement, accounting services, etc.]
Government goods and services
Goods and services that are bought by governments. For example, education, roads, missiles, and bridges.

Exports goods
Goods and services produced in the Turkiye and sold to residents of other countries.
How Do We Produce?

Factors of production

The primary productive resources used to produce goods and services.

Factors of production are grouped into four categories:

• Land
• Labor
• Capital
• Entrepreneurship
Land

Land

All the “gifts of nature” that we use to produce goods and services. All the things we call *natural resources*.

Land includes minerals, water, air, wild plants, animals, birds, and fish as well as farmland and forests.
Labor

*Labor*
The work time and work effort that people devote to producing goods and services.

Human capital

*Human capital*
The knowledge and skill that people obtain from education, on-the-job training, and work experience.
Capital

Tools, instruments, machines, buildings, and other constructions that have been produced in the past and that are now used to produce goods and services.

‘Capital’ in economics means physical capital. It includes semi-finished goods, office buildings, housing, and computers, as well as plant and equipment. Physical capital does not include money, stocks, and bonds. They are financial resources, sometimes called finance capital.
Entrepreneurship

The human resource that organizes labor, land, and capital, and takes risk.

Entrepreneurs are not just managers; they come up with new ideas about what and how to produce, make business decisions, and bear the risks that arise from these decisions. Economists call the new ideas ‘innovation.’
For Whom Do We Produce?

Factors of production are paid incomes:

Rent
Income paid for the use of land or other natural resources.

Wages
Income paid for the services of labor.

Interest
Income paid for the use of capital.
**Profit** (or **loss**)
Income earned by an entrepreneur for running a business and bearing the risk involved.

**Functional distribution of income**
The percentage distribution of income among the factors of production.

**Personal distribution of income**
The percentage distribution of income among individual persons.
Circular flow model
A model of the economy that shows:
The circular flow of expenditures and incomes that result from decision makers’ choices and the way those choices interact in markets to determine what, how, and for whom goods and services are produced.
Households and Firms

**Households**
Individuals or people living together as decision-making units

**Firms**
Institutions that organize production of goods and services.
**Markets**

Arrangements that bring buyers and sellers together and enable them to get information and do business with each other.
Markets

Factor markets
Markets in which factors of production are bought and sold.

Goods markets
Markets in which goods and services are bought and sold.
Factor markets

- Households supply factors of production

- Firms hire factors of production.
Goods markets

- Firms supply goods and services produced.
- Households buy goods and services.
• Firms pay households incomes for the services of factors of production.
• Households pay firms for the goods and services they buy.
Real flows
Orange flows of factors of production and of goods and services.

Money flows
Blue flows of income and red flows of expenditures on goods and services.
Government in the Circular Flow

Households and firms pay taxes and receive transfers.

Government buys goods and services from firms.
Classification of Countries

Advanced Economies
The highest living standards, 28 countries

Developing Economies
Not yet achieved a high standard of living, 128 countries

Transition Economies
Transition from state-ownership of capital to free enterprise, 28 countries.
Figure shows the standard of living around the world.

Average income per person ranges from $95 a day in the United States to $5 a day in Africa.
Unemployment and Living Standards

Unemployment influences the standard of living.

The harder it is to find a job, the longer is the period of unemployment.

The average unemployment rate in the United States in the past 20 years has been 6 percent and on average it has taken about 15 weeks to find an acceptable job.
Figure shows average unemployment rates around the world. The unemployment rate is much higher in Spain than in most advanced economies. The U.S. unemployment rate is among the lowest.
Figure shows inflation rates around the world. Transition economies and Central and South America have high average inflation rates.
Figure shows inflation rates around the world.

The least severe inflation:

- Japan
- United States