

Yogoda Satsanga Mahavidyalaya

B.COM Sem III

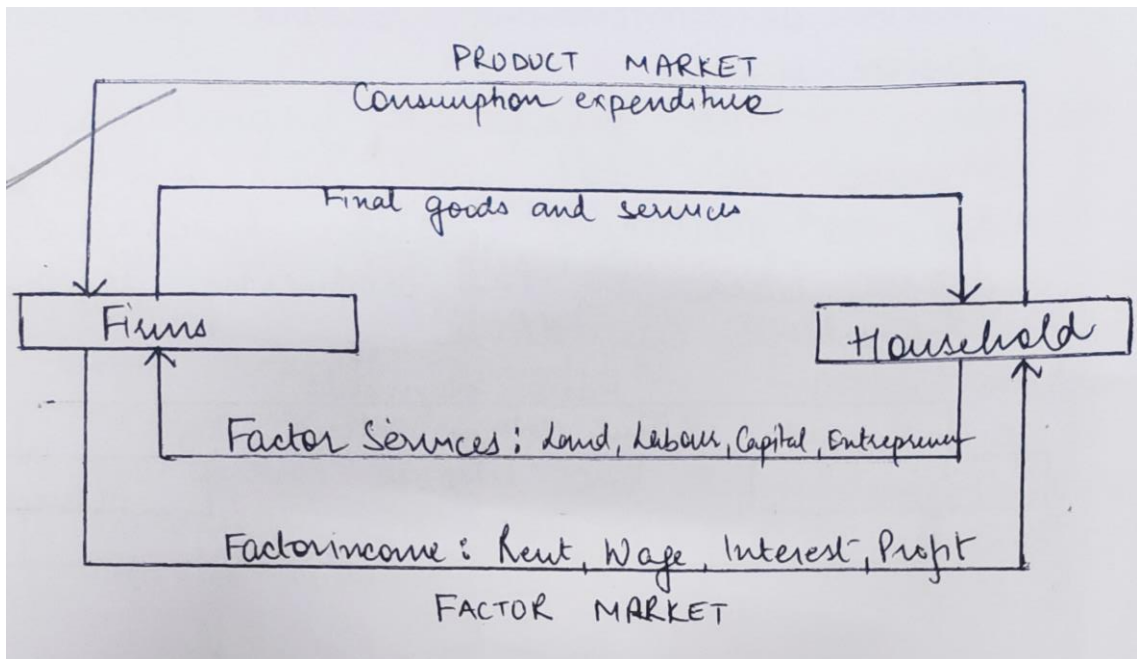
Subject: Macroeconomics

Topic: Circular flow of Income-Two Sector Economy

Circular Flow of Income-Two sector Economy

- In the basic two-sector circular flow of income model, the economy consists of two sectors:
(1) Households and
(2) Firms
- The model assumes that there is no financial sector, no government sector, and no foreign sector.
- **Household supply factor services** and **firms hire factor services** from household. Factor payments by firm is equal to factor income of household.
- Household spend their entire income on consumption. **Firms sell what is produced to household.** This means total production of goods and services by the firms is equal to total consumption by households.
- Now total consumption expenditure of household is income for the firms.
- The firms spend all of this income on factors of production such as labor, capital and raw materials, "transferring" all of their income to **the factor owners (which are households).**

- Now again, the factor owners (households), in turn, spend all of their income on goods produced by firms (all household expenditures become income for firms), which leads to a circular flow of income.



Circular Flow of Income- Two sector economy

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