Edexcel (A) Economics A-level

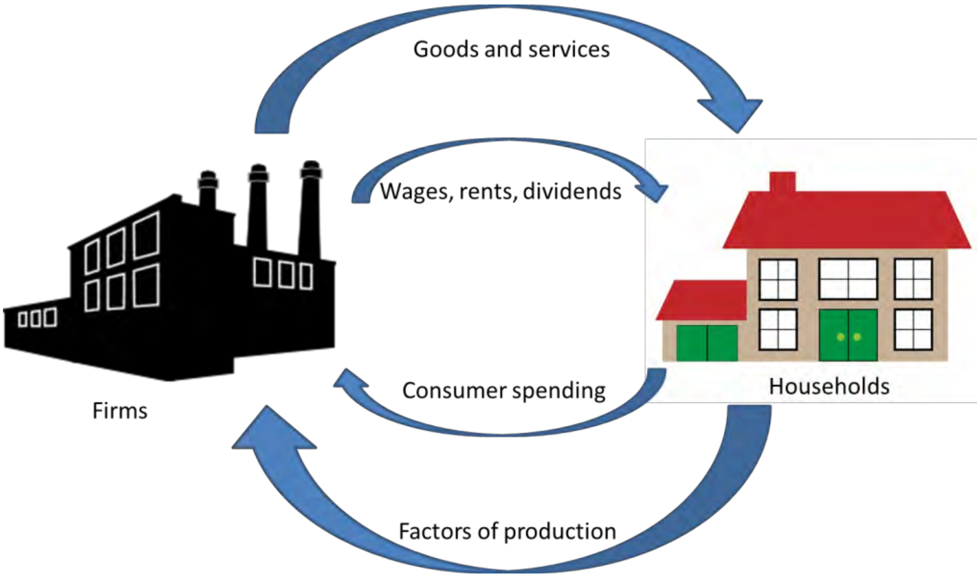
Theme 2: The UK Economy, Performance and Policies

2.4 National Income

2.4.1 National income

Notes

The circular flow of income



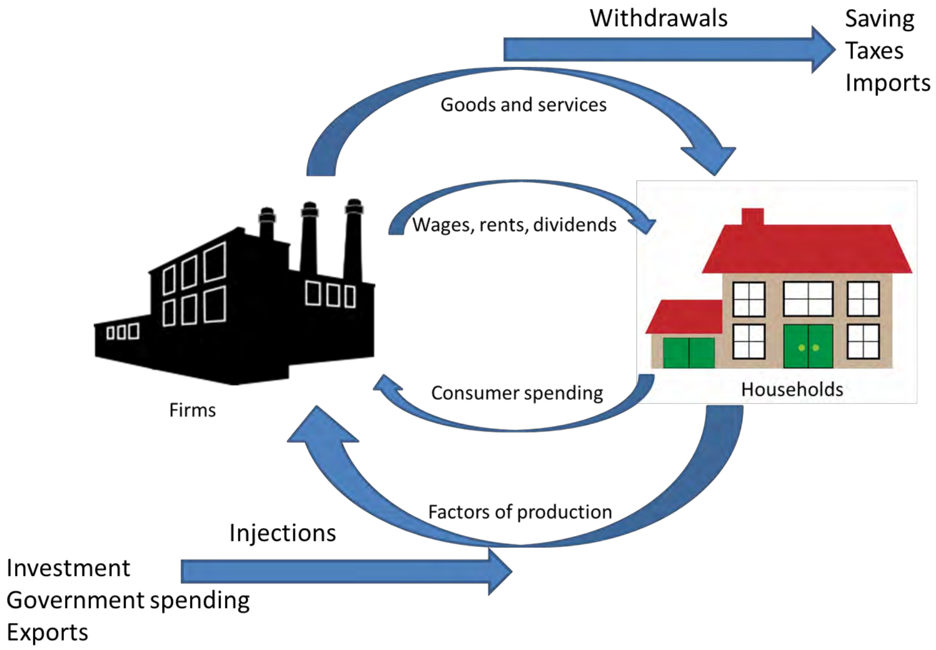
- Firms and households interact and exchange resources in an economy.
- Households supply firms with the factors of production, such as labour and capital, and in return, they receive wages and dividends.
- Firms supply goods and services to households. Consumers pay firms for these.
- This spending and income circulates around the economy in the circular flow of income, which is represented in the diagram above.

- Saving income removes it from the circular flow. This is a **withdrawal** of income.
- Taxes are also a withdrawal of income, whilst government spending on public and merit goods, and welfare payments, are **injections** into the economy.

- International trade is also included in the circular flow of income. **Exports** are an injection into the economy, since goods and services are sold to foreign countries and revenue in earned from the sale. **Imports** are a withdrawal from the economy, since money leaves the country when goods and services are bought from abroad.

- The economy reaches a state of equilibrium when the rate of withdrawals = the rate of injections.

- The full circular flow of income can be derived from this:



The distinction between income and wealth:

- **Income is a flow of money** that goes to the factors of production. For example, wages, welfare payments, profits, dividends, rents and interest are forms of income.

- **Wealth is a stock of assets**, such as savings, shares, property, bonds and pension schemes.