

SSEMI1 Describe how households and businesses are interdependent and interact through flows of goods, services, resources, and money.

- a. Illustrate a circular flow diagram that includes the product market, the resource (factor) market, households, and firms.

The **Circular Flow Diagram** is a model economists use to show the characteristics of and relationships that exist between households and businesses in the economy.

Households, in the **Resource Market** (factor market), are the owners of the productive resources (factors of production) in the circular flow model. They sell their land, labor, capital, and entrepreneurship to businesses (firms) in the Resources Market in exchange for income payments.

Households, in the **Product Market**, are consumers of goods and services in the circular flow model. They buy goods and services from businesses. They spend the income they earned in the Resource Market to buy these goods and services. Consumer “expenditures” is a fancy word for spending.

Businesses (firms) in the **Resource Market** are the consumers of the productive resources (factors of production) in the circular flow model. They purchase the use of land, labor, capital, and entrepreneurship from households in the Resource Market (Factor Market) using the revenue they earned in the product market.

Businesses (firms) in the **Product Market** are producers of goods and services in the circular flow model. They sell goods and services to households. They earn revenue in exchange for their goods and services.

Annotated Resources that relate specifically to the element

Circular flow of income and expenditures. (n.d.). Retrieved April 28, 2017, from <https://www.khanacademy.org/economics-finance-domain/macroeconomics/gdp-topic/circular-econ-gdp-tutorial/v/circular-flow-of-income-and-expenditures>

Circular Flow - The Economic Lowdown Video Series, Episode 6. (n.d.). Retrieved April 28, 2017, from <https://www.stlouisfed.org/education/economic-lowdown-video-series/episode-6-circular-flow>

High School Economic Webinar. (n.d.). Retrieved April 28, 2017, from <http://www.econedlink.org/tool/390/Webinar-High-School-Economics-3rd-Edition>

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- b. Explain the real flow of goods, services, resources, and money between and among households and firms.

In the **circular flow** diagram below, **businesses** and **households** are the sectors of the economy located across from each other on the diagram. The resource and product markets are also located opposite from each other on the diagram. In between the sectors and markets, there are **flows of goods and services, resources, and money payments**.