**Transcript – The Circular Flow of Income**

The circular flow of income is a diagram which depicts a simplified representation of the UK economy.

Will use it to introduce the different types of transactions recorded in national accounts.

Transactions are often referred to as flows.

On the left we have the corporations which exist to make money by selling goods and services.

At the bottom we have the government sector. This includes local and central government.

Government provides services and redistributes money.

The sector includes civil service units such as the Office for National Statistics.

The household sector to the right mainly consumes, but also produces goods and services.

And of course, the UK economy interacts with the rest of the world in the form of exports and imports of goods and services.

Now let's take a look at how money flows between these sectors.

Benefits form a substantial flow from government to households.

Examples of these include Universal Credit and state pension.

These are cash benefits, but government also provides benefits in kind, such as vaccinations provided by the NHS.

Households pay taxes to government, for example, property tax and income tax.

Corporations also pay tax to the government sector, for example in business rates.

Money flows from the government sector to the corporate sectors in the form of subsidies.

At the top of the diagram you'll see arrows representing both imports and exports to the UK.

These could be either goods or services.

At first glance, you might think the arrows are the wrong way round.

Remember, we're looking at the flow of income in this diagram, not the flow of goods and services.

When goods and services are exported from the UK, money flows into the UK in the form of payment.

Similarly, when the UK imports goods and services, money leaves the UK as these goods and services need to be paid for.

Output is an important concept. Output is the value of the goods and services manufactured during the accountancy period.

Intermediate consumption describes goods and services used up in the production process.

It includes expenditure and raw material, utility bills, fuel for vehicles and routine maintenance.

It also includes ink for the printer as well as paper for the printer, but not the printer itself.

Gross fixed capital formation describes the purchase and disposal of items used again and again, including buildings, vehicles and machinery.

The purchase of a printer by a business would be an example of gross fixed capital formation, as the printer can be used over and over, unlike the ink for the printer or even the paper which is used up in the production process.

Not all purchases of output are for the purposes of production.

When a consumer buys a cup of coffee from a coffee shop, it is output from the point of view of the coffee shop.

From the householders point of view, it is final consumption expenditure.

Final consumption expenditure is goods and services purchased, not for use in production, but to satisfy the wants and needs of individuals.

It includes expenditure on household utility bills, holidays, clothes and grocery shopping.

Note that all the flows we have looked at have two sides.

When a coffee shop sells a coffee, it is output from one sector's point of view and final consumption expenditure from the household point of view.

When the tractor factory sells a tractor,

it has both output from the factories point of view and fixed capital formation from the purchasers point of view.

Payments to workers do not fall within the definition of intermediate consumption because workers are not used up in the production process.

Wages and salaries form part of the compensation of employees.

Compensation of employees includes wages and salaries and other payments by employers on an employee's behalf.

Mainly pension contributions and National Insurance contributions.

Finally, we have mixed income.

Mixed income is the income of the self-employed.

We say it is mixed because it's not just a return on labour. If we pay a plumber to install the new heat source pump for us, we're not just paying them for their labour, we're paying them for their capital.

This diagram is referred to as the circular flow of income, and we've used it to introduce some of the main transactions captured within the national accounts.