

Chapter 1: Circular Flow of Income

Question 1

What do you mean by Circular Flow of Income?

Ans: The circular flow of Income refers to the flow of money, services, and goods, etc. This circulation happens in terms of income in the production process, distribution between the factors of production, and at the end the circulation of the product from household to a firm in the form of consumption expenditure on goods and services manufactured by them.

Question 2

Explain the three phases of the circular flow of income.

Ans: The three different phases in the circular flow of income are-

- **Generation Phase-** In this phase, the firm manufactures the goods and services with the assistance of factor services.
- **Distribution Phase-** This phase involves the flow of factor income, which comprises of rent, interests, wages, and profit from firm to the household.
- **Disposition Phase-** Here, the income collected by the factors of production, is used on the goods and services manufactured by a firm.

Question 3

Give two differences between Stock and Flow with examples.

Ans: The two difference between Stock and Flow with examples are.

Basis	Stock	Flow
Time Dimension	There is no time dimension	Time dimension exists as the magnitude can be scaled over a period of time
Nature of concept	It is a static concept	It is a dynamic concept
Examples	<ul style="list-style-type: none">• Total number of Hero Honda bike in Bangalore• National Wealth	<ul style="list-style-type: none">• Hero Honda Car manufactured during February 2018• National Income

Question 4

How many types of circular flow?

Ans: There are two types of circular flow.

- **Real Flow-** The term real flow means the flow of factor services from household to firms. Similarly, the flow of goods and services from firms to household
- **Money Flow-** The Money flow refers to the flow of factor payments from firm to household for factor services. Similarly, the flow of consumption expenditure from household to firm for the purchase of goods and services manufactured by the firm.

Question 5

Give three differences between Real Flow and Money Flow.

Ans: The three differences between Real Flow and Money Flow are.

Basis	Stock	Flow
Kind of Exchange	It includes the exchange of goods and services	It only involves the exchange of money
Difficulty in Exchange	Lots of difficulties involved in the exchange of goods and service	No such difficulties in terms of money flow
Alternative Names	Also, know as Physical Flow	Also, known as Nominal Flow

Question 6

Explain the role of the government sector in an Economy.

Ans: Government sector performs the following activities in the economy.

- They collect taxes from households and firms
- They make transfer payments to the households and provides subsidies to the firms
- They make the payment for the purchase of goods and services from the firms
- They save and borrows money with the help of the financial market.