CHAPTER CHECKLIST

1. Describe the patterns and changes in what goods and services are produced in the United States.
2. Describe the patterns and changes in how goods and services are produced in the United States.
3. Describe for whom goods and services are produced in the United States.
4. Use the circular flow to provide a picture of how households, firms, and government interact to determine what, how, and for whom goods and services are produced.

LECTURE TOPICS

- What Goods and Services Are Produced?
- How Are Goods and Services Produced?
- For Whom Are Goods and Services Produced?
- Circular Flows

2.1 WHAT GOODS ARE PRODUCED?

- What We Consume

People buy millions of different goods and services. We can describe what they buy only if we classify them in large groups.
2.1 WHAT GOODS ARE PRODUCED?

Figure 2.1(a) shows what we consume.
Americans spend the largest share of their income on:
- Medical care
- Housing
- Transport
- Food
- Recreation

Figure 2.1(b) shows that Americans spend:
- A falling share of total expenditure on food and other necessities.
- An increasing share on services, such as meals away from home

2.1 WHAT GOODS ARE PRODUCED?

What We Produce

Businesses located in the United States produce most of the goods and services that people in the United States buy.
Businesses in the rest of the world produce goods and services that the United States imports.
The largest part of what we produce today is services, not goods.

2.1 WHAT GOODS ARE PRODUCED?

Figure 2.2 shows the largest five services produced.
And the five largest goods produced.
2.1 WHAT GOODS ARE PRODUCED?

What We Buy from the Rest of the World

Figure 2.3 shows what we import.

2.2 HOW ARE GOODS PRODUCED?

Factors of production
The productive resources used to produce goods and services.

Factors of production are grouped into four categories:
- Land
- Labor
- Capital
- Entrepreneurship

2.2 HOW ARE GOODS PRODUCED?

Land
All the "gifts of nature" that we use to produce goods and services. All the things we call natural resources.

Labor
Work time and work effort that people devote to producing goods and services

Capital
Tools, instruments, machines, buildings, and other constructions that have been produced in the past and that businesses now use to produce goods and services.

Entrepreneurship
The human resource that organizes labor, land, and capital.

Entrepreneurs come up with new ideas about what and how to produce, make business decisions, and bear the risks that arise from these decisions.
2.2 HOW ARE GOODS PRODUCED?

- **Land**
  All the "gifts of nature" that we use to produce goods and services.
  All the things we call natural resources.
  Figure 2.4(a) shows how land is used in the United States.

- **Labor**
  Work time and work effort that people devote to producing goods and services.

- **Human capital**
  The knowledge and skill that people obtain from education, on-the-job training, and work experience.

**Figure 2.6** shows the U.S. labor force and how it has changed since 1980.

**Figure 2.7** shows measures of human capital and how they have changed since 1910.
2.3 FOR WHOM ARE GOODS PRODUCED?

Factors of production are paid incomes:

Rent
Income paid for the use of land.

Wages
Income paid for the services of labor.

Interest
Income paid for the use of capital.

Profit (or loss)
Income earned by an entrepreneur for running a business.

Functional distribution of income
The percentage distribution of income among the factors of production.

Personal distribution of income
The percentage distribution of income among individual persons.

Figure 2.8(a) shows the functional distribution of income:
Labor income 71%
Net interest income 4%
Personal rental income 2%
Corporate income 12%
Proprietors’ income 9%

Figure 2.8(b) shows the personal distribution of income:
The poorest 20% earned only 4% of total income.
The richest 20% earned 49% of total income.
Circular Flow Model
A model of the economy that shows:
The circular flow of expenditures and incomes that result from decision makers' choices and the way those choices interact in markets to determine what, how, and for whom goods and services are produced.

Households and Firms
- **Households**
  Individuals or people living together as decision-making units.
- **Firms**
  Institutions that organize production of goods and services.

Markets
- **Factor markets**
  Markets in which factors of production are bought and sold.
- **Goods markets**
  Markets in which goods and services are bought and sold.
2.4 CIRCULAR FLOWS

Factor markets
- Households supply factors of production.
- Firms hire factors of production.

Goods markets
- Firms supply goods and services produced.
- Households buy goods and services.

- Firms pay households incomes for the services of factors of production.
- Households pay firms for the goods and services they buy.
2.4 CIRCULAR FLOWS

- **Real flows**
  Orange flows of factors of production and of goods and services.

- **Money flows**
  Blue flows of income and red flows of expenditures on goods and services.

### The Government Sector
- Federal government
  - Major expenditures are to provide:
    1. Goods and services
    2. Social security and welfare benefits
    3. Transfers to state and local governments

### Federal Government
The main taxes paid to the federal government are:
1. Personal income taxes
2. Corporate (business) taxes
3. Social security taxes

### State and Local Governments
The major expenditures are to provide:
1. Local goods and services
2. Welfare benefits

The main taxes levied are:
1. Sales taxes
2. Property taxes
3. State income taxes
2.4 CIRCULAR FLOWS

**Government in the Circular Flow**
Households and firms pay taxes and receive transfers. Government buys goods and services from firms.

**Federal Government Expenditures**
Figure 2.11(a) shows federal government expenditures.

**State and Local Government Expenditures and Revenue**
The largest part of the state and local governments expenditures are on:
- Education
- Highways
- Public welfare benefits
2.4 CIRCULAR FLOWS

State and Local Government Expenditures

Figure 2.12(a) shows state and local government expenditures.

State and Local Government Revenue

Figure 2.12(b) shows state and local government revenue.

2.2 HOW ARE GOODS PRODUCED?

Figure 2.4(b) shows the urban distribution.

A quarter lives in the six largest cities.

Almost a third live in the ten largest cities.

More than a half lives in cities that exceed 1 million.

And the rest...
2.2 HOW ARE GOODS PRODUCED?

Figure 2.5 shows U.S. and global nonrenewable energy resources.

2.4 CIRCULAR FLOWS

- Federal Government Expenditures and Revenue

National debt
The total amount that the government has borrowed to make expenditures that exceed tax revenue—to run a government budget deficit.