Topic 2

Personal finance and the economy

Learning outcomes

After studying this topic, students will be able to:

- describe how government policies influence personal finance;
- describe the impact of values held by UK citizens on personal financial choices.

Introduction

Topic 1 focused on the relationship between the individual and society and the rights and responsibilities that citizens have, particularly in relation to the economy. This topic will explore further the way in which citizens participate in and contribute to the economy. By the end of this topic, you will understand how government policies influence our personal financial decisions and the impact of our personal values on the various financial choices we make throughout our lives.

Personal finance is the money individuals receive and how they use it – spending, giving to charity, saving and borrowing. Our contribution to the economy and to society comes in part through financial choices such as:

- the work we do – including different working options such as full-time, part-time, job-sharing, flexi-time and temporary;
- paying tax;
- saving;
- giving to charity;
- borrowing (discussed in detail in Unit 2, Topic 7);
- spending (discussed in detail in Unit 2, Topic 6);
- investing – buying something like a house that may increase in value and make you money, either because you rent it out and gain an income from it, or because you sell it for more than you paid for it;
- voting for a political party because you agree with its plans for spending or on taxation – this is discussed in more detail in section 2).

Government policies affect the economy of a country and this in turn affects how people receive and use their money. For instance, the interest rates set by the Bank of England and the annual Budget set out by the Chancellor of the Exchequer both influence personal financial decisions because they have an impact on the value of our money and how much we are able to spend and save.

Personal values are people's ideas about what is important in their lives, and they affect their decisions and actions – for instance, people might feel it is important to give to charity or buy goods that are produced ethically. Personal values can also affect the way a person feels about work, the importance they place on saving or whether they think that it is acceptable to borrow money. Some people feel that money is there to be spent, while others believe strongly in the need to prepare for their financial future by saving and investing wisely. These decisions affect not only the individual but also society as a whole.

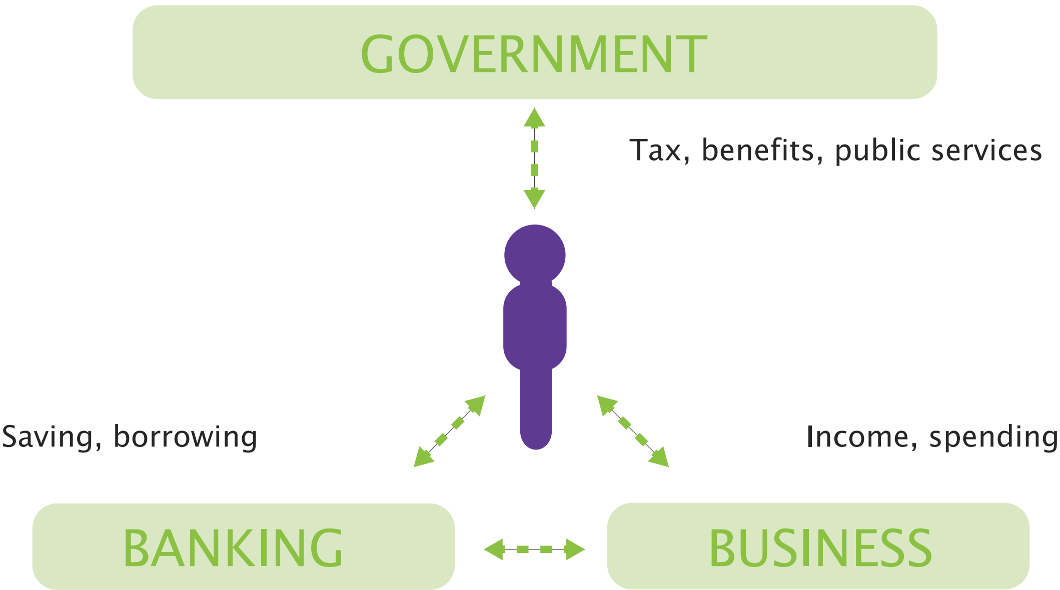
People's values are not fixed – they may change as their personal circumstances change. Imagine, for instance, a person with a family who thinks it is important to give money to charity. If they were to find that their income was shrinking because the company they work for had cut their hours, they might decide that the financial needs of their family have to take priority over giving money to charity.

2.1 How citizens participate in the economy

Having money enables you to participate in society and in the economy. The more money you have, the more choice you have over the items that you buy, giving to charity, putting money aside for the future or having the lifestyle of your choice. You will also pay more tax and be less reliant on the government for money. The less money you have, the more you are restricted in your options and the less able you may feel to contribute to society. This means that activities such as savings and investments and working are strongly linked with our democratic participation in society, as well as our participation in the economy.

One of the major contributions that citizens make to a society is through work. People gain employment, through which they then earn money that they can choose to spend or save in some way. Part of their earnings is also taxed – a percentage of the earnings is taken by the government to spend on society as a whole. This is what we call the economy – money flowing between the individual, government, banks and business – and it is illustrated in Figure 2.1.

Figure 2.1 How money flows around the economy

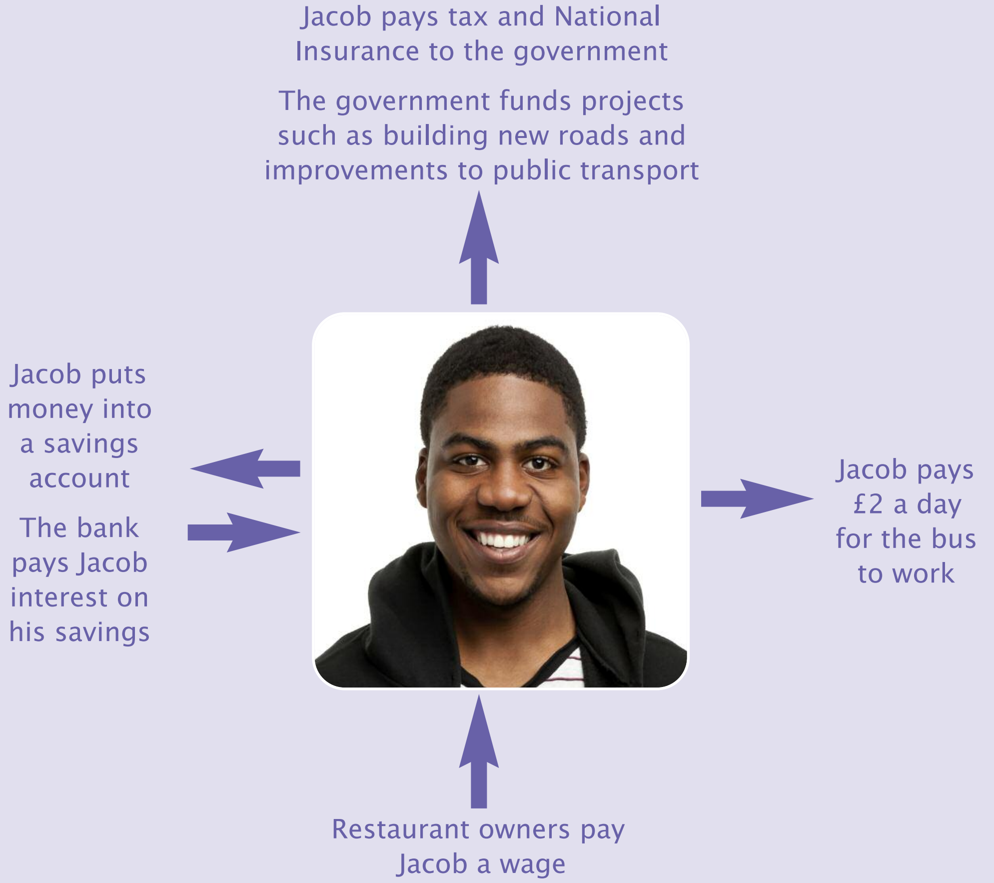


A citizen may be employed by a business and receive money called income or earnings (this will be explained in more detail in Topic 3). Part of this money will be paid to the government through income tax and National Insurance and the government uses this money to pay for public services. An individual may also receive money from the government in the form of benefits.

Money received by individuals in any way may then be used to pay businesses for goods and services or to place in bank accounts. The money put into bank accounts may be saved or withdrawn to make payments. This forms part of a person's personal budget and is discussed further in section 2.3.2 and in Unit 2.

Jacob's role in the economy

Jacob has got a job as a waiter in a local restaurant. He earns £1,040 per month and pays 20% in income tax and 12% National Insurance. This money goes to the national government to pay for things such as public transport, education, health, pensions, defence and welfare. He puts £700 into a bank account. He saves some of this money, spends some and uses some to pay bills.



The taxes that we pay as working citizens of the UK are used to ensure a functioning and fair society for everyone. This is known as 'social justice' and is one of the foundations of an effective democracy. We all pay taxes to ensure that everyone has access to a good standard of education and healthcare, and that we are supported if we cannot support ourselves.

Although there are some things that we pay for that we may think we will never use, we contribute to them for the benefit of society as a whole, and so that we can draw on these services if we do need them. Before an election, political parties set out their plans to spend money or reduce spending in a range of areas; the party that is elected then outlines its policies for using the money it raises from taxation. We pay the government to provide us with certain services, just as we might pay a plumber to fix our taps. And just as the plumber is accountable to the person who pays them and has to do a good job, so the government is accountable to the public also.

We also participate in the economy through our spending and saving habits. Money that we save helps us to be able to afford larger, long-term purchases such as housing or a car. The decisions we make about saving are also influenced by the policies and Budget of the ruling government.

Another way that we can participate in society is by giving to charity. People can contribute to a charity by giving money or goods, or by volunteering to work for the charity. This helps others to be able to participate in society, by providing them with financial assistance and equal opportunities. Giving to charity is seen as a positive contribution to society and is rewarded through tax schemes and incentives that mean people can claim back some of the money they donate.

2.2 Government influence on personal finance

The ways in which citizens participate in the economy are influenced to a large extent by the government. Every year the government outlines its plans for spending and conducts a review of taxation, to show where its money is coming from and that it is spending it wisely. The Chancellor of the Exchequer is responsible for all economic and financial matters. In the annual Budget, the Chancellor sets out the levels of taxation, levels of government borrowing and targets for inflation. The Chancellor is also responsible for controlling how the government spends the money raised through taxes, borrowing and other measures. This is called public spending.

Did you know?

The Budget speech is carried to Parliament from Number 11 Downing Street (the Chancellor's official home) in a red leather case that was first used in 1860 by William Gladstone. Gordon Brown had a new case made in 1997.

The Chancellor is photographed outside Number 11 with the case and then takes it to Parliament to read the Budget speech. The Chancellor is allowed to drink alcohol during the presentation of the speech – this is the only time that alcohol is allowed in Parliament and no other member of the Commons is allowed to drink apart from the Chancellor.

2.2.1 Public spending

The four biggest areas of public spending are education, welfare, healthcare and pensions. These services benefit everyone in the country. Having a good education, being healthy, being cared for in old age and knowing that if you are in difficulties the government will help out all contribute to the well-being of the nation. The taxes that people pay through income tax, for example, help to ensure that we can live in a fair and equal society by assisting the most vulnerable people (elderly people, children, people with disabilities, and so on).

The amount of money spent on public services changes according to the priorities of the government. A government might run either a deficit or a surplus budget, depending on its beliefs and what it thinks the country needs. Generally speaking, a deficit budget is when the amount that the government spends is higher than the amount it receives. A surplus budget, on the other hand, means that there is more money coming in than going out. The impact of this is discussed in more detail in section 2.2.5 in terms of austerity and growth.

Young people (aged 18–24) make up the smallest proportion of voters. This is partly due to the fact that there are fewer young people than old and partly because young people are not registering to vote. A number of reasons have been suggested for this: that young people are not interested in politics; they find politicians boring, old and not interested in the issues that concern them; they mistrust politicians, and so on. The voting age was lowered from 21 to 18 in 1969 and some people argue that it should be lowered again to 16 years of age in order to encourage young people to vote.

In the 2015 general election, 78% of people aged 65+ voted compared with only 43% of people in the 18–24 age group (UK Political Info, no date). Because there are fewer young people voting, politicians have little incentive to address their needs. For instance, a politician standing in an election might have a policy to spend more money on education and training for young people, or youth centres; their rival might be offering to spend money on better transport for elderly people or more police officers patrolling the streets. Because older people are more likely to vote than younger people, the politician whose policies appeal to older people is more likely to be elected. As a result, the older generation has greater influence in the political system. It is clear that exercising a democratic right and responsibility, such as voting, can have a significant impact on government policies and spending and therefore on people's personal financial decisions.

There are four main areas in which the government has an impact on the personal financial decisions that we make – through its policies, public spending (including national debt), the Bank of England and interest rates, and the economic climate.

2.2.2 Policies

It may be difficult to believe, but the way individuals manage their finances is influenced hugely by government policies. The main tool that the government uses to control its budget is its fiscal policy. Put simply, this is how much the government decides to spend and the tax rates it sets. Some of those policies are obviously related to how much money we earn and can spend. For example, the government makes policies about how much tax we pay, what public services to spend tax money on, and what the minimum and living wages should be. This affects how much money we have to spend and how much we can save.

Other policies may also have an impact on personal finances. The amount of money spent on benefits, social services, health, schools, the armed forces, and so on influences the services that citizens can access and so decisions about their own finances. For example, if benefits are cut, claimants will have less income; if a local nursery school is closed, parents may have additional transport costs to take their children to one further away. The age at which state pensions are paid is being raised so people need to work for longer and may decide to save more for their old age in a private pension scheme if they can.

Consider the following examples.

Michelle

I'm a teacher in a local secondary school and I'm well paid. Bill and I are married. He earns less than me and has a long journey to work. When we had our first daughter it would have been better if Bill could have taken paternity leave and I had kept working, but I was the only one entitled to paid leave. I had to go back to work as soon as I could and we had to pay for childcare for our daughter. We didn't get any help with the cost of childcare from the government. By the time we had our second child, the government had introduced shared parental leave and pay, so I took maternity leave for six weeks and then Bill took shared paternal leave and pay for the next 33 weeks.

Jacob

I'm thinking about going to university but I'm worried about the fees, especially if the university I want to go to decides to raise its tuition fees in the future. I can borrow the money for the fees and repay them once I'm earning money, but I will have a big debt to pay off in the future. I can't decide whether to go to university now and take on the debt, or try to save money to pay some of the fees up front.

Rachel

I'm a teaching assistant in a secondary school. I haven't been paying into a pension because I need all my income to pay my bills and for my son's nursery place. The government has introduced a scheme that automatically takes money from my salary and saves it in a pension scheme. Now I don't have enough to pay my bills every month, so I'm trying to find ways to cut back. If I can't do that I might have to work fewer hours because I can't afford full-time childcare for my son. I might even have to stop working altogether!

Each of these examples illustrates how government decisions can affect personal financial decisions.

2.2.3 Public spending and national debt

One of the primary functions of government is to set fiscal policy – in other words, how it will raise money and what it will spend that money on. It also has to provide a review of its spending, to show that it is not using money for personal benefit or in areas where it is not needed. The Budget report is one of the ways that the government remains accountable to the public.

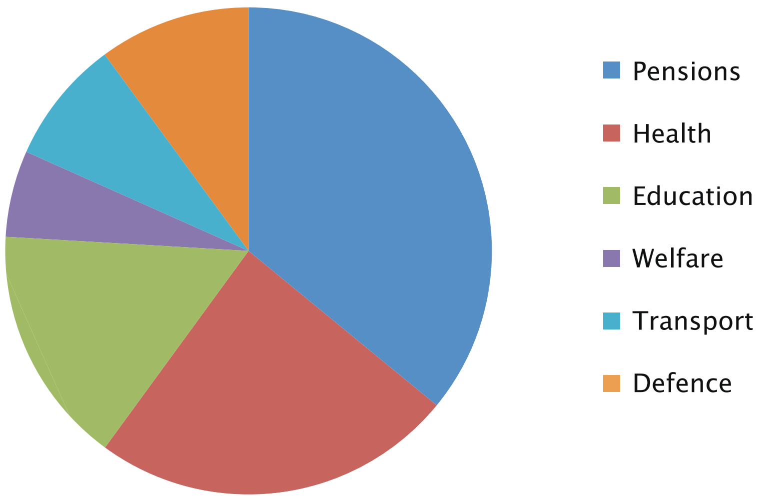
Public spending can take place at both national and regional levels. This means that money may be spent across the whole country or it may be restricted to a particular region, such as Scotland or Wales. The government gives a percentage of the national budget to each of the regions. For some areas of spending, responsibility for setting policy and priorities has been devolved to the regional governments in Scotland, Wales and Northern Ireland. These areas include:

- health;
- education;
- local government;
- the environment;
- economic development.

Policies on tax, employment and benefits are still controlled by the national government for Wales and Northern Ireland. The Scottish government can set the rate of some taxes including income tax, and it will have further powers in future.

Although the total amount of the national budget changes year on year and, therefore, the amount of money given to the main areas of government spending also changes, the ratios of where money is spent have remained quite stable over many years. For example, pensions are the biggest area of spending, followed by health, education, welfare, transport and defence.

Figure 2.2 How a national budget might get divided up for public spending



The ageing population

With increases in medical technology and knowledge and better health, the life expectancy of the UK population has risen. This means that more people are living until they are much older. At the same time, there has been a decrease in birth rates, meaning that we are having fewer children and so the younger and working population is decreasing. An increasing older population means that more pensions and healthcare expenses have to be paid from the national budget. A decreasing working population means that there is less income from taxes to pay for pensions and healthcare.

One solution to the problem of an ageing population has been for the government to raise the age of retirement, meaning that people will work longer and pay taxes for longer. It may also mean that pension contributions have to increase, which will affect a person's budget as they have to save more money to have a decent retirement. This shows the link that exists between changes in our life cycle, government policies and personal finance. This will be discussed in more detail in Topic 11.

In order to pay for public services, the government must raise money. The majority of this money comes from income tax. However, there are other ways in which the government can raise money to spend on public services besides the taxes we pay. One way is that the government borrows money to fund public spending. This is done by selling bonds and gilts. These are mostly sold to financial organisations such as banks and pension funds. But why would they want to buy these?

Imagine that you bought a bond. You decided to buy it because the government will pay you a high rate of interest. The money you pay for the bond goes straight to the government, meaning that they have money to spend in the short term. However, they must then pay interest to you for the time that you own the bond. In the future, the government will want to buy the bond back from you so that they can stop paying interest. The more bonds and gilts the government sells, the more interest they have to pay and this is part of the national debt.

In order to repay national debt, governments can reduce public spending and raise tax rates. When public spending is reduced, this can mean cuts in public sector pay (people employed in government sectors such as education, health and local government) and benefits, which means a reduction in overall income. This reduction in income, combined with larger expenses in the form of higher taxes, can significantly affect our personal finances in terms of how much money we have available to spend and save.

2.2.4 Bank of England and interest rates

The prices of the products and services we buy or use also has an impact on the financial decisions we make. Over time, prices rise through the process called inflation. You may have noticed that milk seems more expensive than it used to be. Or you might remember a time when you could buy more sweets for your money. If you ask your grandparents or carers, they will be able to tell you stories of when the bus cost just 20p or when a loaf of bread was 15p! These changes are the result of inflation, which basically means prices going up over time.

It is the job of the Bank of England to keep inflation low. A target percentage for price rises is set each month by the Chancellor of the Exchequer. The Bank of England sets a Bank rate each month that aims to meet this inflation target. The Bank rate is the base on which other interest rates are set, such as the rates charged to lend you money. This, in turn, affects the price of credit (how much it costs you to borrow money) and how much interest is paid on your savings.

Keeping inflation low has benefits other than ensuring that our wages are enough to be able to afford life's necessities, such as housing and food. A result of keeping inflation low is that borrowing will be cheap and therefore makes it easier for people to access money. For example, if you want to buy a car, you may need to borrow money and that means paying interest. If the interest is too high, you won't be able to afford the repayments every month. Keeping borrowing cheap means that interest rates are low so that you will be more likely to be able to afford the monthly repayments. This means having a greater choice in what you are able to spend your money on, and therefore how you participate in the economy. Inflation rates also have an impact on how much money you make on savings. If interest rates are high, then you will get more money from your savings.

Jacob

I want to save money for uni but I also really want to buy a car. If I save, I'll put the money into a savings account at my bank and earn interest. If I buy a car, I can pay a small deposit but I'll have to borrow the rest and pay interest on the amount I borrow. The interest rates on saving are around 2% and the interest rates on borrowing are around 5%. I'm not sure I can afford the repayments on the loan if I buy the car. I think I'll save the money instead.

Lower interest rates will encourage people to spend. When interest rates are already low, reducing interest rates further may not achieve this effect and so, in order to stimulate extra spending, the Bank of England may make more money available simply by printing more money and exchanging it for bonds (this was discussed previously in section 2.2.3). This is called quantitative easing. Another reason to keep inflation low is that it will stimulate the economy to create jobs. This is because new businesses can afford to start up with low interest rates, and existing businesses can afford to expand and therefore hire more workers.

2.2.5 Economic climate

The economy of a country goes through periods of different economic activity. Sometimes it will be in a boom period, in which debt is low, employment is high, and there is a lot of money in the system. At other times the economy will be in a recession, meaning that there is less money, lower employment and potentially high levels of debt. These changes in economic activity determine the economic climate of a country. In a recession, people may lose jobs, and don't have the money to spend in shops and elsewhere. This means that companies cannot make money and have to reduce their staff numbers, resulting in even higher unemployment, less money and less spending. The extreme of a recession is a depression.

Often, times of recession or depression will result in actions termed 'austerity'. Times of austerity are when people cannot afford to spend much money and wages may decrease. People may not have enough money to pay all their usual bills, and this will mean that they need to make tough financial decisions and budget carefully. They may go without the things that they would like, change the products they buy, or 'make do and mend' (just use or repair whatever they have and not buy anything new). This has an impact on businesses: they may not be able to afford to keep as many people employed, they will be making less money and will therefore be at risk of 'going under' (having to close down). It may also affect organisations such as charities and food banks, because people do not feel that they can afford to make donations as they have to take care of their own needs.

As well as having a personal impact on how much money people earn and spend, during a recession there is less tax revenue paid because more people are unemployed and not paying income tax or National Insurance. There is also less trade, so businesses make lower profits and pay less corporation tax. Taxes such as VAT (tax paid on goods and services) and stamp duty (paid on home purchases) also reduce because people cannot afford to buy as much, so money is also not made through these taxes. This means that the government may have to make cuts in different areas of its public spending. Obviously, these cuts will have an impact on anyone who uses the targeted services. One of the areas that may be cut is the benefits provided by the state. This means that, just at the point when people may need more help from the welfare state – through a greater need for unemployment and low-income benefits and for investment to create jobs – the government has less money available.

Government policy during recessions focuses on trying to lessen the negative impact of the recession, and so it may try to stimulate the economy through job creation and training schemes and by increasing public spending. This means that government debt may rise as the government spends more money, and at a later stage it will have to save money to pay back this debt. To do this, the government may withdraw certain benefits, or set caps (put limits on how much you can earn before you can claim benefits), or change the eligibility criteria for claiming benefits. Keeping interest rates low will encourage people to spend rather than save, as it becomes cheap to borrow money and pointless to save with low interest rates on saving. This has its own problems as people may prioritise spending and living day to day rather than saving and preparing for the future. Ultimately, this means that the government will have to pay higher rates of pensions as people retire who have not had the capacity to save during their working lives.

Other strategies that the government may use are reducing money spent on services and given to local government, raising taxes (if possible) and keeping interest rates low so that people will borrow more money. The government may also give tax relief to businesses that create jobs, as this will allow people to earn money that can be put back into the economy through spending. Training schemes put in place or subsidised by the government will also stimulate the economy by contributing to helping unemployed people to find work, which will in turn raise tax revenue and the capacity for people to spend more money. These strategies have clear impacts on everyone, but particularly on those individuals who rely on benefits – who may find themselves worse off and with very little money.

In contrast, during growth periods, tax revenue will be higher because more people will be employed and paying income tax. More goods will also be sold by businesses, which will then make more profits and pay corporation tax. Revenue from other taxes also increases and the benefits bill falls, both because people do not need as much help and because there is more tax being paid (and so more money available to help those in need). This seems like an ideal scenario for all concerned, with government, businesses, banks and individuals making and spending money. It may also seem that if everyone has enough money then the impact of government policies on our lives may not be as great.

However, increased spending and decreased saving by the public and by government can result in higher levels of borrowing, as interest rates

are low and people feel more secure in their employment and income. This leads to higher levels of debt and there is a danger that the economy 'overheats' (more money owed through debt than actually being earned overall in the system), which can lead to a recession.

This balancing act between boom and recession periods is what is known as a boom / bust cycle and policies made within a particular economic climate may lead to the opposite scenario. Government policy during an economic boom, or period of prosperity, therefore focuses on managing inflation and influencing the amount of private borrowing and spending. The government can encourage people to save by giving them a savings allowance (an amount of savings interest they can earn before paying income tax), offering bonuses for saving to buy a first home or for retirement, and creating tax-free savings products such as ISAs (individual savings accounts); and it can discourage some personal borrowing through higher interest rates. The government uses interest rates and tax rates to manage the economy and to influence how we earn, spend and save our money. The economic climate will be discussed in more detail in Topics 6 and 9.

2.3 Financial values and personal finance

While the government clearly has a huge influence on how we manage our personal finances, these decisions are also made on the basis of our own sets of financial values. Although it is the case that tax taken from our income is compulsory and that interest rates influence our decisions to spend or save, we also make our financial decisions based on very personal attitudes.

It may be no surprise that many of the biggest arguments reported by couples are related to financial matters. This is largely due to the widely differing attitudes and values that people have towards money. Equally, the contribution we make as citizens of a country may be moderated by the ideas we hold about the relative importance of saving and spending.

2.3.1 What values are and where they come from

Values are a set of beliefs about how people should behave and what is important. The values we have come from the family and culture we were brought up in, our peer group and other influences, such as the media.

Jacob

When I was younger, my parents used to give me £5 pocket money every week, but only if I did all my chores! I had to keep my room tidy, do my homework, take the dog for a walk and wash up after dinner. If I wanted to buy something, I had to save up for it out of my pocket money. Sometimes I did extra jobs to earn more money. My parents opened a savings account for me when I was really young and they've always encouraged me to save for later in life. I think this is a really good way of thinking and I'd much rather save up for things I want than borrow money from other people.

The following are some examples of personal values.

People should live within their means. That is, that they budget to only spend what they have as income and savings and not borrow money.

People who borrow money should repay it on time and in full.

It is our responsibility as citizens of a country to help people who are more vulnerable.

You can't take your money with you when you die and so you should spend as much as you can now.

It's not acceptable to claim benefits at all because I should be able to support myself.

Money exists to be spent.

It's important for me to support my family.

You should give money to charity.

These types of personal value may influence your financial decisions as much or more than government policies.

2.3.2 Impact of values on financial decision-making

A person's values strongly influence how they use the money they have to spend, and whether they give to charity, save, and repay debt. Values might also have an impact on people's decisions about whether to borrow money to buy things now that they cannot afford from current income. They also influence people's attitudes towards their responsibilities such as paying taxes, paying bills on time and helping others. You may also believe that it is important to manage your money well and that this may include budgeting and financial planning.

Budgeting is a plan outlining how much income and expenditure a person has – that is, how much money is coming in and how much goes out, so that you can make sure that all of your financial responsibilities are met and that you have money to spend. The money you have left over after paying all bills and putting aside money in savings is called your disposable income. It is called this because you can do what you want with it. A budget is generally set over a short timescale such as a month and includes regular expenses.

Daniel and Sue Baker's budget

Daniel and Sue both get paid once a month, so they have set a monthly budget.

They make sure that they pay the bills for their family's essential needs first, such as food, transport, the mortgage repayment on the house and energy for their home.

They also save money every month because they want to be prepared for emergencies and to be able to support their children as they leave home.

They also make sure they can donate to charity, and they decide as a family which charities to support.

Making a good budget is about deciding what you can afford and what your financial priorities are. Your values will influence your budgetary decisions in terms of the importance you give to making and following a budget, not spending more than you have, and saving for the future (retirement, for example). Financial planning tends to be longer term and includes making provision for future needs rather than relying on others.

Some of these decisions may include:

- saving for an expensive event in the future such as leaving home, buying a car, or going to university;
- paying into a pension;
- taking out life insurance and making a will (this often happens later in life for parents who are thinking about what would happen to their children if they died – these kinds of changes in financial decisions linked to your stage in life are discussed further in Topic 11).

It is often the case that people will have to borrow money at some point in their lives and this will mean that they owe money (usually to a bank). Having some debt does not have to be bad in itself. People use debt to buy expensive assets that will benefit them in the long term such as buying a moped, car or home. The larger of these items, such as a house, can rarely be bought without a loan called a mortgage and these are usually in the tens of thousands of pounds. The interest paid on a house loan makes a significant difference to the monthly repayments and can determine the amount you are able to spend on the mortgage. Anya's example shows the way in which government policies can have an impact on our financial decisions, despite the values we hold.

Anya

I saved enough money to pay for a deposit on a small flat a couple of years ago. I had to borrow £135,000. When I bought it, the interest rate from the Bank of England was 3% and the building society added another 2% to this figure, so I was paying £790 per month. The repayment period is 25 years.

A few months ago interest rates rose by 2% – my repayments are now £955. This is much more than I was paying when I first bought the flat and I can't afford it. I've missed a couple of payments already.

Managing debt can be complicated, as you not only have to make plans for repayment but also consider the kinds of changes that might occur. These could be changes in personal or external circumstances. You may lose your job, for example, meaning that you do not have the money to be able to make your repayments. Or, as in the example above, interest rates may rise so much that you can no longer afford the repayments.

Before people agree to a mortgage, they receive a document that outlines the details of the mortgage they have chosen. Part of this document shows the current interest rate, how much you are planning to borrow and what your repayments will be with this rate. However, a section is also included that outlines what your repayments would be if the interest rate increased. The mortgage providers are obligated to make sure that you understand that, although you can afford the mortgage when you take it out, it may be that your income falls or interest rates rise, affecting your ability to pay.

Budgeting and financial planning are both discussed in more detail in Unit 2.

Other values can also affect our financial decisions, such as attitudes towards employment. Work is one of the key contributions that citizens make in a society and it is the main vehicle through which we can have economic participation. Having paid employment is a means of contributing to society by providing goods or services to the community, paying income tax and National Insurance, and making pension payments. Earning money also helps organisations create wealth through our consumer choices – we choose to spend our money at particular places. Unpaid employment, such as charity work, is another way of contributing to your community. Social enterprises have a positive impact on society by focusing on the improvement of personal and environmental well-being rather than on profit-making and often focus on the needs of the particular community they are in.

Summary

Finally, we can recap what we have learned in this topic.

- As a citizen you are able to participate in the economic system in a variety of ways, but particularly through having a job (employment) and paying tax.
- By spending, saving, paying tax and giving to charity, a person makes it possible for the government to provide essential public services and for a society to become much more equal.
- However, the financial decisions we make are heavily influenced by government policies, including public spending, interest rates, national debt, and shaping and responding to the economic climate.
- The national budget, which is set annually, allows the government to decide where money is needed the most – education, health, benefits, pensions, transport, and so on – and this is public spending. Public spending ensures that all people are able to have a satisfactory standard of living and participate in the life of the nation.
- The amount that people can save or spend is also affected by national interest rates and these are set by the Bank of England.
- How people participate in the economy is also affected by the prevailing economic climate. During a recession people spend and save less, because income will be less as jobs and benefits are lost. With less income comes less tax and this leads to less money available for public spending, meaning that cuts have to be made.
- In boom periods there is much more money in the system and there are higher employment levels and higher levels of spending. However, this may mean that interest rates and inflation rise, leading to a recession once again as people find themselves with high levels of debt that they are unable to repay.
- Finally, personal values have a huge impact on how an individual manages their finances. People make decisions based on what things they think are important and these values can come from the family, religion, education, peers and the media.

Thinking points:

- How much debt is too much?
- Should giving to charity be compulsory?

Key terms

Austerity – a government measure to reduce the amount of money it spends (usually reduced wages and benefits), resulting in difficult financial conditions for a population.

Benefits – money and other financial support (such as reduced bus and train fares or provision of housing) that the government provides for people who are unable to get any other income.

Bonds – a certificate that shows you have bought the debt from a company or the government, in return for which the company or government pays a fixed amount of money in interest each year.

Budget – a plan for how you will use your income, including spending and saving.

Charity – (1) an organisation set up to help a particular group or issue; (2) the act of donating money or time to a cause.

Consumer – someone who uses or buys goods and services.

Debt – money owed to another person or organisation such as a bank.

Deficit – more expenditure than income; more money paid out than coming in.

Disposable income – the money that is left over from your income after you have paid all of your expenses and have put any savings aside.

Earnings – the money that you make from your job.

Economy – the state of a country relating to the amount of money that is in the system and the production and consumption of goods and services.

Expenses – the things that you have to spend your income on.

Fiscal policy – the decisions a government makes about taxes and what to spend public money on.

Gilts – a high-interest, very secure government bond (see 'Bonds').

Income tax – money deducted from your income by the government to pay for public services such as health and education.

Income – all the money (or items worth money) that you receive, including through work, investments and government benefits.

Interest rate – the money you pay as a charge for the service of using someone else's money – for example, if you borrow money to buy a car, you pay back the money you borrowed plus interest; or the bank pays you interest on money saved as it has access to your money.

Investment – something that you buy because it is likely to make you money in the future – for example, property may increase in value so that you can sell it for more than you bought it and make a profit, or you can rent it out.

Mortgage – a large loan to buy a house or property.

Net income – the money that is left over from your income after government tax and charges have been deducted (take-home pay).

Public spending – how the government spends the money it makes (through taxes, for example).

Quantitative easing – a government policy that allows the Bank of England to put more money into the economy by creating more electronically and then buying government bonds (see 'Bonds' and 'Gilts').

Recession – a period of economic downturn which means less money moving around the economy; people spend less, wages decrease, unemployment increases, company profits decrease, and so on.

Revenue – the income of an organisation or government.

Subsidise – pay part of a bill or pay some money towards a big expense – for example, if your housing is subsidised, you will get money towards paying your rent.

Surplus – more income than expenditure; more money coming in than being paid out.

Bibliography and further reading

GOV.UK (2015) *Shared parental leave and pay* – available at: www.gov.uk/shared-parental-leave-and-pay

National Assembly for Wales (2016) *About the Assembly* – available at: www.assembly.wales/en/Pages/Home.aspx

Northern Ireland Assembly (2016) *Northern Ireland Assembly Education Service* – available at: http://education.niassembly.gov.uk/

The Scottish Parliament (no date) *Visit and learn* – available at: www.scottish.parliament.uk/visitandlearn/12506.aspx

UK Political Info (no date) *Voter turnout by constituency, 2015 general election* – available at: www.ukpolitical.info/Turnout15.htm