Module 2

LIBF Award in Financial Education

Spellings

Additional	Financial
Aspirations	Government
Borrowing	Hyperinflation
Capital	Industries
Capitalist	Inflation
Charities	Interdependency
Communist	Interest
Components	Justice
Compound	Management
Consumer	Nationalisation
Consumption	Opposite
Contribute	Organisations
Contribution	Percentage
Corporate	Personal
Corporation	Principle
Cumulative	Privatisation
Decisions	Production
Depreciation	Recession
Distribution	Repossessed
Economic	Representative
Economy	Responsibilities
Excise	Society
Exempt	Taxation
Features	

Key Terms

Taxation: Money paid which contributes to government and the wider society.

Social Justice: the ideal that people should have equal opportunities and equal access to resources.

Capital gains tax: a tax on the increase in value of an asset, such as land or shares.

Topic 5- Understanding Tax

Paying tax is one of the main financial responsibilities that we have as UK citizens. Everyone pays some form of tax, whether in the form of income tax – which those of us who are in employment will pay – or as value added tax (VAT) – which we all will pay as part of the price of the things that we buy – or other taxes. As well as the tax that individuals pay, the government receives money from the tax that businesses pay (known as 'corporation tax'). Tax is a compulsory payment to the government made by individuals and organisations.

The two main types of tax are:

■ Direct tax is the money that is taken directly from your income, such as income tax or National Insurance contributions (NICs). Everyone has a personal tax allowance, which is an amount of their income on which they do not have to pay tax.

■ Indirect tax is the tax that people pay within the price of goods and services, rather than as a separate payment to the government.

Tax laws are extremely complex and the UK has a number of different kinds of taxes that contribute to the 'national purse' – ie how much the government can spend on the country. The largest contribution is made through income tax and National Insurance. Both of these are taken from an employee's salary before it is paid and the deductions appear on the employee's payslip. This type of taxation is known as 'Pay as You Earn' (PAYE).

Value added tax is charged on goods and services, although, some goods (such as children's clothes) are exempt from VAT. Part of the reason for this is that these things are considered to be items that you have little or no choice but to buy, or because they are believed to be of benefit to the nation (so sport, health and cultural activities are VAT-exempt, for example). The purchase price of the item includes an amount of VAT, so that the buyer pays it to the seller. The business that sells the goods or services then pays the VAT on to the government. If you buy a new sofa, for example, part of the price that you pay is VAT. The company that sells you the sofa will then pass that VAT amount on to the government.

The purpose of tax in this instance would be to redistribute wealth in order to achieve a more egalitarian society. This means making sure that the gap between the richest and the poorest in society is not too great. Social justice is also built on the beliefs that those who are financially successful have a responsibility to help others who are not

Topic 6- How the economic system works

When we speak of the 'economic system' of a country, we mean how money, goods and services move between different people and organisations. There are two extreme (and opposing) ideas of how a country's economy can work:

1. In a communist economy, the government makes all of the decisions about what goods to produce and services to offer, how to distribute them, and which individuals can consume them.

The UK is a mixed economy, which falls somewhere between these two extremes, as do the economies of most countries in the world.

2. In a free-market economy, private companies make the production and distribution decisions, and are motivated by making profits. They produce only those goods and services that they think people will want to buy, and set prices at a level that will allow the companies to make money after all of their costs have been paid. Individuals are free to buy any goods and services that they can afford. Government does not interfere

The UK government provides the goods and services that the private sector (ie the part of the economy that is run by businesses, individuals or groups) cannot, or will not, supply because they would not make a profit. These goods and services include public recreational areas such as parks, the military, universal healthcare and educational services, and support for disadvantaged people.

The government gets most of the money to pay for these goods and services from the taxes that citizens and businesses must pay. All citizens can have a say in how this money is shared between the different services that the government offers.

Money is an 'enabler' in the economic system. This means that it allows goods and services to be bought and sold, and enables individuals and organisations to participate in the economy. For example, employers pay money to the individuals who work for them (in the form of staff salaries), and this enables these people to buy products and services from other businesses, such as high-street and online shops. There are **3** sectors of industry to consider **Public** (government funded) **Private** and the **Charitable sector.**

Topic 7- The economic impact of personal financial choices

Personal financial choices are a major part of everyone's life. You may think that if you cannot pay your debts, for example, it affects only you and your family. Your choices can affect different groups in society, as well as the economy as a whole. The idea that changes in one area of society affect changes in another is called 'interdependency'.

Personal finance is how you use your money – ie what you earn, and how you decide to spend and save it. This is known as 'money management'. Being able to manage your money well is a responsibility. Managing your money effectively and making financial choices that help you to make the most of your money are the cornerstones of living well. We rely on money to help us to live a fulfilling life, and we benefit from putting money aside for the future or for emergencies.

How individuals manage their money is closely connected to the economic system as a whole. Both good and poor personal financial choices have particular effects on the economy and society.

The main effects of good financial choices are:

■ less 'bad debt' in the economy
■ less borrowing overall
■ increased spending and increased saving, because when people borrow less, they repay less from their earnings.

Poor financial decisions, on the other hand, can have the opposite effect:

■ increased amounts of personal debt that cannot be repaid
■ more high-risk borrowing (ie borrowing money that has high levels of interest or which cannot be paid back)
■ less saving and less spending (because people use more of their earnings to repay expensive debt).

Individual decisions that are not necessarily positive or negative may have a cumulative effect. This means that there may be unintended consequences as a result of many people taking the same decision.

Making good personal financial choices means living within your means, borrowing only money that you can afford to repay and putting money aside for emergencies or future needs.

1. Staying within a budget
2. Keeping track of personal finance – Also known as 'budgeting'
3. Planning ahead – saving money for emergencies or putting money aside to ensure that you have a stable income on retirement.
4. Choosing financial products wisely – This involves understanding the 'small print',
5. Staying informed about financial matters.

Topic 8- How inflation and interest rates impact on personal finance

Two of the biggest influences on personal finance are inflation rates and interest rates. The effects of these can be positive or negative, depending on our circumstances.

Inflation affects savings decisions, because you may not want to put money aside if you think that it is going to become less useful in the future. On the other hand, if you wait too long to start saving for something expensive, you might end up having to wait even longer before you can buy it, because prices will continue to rise. Ideally, then, you want to find a savings account that pays interest at a higher rate than the rate of inflation; in this way, you can ensure that your money will grow more quickly than prices rise.

The government aims to keep prices stable by keeping inflation rates low. This means aiming for a 2% inflation rate each year. The inflation rate is measured by the average price-change of a basket of goods. As long as the majority of goods and services rise by 2% during a year, it does not matter if some items rise by a larger amount and other items fall.

'Interest' is the cost of using someone else's money. When we borrow an amount of money, called the 'principal', the interest rate is the amount that we pay for the use of that money. Likewise, when we put money into a savings account, the bank pays us interest for allowing it to use our money while it is in the bank's safe-keeping.

The interest received on savings is affected by inflation. This means that although a particular interest-rate figure might be given, the actual interest rate is that figure less inflation. The rate stated by the lender is called the 'nominal interest rate' and the rate that we actually receive after inflation is called the 'real interest rate'. Just like inflation rates, interest rates go up and down. The role of the Bank of England is to try to keep interest rates stable and low, which it does by manipulating Bank rate.

Excise Duty: a tax levied on the manufacture or sale of specific goods, such as tobacco and alcohol.

Economic System: is a system of production, resource allocation and distribution of goods and services within a society or a given area.

Interdependency: the situation in which changes in one area affect changes in another area.

Cumulative effect: This means that there may be unintended consequences as a result of many people taking the same decision.

Inflation: is the rate of increase in the prices that we pay for goods and services.

Depreciation: the situation in which an asset or money decreases in value.

Interest: is the cost of using someone else's money.

Consumer Price Index: one of the main measures of inflation, calculated monthly by measuring the average cost of a 'basket' of goods less major household expenditure, such as mortgages and council tax.