# GCSE FINANCE Unit 1: Finance, the Individual and Society

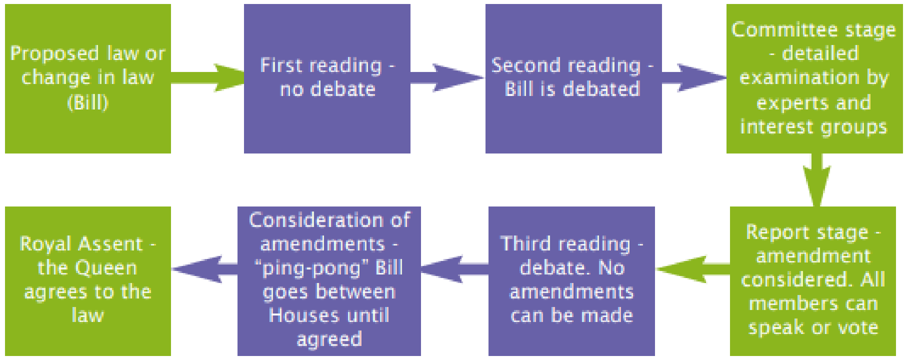
## A: What is a citizen?

■ A citizen is someone with the legal right to live in a particular country; to qualify as a citizen, people must meet conditions set by that country's government.

■ All the citizens of a country have rights and responsibilities that fall into three main categories: political, legal and economic. You can play an active role in society by meeting your responsibilities as a citizen: for example, by having your say in politics, by paying your taxes, and by volunteering. Being a citizen of a particular country is part of a person's identity.

■ The UK is a democracy. We elect Members of Parliament (MPs) to represent our interests when issues are being debated and decisions being made in Parliament. After an election the political party with the largest number of MPs forms the government.

■ You can ask your MP to put forward a specific point of view to Parliament at any time. You can also have a direct say about new laws being made at the proposal and committee stages.




■ As well as electing MPs for central government during a general election, you can elect councillors to represent your interests on regional councils. These councils make decisions about local matters.

## B: Personal finance and the economy

■ 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.

## D: What is income?

■ Your income is the total amount of money coming in from a range of sources. Income comes in and outgoings, such as spending and saving, go out. Together, they are your cash flow. Income is a different idea from money itself: money is the medium of exchange that we commonly use, while your income is the flow of money that you receive.

■ The amount of income that we receive changes over time, depending on our age and circumstances. We can get income from a number of different sources, and it is likely that our income will be from more than one place, for example salary from a job and interest from savings.

■ We can also save or invest money in order to have an income in the future, and we generally do this by means of a pension. When we save with a bank, the bank can lend our money to other people. This is one contribution that we can make to society in terms of the economy.

■ Most people get their income from doing paid work. Income from employment is very important to us as individuals and to the economy; hence the government has passed a number of laws about it to protect us. These are our employment rights, which we are given in return for taking up the responsibility of working, and contributing to society and the economy.

## C: What is Money?

■ Financial systems have a long history. Money too dates back to at least 650BC, and different forms of payment and types of money have been used since that time. Before money people 'bartered'.

■ The main purpose of money is to provide a means of exchange, so that we can buy goods and services, and so that the people providing them can receive payment.

■ In order for money to work properly, it has to have a number of distinctive features that make it possible and effective to use. These features mainly concern portability, durability and holding value. This used to be achieved in the form of cash, ie banknotes and coins.

■ However, the rise of technology has meant that we now pay for many things without cash, and electronic payments are becoming much more common.

■ The bulk of our money comes to us through our work, but people can get money in a variety of other ways, including state benefits, investments, interest on savings, gifts, pocket money, inheritances and selling personal items.

■ In whatever form it comes, money is a central part of the economy and how we live our lives – in terms of earning, spending, saving and participating in society.

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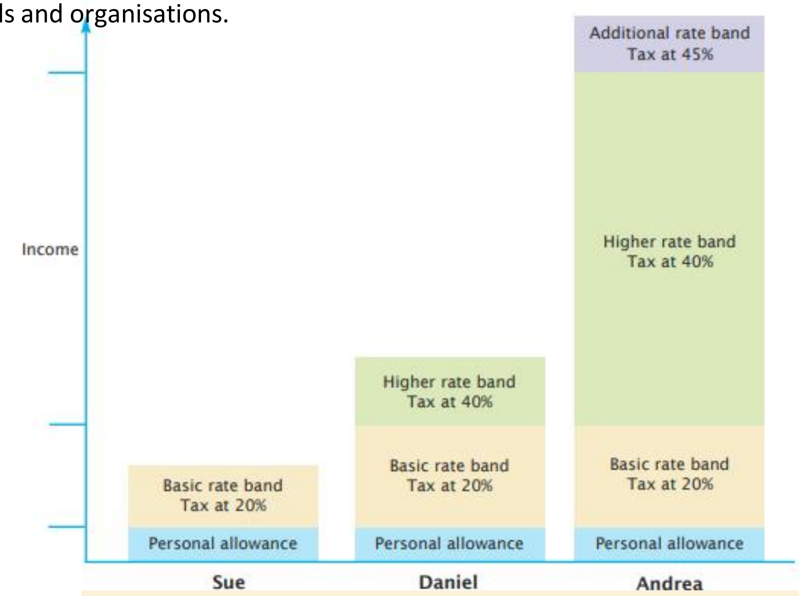
## E: Understanding tax

■ There are various types of tax in the UK that are paid in different ways and collected by different levels of government: local, regional and national.
■ Although it is usually thought that tax is collected in order for the government to raise revenue, there are many other reasons involving social justice ideals. – Tax enables the government to provide services and infrastructure that would not necessarily be provided by the private sector, but which may be considered essential to a nation's health and well-being, such as defence, universal education and universal healthcare. – Collecting tax also allows some of the wealth in a country to be redistributed to achieve a more egalitarian society. – The government helps people to buy everyday essentials by keeping the tax low, or by charging no tax at all, on such goods, for example by charging no VAT on fresh fruit and vegetables. It also uses tax to discourage people from buying items that are unhealthy, for example charging VAT on bars of chocolate and crisps (GOV.UK, 2014).
■ Ultimately, the government sets particular levels of taxation through its annual Budget and other policies, and this has an impact on the financial decisions of individuals and organisations.




**Income and tax bands**

- Sue Baker earns £25,000 a year, so all of her income falls within the basic rate tax band.
- Daniel earns £60,000 a year, so some of his income falls into the higher rate band.
- Daniel's boss, Andrea, earns £170,000, so some of her income falls into the additional rate band.

## F: How the economic system works

■ Organisations make contributions to the economy of a country, in much the same way as an individual does. One key contribution is paying corporation tax to the government; another key role is making and providing goods and services that consumers buy. This helps the economy to grow by helping businesses to expand, to sell more goods and services, and to pay more tax. They also employ people and pay them wages, thus contributing to these individuals' ability to buy goods and services, and to pay tax.
■ However, it is not only the specifically money related aspects of organisations that feed into the economy. Social responsibility, taken up through corporate policies or through the charitable sector, also leads to economic growth.
■ Corporate social responsibility has been shown to increase profits and employee satisfaction at work, while the charitable sector spends money in the economy, helps individuals to become more able to contribute to the economy and reduces the financial burden on government welfare.
■ Money flowing between the different players in the country – the people, the businesses, banks, charities and government – is what makes the economy work well.

## G: The economic impact of personal financial choices

■ This topic has explored money management, and the broad social and economic outcomes that are possible through either good or poor personal financial choices.
■ A major point is that the economy and our personal finances are interdependent. This means that any changes in one area will affect changes in other areas.
■ Topic 2 looked closely at how the economy and political decisions of government can affect our financial decisions. This topic has reinforced some of the underlying factors that are present in our money management decisions and has also shown that our personal financial choices can affect the workings of the economy.
■ Good financial choices are about living within your means and not having levels of debt that you cannot repay. Good money management means that people are financially capable. The financial capability of its citizens is important to a country as a whole.
■ Good personal financial choices have a positive impact on the economy, including reduced bad debt, less borrowing overall, an increase in spending and increased savings (because less money is being used on repaying debt), and more money available for the banks to lend and for the government to give to those who need it.
■ Poor financial decisions, on the other hand, are heavily linked to high levels of personal debt. The types of issue that lead to spiralling debt are high-interest loans and people taking out loans that they cannot afford to repay. This results in high levels of bad debt, more high-risk borrowing and an unstable economy, built on ever-increasing debt and, ultimately, the threat of recession.

## H: How inflation and interest rates impact on personal finance

■ In this topic, we have learned about inflation rates and interest rates, and how we are linked together. Prices go up over a period of time and various measures are put in place to ensure that any negative impacts of this are minimised. This includes increases in wages or benefits, and increases or decreases in interest rates to keep inflation low.
■ Fluctuating interest and inflation rates can be both positive and negative. If you own your own house or other investment, then high inflation means that the value of your investment goes up. However, in general, the higher the inflation rates, the worse off you will be, because you will be paying more for goods and services.
■ The same is true of interest rates. If interest rates are high, then those who have substantial savings will receive a good return on their money. However, those who have loans may find themselves paying higher monthly repayments, thus decreasing their real income.
■ Changes in inflation and interest rates impact on our financial planning in terms of long-term saving or borrowing. This also feeds into the economic cycle of a country, which we will discuss in Topic 9.

## H: How inflation and interest rates impact on personal finance

Figure 8.6 Impact of high interest rates on savers and borrowers

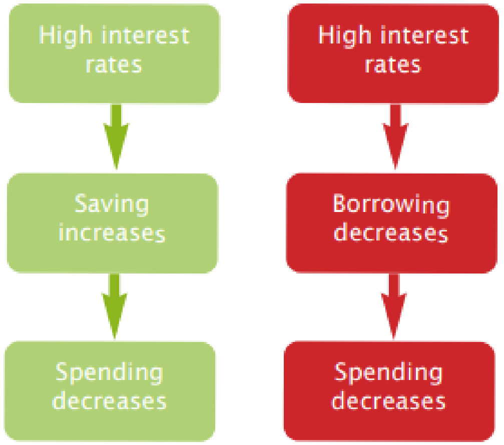
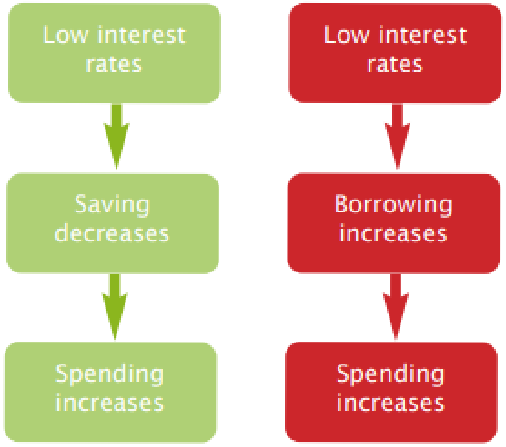



Figure 8.7 Impact of low interest rates on savers and borrowers




## I: Impacts of economic cycles and demographic changes

■ Perhaps the biggest impact on our personal financial planning is the relationship between short-term and long-term planning. Our present needs can sometimes be outweighed by the need to put money aside for the future. Two of the most important reasons to factor long-term savings into our budget plans are the economic cycle and demographic changes.

■ Despite government attempts to maintain a stable and growing economy, the economic cycle shows that it is inevitable that there will be a downturn at some point. Knowing that, and understanding the indicators that point to change, can help us to plan for future financial difficulties.

■ The demographic trend towards an ageing population also has a bearing on our personal financial decisions, particularly given the move towards an active retirement and the fact that the government will not necessarily be able to afford to pay out full State Pension in the future.

■ Although we cannot predict exactly how the ageing population will affect individuals and the economy, we can make plans for the future in terms of our personal finances and what we know about economic cycles.

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## J: Foreign exchange rates and trade

■ In this topic, we have learned about the main features of foreign currency exchange, and that it can have a significant impact on nations, society and individuals.

■ Foreign exchange rates exist in all countries and are constantly changing. The theory is simple: you pay money to buy the currencies of other nations. However, in practice, this has wide-reaching effects and can mean that economic conditions in a country either improve or get worse, simply on the strength of the national currency.

■ There are different impacts on the economy, based on how weak or how strong the national currency is.

– If the currency is strong, exports will be expensive and imports will be cheap (**SPICED**). Cheap imports can then lead to fewer sales for local businesses, which may result in job losses, reduced income for the employees that remain and a greater benefits bill for the government, as well as social costs.

– A weaker currency will mean the opposite – ie that exports are cheap and imports are expensive. The local economy will grow, but this could cause prices to increase and lead to all the issues that come with rising inflation (as described in Topic 8).

■ Countries go up and down in the economic cycle (see Topic 9), and at each point there are different positives and negatives for the citizens who live in that country.

## K: The personal life cycle

■ As our lives change, so do our financial needs and wants. Each life stage brings with it its own issues relating to income and expenditure, and these can influence our personal financial planning. People find it much easier to plan for the short term, so whatever needs are most immediate tend to get dealt with first. ■ We make priorities about where is the best place to use our money. These priorities also change as we move through the life cycle and our circumstances change. Although you may not be thinking about saving for a house now, there may come a time when you want to buy a property – and what you can buy will depend on how much money you have.

■ Although it can be difficult to predict what will happen in our lives and what we will need money for, there are events that are more likely at different life stages, and we should take these into account in our financial planning.

Figure 11.4 Comparing income and expenditure over time and taking life events into account