Chapter 1
Planning to achieve aspirations

Introduction
In this chapter, you will learn about planning to achieve goals and about the different factors that can help or hinder that planning. You will learn how to plan, in the short, medium and long terms, and how to achieve realistic lifetime aspirations. You will:

• recognise the significance of financial budgeting to achieve realistic lifetime aspirations and the factors affecting processes throughout the life cycle;
• understand the nature of budgeting, and of surpluses and deficits;
• appreciate the need for short, medium and long-term budgeting;
• recognise sources of income and expenditure;
• understand the difference between mandatory and discretionary expenditure;
• appreciate how different stages in the life cycle require different budgets; and
• understand the personal and financial consequences of living beyond a budget.

Learning outcomes
When you have read this chapter, you will:

• have built on your definition of ‘aspirations’ and be able to explain how people can plan to achieve them;
• understand the idea of budgeting and know how to prepare a personal budget;
• know different sources of income and types of expenditure;
• understand how different stages in the life cycle impact on a budget; and
• understand the consequences of living beyond your means.

1.1 Introduction
When we talked in Unit 1 about the aspirations that you might have at each stage of your personal life cycle, we were referring to realistic lifetime aspirations. Remember, aspirations are those things that you would like to achieve at some point in the future.
Realistic aspirations are those that you actually have some chance of achieving, even though some of them may be far into the future. This chapter will look at how you might define aspirations as realistic, and how careful financial planning and management – and the use of financial products – can help you to meet those aspirations.

### 1.2 Aspirations

An ‘aspiration’ is something that you hope to achieve or gain in the future. People have all sorts of different aspirations: some are very detailed and some are quite general. They may also be defined by time: some are fairly short-term aspirations; others are hopes for much further into the future. The further into the future they are, the more planning will be required.

Some aspirations are more achievable than others.

**Activity 1.1**

What are your short, medium and long-term aspirations? Decide on the target that you want to reach and then work backwards in time to see what you will have to do to reach that target. If you want to be a surgeon, for example, what do you think you will need to do to achieve that goal?

It is often easier to see what is needed if you take the steps backwards from the achievement. Going through the above process should help you to start to see what things you would need to do to get there. For example, is there any training that you should be doing now to develop the skills that you will need? Some people’s aspirations will be more realistic than others.

**Activity 1.2**

Within your group, list a set of aspirations, and then divide them into those that are realistic and unrealistic. Do you all agree?

Examples might be as follows.

<table>
<thead>
<tr>
<th>Unrealistic</th>
<th>More realistic</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ruling the world</td>
<td>Being on the local council/getting to the Houses of Parliament/becoming a ‘mover and shaker’ in business, politics, etc</td>
</tr>
<tr>
<td>Marrying a princess/good-looking, charming billionaire</td>
<td>Marrying someone just right for you</td>
</tr>
<tr>
<td>Being the richest person in the world</td>
<td>Having thousands of pounds in the bank</td>
</tr>
<tr>
<td>Breaking the one-minute mile in running</td>
<td>Running a mile in under four minutes if you are already really competitive at it</td>
</tr>
</tbody>
</table>
Sometimes, it’s not clear where you should draw the line between what is achievable and what isn’t. The likelihood of your getting to your goal can depend on lots of things, such as:

- where you start from – if you want to be a millionaire, it might be an easier goal to achieve if you’re already quite well-off;
- how capable you are – if your goal is to break a world record at sport, you have a head start if you’re fit and able;
- what information you have – that is, knowing what is needed to achieve your aim and where to get advice and help;
- how much drive you have – how much do you really want your goal? Are you willing to do what it takes and to sacrifice some things along the way, in order to get there?
- how much good or bad luck comes your way – sometimes, people suffer setbacks or disasters that are completely outside their control, which are so bad that they can’t find a way around them; and
- how well you plan – along with commitment and drive, planning is a very important factor in achieving your realistic life aspirations.

1.2.1 Lifecycle factors

Aspirations (and their achievement) will also be affected by the stage of the life cycle through which you are passing. Some people realise that they may achieve their aspirations only by passing on hopes and ambitions to children, or even grandchildren. This means that you need skill at planning in order to anticipate what might happen in the future and how this might impact on your plans.

**Activity 1.3**

List some of the things that could go wrong and derail your plans. Next to each, write the name of a financial product that might help you to anticipate the problem and to reduce its effects.

1.3 Budgeting

Part of your planning for the future must involve financial planning. Budgeting is the process of planning future income and expenditure. In other words, a budget predicts the income on which you might be able to rely in the future and where you might spend it. This is also known as ‘cash flow analysis’, because it looks at what cash is coming in, what is going out and the net balance, or difference, between the two sides.

- **Income** refers to money coming in.
- **Expenditure** refers to money going out.

The balance is the difference between income and expenditure at any point in time.
A budget is a financial plan of forecast income and expenditure.

If a budget has more income than expenditure, it is in surplus – that is, you have money left over when you’ve done your spending. If there is no surplus and you are just making ends meet, your budget is balanced. If you are actually spending more than you have coming in, then one of two things is happening: you are either using savings or you are borrowing from someone or somewhere. Either way, the budget is running a deficit.

A surplus arises when income is greater than expenditure.
A deficit arises when income is less than expenditure.

It’s important to remember, however, that a deficit need not always be a bad thing. Sometimes, it is necessary to have the flexibility to spend now even though, in the long term, your income won’t support such spending on a regular basis.

Activity 1.4
Would you rather have a balanced budget, a surplus, or a deficit in the long term? In which situation do you think you are right now? If you have a surplus or a deficit, do you know what to do?

1.3.1 Planning a budget
What matters is to ensure that you know what your budgetary position is, so that you can manage and keep control over your money.

You can use a table such as the one shown in Activity 1.5 to balance your budget. Everyone’s budget planner will be different, because everyone’s financial arrangements are different. What the process will show you is whether you are, on average, spending more or less than you have coming in.

Activity 1.5
On the next page is a typical budget planner showing income and expenditure. Draw up a similar table for yourself. How do you think this will change as you get older?
Income (examples) | Budget | Actual
---|---|---
Pocket money/allowance
Income from jobs round the house
Part-time job
Lunch money
Other
Total income

Expenses (examples) | Budget | Actual
---|---|---
Subscription(s) to magazine(s)
CDs, etc
Going out
Lunch (per month)
Hairdresser
Holiday money (total for the year divided by 12 months)
Christmas presents, birthday gifts, etc (total for year divided by 12 months)
Other
Total expenses

Excess of income over expenses (ie surplus) or excess of expenses over income (ie deficit)

1.3.2 Balancing your budget

If someone finds that they are spending more than they have coming in, they may need to make changes. There are two options:

- obtain more income; and/or
- spend less.

Obtaining more income is often the harder of the two. People of school or college age may decide to take on a part-time job, put savings into an account that will give interest, or ask for a bigger allowance (and perhaps do more work round the house to earn it). To save money, you could save on lunchtime expenditure by taking sandwiches, walking
instead of taking the bus, or limiting expenditure on a specific area, such as clothes, make-up, or entertainment.

Some of these things may be largely out of the individual’s control. For example, their savings may already be earning the maximum rate of interest available and it may be hard to persuade their family to give them a higher allowance.

### 1.3.3 Short, medium and long-term budgeting

Because aspirations are short, medium and long-term, these timescales must also be applied to a budget. If, for example, you really want to go to a football match next weekend and a ticket is £30, then it is no use waiting for your savings interest to mount up to a sufficient level. You will need to find short-term ways in which to boost your budget: perhaps you can borrow the money or perhaps you can work extra hours in your job? Alternatively, you might plan in advance. If you were to know that you want to go to a particular match a long time beforehand, then you could establish a medium-term plan to reach your target. If you were to know six weeks in advance, for example, you could plan to save £5 a week, or to earn enough extra money to cover the cost.

Long-term budgeting takes even more planning. Some couples may plan their wedding over a two or three-year period, earning and saving so that they can have the wedding day that they want. Some people may plan for a particular aspiration over many, many years. For example, if one of your aspirations were to be to retire early, then you would have to start planning this very early on in your career. To be able to plan for the future, you will need a clear idea of where income may come from and what you may have to spend.

### 1.4 Sources of income and expenditure

There are numerous sources of income and, of course, countless ways in which to spend money. Some outgoings are mandatory – in other words, compulsory – and you cannot avoid them. Taxation, for example, is taken from most people’s income at source – that is, before income reaches them. Income can also come from different sources and good budgeting means that you need to be able to tap into these.

#### 1.4.1 Sources of income

All money that comes in to you is income. Income may first be divided into ‘earned’ and ‘unearned’ income; earned income is that for which you have to work.

**Activity 1.6**

- List possible sources of income for school or college students.
- List possible sources of income for working people.
- List possible sources of income for retired people.

Compare your lists with those of others in your group, so that you can compile a ‘master list’.
1.4.1.1 Earned income

The majority of people earn income by working regularly for someone else – that is, they are employed. The employer is often a business, but it might also be a government department, a charity or another individual.

Employees can receive earnings in a number of ways, the most common being:

- in the form of cash, perhaps as a weekly pay packet;
- monthly as a cheque for the whole month’s work; and
- monthly by bank credit – that is, transferred directly into their bank account. Most companies like to pay people in this way.

Activity 1.7

Why might employers prefer to pay their employees by bank transfer rather than by cash or cheque? What are the advantages for the employee?

Other people earn their income by working for themselves – that is, they are self-employed. These people don’t rely on a wage from someone else; rather, their income comes out of the money made by their business. This means that they cannot take a wage if their business doesn’t make money. Because their income is not guaranteed, they may also find it harder to obtain credit.

Activity 1.8

What kinds of business can you list in which people are typically self-employed?

Other people own and manage larger businesses that employ a number of people. These owners (or part-owners) may take a regular or salaried income for the job that they do, in addition to sharing in the profits of the business.

Did you know?

Some benefits – called perquisites (‘perks’ for short) – that people get through work count as income, especially for tax purposes, even though they don’t take the form of money. For example, in some jobs, employees are given luncheon vouchers, which can be exchanged for food at a range of places. This means that the employees don’t have to spend their own money on lunch. Other employees may be given a company car for their work journeys, but they may use it privately too. This means that they don’t have to go out and buy a car for themselves.
Perquisites (‘perks’) refer to extras that come with certain employments.

Activity 1.9
What other things can you think of that might be classified as ‘perks’?

1.4.1.2 Unearned income

Some sources of income do not arise from employment or economic activity such as self-employment. These may be divided into benefits provided by the state and other unearned sources.

1.4.1.2.1 State benefits

The government provides a range of benefits. Most of these are intended to help those who can’t earn sufficient income for themselves, either temporarily or permanently, because of unemployment or disability.

Some state benefits are means-tested – that is, you can get them only if you meet certain criteria, such as showing that you need to receive the benefit because you don’t have sufficient savings or income.

People have to pay tax on some benefits and not on others.

Benefits include the following.

- **Jobseeker’s Allowance (JSA)**
  
  Jobseeker’s Allowance is the main benefit for people in the UK who are aged between 18 and State Pension age, who work an average of less than 16 hours a week, and who are available for and capable of work and actively seeking it. It is paid fortnightly, and the amount paid depends on a person’s age and circumstances.
  
  JSA is not intended to be a long-term source of income, but an interim allowance for people who are actively seeking, and should ultimately gain, employment.
  
  Income-based JSA is to be gradually replaced from April 2013 as part of a move towards a new benefit called Universal Credit.

- **State Pension**

  State Pension is a regular income that becomes payable when someone reaches State Pension age. At present, State Pension age for men is 65. On 6 April 2010, State Pension age for women began to increase gradually from 60 to 65, to become the same age as that for men from 2018. Under new government proposals, from December 2018, State Pension age for both men and women will begin to rise to reach 66 by October 2020. The government also intends to bring forward to 2028 (rather than 2036, as under current law) increases of State Pension age to 67.

  State Pension is usually increased every year, to help pensioners’ standards of living to keep pace with inflation, at least in part.
State Pension comes in two parts: basic State Pension and State Second Pension (S2P).

- The amount of basic State Pension that people receive depends on their work history: people who work pay National Insurance contributions (NICs), and if they have paid enough NICs, they get the full basic State Pension. If they have worked fewer years, their basic State Pension will be reduced. Although there is a minimum income guaranteed through Income Support, basic State Pension is regarded by many as the foundation for an individual’s retirement income.

- State Second Pension (S2P) is available only to certain people. It gives some additional State Pension to people on low or medium earnings, people who can’t get a full National Insurance record (because they have to stay at home caring for someone else), or people who can’t work because they have a long-term illness or disability. Pension Credit can also be claimed by people over the age of 60 to guarantee them an income of at least a set amount. For claimants over the age of 65, it gives them a little extra if they have saved up during their lives, to reward them for having saved. No entitlement to S2P is built up during periods of self-employment.

Did you know?

There are many other state benefits aimed at people in need at all stages of the life cycle. These currently include:

- Attendance Allowance;
- Child Benefit;
- Disability Living Allowance (to be gradually replaced by Personal Independence Payment from 8 April 2013 – see https://www.gov.uk/pip/overview for more details);
- Housing Benefit*;
- Employment and Support Allowance*;
- Income Support* (known as Pension Credit if the recipient is State Pension age); and
- Bereavement Allowance.

These benefits can change according to government policy, as is evidenced by the phased introduction of the new Universal Credit from 29 April 2013.

Universal Credit is a new simpler, single monthly payment for people in or out of work, which merges some of the benefits (including those marked * above) and tax credits. Most people won’t be affected initially, because Universal Credit is being introduced gradually over the next few years. Further details can be found online at https://www.moneyadviceservice.org.uk/en/articles/universal-credit-an-introduction
Activity 1.10

At present, a higher percentage of men than of women qualify for the full basic State Pension. Why do you think this is the case?

Activity 1.11

Visit the Department for Work and Pensions (DWP) online at http://www.gov.uk/browse/benefits to look at the range of benefits available to various people.

Think about the different benefits and the circumstances in which they are intended to help people, and allocate each benefit to one or more phases of the life cycle.

1.4.1.2.2 Grants

There are a wide variety of grants available in the UK for people who are studying or training, including the following.

- **National grants and bursaries**
  
  At one time, student grants were available to most people who went to university or college, but this is no longer the case. Bursaries (a kind of grant) and scholarships are, however, still available for some kinds of study; this is extra funding that students do not have to pay back. For example, the National Health Service (NHS) still gives bursaries for the first year of study in several medicine-related areas. Those training to become teachers also receive a bursary.

- **Trusts and charities**
  
  Certain trusts and charities are set up to help people who otherwise wouldn’t have the opportunity to study further. Usually, applicants have to fit a trust’s specific criteria in order to qualify for help from it, because a trust’s resources are generally quite limited.

- **Company sponsorships**
  
  Some big companies and the armed forces will sponsor students through particular courses, in the expectation that the student will work for them afterwards, using the knowledge and skills that they gained on their course. They may require the student to work for them for a set period of time. If the student wishes to leave the company, the original sponsorship agreement will usually require them to repay some (or all) of the sponsorship money.

1.4.1.2.3 Personal and occupational pensions

In addition to State Pension, many people have a private pension paid to them. State Pension is usually increased every April roughly in line with the rate of inflation, so it is worth the same each year in real terms – that is, in terms of the goods and services that people can buy with it. It is increasingly harder for the government to cover the cost of paying pensions from the taxes paid by working people because the ratio of older people to younger people is growing, and because there are many other areas of public
expenditure for which it must pay. The amount that the UK government has borrowed has increased sharply because of the cost of bailing out certain banks in 2007 and 2008, and because of the recession that followed the financial crisis. In an effort to reduce the national debt, the government has implemented a series of cuts in public spending.

It is important, therefore, for most people to have some sort of separate savings plan for their retirement. The earlier a person starts to save towards retirement, other things being equal, the larger their pension fund will be and the greater the chance that they will have a reasonable standard of living in retirement. These plans may include the following.

- **Occupational pensions**
  These are pensions that employers set up for their employees and into which the employer makes payments on the employee’s behalf, so, in some ways, the employee might regard the pension as part of their pay package. In most cases, the employee also pays in a percentage of their monthly salary. When they retire, the pension will give them a regular income on top of their State Pension.

  Most occupational pensions used to be related to an individual’s salary at the date on which they left employment (a ‘final salary’ pension scheme), but these are now increasingly being replaced by ‘money-purchase’ schemes, which buy an annuity with the money in the employee’s pension fund on the date on which they retire. The annuity then pays them a stated amount each year (hence the name ‘annuity’) for the rest of their life (see below).

- **Stakeholder schemes**
  These are a low-cost option for retirement, aimed at encouraging people who might not normally save for a pension. Financial services companies provide them and most employers have to make them available to their staff. You can, however, also have one if you are self-employed or not employed at all. Stakeholder schemes are particularly intended for those who do not have access to an occupational pension scheme; often this means the low-paid or those who are not in pensionable employment.

- **Personal pensions**
  These are pensions that you set up yourself – perhaps because you are self-employed (there’s no employer to give you an occupational scheme), or because you move around from job to job and cannot build up a reasonably sized pension with a single employer. A personal pension plan is run by a specialist financial services provider – usually a life insurance or pensions company – and the saver makes payments into it.

With effect from 1 October 2012 and the commencement of the phased introduction of the workplace pension reforms, all employers must now comply with requirements to ‘auto-enrol’ (that is, enrol automatically) all eligible ‘jobholders’ in either the National Employment Savings Trust (NEST) or an equivalent qualifying pension arrangement with benefits that are broadly similar to, or better than, those of NEST.

NEST is a large, trust-based, defined-contribution, multi-employer pension scheme. Its aim is to extend the benefits of employer scheme to those workers currently without access to an employer-sponsored scheme.
Where possible, employers are likely to want to use their existing pension schemes to meet the auto-enrolment requirement. The employer is able to certify that its desired scheme meets the tests to be regarded as a qualifying pension scheme for auto-enrolment purposes. These tests are not straightforward and the Department for Work and Pensions (DWP) has now issued a number of guides (and updated others) outlining how an employer can determine whether its existing scheme meets the required test standards.

1.4.1.2.4 Other unearned income

Other unearned income often comes from financial dealings and includes:

- interest from savings;
- dividends from shares in either private or public companies;
- payments from insurance endowment products;
- annuities – that is, financial products that give a regular income to the person who owns them, who pays a lump sum to an annuity provider (such as a life assurance company), which pays a regular income in return.

**Dividends** are a share in the profits of a company.

1.4.1.2.5 Unexpected income

Finally, we can deal with those sources of income that are unexpected and therefore not part of planning. These may be termed windfalls. Many members of mutual societies received windfall payments of cash or shares when the society became a public company (see Unit 1).

**Windfalls** are one-off payments, such as gifts, inheritance and even wins on the lottery or from other gambling.

1.4.2 Expenditure

Expenditure occurs when you spend your income on buying goods and services. Most people have money coming in – usually on a regular basis – and then a certain amount of it goes straight back out, in the form of regular commitments – that is, payments that must be made on a regular basis. It’s when the commitments are greater than the income, or when the income stops for some reason, that there is a problem.

People have different commitments at different stages of their life cycles. For example, school or college students who have a part-time job may pay only a few regular commitments, such as:

- an amount towards their keep at home – some young people begin paying something towards their food and bills to their parents or guardians as soon as they start getting an income; in other cases, families cover all of a teenager’s costs until the person is out of their teens and well into their 20s;
• regular bills, such as mobile phones (although, for someone under a certain age, the phone company may have wanted the parents to promise to pay the bills); and
• regular subscriptions to clubs, magazines, etc – for example, if someone has ordered a particular music magazine on a regular basis, they may have set up an automatic payment to the magazine.

Activity 1.12
What do you think are the pros and cons of contributing to your keep?

Activity 1.13
What method would the phone company typically use to get payment from you for a bill? Why would it use this method? What method might you use to pay for a fan club, the payment for which stays the same each month?

1.4.2.1 Mandatory and discretionary expenditure
You can split regular outgoings into voluntary (that is, those on which you have chosen to spend money, but don’t have to if you don’t want to) and involuntary (that is, those payments about which you don’t have much choice). Voluntary expenditure is called discretionary expenditure; compulsory expenditure is called mandatory expenditure.

Discretionary expenditure is that spending over which you have a choice.
Mandatory expenditure is that spending over which you have little, or no, choice.

1.4.2.1.1 Mandatory expenditure
Mandatory, or compulsory, expenditure includes taxation. Tax is one of the UK government’s ways of raising money to pay for the expenditure that it makes on, for example, education, health care and benefits, law and order, and defence.

Direct taxation takes account of your personal circumstances and is paid straight to the government from your income. No one pays tax on all of their income, because everyone has a personal allowance – that is, an amount that they may earn before they have to pay any tax. This allowance is usually updated in each annual Budget. Indirect taxation, on the other hand, is paid as part of the price of products that you buy. For example, when you buy petrol for a car, the tax on the petrol is included in the price.

Your personal allowance is the amount that you are allowed to earn before you must pay basic rate tax.
There are various personal taxes in the UK, including income tax, capital gains tax and inheritance tax. The main one for the purpose of regular budgeting is income tax, which is a direct tax.

- Income tax is a charge levied by the government on income. It is known as a direct tax, because the amount that people have to pay is assessed directly each year on their income for that period. Income tax has to be paid on most sorts of income, although, sometimes, the government exempts certain things – that is, it allows you not to pay tax on them. It does this either to encourage you to do certain things – for example, to invest in things that it wants you to – or because it make no sense to tax the income. An example of tax-exempt income would be some state benefits: the government doesn’t tax them because they are paid to people who are already on low incomes.

Income tax is charged at different percentages for different amounts of money earned; these are called ‘tax bands’. The result is that people pay a higher percentage of their income as tax if they earn higher levels of income.

- Value added tax (VAT) is a form of indirect taxation. It is a tax levied by the government on the supply of goods and services, with a current standard rate of 20 per cent (raised in January 2011 from 17.5 per cent). There are some goods and services that are subject to lower VAT or are exempt. Domestic power and fuel, for example, are taxed at 5 per cent; some essential items, such as most food products and children’s clothes, are free from tax. In addition, some services are exempt. These include banking, insurance and finance, health services, educational services, and burial and cremation services.

- National Insurance contributions (NICs) are paid only on earned income (not on investment or rental income, for example). This money goes into the government’s pot of money collected through taxes. If someone works after qualifying for State Pension, they no longer have to pay NICs.

- Council Tax is based on the occupation or ownership of property. If you own, part-own, or rent a house, you will almost certainly have to pay Council Tax. Different houses are given different tax bands according to the value of the property and so the amount of Council Tax paid will vary from house to house. Council Tax is paid to the local authority – that is, to your local council – for the area in which you live.

**Activity 1.14**

Look up the current income tax bands on the Internet. We do not publish them here because they change each year. At the time of writing (April 2013), there are four main tax bands:

- 0 per cent on the personal allowance;
- 20 per cent basic rate;
- 40 per cent on that income earned above a particular level; and
- 45 per cent on income earned above £150,000 (reduced from 50 per cent in April 2013).
Work out how much someone on the following incomes would pay each year in income tax. To find the tax allowances and rates that apply, visit http://www.hmrc.gov.uk/rates/it.htm

a) £20,000
b) £40,000
c) £50,000

Did you know?

Most people in paid employment find that their employer deducts an amount for tax each week or month from their salary or wage packet. This system of deducting the tax from the salary before it is paid is called ‘pay as you earn’ (PAYE).

The employer pays the income tax direct to HM Revenue & Customs (HMRC) – the government department that administers income tax. These employees pay only any additional amount that they owe at the end of the tax year. If people pay too much income tax in the year, they may get some money back – a tax rebate.

Self-employed people are charged for income tax through a system of self-assessment. Each year, they must account to HMRC for the taxable income that they have earned, less any items that they are allowed to deduct, and they pay income tax on the net amount.

1.4.2.1.2 Discretionary, but necessary, expenditure

Some expenditure is, technically, discretionary, in that you have a choice whether to spend it or not, but it may be considered necessary expenditure, because it maintains needs such as food, shelter and heat.

Imagine that you are living in your own home, rather than with parents. You would have to pay for the following items.

- **Food**
  
  You would need to budget a weekly amount to ensure that you could eat.

- **Water**
  
  Your use of water is usually free, but you have to pay water rates for the supply of clean water, and for the disposal of waste water and sewage. In an increasing number of cases, use is also monitored via a meter and charged for accordingly.

- **Rent or mortgage**
  
  Once you move away from home – for example, into a flat or student accommodation – you will almost certainly have to pay rent. This is usually due either weekly or monthly and can account for quite a high proportion of income. There may also be other payments required: for example, a bond against breakages or damage.
When you are in a position to buy a property, you will usually need to borrow from a bank or building society to pay for it through a mortgage – that is, a special type of loan in which the money borrowed is secured on the property that you’ve bought. What this means is that if you don’t keep up the repayments on the loan, the bank can take the property away from you and sell it to get its money back. This is called ‘repossession’. Mortgage repayments are usually made monthly by standing order or direct debit and, like rent, they usually account for quite a large proportion of the borrower’s income.

- **Insurance**
  An insurance policy is a financial product that promises to pay out a certain amount if, or when, a certain event happens and it is used to protect you against the financial consequences of certain mishaps. As well as unexpected losses, policies may be taken out to pay out in different circumstances: on sickness, unemployment, etc. For many, the cost of the policy (known as the ‘premium’) will be paid monthly and so will be another regular expense.

- **Utilities**
  Things such as electricity/gas, telephones, etc, are known as ‘utilities’. In many cases, people pay these essential bills monthly or quarterly. Often, the money is taken directly from their bank account by way of a direct debit.

### Activity 1.15
Visit the website of a large insurer, such as [http://www.directline.com/](http://www.directline.com/).
See if you can find a type of insurance offered by that insurer that protects:

- your family, against the financial consequences of the breadwinner dying and the family suffering financial problems;
- you against the financial consequences of your car being involved in a crash; and
- you against having to pay big vet’s bills if your dog gets ill.

### Did you know?
Very often, people buy insurance voluntarily because they want to protect themselves or their family from unexpected losses, but, sometimes, it is compulsory.

For example, if a bank lends money to you by way of a mortgage, secured on your house, it will usually insist that you also pay for two kinds of insurance:

- life insurance, which pays out if you die, and so ensures that the bank’s loan will be repaid;
- property insurance, which pays out if the building burns, or falls down, or is damaged. This protects the bank if anything happens to its security – that is, the property that it will claim if you don’t repay the loan.
1.4.2.1.3 Discretionary expenditure

Discretionary spending is money that you are free to spend as you want – that is, it’s not committed to anything in particular. If you’re lucky, it’s what is left over after you have received your income and paid out all of the mandatory expenditure and necessary expenditure. This is the money that you have to spend on wants such as entertainment, fashion, music, transportation, holidays, leisure products, etc.

Many people choose to give some money away. Voluntary giving means giving to charities, good causes, and so on.

Figures from the Charities Aid Foundation (CAF) report UK Giving 2012 show that over half – 55 per cent, down from 58 per cent in 2011 – of the UK adult population gives to charity in a typical month. The average donation was £27 – down from £31 in 2010–11.

Some voluntary giving is not regular, but much of it is. For example, many people set up standing orders and direct debits from their bank accounts. Other people make donations straight from their salaries or wages.

The government makes charitable giving attractive by giving people automatic tax relief on charitable donations up to a certain amount. People like this, because it makes them feel as if, for every pound they give, the government is also giving a bit too.

To be recognised officially as a charity, organisations have to register with The Charity Commission (http://www.charity-commission.gov.uk). If you haven’t heard of a particular charity, it’s always a good idea to check that the organisation to which you are planning to give is a registered charity.

Charities that can accept standing orders into their accounts include: Age UK; Guide Dogs for the Blind; Save the Children; the Royal National Lifeboat Institution (RNLI); and the Royal Society for the Protection of Birds (RSPB).

Activity 1.16

List some of the charities that you know and outline what they aim to do with the money that they raise.

1.5 Budgets and the life cycle

Each stage of the life cycle will have different budget constraints, because it will have different sources of income, and different mandatory and discretionary expenditure.
Table 1.1 gives some typical examples.

### Table 1.1 Budget constraints throughout the typical life cycle

<table>
<thead>
<tr>
<th>Lifecycle stage</th>
<th>Responsibility</th>
<th>Likely income</th>
<th>Expenditure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Birth and infanthood (0–2 yrs old)</td>
<td>Someone else has responsibility for the budget</td>
<td>Birthday money</td>
<td>Nil</td>
</tr>
<tr>
<td>Childhood – preschool (2–5 yrs old)</td>
<td>Someone else has responsibility for the budget</td>
<td>Birthday money</td>
<td>Nil</td>
</tr>
<tr>
<td>Childhood – school (5–12 yrs old)</td>
<td>Partly the child’s; partly that of the parent or guardian</td>
<td>Pocket money; Birthday money</td>
<td>Mandatory: indirect taxation when buying toys and other goods Discretionary: toys; games; birthday gifts; savings</td>
</tr>
<tr>
<td>Teenager (13–19 yrs old)</td>
<td>Mostly the teenager’s, especially as they get older</td>
<td>Pocket money or allowance; Birthday money; Wages from part-time work; Educational Maintenance Allowance (EMA – now closed to new applicants in England)*</td>
<td>Mandatory: indirect taxation; direct tax (if enough is earned) Discretionary: keep; entertainment; leisure; fashion, etc</td>
</tr>
<tr>
<td>Young adult (18–25 yrs old)</td>
<td>The adult’s own</td>
<td>Part-time or full-time work; Student loan; Parental support; Government support, eg Jobseeker’s Allowance (JSA); Possible windfalls</td>
<td>Mandatory: possibly direct tax; indirect tax; rent or mortgage; rates, food; fuel; some insurance (eg car) Discretionary: savings; investment; pension; insurance; entertainment; car; leisure; fashion, etc</td>
</tr>
</tbody>
</table>
1.5.1 Living within a budget

Sometimes, to keep your budget balanced, you will have to do without discretionary expenditure. Remember, this is expenditure on wants and desires rather than needs, so although it may not be much fun to do without it, it is possible. Your budget may then look like Table 1.2.

Table 1.2 The balanced budget

<table>
<thead>
<tr>
<th>Income</th>
<th>Expenditure</th>
<th>Discretionary expenditure</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>£500</td>
<td>£500</td>
<td>Nil</td>
<td>Nil</td>
</tr>
</tbody>
</table>

If you have earned enough to cover mandatory expenditure, you may have enough left to spend on yourself. Your budget would then look like Table 1.3.
Table 1.3  The balanced budget – with discretionary expenditure

<table>
<thead>
<tr>
<th>Income</th>
<th>Expenditure</th>
<th>Discretionary expenditure</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>£500</td>
<td>£400</td>
<td>£100</td>
<td>Nil</td>
</tr>
</tbody>
</table>

Sometimes, in order to achieve something sooner rather than later, you will need to borrow money, so you will have debt repayments to make, perhaps on a credit card or bank loan. Your budget may then look like Table 1.4.

Table 1.4  The balanced budget – with debt

<table>
<thead>
<tr>
<th>Income</th>
<th>Expenditure</th>
<th>Discretionary expenditure</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>£500</td>
<td>Mandatory £400</td>
<td>Nil</td>
<td>Nil</td>
</tr>
<tr>
<td></td>
<td>Credit card £50</td>
<td>Nil</td>
<td>Nil</td>
</tr>
<tr>
<td></td>
<td>Other debt £50</td>
<td>Nil</td>
<td>Nil</td>
</tr>
</tbody>
</table>

This is managing the debt, but, again, leaving no room for discretionary expenditure.

1.5.2  Debt management

There is no problem with borrowing as long as you know how to manage debt. Some one-off purchases are too big to be afforded out of income, unless you are willing to save up for a long time to buy them. Also, some of these large items need to be purchased quickly and unexpectedly, such as a new fridge, washing machine, etc, when the existing one breaks down and cannot be repaired (and you haven’t insured against the breakdown).

You might decide to save up the money and wait until you have enough to buy the item. An alternative is borrowing to buy the item, which means that you can have it immediately, but it also means that you must pay back the money that you have borrowed out of the income that you expect to get in the future.

The British public has a huge appetite for borrowing, with the personal lending market estimated to be worth about £1,000bn. Total personal debt in the UK came to just under £1.5tn (£1,421bn) in October 2012, £1,264bn of this being secured lending on property. (Source: http://www.creditaction.org.uk)

Many students leave university not only with a degree, but also with a large amount of debt. The Push National Student Debt Survey has estimated that students who began their courses in 2011 can expect to owe £26,100 by the time they have graduated. University fees are set to increase: in December 2010, the coalition government decided that university fees in England would rise to a maximum of £9,000 in 2012–13 from £3,375 in 2011–12. The amount borrowed by the average student will almost certainly rise significantly. Much of this debt is, however, in the form of a ‘student loan’ – that is, a special government scheme that allows students to borrow at a low rate of interest, and to begin to pay back the loan only if and when their income reaches a certain level. This level is currently £21,000, having increased from £15,000 on 1 September 2012.
Almost 80 per cent of the UK’s borrowing is in the form of mortgages, which allow people to buy their own home. Because the interest rates on mortgage loans are usually lower than the rates on some other kinds of personal loan and because they typically stretch out over a long period, the monthly repayments can be cheaper than they would be on other kinds of personal loan. For this reason, during the early 2000s when house prices were high, many people took out second mortgages on their houses and spent the money on other things, such as holidays and cars, or used the money to cover the costs of emergencies, such as sickness or unemployment. This additional borrowing based on the value of a house was known as ‘equity withdrawal’ and it was a very common practice in the years that preceded the financial crisis. After the crisis, however, it fell into disuse and the trend has reversed, with many people paying off part – or all – of their mortgages in order to free themselves of debt.

1.5.3 Deeper into debt

The problem with debt comes if you fail to manage it properly. You will then hit what is called a ‘spiral’ of debt. Failure to repay the debt in any one month simply carries it over to the next month, effectively reducing your income before you even have it. Your budget might then look, month to month, like Table 1.5.

**Table 1.5 The debt spiral – month one**

<table>
<thead>
<tr>
<th>Income</th>
<th>Expenditure</th>
<th>Discretionary expenditure</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Month one</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>£500</td>
<td>Mandatory 400</td>
<td>Nil</td>
<td>–£20</td>
</tr>
<tr>
<td></td>
<td>Credit card £60</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Other debt £60</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Month two</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>£480</td>
<td>Mandatory £400</td>
<td>Nil</td>
<td>–£40</td>
</tr>
<tr>
<td></td>
<td>Credit card £60</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Other debt £60</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Month three</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>£460</td>
<td>Mandatory £400</td>
<td>Nil</td>
<td>–£60</td>
</tr>
<tr>
<td></td>
<td>Credit card £60</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Other debt £60</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

You can see where this is heading – and remember, we haven’t included additional interest, or any penalties that might be charged for not meeting repayments.

1.5.4 The consequences of poor debt management

Debt itself is not a problem as long as people can afford to make the repayments. Borrowing is a central feature of our economic society, which allows people to buy and own products for which they would otherwise never be able to save up. But failure to manage debt leads to personal problems: people deep in debt may be unable to feed
themselves (or children) properly, may be excluded from many financial products and may have difficulty in finding or keeping somewhere to live. They may also find that they are excluded from credit if they have a bad history of repayment. It is thus vital that you learn to monitor and manage money.

1.6 Conclusion

All of us have hopes and dreams for the future, which we can call ‘aspirations’. In order to achieve these aspirations, we need to use financial planning tools, such as a budget. Budgets are affected by what we earn or otherwise receive, what we must spend and what we choose to spend, and by our ability to manage all of these streams. If we insist on living beyond our budget, the consequences can be severe.

Chapter summary

In this chapter, you have:
• learned how to set goals and how to plan to achieve them;
• learned about budgeting, including surpluses and deficits, and budgeting over different time periods;
• identified sources of income and expenditure, and learned about making the choice of whether and what to spend;
• learned about how different stages in the life cycle require different budgets; and
• looked at the consequences of living beyond a budget.

Key words: income; expenditure; budget; surplus; deficit; perquisites (‘perks’); dividends; windfalls; discretionary expenditure; mandatory expenditure; personal allowance
Suggested answers to activities

Activity 1.1
If you were to want to be a surgeon, you would need (working back from last to first):

- to pass exams;
- to work as a junior surgeon;
- to pass exams;
- practice in a teaching hospital;
- practice on a ward;
- to qualify as a doctor;
- to pass exams;
- to get a place at medical school;
- to get a degree;
- to pass degree exams;
- to get a place at university;
- to pass A level exams; and
- to pass GCSE exams.

Activity 1.2
This is a question for discussion and the answers obtained may vary.

Activity 1.3
You may have listed the following ways of anticipating any given problem and reducing its effects:

- insuring against certain events;
- taking out a loan to provide a lump sum when needed; and
- putting money into a savings account so that you can finance a specific project at a later date.

Activity 1.4
This is a question for discussion.

Activity 1.5
The answer to this question will vary from person to person.

Activity 1.6
Possible sources of income for school students include:

- payment for doing odd jobs around the house;
- payment from a part-time job, such as a paper round, working in a shop, fruit picking, etc;
- gifts from parents, grandparents, other family, godparents, friends, etc; and
- pocket money or an allowance.
Possible sources of income for working people include:

- earned income – that is, wages or salary from employment or self-employment;
- state benefits – that is, support from the government;
- maintenance payments, such as from an ex-spouse; and
- investment income, such as that from shares.

Possible income for a retired person includes that from:

- State Pension;
- a part-time job;
- a personal pension – that is, private saving for retirement;
- interest on deposits; and
- investment income.

**Activity 1.7**

An employer might prefer to pay employees by bank transfer because of:

- the security – there is less chance of the money being stolen, either from the business’ premises or from the employees once they have been paid; and
- the administrative ease and speed – the money goes straight into the person’s account on the same day of each month, which is easier for the employer than having to count out cash or write out a number of cheques.

The advantages to the employee are the same as those to the employer – that is:

- the security; and
- the speed of payment (it can take several days for money paid by cheque to be available to spend).

**Activity 1.8**

The kinds of business in which people are typically self-employed include:

- tradesmen, such as plumbers, electricians, etc;
- professionals who are in business on their own (sole practitioners), such as accountants, lawyers, architects or web designers;
- artists, such as musicians, painters, actors and writers; and
- small shops run by their self-employed owners.

**Activity 1.9**

Other things that might be classified as perks by employees include:

- discounts on the things that their employer makes or sells;
- free private health insurance; and
- free tea and coffee.

**Activity 1.10**

More women than men have taken time off work to raise families or look after older relatives. This means that they have fewer years of making National Insurance contributions.
Activity 1.11
There are a huge number of benefits available, many of which depend on circumstances, such as expecting a baby or suffering a bereavement. A few that might be encountered at different stages in the life cycle are as follows.

<table>
<thead>
<tr>
<th>Lifecycle stage</th>
<th>Benefit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Teenager (13–19 yrs old)</td>
<td>Income Support; Housing Benefit; Council Tax Benefit</td>
</tr>
<tr>
<td>Young adult (18–25 yrs old)</td>
<td>Housing Benefit; Child Benefit; Child Allowance</td>
</tr>
<tr>
<td>Mature adult (26–64 yrs old)</td>
<td>Income Support; Guardians’ Allowance; Widowed Parent’s Allowance</td>
</tr>
<tr>
<td>Old age (65 onwards)</td>
<td>Incapacity Benefit; Attendance Allowance; Disability Living Allowance</td>
</tr>
</tbody>
</table>

Activity 1.12
If you contribute to your keep, you benefit because:
- an introduction to budgeting will help you to manage your finances better in later life;
- you will develop a sense of responsibility; and
- you will be helping your family to manage the home bills.

If you don’t contribute, however, you may be able to:
- avoid pressure and responsibility;
- have fun with your money while you still have few responsibilities; and
- start saving for your own future.

Activity 1.13
A mobile phone company would use a direct debit for a variable bill. For a fixed amount, you could use a standing order. If you can’t remember the difference, review Unit 1.

Activity 1.14
The answer to this question will be found on the website given.

Activity 1.15
You will have found:
- life assurance;
- motor accident insurance; and
- pet insurance.

Activity 1.16
The answer to this question will vary from person to person.