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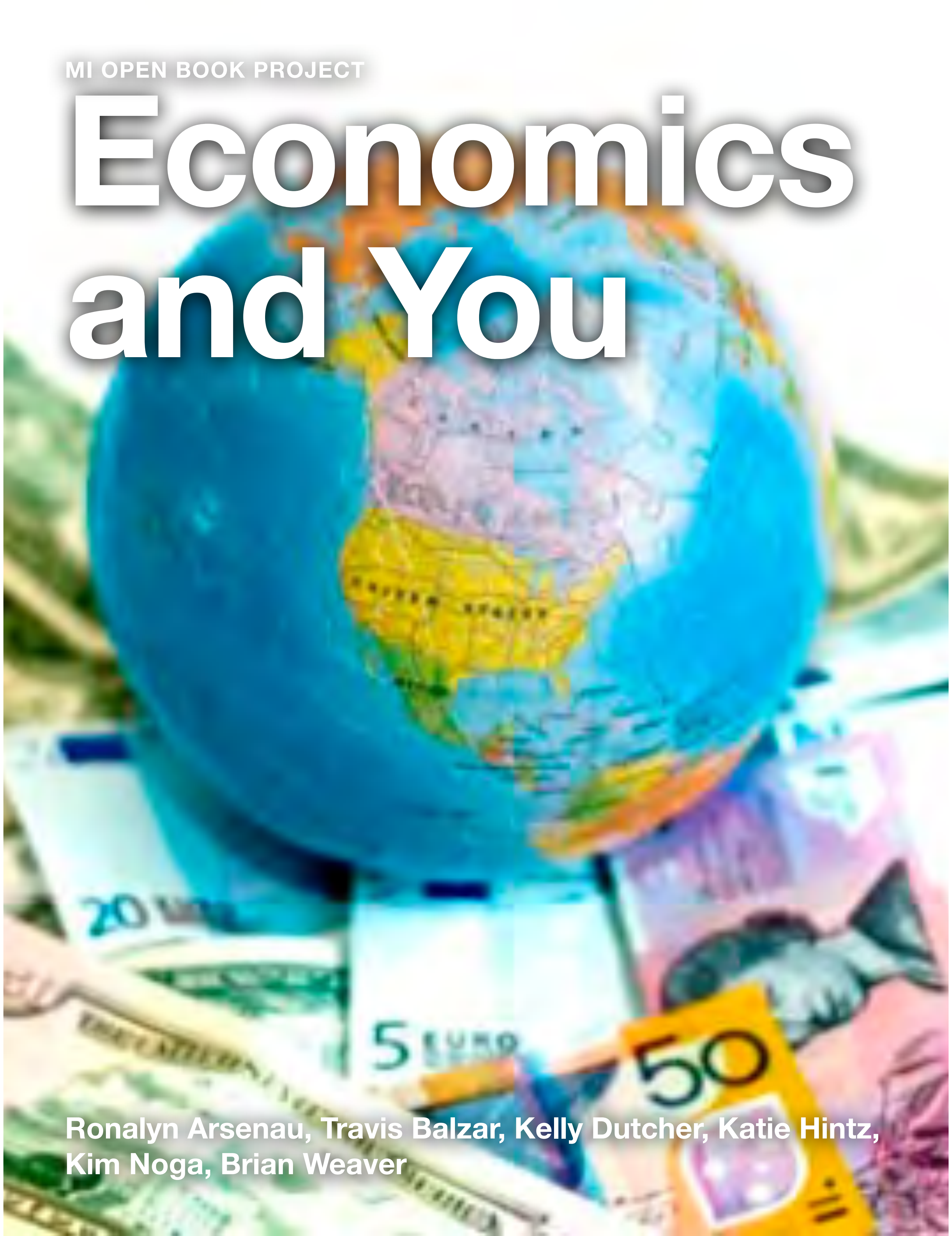
Economics and You



Ronalyn Arsenau, Travis Balzar, Kelly Dutcher, Katie Hintz, Kim Noga, Brian Weaver

Economics and You

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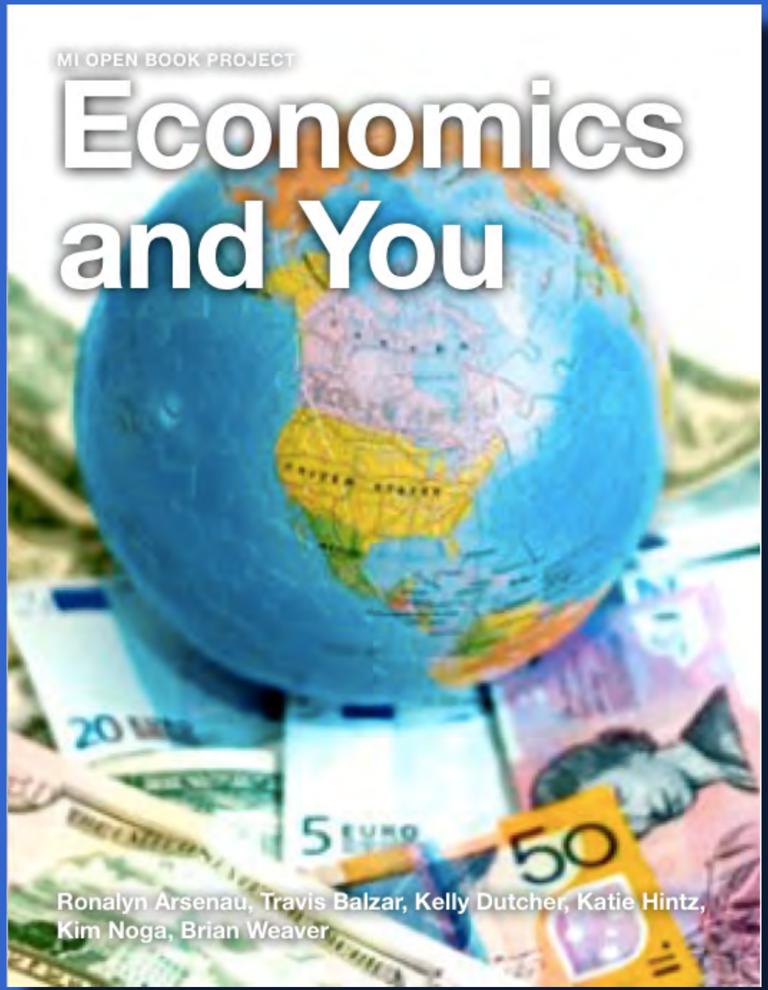

This is version 1.5 of this resource, released August 2018

Information on the latest version and updates are available on the project homepage: http://textbooks.wmisd.org/dashboard.html

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The Michigan Open Book Project

Project Manager: Dave Johnson, Wexford-Missaukee Intermediate School District

Economics Team Editor: Rebecca Bush Ottawa Area Intermediate School District

High School Economics Authors

Ronalyn Arsenau - NICE Community School District

Travis Balzar - Shepherd Public Schools

Kelly Dutcher - Harbor Springs Public Schools

Katie Hintz - Gladwin Public Schools

Kim Noga - Ionia Public Schools

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About the Authors - Economics and You

Ronalyn Arseneau

NICE Community School District

Westwood High School

Ronalyn Arseneau teaches Economics and Business at Westwood High School in Ishpeming. She is a member of the State Executive Board of the Michigan Business Education Association, serving as Vice-President for Membership. She and her husband, Barry, enjoy traveling to spend time with their three children and their grandson.

Travis L. Balzer

Shepherd Public Schools

Shepherd Public Schools

Travis L. Balzer is a Shepherd High School social studies teacher concentrating in Economics, Civics and History. Mr. Balzer (Mr. B) resides in Shepherd with his bride Haley, and daughters Makayla and Mia Jean. A Gladwin High School graduate. Parents Vicki and Teddy reside in Gladwin. Travis' sister, Kristal and two sons, Isaac and Adam reside in the Lansing area. Mr. Balzer earned an Economics and Management degree from Albion College and proceeded to obtain teaching certification from Saginaw Valley State University in Social Studies. In addition, obtaining a masters in Educational leadership from Grand Valley State University. Hunting, exercising including P90X, biking, running

Kelly Dutcher

Harbor Springs Public Schools

Harbor Springs High School

Kelly Dutcher teaches Economics, Civics, U.S. History, and College Readiness at Harbor Springs High School. Aside from teaching, she is also a Michigan Youth in Government advisor, and class of 2017 sponsor. Mrs. Dutcher is a graduate of Lake Superior State University where she received her BS in Social Studies and Secondary Education. She is currently working towards receiving her MA in American History and Government at Ashland University, and will spend a month this summer as a James Madison Memorial Fellow studying in Washington D.C. Kelly loves teaching at the high school level, and helping bring social studies to life for her students. She shares her life with her husband Jordan and three joyful girls: Daphne, 5; Audrey, 3; Meredith 2.

Katie Hintz

Gladwin Public Schools

Gladwin High School

Katie is completing her seventh year as a teacher at Gladwin High School, where she has taught every Social Studies course available, including: American Government, Sociology, Current Events, World History, Economics, Social Problems in the United States, and Law. A graduate of Saginaw Valley State University's Secondary Education Program, she majored in History, minored in Sociology and earned a Social Studies Endorsement. As Social Studies Department Chair, she was inspired to participate to the Open Book Project because of the disjointed resources that most economics teachers are forced to scrape together to create a captivating curriculum.

Currently, she is working on completing her Masters in Global History at with American Public University. Her final thesis on the Food Industry is due to be published September,

Kim Noga

Ionia Public Schools

Ionia High School

Kim has a B.A. in History/ Social Studies and an M.A. in Curriculum and Teaching, both from Michigan State University. For the past 14 years she has been employed at Ionia High School where she teaches Economics, U.S. History, and Humanitarian Studies. Her hobbies include reading and traveling the world.

Brian Weaver

Big Rapids Public Schools

Big Rapids High School

Mr. Weaver has been teaching high school social studies for fourteen years. After one year at New Directions Alternative High School in the Big Rapids Public Schools he moved to Big Rapids High School where he has taught US History & Geography, American Government, World History & Geography, Economics, Geography, Psychology, and Modern Social Problems. Before becoming a high school teacher, Mr. Weaver worked in higher education as a development officer and administrator. As Director of Development for Ferris State University he oversaw fund raising activities for Kendall College of Art and Design and served as Director of the Kendall Foundation. In ten years of service at Northern Michigan University he served in a variety of development posts including Director of Development Research and Director of Annual Giving. Mr. Weaver caught the teaching bug during his service in the Peace Corps on the central Philippines island of Leyte where he taught in a two-room school house. His many interests include reading, woodworking, and home improvement

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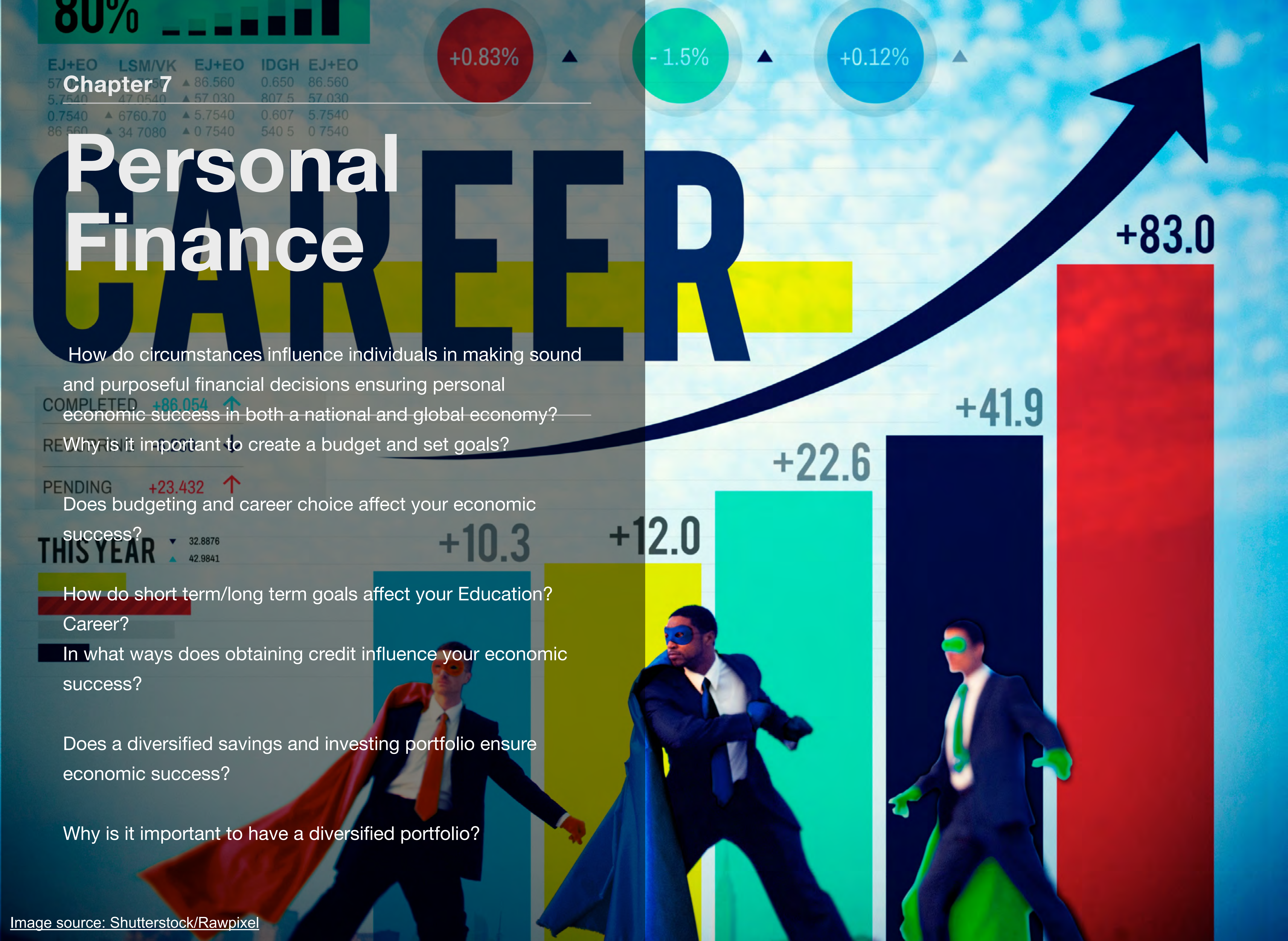


Chapter 7

Personal Finance

How do circumstances influence individuals in making sound and purposeful financial decisions ensuring personal economic success in both a national and global economy?

Why is it important to create a budget and set goals?

Does budgeting and career choice affect your economic success?

How do short term/long term goals affect your Education? Career?

In what ways does obtaining credit influence your economic success?

Does a diversified savings and investing portfolio ensure economic success?

Why is it important to have a diversified portfolio?

Image source: Shutterstock/Rawpixel

Section 1

Career and Budget

QUESTIONS TO GUIDE INQUIRY

1. **How do circumstances influence individuals in making sound and purposeful financial decisions ensuring personal economic success in both a national and global economy?**
2. **Why is it important to create a budget and set goals?**
3. **Does budgeting and career choice affect your economic success?**
4. **How do short term/long term goals affect your Education? Career?**

As you have probably already learned, Economics is about choices.

When you were younger (and maybe recently as well) people probably asked you “What do you want to be when you grow up?” Five year old you may have said “firefighter” or “doctor” but as you approach your final years in high school the time is getting closer when you’re going to need to make a decision about how to spend your years post high school.

Interactive 7.1 10 College Majors To Watch

The widget on this page identifies 10 college majors that are currently in high demand. That means that there are many jobs in this field available and managers are having a hard time keeping them filled. As you look at each one, think about some of the following things:

- Would you enjoy it?

- Is it a good match for your skills and abilities?
- What further education is necessary to attain this job?

Choosing a career can be a daunting task, particularly as a high school student. What if what you want to be doing 30 years from now is not what you want to be doing right now? The best option in choosing a future career is to pick a path that feels right when the time comes and keeping in mind the realization that you can change your mind in the future. Just because you pick a career today does not necessarily mean you have to stick with it for the rest of your life. If Economics is about the choices we make, it's always important to remember that you can make that choice again in the future. Your needs and wants will ultimately morph over time.

Once you've made the all important decision about the career you want to pursue, it is necessary to consider what further education you need. Does it require attending college? A trade school? Will you be able to receive some on the job training? Most importantly: How will you pay for it?

One Option: Student Loans- FAFSA: What is the purpose of the FAFSA?

Every year millions of people decide to enter or return to school, and with the cost of college on the rise, one option people turn to is student loans. The first step in applying for this process is to get your "place in line" for the available funds by filling out a form known as the Free Application for Federal Student Aid (better known as the FAFSA.) This is a form that you can fill out every year if you're planning on attending school during the next academic year. It is used to determine whether or not you are eligible for financial aid. Taking out loans for college is not a decision to be made lightly - when it's over you could be paying this debt off for anywhere between ten and twenty five years.

Interactive 7.3 Types of Aid available

Learn more about the types of student aid available by viewing this video.

Interactive 7.2 FAFSA

Learn more about the FAFSA at the main FAFSA website.

What are the differences between grants vs. loans?

How do unsubsidized and subsidized loans compare?

What are the best options for paying for your education?

Interactive 7.4 The 4-1-1 On College Education

Read through the materials on this website for more information.

For many careers a college education is a necessity. With the cost of that education rising however, one needs to consider what the cost of that education can mean.

To some, a college education is an investment. While you'll pay for that investment in the form of loan repayment, there have been studies performed which have clearly shown that there is a widening gap in personal incomes between those who have a college degree and those who have only completed high school.

If you're not completely terrified about both having to think about what you want to spend the rest of your life doing, and how you're going to pay for it, it can be time to start thinking about and setting your ultimate goals.

SMART Goals

When thinking about your future, the best goals are SMART goals. SMART in this case is an acronym. It stands for "Specific, Measurable, Attainable, Realistic, and Timely. SMART goals can help you financially make decisions for your future.

S: Specific and significant - Your goals have a much greater chance of being achieved if they're specific. The goal of "making money" isn't specific. How are you going to do that? What is it that you will accomplish that will help you reach that end goal? To make this goal more specific, instead think about a statement like "Get trained after (or during if you have a career technical center available to you) high school to become a professional welder."

You will need to consider 5 W's to help make your goal specific: Who is involved, What do you want to accomplish? Where will you need to go? When will this need to be accomplished by? Why are you wanting to do it?

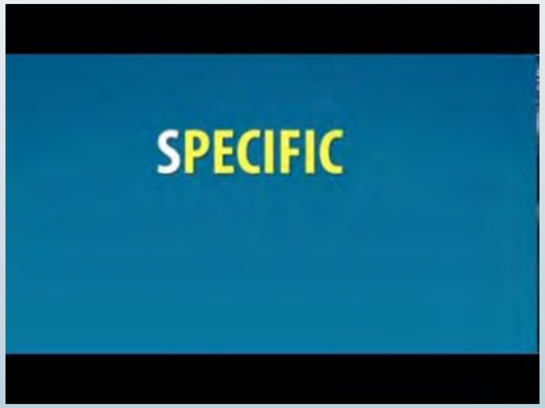
M: Measurable and motivational - You're also going to need to spend some time establishing the criteria that you'll use to measure your progress toward the achievement of your goal. This too requires asking some questions. The biggest is "How will I know when it is accomplished?"

A: Achievable and appropriate - When you identify your goals, you'll have to decide how you can make those goals come true. How will you achieve them? This requires planning.

R: Relevant and result-based - Is the goal you've come up with something you're willing to work for? Is it something you're able to work for? You are the only one who can ultimately decide how high your goal can end up being.

T: Time-bound and time oriented - A goal needs an end point. If the goal is to become a professional welder and you've figured

Interactive 7.5 More on SMART Goals



Learn a little more about SMART goals in this video.

out the steps you need to get there, establish your concrete goal of when you can realistically accomplish this. Saying "someday" isn't timely. Saying "tomorrow" isn't realistic. Set your time goal and do your best to stick to it.

A Budget - Your Financial Plan For Getting There

How well do you understand money? What about the cost of living? Take a moment in the box below to answer the following questions before moving on:

After you enter the work force:

What kind of car do you want to drive?

What kind of phone will you have?

Will you have a TV? Will it require Cable/Satellite?

Are you going to regularly eat out? Where?

What kind of place will you live in? (Apartment? House? Mansion?)

Every one of those questions has a financial cost. A car payment can be $199 a month, or much higher depending on the vehicle you chose. If you chose the latest iPhone model along with an expensive data plan, count on another $50-$150 a month. Cable TV is great, but the price to get that sports package you may want is much higher than the cost of the basic package. Not to mention the power bill, which goes up the longer that TV is on and every time you plug that phone in to recharge it.

A house or apartment costs money. It's not just your mortgage or your rent payment. It's the power bill. The heating bill. Unexpected repairs that creep up. And of course, to live, you have to consume food and water. If you live in the city limits that might add a water bill to your monthly totals.

Because all of these things have a financial cost, it's important to make certain that you have enough money coming in every month to cover these expenses. The best way to do this is to create (and stick to) a budget.

Interactive 7.6 A Sample Family Budget

To get a sense of what expenses you might have each month, take a look at this sample family budget.

Why Budget? How do Americans budget?

A budget is a summary of two things: Your income and your expenses. It can be simple or elaborate (like the one on the previous page) The main purpose of a budget however is to help you make decisions. If you really want those tickets to the concert you've been wanting to go to, how long will it take you to save up for it?

A good budget serves the basic purpose of letting you track how much money is coming in and going out. It can also help you figure out if you have any wasteful expenditures and achieve your ultimate financial goals.

Why is budgeting so difficult?

Budgeting doesn't have to be a painful experience, but for some it is. One of the reasons why people may not stick to a budget goes back to the concept of choices. To pay for all of those things listed in the sample budget on the previous page, they may have to give up some things that they don't want to think about. The daily trip to Starbucks, new music downloads, a NetFlix subscription - all things that may give someone some enjoyment, but come at an opportunity cost.

Dialing down further on what a budget it, (and why it can be difficult for some to follow) a person should understand two different types of income. **Disposable income** is the amount of money you have left when your paycheck makes its way to you and all of the required taxes are taken out. Suppose you have a job that pays you $1500 every two weeks. When all the taxes required at the local, state, and federal levels are taken out, you may end up with $1000 actually making it into your bank account.

That money makes its way to you in the form of a paycheck, and once deposited in your bank account you then have to send some of that money out to pay your mortgage/rent, your car payment, your power bill...all of the necessities. Once all of this has been taken care of you're left with **discretionary income**, the amount of money you have left over to invest, save, or spend after paying your bills. For some it is difficult to see that end number. That thing you're hoping for, whether it's a strong savings account, concert tickets, etc. can seem like it's a long ways off - or even impossible.

It is for these things however that a budget can be one of the most useful tools in a person's financial life. Imagine for a moment that you're saving up to buy a new television set. This is an economic want that many people experience. Maybe the one you're hoping to get costs around $1000, and after paying all of your bills each month you are left with $100 to your name. There are several ways you could move forward. If you saved that $100 every month (and luckily encountered no emergencies) you could have that television set in 10 months. That choice however means you have no money left over for your daily trip to your coffee shop.

If you've kept a detailed household budget going however, you might see that there are certain things you can cut out to help you get that television faster. Do you really need that NetFlix subscription? Can you shop at a different grocery store to save money? Do you have a savings account with more than the recommended "3 months of living expenses" (more on that in a moment) in it? If you budgeted $200 a month for groceries and are able to save $90 by shopping elsewhere or buying a cheaper brand, and eliminated your NetFlix subscription you could have just doubled your discretionary income and given yourself a path to obtaining your economic want of a new television faster.

Practice budgeting with these two interactive games:

Interactive 7.7 GenIRevolution

Interactive 7.8 Spent

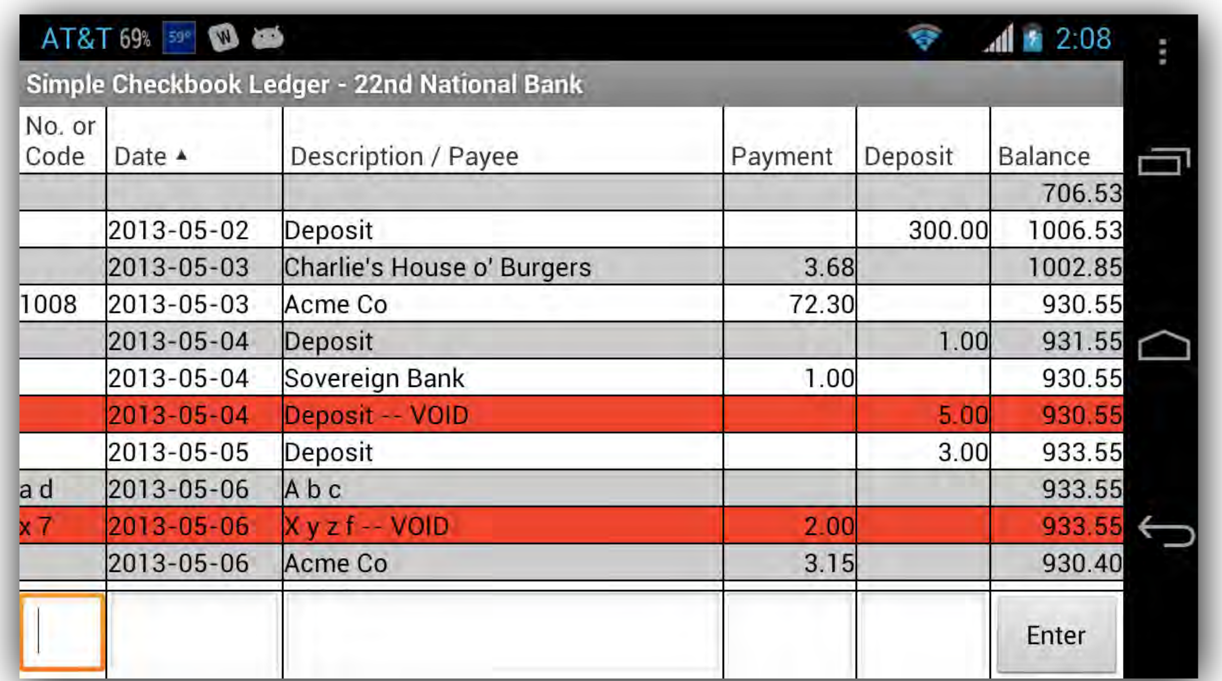
Your Savings

Your budget is only one step in the fast paced world of "being a responsible adult." The next thing that many economists suggest is that you should get a savings account going with at least three months worth of your monthly income in the event of an emergency. Others suggest more, anywhere between six and nine months worth is ideal. The reason behind this is simple and unavoidable: There will be situations that arise suddenly that you may not have control over. It could be that you find yourself temporarily unemployed, have a major home repair, or find yourself with some large out of pocket medical expenses that may not be covered by insurance. Whatever the case may be, saving at least three months worth of income will provide you with a financial cushion upon which you can fall when times get rough.

How Important is it to Keep up to Date With Your Finances?

The digital age has brought many improvements to people living today. Financial transactions which used to take several days to complete can now be done instantaneously. Even more useful is the ability to log in to your bank's website at any time of day or night to see exactly how much money you have there. For many this is a way to keep your check book balanced regularly, but for others this can lead to financial issues if an accurate register of transactions is not actually kept.

Balancing your checkbook can be an easy task if you keep up to date regularly, but it can be a nightmare if you don't. This helps you manage your money, keep tabs on your cash flow, and avoid overdraft and the fees that come with having insufficient funds.



No. or Code	Date	Description / Payee	Payment	Deposit	Balance
					706.53
	2013-05-02	Deposit		300.00	1006.53
	2013-05-03	Charlie's House o' Burgers	3.68		1002.85
1008	2013-05-03	Acme Co	72.30		930.55
	2013-05-04	Deposit		1.00	931.55
	2013-05-04	Sovereign Bank	1.00		930.55
	2013-05-04	Deposit -- VOID		5.00	930.55
	2013-05-05	Deposit		3.00	933.55
a d	2013-05-06	A b c			933.55
x 7	2013-05-06	X y z f -- VOID	2.00		933.55
	2013-05-06	Acme Co	3.15		930.40

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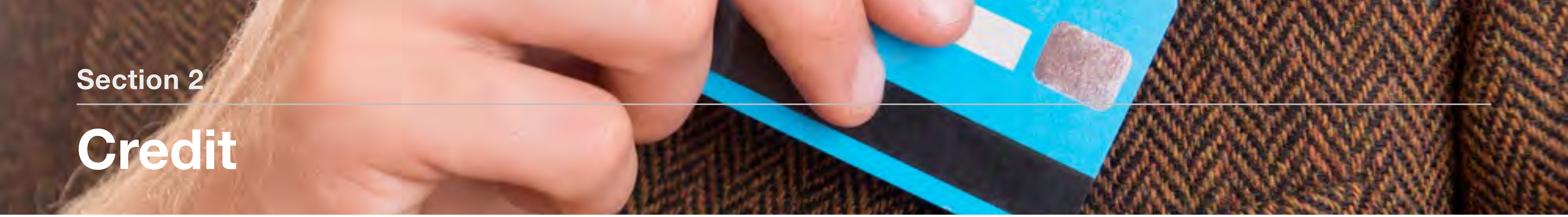
Why is it important to create a budget and set goals?

Does budgeting and career choice affect your economic success?

How does Short term/long term goals affect your Education? Career?

Interactive 7.9 Balancing Your Checkbook - Online Simulation



Section 2

Credit

QUESTIONS TO GUIDE INQUIRY

1. **In what ways does obtaining credit influence your economic success?**

Lets say you've saved up three months worth of salary and have a really well put together household budget. Things are looking up. You've got a job, you've got savings, and you're financially secure. Then - you have a really bad week. The transmission goes on your car and you suddenly have to come up with thousands of dollars for a replacement. At the same time there's a nasty thunderstorm where it pours so hard it floods your basement. Your savings is quickly depleted handling just one of these emergencies, and just when you thought things couldn't possibly get any worse, you break your leg and the medical expenses are only partially covered by your insurance.

That emergency fund can take forever to build up, and can be wiped out extremely fast if you're not careful. There may be cases in life, particularly when buying an automobile for the first time, when credit can help you. When used responsibly, credit can help you buy big things. **Credit** is borrowed money that you can use to purchase goods and services when you need them. Because it is borrowed money, you agree to pay the money back within an agreed upon time. Once you have credit, you have what's known as a credit score. Credit scores give lenders, people who lend money to others, a quick overview of whether or not you're a good candidate to lend money to.

Your credit score:

- Can help you get a loan faster. Many credit decisions can be made within minutes.
- Is a fair way to make a credit decision. Lenders make their decisions based on facts from your past and present. Things like race, gender, religion, etc. are not taken into account. Also, if you make some mistakes, a bad credit score doesn't haunt you forever.
- Can be improved by paying all your bills on time, and by not using too much of the credit that is available to you to spend.

When first trying to get credit, the best place to start is to see if your own bank has a credit card for someone with a limited credit company. If that doesn't work you can also try to get a credit card at a department store or a gas station. Sometimes these cards are easier to get, but they come at a cost - interest rates. An **interest rate** is the cost of carrying a credit card balance from month to month. It is the rate at which interest is paid by a borrower (that's you) for the use of money that you borrow from a lender. You'll learn more about Interest rates shortly.

Interactive 7.10 Feed The Pig - Credit

Learn more about Credit at this website.

In summary, credit is obtaining goods and services before payment based on trust that payment will be made in the future. Credit does mean however, that you will be going into debt.

Your credit rating is an analysis of your credit worthiness in obtain credit.

What factors go into creating your credit score?

How can you improve your credit score?

Debit vs. Credit cards

If you have a checking account it's more than likely that your bank will issue a Debit Card. A Debit Card looks just like a credit card and probably has a Visa, Mastercard, or Discover Card logo right on it. These cards allow you to pay for goods and services at businesses that accept major credit cards. Unlike credit cards however, a debit card is directly tied to your bank account. If you have money in your account you're able to access it easily with these cards.

If however you end up spending more money than you have in your account, several things could happen. The most likely is that the transaction will be rejected by the merchant and you'll have to find an alternative method of payment. Some banks allow for you to spend more money than you have but charge you a fee known as an "over draft fee." It's costly to carry a negative balance at your bank!

So while debit cards allow you to transfer money electronically just like a credit card, this is real money from your bank account

Debit Cards allows the holder to transfer money electronically when making a purchase for a good or service. This is money on hand that the holder has in a saving/checking account. Debit cards are connected to your bank account, whereas Credit cards are not.

Interest Rates

If you carry a credit card balance from month to month you'll be required to make a minimum monthly payment. While your minimum payment may be low (or high) it is important to pay off your credit as quickly as possible. Every month you carry a balance you're charged interest on the amount of money you owe, which is calculated by multiplying your balance by the interest rate.

Interest rates can be low. Some places like credit unions offer rates that can vary from anywhere between 6%-10%. Bigger banks, particularly national ones can match that but often go much higher. It's not uncommon to receive credit card offers in the mail that offer rates between 17-20%!

Pretend for a moment that you and a friend both have $2,000 in credit card debt. The credit cards require minimum payments of $60 a month (roughly 3% of your balance.) Because you don't have much money, you make the minimum monthly payments. Your friend adds an additional $10 each month.

That $60 you send only covers a portion of the debt. This is called the "principal." The rest of that $60 is interest. Creditors use a formula every month to calculate your minimum payment that takes place every month until you pay off your card.

In the end, just making minimum payments it will take you about 15 years to pay off the $2,000. In addition to that $2000 you borrowed, it'll also cost you over twice that in interest. Think about that - over time you'll pay $4,000 for that $2,000 your initially borrowed.

Your friend is in a better place. He or she will pay about $3,000 total over a seven year period because

Interactive 7.11 Credit Card Payoff Calculator

Explore how long it could take you to pay off a credit card debt with this interactive calculator.

they pay a little more each month. That means that initial $2000 only cost them about $1200 extra.

Home Ownership and Credit

Another major decision you'll make as an adult will be the decision on whether or not you want to buy a home. Buying a home is considered a major purchase. Unlike renting, the home you buy becomes yours. Should you need to move for a career opportunity it can be difficult to resell your home depending on the housing market at the time. It also means your monthly budget will have a relatively large expenditure as part of your discretionary income.

The advantages to home ownership are many. For one, you'll build equity in your home by making improvements (and payments) over time. You can deduct your mortgage interest on your taxes, and you can build a solid credit score while making your mortgage payment each month.

A Mortgage is a line of credit for your home. Because homeownership is a long term commitment, your lender will want to make certain you're able to actually make your payments. Another way they do this is by requiring a down payment. A general rule of thumb is to put down twenty-percent of your home's purchase price. That means, if you buy a house for $100,000, you would pay the seller $20,000 and borrow the remaining $80,000 from the bank.

The 20% rule is generally a good idea, but it can be difficult to save that much money. Sometimes a potential home buyer is able to take advantage of a 0-3.5% down payment. These lower rates also come at a cost - generally you'll be required to get mortgage insurance which helps protect the lender if you are unable to make payments and go into default. This is an extra fee wrapped into the cost of your home which will increase the mortgage amount that you pay over time.

Interactive 7.12 15 vs 30 - Mortgage Calculator

Use this online calculator tool to determine some of the pros and cons of a 15 or 30 year mortgage.

Generally, the terms of a mortgage take place over either 15 years, or 30 years. Thinking about what you know about credit from this section, answer the following questions:

How does interest affect a mortgage?

Would you choose the 15 or 30 mortgage? Why?

Would there be a better option than getting a mortgage?

How does paying extra affect your mortgage interest rate?

How does paying extra affect your mortgage total payment?

How does paying extra affect your mortgage total cost?

Another thing to think about when buying a home is the concept of Escrow. **Escrow** is essentially what happens when money is deposited by one person with a neutral third party so that it can be delivered to another party upon completion of an event. The third party will then pay both your home insurance and property taxes. This can be handy because instead of paying a separate home owners insurance bill and a separate property tax bill, Escrow can take care of these expenses for you - but once again, as part of your normal monthly payment.

Interactive 7.13
Understanding the Escrow Process

Is Escrow worth it? Learn more about Escrow and the process at this website.

Now that you understand more about the home buying process, it's a good time to evaluate where you're heading in the next few years. It probably doesn't make sense for you to buy a house right out of high school. It is also quite possible you might decide never to take the home ownership plunge.

While renting you will still have a monthly expenditure in your budget, but that total can sometimes be less than what you would pay if you bought a home. The biggest downside is that you'll never own the place you live when you rent. Owning a home isn't for everyone and needs to be done at a time in a life when you're financially stable.

Compare and contrast the advantages and disadvantages of renting vs. buying a home. What are the advantages and disadvantages of each?

Automobile Ownership and Credit

A type of credit you may encounter before you ever think about buying a home does involve how you get to and from work and school on a daily basis. The decision to lease or purchase a new or used vehicle is another one of the big life decisions heading your way after graduation. The questions you'd ask yourself include:

Do I want a new car?

Can I make due with a used car?

How do I purchase a car?

What is leasing a vehicle? How do I do that?

These can be daunting questions and yes - the answer to each is an economic choice. There are hundreds of makes and models of cars available. Narrowing down the list can be difficult. If it's just you, you might be able to make due with a small passenger car that seats 4-5 people. When you're older and have a family, an SUV or minivan might make more sense for your lifestyle. If you live in a place with frequent snow storms, you might want to look instead at a vehicle with all wheel or four wheel drive.

Once you've determined the kind of vehicle you want, the next major issue you'll encounter is the price. Affordability of a vehicle can be tough to grapple with. You may not be able to afford a brand new vehicle outright without getting a loan. Whether buying new or used, you will need to make a down payment. You'll want to think about how long you want to be paying that car off. A 60 month loan may offer you a lower monthly rate, but do you want to be paying for your vehicle for 5 years? It is essential to figure out how much money you can dedicate each month to the purchase of a vehicle.

Once you've figured out what vehicle you want, and how much you're able to pay for it, you're confronted with yet another choice. Do you want a new car that is protected by a warranty for a long period of time, or do you purchase a used vehicle. It's nice knowing that the dealership and the car manufacturer will cover the costs of any defects in the car for the first few years of ownership, but a new car is far more expensive than one driven by a previous owner. The trade off of buying used instead of new however means that you may be breaking into that emergency fund you've been socking away (see what that's important?) to pay for repairs that creep up.

An alternative that allows you to get a newer vehicle at a smaller monthly payment is leasing. When you lease a vehicle you generally have to pay a smaller down payment than when you purchase it outright, and your monthly payment is much lower. This can be convenient, but leasing comes at another cost. If you put more than 10,000 miles on your car in a year you can be charged for the extra mileage.

Before purchasing or leasing your new or used vehicle there's another thing to consider that can't generally be solved in the dealership offices. Finding out the insurance rates for the car you're looking to purchase. Car insurance generally protects a driver from having to pay large out of pocket expenses if you're in an accident or something happens to the car, and in most states is a required part of automobile ownership. Depending on the vehicle's safety rating, your driving history, and the history of the vehicle (if it's used) your insurance rates may vary. Age is also a determination in insurance rates. Generally younger people who are not as experienced as a 30 year old have to pay more. You can generally pay your insurance rates monthly, quarterly, or twice a year. No matter which option you choose, it is an additional expense that doesn't go away even after you've finished paying off the vehicle.

Finally, it’s time to figure out how to pay for the vehicle. If you’re buying a used vehicle and not taking out a loan this can be a relatively easy process. If you decide to take out an auto-loan to help you pay for it however, everything you’ve learned about credit in this section comes back into play. Your credit history will significantly impact the approval of your loan, and how much you could end up paying each month.

What are the advantages and disadvantages of buying a car?

What are the advantages and disadvantages of leasing a car?

In which ways does obtaining credit influence your economic success?

Section 3

Saving and Investing

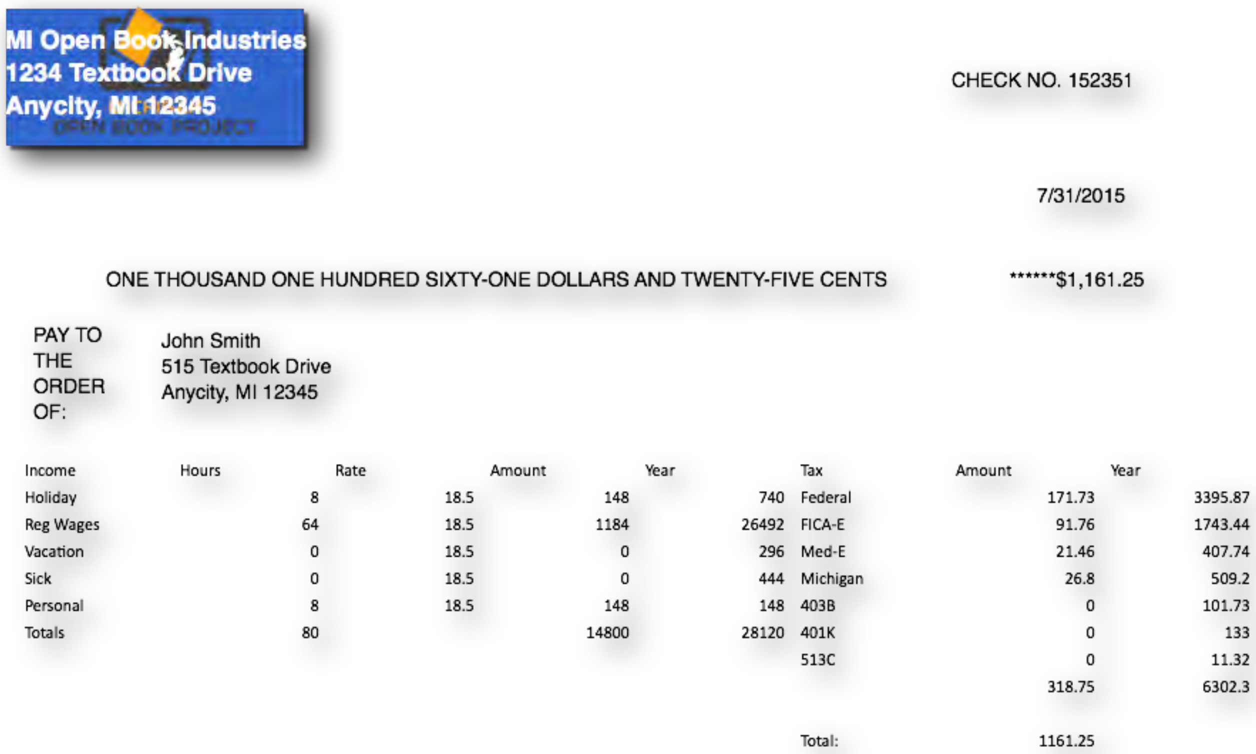
QUESTIONS TO GUIDE INQUIRY

1. **Does a diversified savings and investing portfolio ensure economic success?**
2. **Why is it important to have a diversified portfolio?**
3. **How does the government protect consumers, workers, and their savings?**

Who is This FICA Guy And Why Does He Take So Much?

You worked hard for two weeks. You picked up extra hours and are excited when payday comes around to pick up your first ever paycheck. In your head you've figured it out. You worked X number of hours, and your rate of pay is Y. Multiplying these two you're excited as you rip open the envelope and see...

...less than you were expecting. You blink in disbelief and immediately assume that someone in payroll made a mistake. Then you scan the paycheck stub a little more and see that they've taken taxes out. Medicare. Just who is this FICA guy, and why does he get so much?



MI Open Book Industries
1234 Textbook Drive
Anycity, MI 12345

CHECK NO. 152351

7/31/2015

ONE THOUSAND ONE HUNDRED SIXTY-ONE DOLLARS AND TWENTY-FIVE CENTS ******$1,161.25

PAY TO THE ORDER OF: John Smith
515 Textbook Drive
Anycity, MI 12345

Income	Hours	Rate	Amount	Year	Tax	Amount	Year
Holiday	8	18.5	148	740	Federal	171.73	3395.87
Reg Wages	64	18.5	1184	26492	FICA-E	91.76	1743.44
Vacation	0	18.5	0	296	Med-E	21.46	407.74
Sick	0	18.5	0	444	Michigan	26.8	509.2
Personal	8	18.5	148	148	403B	0	101.73
Totals	80		14800	28120	401K	0	133
					513C	0	11.32
						318.75	6302.3
					Total:	1161.25	

When you started that job, chances are you filled out a W-4 form and submitted it to your employer. What you select on that form impacts what you take home from your employer every time you're paid. On a first glance, one might want to make certain that they're paying as little as possible each pay period to make certain that you get as much money in your bank account as possible. This has a downside however. The money taken out of your paycheck is used to pay taxes to the local, state, and federal government. At the end of each year you're responsible for preparing a tax-return and filing it before the yearly deadline (usually April 15th.) The more you have taken out of your paycheck now can sometimes lead to something known as a “tax refund.” A tax refund is money that you have overpaid to the government each year. If you pay more than you owe, the government will send you a check for the difference.

How Much Do You Pay In Taxes?

How much you make affects how much you pay in taxes. Generally individuals are placed into a tax bracket based upon how much money they make in a year. The United States currently uses a sliding scale that takes more money out depending on how much you make.

Why Do We Have Income Taxes, and Where Does The Money Go?

Just like you need a steady income to pay for your expenses, a government needs revenue to operate. Most of the money that you make at your job is taxable, which means it is subjected to the government’s tax rate. The first federal income tax was imposed in the 1860s when the government needed money to fund the Civil War. Because this was not an expressly stated power in the United States Constitution, Congress eventually passed an amendment to the Constitution which granted it this power. The 16th Amendment took effect in 1913 and authorized taxes on income. It provided the framework for what we all pay today.

The federal tax dollars you pay go many different places. The United States Treasury has three main categories: mandatory spending, discretionary spending, and interest on debt. **Mandatory spending** is federal spending that is based on the cost of existing laws. **Discretionary spending** is federal spending that can vary from year to year. Congress appropriates money to places like the Military (which accounts for almost half of the discretionary spending budget) transportation, veterans benefits, education spending, and more. The final group is **Interest on debt**, which is the amount of money the government pays on it’s debt. Just as you learned in the previous section about paying interest on money you borrow - even our government isn’t immune to this.

Interactive 7.14 Where Does The Money Go?

Learn more about where the revenue the Federal Government takes in through taxes goes at this website.

What Does the FICA Tax Cover?

If you look at a paycheck stub like the one at the front of this section however, you’ll notice that you don’t just pay Federal taxes. Underneath the Federal line is one labeled FICA. FICA stands for the Federal Insurance Contributions Act. FICA is a payroll tax that employees pay to fund both Social Security and Medicare.

Social Security was established during the Great Depression. Prior to this massive economic downturn, the United States had never mandated any retirement savings. If elderly people had not saved money during their working lives, they did not have an income in their later years. The government also did not have money to pay for people who became injured on the job, or were never able to work due to disabilities that they were born with. President Roosevelt's New Deal in the 1930s introduced the program of Social Security to help solve these problems. Medicare was added in the 1960s to help the elderly with the rising costs of health care after retirement.

Interactive 7.15 Where does your Tax Money Go?

See how the Federal Government spends most of its money at this website.

Why Do We Have State Income Taxes?

The Federal Government isn't the only one with their hands on your paycheck. States impose additional income taxes on your earnings, and they do this for the same reason - they need money to effectively operate. States all collect this money differently. Some have a sliding scale like the Federal Government. Others use a flat tax rate, which means you pay a certain percentage on all all income levels. There are also states that don't impose an income tax at all. If you do pay state tax however, you are able to deduct them from the taxes you pay to the Federal government every year. States use the money that they collect from all sources to pay for things like road repair, and education.

Saving and Investing for Retirement

This chapter has spent considerable time describing what a budget is, why you should have one, the benefits and pitfalls of all different kinds of credit, and now where part of your paycheck goes before you even see it. It's more important than ever however to start thinking about how you will be financially secure when you retire as early as possible. No matter how much you love your job, some day you're going to want to retire.

It might be hard to believe but it is never too early to start planning for your retirement. The longer you wait to start saving, the less time you are giving to your money to work for you in the present. The good news is that if you are already currently working, you are already putting some money away for retirement in the form of the FICA tax, or Social Security tax that is withheld by the government. However, since most experts agree that Social Security payments alone will not fund a comfortable retirement for anyone, the sooner you can start saving for retirement, the better.

You might be asking yourself, “How do I know how much money will I need for retirement?” There are many variables that affect this answer, but most financial advisers agree that you will need approximately 70% of your pre-retirement income in order to continue to live a comfortable lifestyle once you do decide to retire.

Thinking about these things might prompt another important question: “Where does the money come from for my retirement?” As discussed in the paragraphs above, the first source is Social Security. But, before you assume that Social Security will still be available by the time you retire, you may want to check out a recent article that discusses the availability of Social Security as well as projected bankruptcy timelines at the website to the left.

Interactive 7.16 Social Security is Running Out

Learn more at this website.

Interactive 7.17 Face the Facts - Social Security

Since many pensions are disappearing in the private industry, after Social Security, the rest of your retirement income depends on you. So, the first step in trying to figure out how much to save is to try and determine how much you will need. One tool that many people find helpful is that of a retirement calculator. An example of a simple retirement calculator can be found in the video to the right.

Interactive 7.18 Retirement Calculator Movie

The bottom line is this: start saving early, and save often.To get a better idea as to the best ways to save, you may want to determine your risk management profile. One tool to assist with this task is the “iprofile” which can be found at:

Interactive 7.19 iProfile

Additionally, some of the questions that you may want to ask yourself are:

Throughout my life should my investment risk level change?

Where should my risk level be during the early part of my career?

Throughout history, when has a high risk level proven to be detrimental to an investment portfolio?

Diversification is spreading investments around instead of investing in one single thing. Diversifying can iron out the ups and downs of investing.

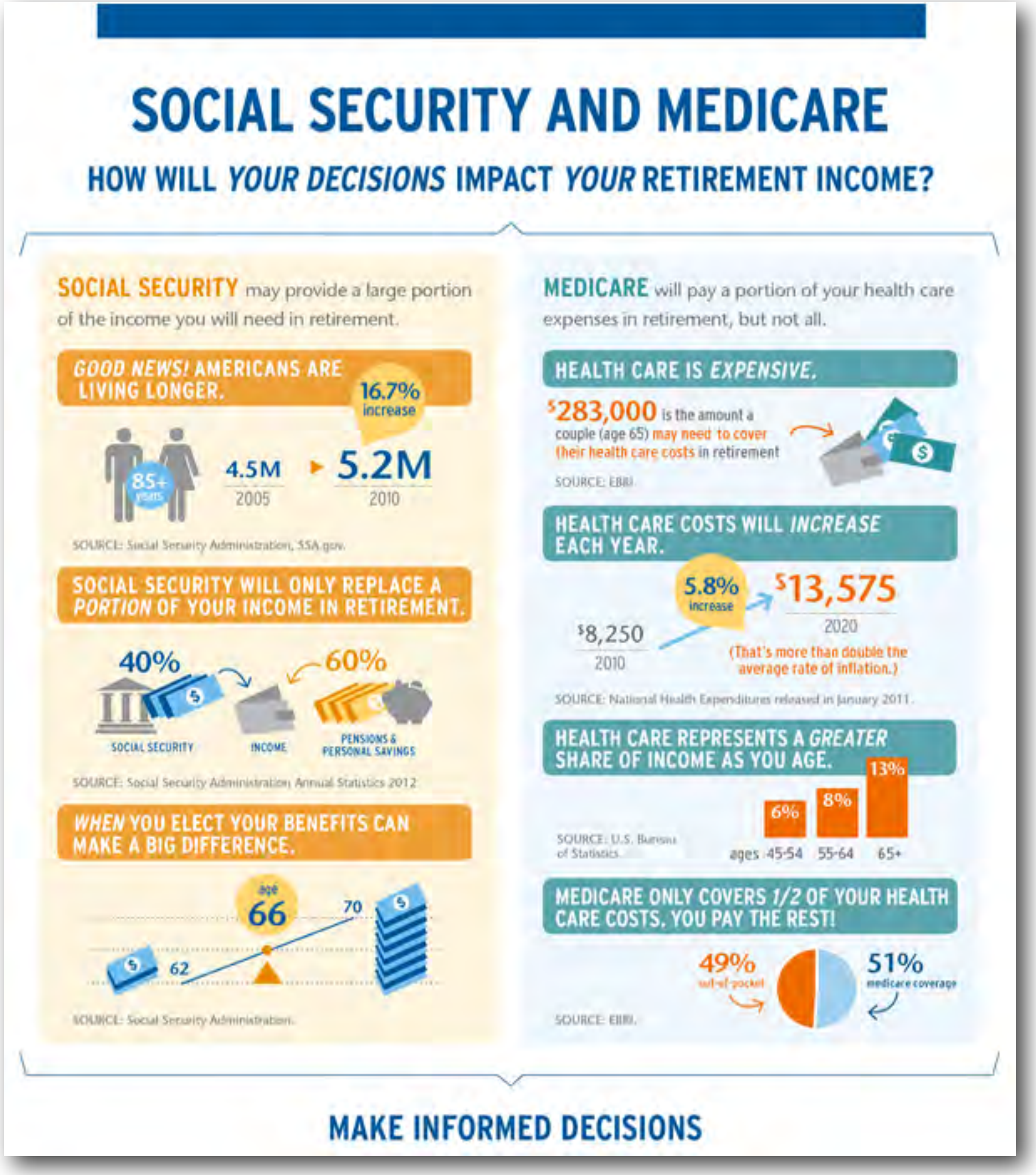


Image source: http://blog.principal.com/wp-content/uploads/2013/04/soc-sec-and-medicare-mm6094.gif

I Can’t statements- why can’t I save in my life?

Ages 21-30

I can’t save now. I’m just getting my start in life, I don’t make a lot yet, and I’m entitled to a little fun while I’m young. There is plenty of time. Wait until I start making a little more. Then I‘ll save.

Ages 30-45

I can’t save now. I’ve got a growing family on my hands. Children and a house cost a lot of money. It takes all I have to keep them going. As soon as they are a little older, it’ll cost less. Then I’ll save.

Ages 45-55

I can’t save now, I’ve got two children in college. It’s all I can do to pay their expenses. In fact, I had to borrow for their tuition last fall. This is the most expensive period in a person’s life. I can’t save a penny.

Ages 55-65

I can't save now. I know I should. But things aren't breaking like they did. It's not easy for a person my age to step out and get a better job. Ill have to ride along where I am. Maybe something will break.

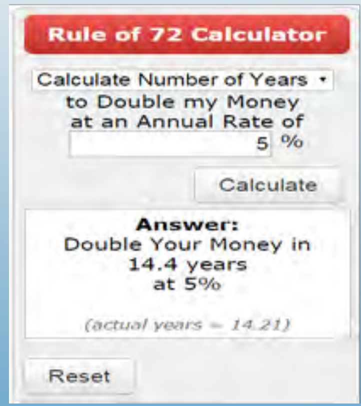
Age 65

I can't save now. Were living with my son and his wife. My check from Social Security doesn't go far. I wish I had started saving 20 years ago, but it’s too late now. You can't save when there’s no income.

from The Northwestern Mutual Life Insurance Company - Milwaukee

So, now that you’ve convinced yourself that saving and investing is important, what are some of the best ways to do just that? How can your money accumulate? How does interest (the rate of return) affect your money? Try using the tool below to help you start answering those questions.

Interactive 7.20 The Rule of 72 Calculator



What is the incentive on Saving early?

Interactive 7.21 Finance Activity - Invest Early

How much is enough for retirement?

Economists say around 15% of income is a good target to save and invest for retirement.

Note: Financial Advisors advise “Paying yourself first!”; pay yourself 15 percent immediately for your retirement and saving whenever you receive money from a paycheck or other sources..

What does investing for retirement at 15% provide for? Economics say with saving around 15% of your income, it would allow you to live with 60-80 percent of the income during retirement.

Stocks

Interactive 7.22 Wall street Survivor

How good are you at the Stock Market?

Are stocks worth the risk for their return?

Will you become a shareholder?

What is a ticker symbol?

How and why do economist describe the stock market as either

a bear market or bull market?

What are Corporate Bonds?

With the risk, is the return worth the agreement of the debt to be paid back?

Stock vs. Bonds? Which do you choose… or a combination?

Interactive 7.23 Stocks vs Bonds - Which Do You Choose?

Interactive 7.24 How The Stock Market Works

Other Ways To Save:

Mutual Fund: Investment fund diversified with such assets like stock and bonds managed by professionals/brokers.

Life insurance: Is life insurance needed?

Term insurance that pays out a sum of money after the death of the insured person.

Cash-value (whole) life insurance has death benefit; and has a cash value. This accumulated amount can serve as an account for your use.

Pension plans: Social security is a form of pension; Pensions are retirement plans. Pension plans in the private and public sectors are being eliminated more and more.

IRA: tax deferred; own tax on your earnings/withdrawal; tax paid at withdrawal

What is tax Deferred?

403b: Employees non -profit tax exempt organization; matching contribution option.

401k: Business sponsored retirement plans; business can contribute matches.

Would you want the business you are working for to match your contributions?

Interactive 7.25 401 K Calculator

Traditional IRA: Tax on lump sum upon withdrawal. This account is tax deferred; A traditional IRA is an individual retirement account. .

Roth IRA: Tax free growth, owe no tax at all on your earnings as they accumulate or when you withdraw; no required withdrawals; maximum contributions per year

Certificate of Deposit: Term for investment with time it take to matures; CD’s have a date of maturity with generally a comparatively lower rate of return.

Interactive 7.26 Which is better - Roth or Traditional IRAs?

Financial Investors and advisors helpful hints:

What is the difference between a trust and will?

A trust is an estate planning tool created to facilitate the transfer of one's assets to their heirs in a private manner, outside of probate court. It can be thought of as "the family bank". Upon death, an executor (normally an attorney) and the trustee(s) (normally heirs) work together to execute the transfer of assets within the trust in accordance to the terms set forth by the deceased. Most commonly upon death, the instructions and assets of the trust become irrevocable.

A will is simply a letter of intent stating the wishes of how one would like their assets transferred upon death. It can be as simple as a handwritten letter, which is why the validity of wills can be easily challenged in court. Execution of a will is a very public process, anyone is able to see it if they wanted, including the assets owned by the decreased and who it is being passed to.

If a deceased person dies without having a will and/or trust established, they are said to have died intestate. This means that the courts will control the passing of assets based on state intestacy laws. Every state has its own set of laws stating who gets what and in what hierarchical order; spouse, children, parents, siblings, etc.

Student Practice Applications:

Interactive 7.27 Financial Football

Interactive 7.28 Financial Soccer

Reflection:

1) Does a diversified saving and investing portfolio ensure economic success?

2) Why is it important to have a diversified portfolio?

Protecting all of your hard work: Identity Theft and Consumer Fraud Protection

As with any other discipline in social studies, economics is no different from the standpoint that along with personal economic rights comes consumer responsibility. While you as an individual worker and consumer have the right to safety, the right to be informed, the right to choose freely, and the right to be heard, there are also responsibilities that accompany these rights. Using products safely is a primary responsibility of consumerism, as is choosing goods and services carefully, seeking information and using it to make informed decisions, and speaking up to let likes and dislikes be known.

Of course, from the government's side of things, multiple agencies exist to assist consumers and workers and to help them protect their purchases and investments. The Consumer Products Safety Commission (www.cpsc.gov) serves consumers in multiple ways such as posting important recall information on products, providing safety education about products, communicating regulations, laws, and standards about products in consumer-friendly language, and publishing research and statistics on commonly used and popular products.

When thinking about the protection of savings, one might ask, "Are there government agencies that can help me protect my savings and investments?" The answer is, yes. Both credit union institutions, through the National Credit Union Administration (NCUA) and banks, through the Federal Deposit Insurance Corporation (FDIC) protect savings accounts up to $100,000.

But what about identity theft? Sometimes referred to as, "True-name Fraud" identity theft occurs when someone wrongfully acquires and use a consumer's personal identification, credit, or account information without their permission. This illegally acquired information such as a social security number, pin number or password is then used to steal a person's identity. Often, once a person's identity is stolen, thieves will drain savings accounts and/or rack up huge credit card debts purchasing big ticket items such as automobiles, boats, trips, and jewelry, just to name a few.

Experts offer tips to avoid identity theft. Here are the most recommended:

*Monitor your credit report.

*Don't give out personal information to unknown people or companies.

*Protect your credit and debit cards.

*Protect your mailbox.

*Protect your wallet.

*Use passwords and PINs that cannot be easily guessed.

*Use anti-virus software on your computer.

*Notify your bank when you change your address or phone number.