Equality Relations and Net Worth Key Terms

Name: ______________________________ **Date:** ____________

Directions: Read and review the terms below.

Consumption: Use of a good that reduces its value.

Example 1: Eating a slice of pizza is consumption.

- A pizza ready to be eaten is worth $20, and a pizza in your stomach is worth nothing.

Example 2: Wearing a pair of sneakers you just bought from the store is consumption.

- Sneakers that have been worn are worth less than sneakers that have never been taken out of the box.

Example 3: Watching your high school football team play a game is **not** consumption, even if it's entertaining, since you didn't have to buy a ticket.

- Nothing decreases in value as a result of you watching the game.

Wealth: A measure of your ability for consumption. The greater your wealth, the greater your ability to consume goods.

- You can use **cash** to pay for goods to consume, so having cash does increase your wealth, but it's not the whole story.
- You can also use other valuable items to fund consumption, such as gold or silver.
- If you have a lot of cash but you owe someone money, then the cash you need to use to pay them back can't be used for consumption and so doesn't help with your wealth.

Income: An increase in wealth and in your ability to consume goods.

- The most familiar form of income is **wages,** where, in exchange for your labor, you receive cash.
- Having more cash may increase your ability to consume goods.
- Wages aren't the only way you receive cash. You could:
    - Receive cash for your birthday
    - Receive cash from an inheritance
    - Even cash that is stolen can be thought of as income!
- Another important source of income comes from financial instruments, such interest from your investments, for example.

Expense: A decrease in wealth and in your ability to consume goods.

- The most familiar kind of expense is when you spend cash to immediately consume something. With typical expenses, you purchase something and it almost immediately loses its value.

- When you have less cash, your ability to consume goods decreases.
    - You pay $10 for a pizza and eat it.
    - You buy a movie ticket and it has no value once the show is over.
- Any time your cash decreases without you gaining anything of financial value in return you incur an expense. This includes:
    - If your bank charges you a fee for dipping below the minimum balance.
    - You lose your wallet.
- If you spend cash on something that retains its value, this is *not* an expense.

Cash Balance: The amount of cash you have at a particular time.

- Your cash balance will increase or decrease as you receive income or incur expenses.

Assets: Property that stores value or reduces expenses. The more assets you have, the greater your wealth.

- The most familiar kind of asset is an item that can be sold at some point in the future, such as a house, a car, or gold. Possession of such an item increases wealth, since one can sell it and use the cash for consumption.
- Cash is an asset since it stores value and, of course, can be used to obtain items of value.
- Property can also be an asset, if it retains its value over an extended period of time, even if it can't be resold. For example, a two-year old computer can't be resold (at least for any significant sum). However, it retains its value for the person who owns it. A computer generally remains functional for around three to four years.
- If you own an object that remains useful for an extended period of time, this in effect reduces your expenses, since you don't have to buy another one during that time.

Liabilities: Obligations to make future payments. Liabilities are your debts.

- The greater your liabilities, the less your wealth, since the money you use to pay off your liabilities cannot be used for consumption. So, liabilities that contribute negatively decrease your wealth.
- Liabilities typically come from borrowing cash. You borrow cash for immediate use on the condition that you must pay it back later. For example, you take out a loan to pay for your college tuition.
- Unpaid liabilities typically increase over time due to interest that is added to the amount borrowed.