Budget Smarts—Pay Yourself First

When setting a monthly budget, some people are jubilant if their expenses simply equal their income. However, in the long-term it is very difficult to save and invest unless disposable income exceeds expenses. Setting up and following a monthly budget that emphasizes long-term savings can be an important step in achieving financial success.

Budgeting can be simple or complex, based on your income and lifestyle. Regardless of the complexity, you must develop a budget that pays you first if you wish to save and invest. Here are four tips that can help you proceed down the road to healthier financial times:

1) Evaluate What You Spend. Begin the process by recording all your expenses. List living expenses first: rent, heat, telephone, mortgage, electricity, and taxes. Add services, such as child daycare, next. Follow with necessities: food, clothing, medical expenses, and insurance costs. Remember to include entertainment, even if only a night at the movies and the cost of a babysitter. At this point, most lists end, but you must add one more line labeled "my investments and savings." If you treat investments and savings as an expense, which needs to be made on a weekly or monthly basis, you are a lot closer to setting money aside not only for your most important expenses, but also for yourself.

2) Allocate Income in Terms of Percentages. Determining what percentage of your income is allocated to each expense is critical to your success in developing a budget. Trimming expenses a little bit at a time vs. large cuts taken all of a sudden will be much easier to manage. By categorizing expenses as either fixed or flexible, you can determine where percentage cuts can be made. Remember, you have discretion over flexible expenses, but not over those that are fixed, and it is generally flexible expenses that erode earnings.

3) Set Up Spending Priorities. Ranking expenses is your next step. You can then eliminate the unimportant items, which in itself may be enough to allow the beginning of a modest investment and savings program. If it isn`t, eliminate some of the moderately important expenditures.

4) Pay Yourself First. You should now be able to pay yourself first. To do so, you should get into the habit of writing out a check to a special account rather than leaving the amount in your regular checking account. What type of special account you use depends on how much you have. If you begin with two hundred dollars, it might be a savings account or money market fund. If you are retirement-minded, and you qualify, contributions to an Individual Retirement Account (IRA) might better suit your needs.

In addition, most insurance companies and mutual funds have established monthly checking account deduction plans that allow you to make a regular contribution of a fixed amount each month to a wide variety of funding choices. This method can help establish a more disciplined approach to savings.

Periodic reviews of your budget, with the understanding that you must always make room to pay yourself first, is important to your long-term financial success.