

Budgeting to Acquire Savings: A 3-Step Approach for Community Educators to Teach Limited Income Consumers

Fact Sheet FS-958
2013

Literature on consumer budgeting indicates that the way low-income consumers construct their budgets has an impact on whether savings are acquired or not (Thaler, 1990). Richard Thaler (1985, 1999), University of Chicago, found that most low income consumers construct their budgets mentally, in a process he called mental accounting; or mental budgeting, as referred by Antonides, Groot, and Raaij (2011). Mental budgeting relates to consumers using their thoughts in figuring out what items to buy, and then going into a store to buy the items (Heath & Soll, 1996). According to Richard Thaler, a major problem with mental budgeting technique is unplanned spending, which could lead to spontaneous use of money that could be allocated for savings. Most modern budgeting texts are too elaborate to most limited income consumers and contextualized in favor of those with money to save. Discussion topics, such as financial goal setting, financial statements, and balance sheet (*Assets, Liabilities, and Net worth*) could be puzzling and complicated to most limited income consumers; especially when they may be struggling with saving. This publication revisits traditional household budgeting discussions in economics textbooks during 1970 and 1980; notably, Paul Samuelson (1976) to derive a basic framework, a 3-step approach for community educators to teach limited income consumers how to budget their incomes. This basic framework construes budgeting in a narrow sense that enable limited income consumers to *Estimate, Evaluate* and *Allocate* income to goods and services with the intention to acquire savings.

Step-1: Estimate

It is essential to encourage consumers to rely on itemizing or documenting potential expenditures rather than to rely on their heads to remember their potential expenditures (*mental budgeting*).

In doing so, consumers develop skills needed to enable them to gain control of how and where their money is actually spent.



A: Estimate Expected Income

- Estimating expected income requires consumers to have a full knowledge of their Total Income or a ballpark figure of income after taxes, which is called Disposable Income or Take-home Pay.

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Estimating: Total Monthly Income (TMI)
List the dollar amount of all your after tax Income

• Salary/Wages	<input type="text"/>
• Public Assistance (TCA)	<input type="text"/>
• Child Support	<input type="text"/>
• Alimony	<input type="text"/>
• Interest/Dividends	<input type="text"/>
• Social Security	<input type="text"/>
• Income Credit	<input type="text"/>
• Others	<input type="text"/>

What is your Total Monthly Income?

- When estimating Total Income, the frequency which the consumer receives income (e.g. hourly, daily, weekly, biweekly, and monthly) must be considered. If a paycheck is received weekly, it is logical to create weekly income estimates.
- Estimating income may include one or more sources : Salary/Wage, Public Assistance, Temporal Cash Assistance, Food stamp, Child Support, Alimony, Interest/Dividends, Social Security, Income Credit, Tax Refund, etc.

- If there is more than one income source in the household, the total expected income from all sources should be added to account for Total Income.

B: Estimating Planned Expenditures (Expenses)

- Estimating expenses falls into two categories: Planned Spending and Planned Saving. How a consumer plans to allocate his or her income should be clearly outlined in the spending and savings plans.
 - **Planned Spending:** The consumer should list all basic necessities of life (rent, food, electricity, water, and insurance – health, life, home, auto insurance) and then assign the estimated cost to each item.
 - **Planned Saving:** The amount of money the consumer plans to save each pay period, whether it be daily, weekly, or monthly. When estimating total expenses, planned saving should be included as a basic necessity. In other words, consider planned savings as a bill that must be paid weekly or monthly into a saving account for future consumption or emergencies.
- Add the estimated cost of all items (Planned Spending and Planned Saving) to get the Total Planned Expenditures (Expenses).

(Note that at this point a budget, or spending plan, has been created. But is the budget realistic? Evaluating the budget is an essential step for future success.

Step-2: Evaluate

Step-2 requires comparing the Total Income (TI) and Total Planned Expenses (TPE) to look for one of three budgeting indicators: The indicator can either be a budget Surplus, Breakeven or Deficit.

Budget Surplus: If the TI is greater than the TPE, then the budget indicates a Budget Surplus. In other words, there is still some unspent income.

Breakeven: If the TI is equal to the TPE, the budget is at Breakeven (no surplus or unspent income).

Deficit: If the TI is less than the TPE, the budget is in a Deficit. In other words, there is not enough income to pay for all planned spending.

Step-3: Allocate Income

After evaluating for budgeting indicators (surplus, breakeven, and deficit), the final step is allocating income to household priorities (priorities should be based on vital necessities as previously discussed). Note that any potential problem with income allocation depends on the budgeting indicator.

A) Budget Surplus: In a Budget Surplus, consumers have extra income or surplus money from good budgeting.

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Extension in your community

Money \$ms

Estimating: Total Monthly Expenditure (TME)

• Planned Savings	<input type="text"/>	• Gas/Oil	<input type="text"/>
• Rent/Mortgage	<input type="text"/>	• Electricity	<input type="text"/>
• Food	<input type="text"/>	• Water	<input type="text"/>
• Property Taxes	<input type="text"/>	• Barber shop/Hair Salon	<input type="text"/>
• Cable TV	<input type="text"/>	• Health Insurance	<input type="text"/>
• Telephone	<input type="text"/>	• Day care/Eldercare	<input type="text"/>
• Transportation/gas	<input type="text"/>	• Education	<input type="text"/>
• Life Insurance	<input type="text"/>	• Personal expenses	<input type="text"/>
• Home Insurance	<input type="text"/>	• Clothes	<input type="text"/>
• Auto Insurance	<input type="text"/>		

What is your Total Monthly Expenditure?

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Money \$ms

Estimating: Total Monthly Expenditure (TME)

• Planned Savings	<input type="text"/>	• Gas/Oil	<input type="text"/>
• Rent/Mortgage	<input type="text"/>	• Electricity	<input type="text"/>
• Food	<input type="text"/>	• Water	<input type="text"/>
• Property Taxes	<input type="text"/>	• Barber shop/Hair Salon	<input type="text"/>
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• Life Insurance	<input type="text"/>	• Personal expenses	<input type="text"/>
• Home Insurance	<input type="text"/>	• Clothes	<input type="text"/>
• Auto Insurance	<input type="text"/>		

What is your Total Monthly Expenditure?

The key decision that must be made in this situation is whether to save the surplus money or spend it. Some recommended savings strategies for a budget surplus:

- Use the surplus money to pay down debt or save it for periodic expenses.
- The surplus money can be used to boost planned savings (in economics, savings occurs if surplus money is kept in a bank account for future use).
- Use the surplus as a motivation to improve on budgeting: Set budgeting goals to save each time there is surplus money.
- Set financial goals for savings. Consider what might be done with surplus income that could generate additional income (i.e. where can saving be kept to generate interest income).

B) Breakeven: In a Breakeven budget, the consumer is allocating all income to planned spending. This requires immediate modification of the budget to gain savings. Recommended strategies for modifying planned spending so that income can be greater than spending include:

- Cook meals at home and suspend going out to eat.
- Prepare and take your snacks and/or lunch to work.
- Buy inexpensive items.
- Shop at discount stores to benefit from discount prices.
- Use coupons to buy at reduced prices.
- Look for bargains, items on sale.

How about planned savings? Note that no recommendation to modify planned savings is mentioned. Any attempt to reduce planned saving should be a last resort solution.

C) Deficit: In a budget Deficit, the consumer has problems allocating income to budgeting priorities because the estimated income is less than the planned spending. Recommended strategies to modify planned spending in a Budget Deficit situation include:

- Prioritize planned spending to allocate income to vital necessities first.
- Find ways to cut planned spending by forgoing some items on the budget.
- Substitute - buy cheaper goods with similar satisfaction instead of more expensive goods.
- Make use of available community resources, such as subsidies from community organizations, food banks, food stamps or supplements, WIC, etc.

Conclusion

This factsheet, “Budgeting to Acquire Savings: A 3-Step Approach for Community Educators,” is a basic approach for community educators to teach low income consumers how to budget limited income to acquire savings. In addition, the factsheet comes with a tool that the community educator can use to demonstrate and manipulate consumers’ items and cost of items to increase savings.

Tools for budgeting

For accurate budgeting results, consumers need basic tools to help with calculations during budgeting (such as the basic pocket calculator, multiplication and addition tables, calculator on the cell phones).

Household Budgeting Tool

This author has a basic tool designed in Microsoft Excel. The tool is for the community educator to demonstrate during teaching or coaching, the practical significance of budgeting to increase savings. It is also optional for any limited income consumer who may prefer budgeting using the computer. Using this tool, the educator can manipulate the budget to maximize saving.

(See textbox comments regarding tool).

Household Budgeting	Items	Cost	Items	Cost
Click on the Dark Blue Cell Enter your Total Monthly Income and press Enter Key (Note the impact on Total Budget)	Planned Saving	\$150.00	Water	\$20.00
Monthly Total Income	Rent/Mortgage		Barber shop	
	Food		Hair Salon	
Total Budget	Property Taxes		Day care/Eldercare	
	Cable TV		Education	
-\$190.00	Telephone		Personal expenses	
	Transportation/gas		Clothes	
	Car payment		Health Insurance	
	Car Insurance			
	Car maintenances			
	Gas/Oil			
	Electricity			

1. Click each cell under Items
2. Enter the item you plan to buy
3. Change current items if necessary
(these are just examples)

1. Click each cell
2. Enter the cost
3. Change the cost
(Note: Current en

Using this interactive tool gives the audience or end-user a practical experience on planning to allocate limited income to consumption. For questions regarding the use of this tool, please contact: MELonge@umd.edu
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The only training required to use this tool is the clicking of the mouse, and the only activity to do is to type in your TMI and TME, and manipulate prices or cut items to reduce cost and increase savings. The tool is automated and does all the calculations for you:

- Your Total Income (Budget) decreases as you assign the cost of items.
 - Your Budget will increase as you reduce the cost of items.
- Budgeting to acquire savings is a skill, and the skill can only be acquired by practicing tracking your income and expenses, estimating and evaluating your budget to ensure that some amount of money is saved out of every given pay period.

Reference

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