

Learn how to budget with the help of psychology

ALGARHI, Amr <<http://orcid.org/0000-0003-2281-3021>> and LAGOS, Konstantinos

Available from Sheffield Hallam University Research Archive (SHURA) at:

<https://shura.shu.ac.uk/34120/>

This document is the author deposited version. You are advised to consult the publisher's version if you wish to cite from it.

Published version

ALGARHI, Amr and LAGOS, Konstantinos (2024). Learn how to budget with the help of psychology. *The Conversation*. [Article]

Copyright and re-use policy

See <http://shura.shu.ac.uk/information.html>

Learn how to budget with the help of psychology

Amr Saber Algarhi, Konstantinos Lagos

Published on the Conversation UK on 19 August 2024, 5:15pm BST

To cite this article:

Algarhi, A.S. & Lagos, K. (2024, August 19). Learn how to budget with the help of psychology. *The Conversation UK*. <https://theconversation.com/learn-how-to-budget-with-the-help-of-psychology-236711>

Developing an understanding of how to manage [personal finances](#) can be even more crucial in the early stages of your career when your salary may be relatively low.

But traditional financial advice often falls short of addressing the psychological factors affecting financial decision-making for [young professionals](#).

Budgeting is not about being stingy. [Research](#) has shown that personal budgeting is a key part of how we handle money, which may significantly affect how much wealth we build up over time. In fact, good budgeting habits can explain why some people end up way richer than others, even on [similar salaries](#).

So, how do you craft a budget that works? Well, you first start with the basics. Begin by figuring out how much money you earn from all sources, in order to identify your total income. Keep meticulous track of every pound and penny you spend – even on an impulsive coffee – and divide your expenses into “essentials” and “luxuries”.

This will allow you to trace when and where you spend your money. Set yourself some clear short and long-term financial objectives and distribute your income between different expense categories and savings [targets](#).

The next question is how do you put these basics into practice? There are some popular budgeting [techniques](#) that can help you do so.

1. The 50/30/20 rule

Allocate 50% of your take-home pay to your needs (food, mortgage, rent and so on), 30% to your wants (for example, entertainment), and 20% to savings or clearing debts. The advantage of this balanced technique is that it gives you flexibility while making sure you are still saving, allowing you to stick to a plan while adapting to changing circumstances.

2. Zero-based budgeting

Plan where every pound goes before spending it and give every quid a particular purpose, ensuring your income minus your spending equals [zero](#). This technique stops you from overspending by seeing your money as separate units rather than [one single pool](#). This aligns with the concept of [mental accounting](#), which suggests that we value our money differently based on the [mental category](#) we assign it to.

3. Pay yourself first

Make savings a priority by automatically setting money aside as soon as you get paid. This will help you overcome the temptation to overspend now and undersave for the future.

4. The envelope system

Put money for different spending categories in separate envelopes. This is a hands-on way to control money, as when an envelope is empty you'll know you have reached your limit for that category. If this feels outdated, there are several [apps](#) that digitise this technique.

However, knowing what kind of spender you are can help you choose the best budgeting technique.

In fact, [research](#) has suggested that if you are prone to impulse buys, you might need a more tailored approach. A budgeting method that combines commitment to your goals and flexibility to deal with unexpected situations may be a good option.

The best budgeting approach though may be determined by acknowledging [present bias](#). This concept, discussed in behavioural economics, explains how our self-control can be affected by our preference for smaller immediate rewards over larger longer-term ones, which can ultimately define our financial decisions.

For example, if you are pretty good at resisting temptation, having separate budgets for different things (like groceries, entertainment and so on) can work well. Or if you often give in to impulse buys, a simpler approach focusing on hitting a certain savings target might be better.

But here is a surprising twist – people who struggle with self-control might benefit from less strict budgets. Even though this sounds counter-intuitive, overly strict budget plans can lead to poor spending choices when your preferences change unexpectedly.

Since keeping a budget can be challenging, especially when life is unpredictable, instead of having strict category budgets you can opt for flexible limits that allow you to move money between categories. This can account for changes in your spending needs from month to month.

For example, you could mix the “pay yourself first” technique with a flexible budget to balance saving commitments and spending choices. On top of that, build some buffer into your budget for unexpected expenses or changing preferences. And try using mental tricks to sort your money, but allow yourself to move funds between categories if needed.

Smart budgeting forms the basis of financial stability and growth. By grasping the psychology behind financial behaviours, you can develop better ways to manage your personal finances.

Even though there is no single budgeting technique that works for everyone, finding a budget that clicks with your personality and spending habits is crucial.

By combining insights from behavioural economics with practical budgeting techniques, you can draw a financial plan that balances discipline with the flexibility to deal with life’s changes.

It’s not about creating the perfect spreadsheet, it is about crafting a real-world financial plan. With the right approach, you are not just budgeting – you are setting the stage for long-term financial success.