The 50/30/20 Rule For Budgeting

These magic rules will get you on the track to be richer in just 14 days.

Hey guys, it's Ronald Park, and welcome back to the channel.

Radio host Dave Ramsey famously said, "A budget is telling your money where to go instead of wondering where it went."

And today, I want to talk about a budget strategy that could help you save up to 50% of your monthly income.

But let's start with the basics. How many people do you know really keep track of their spending habits?

It turns out those elementary school lessons teaching you how to balance a checkbook were a lot more important than you think because too often, people don't realize that their daily spending habits may be leading them into the welfare office. Some might even consider borrowing just to make ends meet.

But even borrowing isn't a longterm solution; it's a stopgap at best – and the emotional burden of debt is one of its most stark realities. It's critical to create and follow a spending plan if you want to help secure your financial future.

And there's only one answer that makes any sense. The only way to ensure a financially stable lifestyle is to do much more investing and saving than spending.

You don't have to go far in today's America without running into the average hard working family man who regularly goes broke just a few days after receiving their paycheck. This is a hard cycle to break, but one that's incredibly important.

And so we return to Mr. Ramsey's words. Let's start telling your money where to go, shall we?

What is the 50/30/20 rule?

Your accountant may have mentioned the 50/30/20 rule of budgeting, but you don't really get the specifics without asking. Essentially, the rule sums up a budgeting plan that can help you maintain and track your income. Before you can really finely-tune your financial intelligence, you need to learn how to manage your finances. This will eventually allow you to create more investments and diversify your sources of income.
The recommended spending habit is relatively straightforward, and the rule has an excellent, pragmatic approach: you should commit 50% of your income to your essential needs, 30% to your wants, and 20% into your savings.

Follow this, and you're more likely to steer clear of bankruptcy.

It's strange to think that something as simple of keeping a clear record of your spending habits – the kind of thing you first encounter as a human being when it comes to money – gets so lost along the way. But bills that seem insignificant, especially when they're just automatically paid every month, can pile up much more than you might realize. Advertising executives were on fire the day they figured out yearly fees only look scarier than monthly ones.

So whether you need help managing those everyday bills, you're saving for a rainy day, or you have more lofty, long-term goals, the 50/30/20 rule is the easiest way to ensure a worry-free financial plan.

50/30/20: Origins

Now you've been introduced to the concept, time for a history lesson.

Not so long ago, in 2005, Harvard bankruptcy expert and US senator Elizabeth Warren, with her daughter, Amelia Warren, released a book entitled, "All your worth: The Ultimate Lifetime money plan."

In it, Elizabeth and Amelia examined 20 years of financial history to better understand an everyday part of American life – the need to get our daily finances in check. Their central conclusions revolved around this very plan. And we don't need to give you a rundown of Senator Warren's credentials.

So get a piece of paper and write down the three most important points you need to know when enacting the 50/30/20 budget plan.

Let's dive in:

The 50/30/20 budgeting plan divides your after-tax income into three categories.
These are:
1) The essentials.
2) Your wants, and
3) Your savings.

Rule 1: Devote 50% of your income on essential needs.

The path to financial freedom starts here.

It's not hard to pare down the bare essentials of modern life, food, water, shelter. And these days, you may as well throw in internet, cell phone, and maybe even a few streaming services—no need to be as literal as Baloo the Bear.
In fact, we work every day to take care of these needs, and provided you earn; this budget plan maintains a perfect balance to cut down on unnecessary expenses.

Rule 2: Spend 30% of your income for your wants.

Now we get to the fun stuff. What good is living if you don't have some things to stimulate you emotionally and intellectually. In our current climate, we're spending a lot of time alone, or in small numbers, so more of our wants are going toward the arts.

Some financial experts, the coldest, don't feel this category is necessary, but I digress. If you're anything like me, albums, books, the next season of Stranger Things – they matter. But there's only a certain amount you can really allow yourself.
So start asking yourself if you really want what you're going to shell out for; I don't consider a cell phone a want, considering no one has a landline anymore — but you might be a gamer, you might be a musician. It's about whatever YOU value.

So things like gym memberships, weekend trips, shopping, clubbing, and dining out with friends. This part is entirely up to you.

This should go without saying, but the fewer items you have in this category, the better.

Rule 3: 20% of your income should go in your savings

Lastly, faithfully put 20% of your income into your savings account. I can't stress how crucial this is. Doing the first two steps doesn't mean anything without the last.

Your savings are there for a reason, whether it's for emergencies or planning retirement.

Now that might not really sound urgent. After all, you're young and charming with a fantastic sense of humor. However, these days, most financial advisors will tell you to start planning for retirement as early as 35.
The best way to do this is to start that savings early, and that begins with that 20% we've been talking up. Start saving very early, especially in fixed deposit, and you'll earn compounding interest that'll help your finances grow in ways you never imagined.

With that 20% of your income in the next ten years, you'll be a task-free millionaire. You know, you hear these horror stories about addictions to spending, and it can be a serious condition — but if you treat it properly, that same kind of euphoric rush can come from watching your accounts grow as well.

How to Budget with the 50/30/20 rule

Follow these steps to implement the budgeting rule:

Step 1: Analyze Your Spending Habits

Naturally, before you know how the rule will affect you, you need to know your spending habits and how you want to budget them.

That starts with asking yourself, what area in my life do I spend the most on?

How much goes toward eating out as opposed to dining in? And how much of that dining in is take-out?

Start by making a list of what your paycheck goes toward. It may be your rent, food, transportation, and utility bills. Write down how much these bills exhaust from your income in a month and write down the numbers.

Now, you know the exact amount spent on your essential needs.

Step 2: Fetch out the large expenses that always go into your "Wants"

Now it's time to work on your want list. We've already established what you want, so let's how much it's running you every month.

We're dealing with clothes, movies, amusement parks, music, that 4K Blu Ray of The Fifth Element you inexplicably can't live without.

Take a look at your credit card statements over the last few months and fetch out any common trends on your expenses.

Marilyn Monroe once said that before leaving the house, she'd turn around and the first item of jewelry that stood out, she'd remove it. Look at your wants list the same way; if there's a glaring expense that you can do without, nix it as fast as possible. Budget 30% of your income towards these wants and leave the rest behind... or maybe accept that The Fifth Element is really overrated.

I'm not saying that this won't be a complex and even daunting list to make. It can be a little stunning when you realize just how much of your income winds up squandered in careless ways you always assumed you had covered. Ideally, you want to work out which of your wants you can cut back on to contain within 30% of your take-home income. Remember, these three steps are interrelated, and the fewer items on your wants list, the more you'll be able to put toward that ever-so-elusive 20%.

It will undoubtedly be tempting to fall back on your old ways, maybe bring back some old habits and desires. But that's where I urge you to stay strong.

Remember the Swedish proverb, "He who buys what he does not need steals from himself."

If you find you spend too much eating out, maybe reconsider catching breakfast on the run and wake up a little earlier to cook it. Bring lunch to work; that's two meals formerly eaten out that you just saved around 20 bucks a day on.

And once we're out of this pandemic, perhaps it might be high time to re-invent yourself a little. Sober bars are springing up and gaining in popularity, or simply having a potluck or party rather than a pricey night out at a club will get you closer to the last step. Get ready, because I want you to underline this.

Step 3: Be addicted to saving 20% of your income per month

"Do not save what is left after spending but spend what is left after saving" (NOTE TO EMPLOYER: IS this meant to be said or appear onscreen? I think the latter would work better)

Warren Buffet said that, and it couldn't lay out the fundamentals of this rule any more succinctly. Anyone can faithfully adhere to the budgeting rule and still lead a pretty comfortable life.

And I'll throw one more quote at you: Life is what happens to you when you're busy making other plans. John Lennon was rarely wrong, and you're going to want to be sure the unexpected doesn't upend your entire existence.

Advertisers and salespeople run a pretty nice racket, and it's easy to fall under their spell. But fidelity to the plan and some good, old-fashioned self-control can make all the difference.

It's quite simple. You want to make this third step, in practice, the first thing you do. Just make it mandatory to transfer 20% of your after-tax income to your savings or fixed deposit account before you worry about the other two.

We can't sugarcoat this. It may initially look like this kind of plan is too limiting or restrictive. And maybe you feel you really deserve that ridiculous car you've been eyeing. We can't make those decisions for you. But after you've witnessed the money pile up in your accounts after just a few months, the last thing on your mind will be complaining.

Example of the 50/30/20 Budget Plan

Let's take a real-life circumstance. Let's say your task-free income every month is $10,000.

That means 50% goes to needs, so $5,000 definitely needs to be allotted.

We can reasonably assume $2,000 will settle your monthly rent bill, and then you can split the remaining $3,000 among your food/beverage needs, utilities, transportation, and minimum credit card payments.

In any case, if $2,000 can't pay your rent, you're clearly living a charmed life, so why you're tuning in to simple financial planning is beyond me.
Remember, your goal is to allocate all these expenses into 50% of your take-home after-tax income.

You can spend $3,000 a month on your wants, whatever they may be. That's quite a bit per month, with plenty of wiggle room. You may, of course, not make so much, and you'll need to adjust accordingly. The principles are still the same.

Also, and this might be something to consider given the current circumstances, there are plenty of ways to have fun and entertain yourself that don't cost an arm and a leg. I know more than one person who has attempted their own sourdough loaf while under quarantine, and not only is it rewarding, think of what you'll save by making your food from scratch. So take advantage of the era of remote-work and zoom calls. Embrace a new hobby.

Now comes that ever-so-crucial $2,000, the 20% of your task-free income. Feels almost like it's mocking you a little, taunting you to spend it on something frivolous. These feelings pass; just get comfortable with the fact that you're going to save a bundle. Commute that $2,000 to your savings so it can later be used to solve your occasional needs like health maintenance, emergency, and debts when they set in. You can also put this 20% toward things like investments, but we'll be getting into specifics about that when we talk more in-depth about retirement.

Benefits of the 50/30/20 Budget

I think I've laid out a pretty solid case for the 50/30/20 rule. But perhaps you haven't quite seen the benefits yet. Here's what you're not seeing:

1. It gives you the freedom to manage income wisely and sets you on the path to financial freedom.

1. Here's a question whose answer may surprise you: Do you remember the last time you touched physical money? Especially today, where some places don't even take cash, and you pay for almost everything with cards. It's too easy to feel as though you spent nothing when you tapped your debit on the scanner, but those impulse buys add up. So the 50/30/20 plan allows you to track your expenses and see how you may be mismanaging your money.

1. 2) Simply having a savings account will allow you to make investments for your future.

1. 2) After six months of applying this rule, you stand to be five times richer. I know it sounds like I'm just giving platitudes, but I can't tell you how many times I've gone over someone's financial statement and realized they had no idea just how much they were wasting. The better decisions you make, the more you can invest in a comfortable retirement.