Thesis on causes of not keeping personal budgets

Economics, Budget

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Introduction to Personal Budgeting

Families and households are one of the fundamental elements of an economic system. People in families work, earn, spend and save money. Earning an income and consumption of goods and services are an integral part of household economics. People consume goods and services to satisfy their multiple needs and wants. Consumption expenditure of a family / household is the value of the goods and services consumed. On the other side household income, is an on-going flow of economic resources received from legitimate sources. It includes money received through employment, as profit from business activity, by ownership of property, or as a pension. If income is greater than consumption expenditure, saving has taken place and wealth has been increased. But, if income is less than expenditure value, there is dissaving and the assets decreases. Wealth is the sum total of economic resources available at a point in time. It includes, for example, cash in hand, the value of unincorporated businesses and land / building property owned, motor vehicles, shares / debentures, and other non-financial and financial assets. Debts and other liabilities are depreciating wealth, and their value is deducted from the value of non-financial and financial assets when determining wealth.

In the process of wealth creation, there is a common discipline among the successful households, i. e. Personal Budgeting. Personal Budget is a simple plan that allocates expected / actual personal income towards living expenditure, savings and debt repayments. Past spending and personal debt have a bearing while creating a personal budget. The main function of personal budgeting is to recognize where the income and expenditure exists in the household unit; it is not forecasting future purchases.

Personal budgeting gives negative connotations to many, though it is not difficult to have one. In fact, understanding a few key concepts can help to avoid several common difficulties of our lives. The major causes of not budgeting seem to be the fear of losing personal control. Personal budgeting is a self imposed rule and for some people following rules and regulations apparently threatens particular behavioral freedoms. Such persons feel that the rules in the budget is taking away their choices or at least limiting their range of alternatives.

Another reason for not budgeting is the feeling that making a budget is too time consuming and that the process is complicated. This is a myth and a baseless assumption. There are many software packages available now to guide through the process of making a budget, updating and tracking it. Even without the software, budgeting is possible. It is just a paper – pencil task. It would take maximum of 15 to 20 minutes to create one, and 5-10 minutes updating and reviewing it on daily basis.

Ignorance of making a budget is yet another cause that people are not following this financial order. This is a very genuine reason and many people struggle to create one. There are many budget sheets available in the Net, What required is a search for a budget sheet, identify the one that suits your style and start using it. Dave Ramsey (200) says in his book ‘. do one for each month and create it a few days before that month begins’.

There are some people who know how to make a budget plan, know the value of it, but just lack the determination to follow it perpetually. They fail to make 'personal budgeting' a habit. One reason for this abandonment is the availability of money in plenty. When the cash flow is very much more than the need of the time, then the rigor to follow the budget weans off. The reason is the thought such as ‘ I have lots of money surplus every month and the need for budget is just not there’ creeps into the mind. Even in the midst of wealth do not leave budget is what is advised by Dave Ramsey (200).

Effects of not keeping Personal Budget on the Economy

Without a personal budget people tend to spend money on unnecessary and unwanted matters and also on unaffordable things. There are many ill effects on the economy if the budgets are not followed. Many of the modern days' financial products and instruments work on the basis of savings by the individual earners. For a healthy society and economy each of the household units must be productive and stress free. Savings are the effect of individual budgeting and they feed the economy in many ways. At least there are three modes of financial institutions where the savings of public are very important. One is the insurance, another is the investments in the IPOs of the companies, and the third one, the Banks.

An individual can pay premium to the insurance scheme only if the individual earns and saves money. Paying premium is a disciplined activity. Insurance gives coverage to the individual who is insured and gives protection not only to the individual, but also to the near and dear ones who are associated with the individual. In case of an accident, an individual who is insured will have a different life experience than the one who is not insured (mostly distressing). In a given economy, if there are more individuals who are not insured, then that economy runs a very high risk on many economic measures. Even calamity or disaster of petite magnitude can cripple the economy for a long time.

Banks, as another element of the economic system, are existing to promote the wealth creation and it is their responsibility to avoid wealth degradation. The primary source of funds for the Banks is the savings from the households. In that context “ Personal Budget” of Bank’s customers has prominence. It is through household savings, Bankers get the fund for lending and for other financial activities. Hence, Banks are very much keen in the financial profile of the earning individuals. If a majority of citizens of a particular country do not keep a restraint on their expenditure or do not follow a financial plan, the savings account holders will withdraw their savings and the borrowers might fail to remit monthly installments. Both these trends will affect the bank adversely, leading to collapse of the bank.

If an economy decides to grow and be more productive, it must constantly invest in capital goods, technology and infrastructure. According to Keynesian economics, excessive spending or excessive saving by households leads to failures in investments. The funds for investments reach the companies mainly in two ways. One way is through the borrowings from financial institutions, another through the public offers of shares. If the earning individuals do not follow a planned expenditure, they will not have the disposable funds to participate in the corporate investments, consequently affecting the business enterprises of the country negatively. Research studies indicate that higher investment by the economic entities (banks, Government, households etc) has been associated with higher economic growth, while relatively higher consumer spending have caused relatively low economic growth (an example for this phenomenon is the crash of US economy in 2008).

Effects of not keeping Personal Budget on the people

As it is bad for the economy, lack of financial discipline is equally horrific for the households too. It can affect the psychological, economic and social mix of a household. First and the foremost effect is the capacity to create wealth is diminished. In the absence of budgets there may not be savings / surplus available when the opportunity to acquire wealth is presented. Also when a disaster strikes, there may not be enough resources to withstand the shocks, forcing the household to mortgage the assets for funds or seek inferior employment.

Second probable adverse effect of non-budgeting is when the income is not growing proportionately to price rise. Due to economic conditions sometimes income / cash flow might stagnate. During such situations if priorities are not fixed and controls on expenditure are not applied, the financial condition of the unpredictable households may aggravate to bankruptcy. The financial controls can be applied only with reference to budgets and the budgets need to be changed according to the economic conditions. Sometimes the stagnation of income levels might prolong for years, all through patient application of financial principles need to be employed.

Third effect is on the psycho-social fabric of the household. Following the self imposed rules enhances personal confidence and self esteem. By not having any discipline with finance might drain not only money but also the psychological sap, which may lead to fear and cynicism. A self control is needed to meet the conditions of budget and self-control is defined as the capacity to alter one’s responses, such as by overriding some impulses in order to bring behavior in line with goals and standards. A budget which has a clear goal, need to be achieved within a specific time. If the individual is not in the habit of goal seeking and of self control, then there may be loss of active awareness about the sources and total income and setting aside a specific amount for expenses and debt repayments. It is very important to learn the skills of financial principles in combination with self control.

Final note

A personal budget is a healthy practice of managing finance and if followed by large number of people, it can lead to a strong economic system and a robust society. It is about managing and tracking one’s financial resources and not just controlling alone. It is about channeling the money towards your desired goal and not allowing your money pushing you where to go. Personal budgets are essential financial tasks in microeconomics. There is an old saying “ If you don’t economize, it will agonize”. It is very true of Personal budgets.

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