The Chocolate Pie Theory of Personal Finance

The good news – after only one month of tracking expenses, you and your budget buddy are well on the path to financial greatness. As a reward, grab some chocolate and settle in to learn about the Chocolate Pie Theory of Personal Finance.

Think about having a chocolate pie sitting in front of you. There are only three things you can do with that pie:
1. Eat the entire pie and start looking around for more pies to eat (this would be me, by the way)
2. Eat the entire pie, without craving more
3. Eat some of the pie and save the rest for later

Think of the money you earn each month. There only three things you can do with this money:
1. Spend all of the money you earn, plus more
2. Spend exactly what you earn
3. Spend less than you earn and put some money aside for later

Guess which of these options is the easiest and the most fun? Take a bite of chocolate if you selected Option 1. Most people spend more money than they make, and it is not unusual for families to spend an additional $500 - $1,000 each month above and beyond their paycheck.

Astonished by that thought? Think about a month where you needed new tires for the car ($250), enrolled your kids in sports camp ($150), and hired a babysitter so you could enjoy a nice dinner out ($100). See how easy it is to spend $500?

How can you spend money if you don't have it? Take another bite of chocolate if you guessed "credit cards!" How did you pay for the tires, sports camp, and dinner out? Probably with a loan that charges 20% interest. Think about it – you borrow money to buy houses and cars because you don't have enough cash to buy them outright. When you don't have cash to pay for everyday items, you borrow money using a short-term loan that usually charges a high rate of interest.

Many people don't think of credit cards as short-term loans, but that is what they are. If you are using credit cards on a regular basis and not paying them off in full at the end of the month, you are using credit to artificially inflate your income. Think of that nice dinner out that costs $100. If you don't have the money in your checking account to pay for the dinner, you pull out your credit card and charge it. See how easy it is to artificially inflate your income by $100!

I don't think there's anything wrong with artificially inflating your income as long as you know the following things:

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1. That you are doing it intentionally
2. That you understand the pros, cons, and ramifications of living beyond your means
3. That you understand the emotions behind your actions

Too many people are spending more money than they earn by not really understanding the items listed above. It's just so easy to use credit as a way of buying things we want or need without knowing how this will impact us in the future.

The problem with using debt to fund your life style is that it is probably not sustainable in the long run. Think of Bernie Madoff - he was using other people's money (which is what credit is) to fund his lifestyle for many years. We all know how that story ended, and it hasn't been pretty for anyone. I want your life to be filled with fun and spending up to the very end, without worrying if your money will outlast you versus you outlasting your money.

Until we meet again next month, decide what kind of financial appetite you would like to have. Do you want to spend more than you make, exactly what you make, or less than you make? Knowing what you want your financial life to look like is the first step in creating your best financial year ever.

