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# The budgeting menu

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It has long been recognized that one important tool to help individuals achieve financial health and wellbeing is budgeting. Governments, consumer protection bureaus, banks, self-help books, and wealth managers all seem to agree that it is critically important that consumers maintain a budget to help them accomplish financial goals, avoid unpleasant financial shocks, save for retirement and in general work towards financial security. Clearly, there is a strong consensus that budgeting matters.

Yet despite the consensus, there is also a large variation on what people actually mean by the word “budget”. We looked through several budgeting apps, tools, self-help books, and academic research to understand what the term budgeting means and what the process of budgeting truly entails. On the one hand, we found that budgeting could involve something as simple as determining how much one is willing to spend for a given purchase. For instance, people often set a budget for buying a new home, a new car, for a particular vacation or even for shopping trips. That very act of setting a limit on a purchase can help curb overspending.

On the other hand, budgeting could be as complex as the process of setting monthly or weekly targets for spending in various product categories, tracking actual expenses, and using the learnings to continually update the budget over time. From an individual perspective, this involves the categorization of expenses into groups, the allocation of incomes across these groups (and to savings and other non-discretionary expenses), the tracking of expenses as a function of category, and then the updating of the budget. Self-help books and popular budgeting tools empower users to do all of the above. In addition, as these tools are in a competitive marketplace, they each try and flex their technological muscles to differentiate themselves by offering an ever-increasing array of features that add sophistication, but also complexity.

What exactly do people mean when they say that budgeting is good for financial well-being? How does budgeting help from a psychological perspective? Are budgets always useful? As behavioral scientists interested in helping consumers make prudent financial choices, we believe that the answer to this question is important, yet complex.

As the budgeting process increases in complexity, it is likely more useful - but at the same time, it could deter people from the very act of getting started. For instance, many have lamented that the cognitive effort required in logging and monitoring expenses increases the likelihood that people stop - or sometimes don't even start - using budgeting apps altogether. Others are worried about supplying potentially sensitive personal information to a website or an app as a loss of privacy. Clearly, budgeting tools need to have the sophistication and features to render them useful, but they also need to be simple to draw people into using them regularly. As Albert Einstein famously said, "everything needs to be made as simple as possible, but no simpler."

What is the sweet spot? To answer that question, we believe that it is critically important for us to understand the psychological process that results in budgeting actually helping consumers. In the simplest case for a hypothetical user named Jackie, the very act of thinking about expenses might increase vigilance and lead to more prudent financial decision making. Research done by us and others suggests that the mere act of recalling past expenses, and systematically engaging in analysis of those expenses *via-a-vis* incomes might change the way in which Jackie might process incoming information. Perhaps they might pay greater attention to prices or be more likely to have thoughts about opportunity costs (i.e., what else could I do with the money that I might spend on this product) that result in more prudent decision-making.

On the other hand, for a second user named Charlie, the mechanics of setting targets and monitoring progress towards those targets provide them with actual numbers of available dollars at any given time - information that they need to curb consumption. In particular, Charlie might be using the act of budgeting to create a set of spending rules - rules such as "it is ok to spend on a show if my cumulative entertainment

expenses haven't exceeded (say) \$300 this month." Charlie might use budgeting more as a metering device; a calculator that provides a running total of expenses and available discretionary dollars in each spending category.

In between the relatively simple mechanism for Jackie and the cognitively complex one for Charlie, there might be a number of other processes by which budgeting could help consumers. These processes might include:

1. the development of healthy spending habits, or
2. learning about their own spending habits and identifying areas where they could cut down.

A classic situation where learning happens is in the area of small-frequent purchases. A \$5 cup of cappuccino might seem trivial, but a monthly budget of \$150 might be seen as an expense to cut down on.

Now, since A benefits by being made more vigilant, a simple budgeting intervention that gets A to reflect and recall expenses will likely make their spending more prudent. It is also perhaps overkill to send Jackie to a budgeting tool that requires them to categorize, set limits, and track – not only might it not help, but the required effort might also demotivate, frustrate, and make them lose interest in budgeting altogether. Charlie, who benefits not from an overall level of vigilance but more from the cognitive process of tracking and using the resulting numerical output to make decisions, may find a simple budgeting intervention ineffective and will benefit from a more complex tool, complete with all the bells and whistles.

# What does this mean for those of us working to help people achieve financial health?

Our first recommendation is that we recognize that different people will benefit from budgeting differently. The fit between the budgeting tool and the way in which budgeting helps people is critical and needs to be assessed.

Our second recommendation has to do with the fact that we need to not just find the most appropriate tool for each type of user, but also work hard to help them make budgeting a habit.

For instance, our hypothetical Charlie will benefit from a sophisticated tool, but might balk at the effort required to use it from the get-go. Just as we do not expect a novice skier to execute parallel turns on blue slopes or an introductory math student to solve partial differential equations, we should similarly not expect a novice budgeter to unflinchingly adopt a sophisticated budgeting tool. Instead, we need to create a pathway by which we start them on simple tools and gradually upgrade them to tools with increasing levels of sophistication. As one of us wrote elsewhere, getting people to engage in complicated behaviour change is like helping them climb a ladder; one step at a time!

There is no one way in which budgeting is done; it comes in different shapes, sizes, flavors, and complexities. It is not a one-size-fits-all solution. Unless we think long and hard about what the benefits of budgeting are and to whom, we may end up overwhelming a segment of people completely. We therefore advocate for a menu of budgeting tools, some

that are appetizers, and others that are main courses. Therefore, in scaling up the use of budgeting to a large proportion of our population, we need to keep in mind that:

1. the most helpful intervention isn't the most complex,
2. indeed, some tools should be kept simple because their role is simply to get people into the budgeting habit such that they can then "graduate" to more sophisticated tools, and
3. successfully scaled solutions need not be homogeneous.

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