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Watch Out for Lifestyle Creep!

The idea behind lifestyle creep is that as your income rises (due to raises, promotions, cost of living adjustments, etc.), your discretionary spending becomes "essential." In other words, what you used to call "fun" spending is now necessary to maintain your standard of living.

An Example of Lifestyle Creep

Bob's budget on his old salary was $3,000/month, and his income and expenses were in balance. Life was good for Bob, at least financially. Over the years, his salary increased to $4,000/month. But Bob's expenses increased by $1,000/month as well. Now Bob is wondering why he never seems to have any money left over at the end of the month. The source of his problem? Lifestyle creep, or sometimes it's called lifestyle inflation.

As his income increases, his expenses increase to consume his higher income. Going out to eat every other week used to be a treat; now it's a weekly routine that he doesn't even pause to think about. It's the old "frog in the pot" syndrome; as the heat in the pot slowly rises, the frog doesn't realize the danger until it's too late!

How to Deal with Lifestyle Creep, But Still Have Fun

One way to handle lifestyle inflation is to go 50/50 (or some other reasonable split percentage) with your pay increases. The idea is when you get a raise, keep half of it in your paycheck. Your take-home pay rises, and you enjoy having more money in your checking account. But put the other 50% towards one of your financial goals (paying off debt, building an emergency fund, saving for college, saving for retirement, etc.).

You never miss the 50% going towards your goal, because it never made it to your checking account in the first place. Smart money tip: have that 50% going towards your goal put on autopilot; set up your paycheck to have your 50% goal money go automatically into a retirement account, or an emergency fund savings account, or wherever it needs to go.

SEE OTHER SIDE

Another way to deal with lifestyle creep: forget about keeping up with the Jones. Behavioral psychologists tell us that we are "herd animals," that we all want to be part of the tribe. Remember peer pressure from your school days. That same social pressure continues as we age and become working adults. So when your neighbor comes home with a shiny new car, you may feel the urge to make a similar purchase (so you can be seen to fit in with your neighbors).

What you don't know is how your neighbor paid for the car. Perhaps she received an inheritance. Maybe he is drowning in debt and just made things worse by financing a new car. Or perhaps it's a company car. The point is, don't let what your neighbors do drive your financial decisions. Unless you know their full financial background (tax returns, net worth statement, bank accounts, etc.), you're probably comparing apples and oranges.

One final way to deal with lifestyle inflation is to use that simple financial tool known as a budget, or better described as a spending plan (because we all seem to like the idea of spending). When you really know where your money goes, you tend to make better financial choices when your income increases. That's because you have consciously made some lifestyle decisions about how much money you want to spend on housing, entertainment, transportation, saving for retirement, etc. That which gets measured, gets done. The reason? Measurement and reporting (awareness) keep you focused on your spending.