The 50/30/20 Budget Rule Explained With Examples

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U.S. Sen. Elizabeth Warren popularized the 50/20/30 budget rule in her book, *All Your Worth: The Ultimate Lifetime Money Plan.* The rule is to split your after-tax income into three categories of spending: 50% on needs, 30% on wants, and 20% on savings.1

This intuitive and straightforward rule can help you draw up a reasonable budget that you can stick to over time in order to meet your financial goals.

Key Takeaways

- The 50/30/20 budget rule states that you should spend up to 50% of your after-tax income on needs and obligations that you must have or must do.
- The remaining half should be split between savings and debt repayment (20%) and everything else that you might want (30%).
- The rule is a template that is intended to help individuals manage their money, to balance paying for necessities with saving for emergencies and retirement.
- People who follow the 50/30/20 rule can simplify it by setting up automatic deposits, using automatic payments, and tracking changes in income.

50%: Needs

Needs are the bills that you absolutely must pay and the things necessary for survival. Half of your after-tax income should be all that you need to cover those needs and obligations. If you are spending more than that on your needs, you will have to either cut down on wants or try to downsize your lifestyle, perhaps to a smaller home or more modest car. Maybe carpooling or taking public transportation to work is a solution, or cooking at home more often. Examples of "needs" include but aren't limited to:1

- Rent or mortgage payments
- Car payments
- Groceries
- Insurance and health care
- Minimum debt payments
- Utilities

30%: Wants

Wants are all the things you spend money on that are not absolutely essential. Anything in the "wants" bucket is optional if you boil it down. For example, you can work out at home instead of going to the gym, cook instead of eating out, or watch sports on TV instead of getting tickets to the game.

This category also includes those upgrade decisions you make, such as choosing a costlier steak instead of a less expensive hamburger, buying a Mercedes instead of a more economical Honda, or choosing between watching television using an antenna for free or spending money to watch cable TV. Basically, wants are all those little extras you spend money on that make life more enjoyable and entertaining. In general, examples of "wants" include but aren't limited to:1

- New unnecessary clothes or accessories like handbags or jewelry
- Tickets to sporting events
- Vacations or other non-essential travel
- The latest electronic gadget (especially an upgrade over a fully functioning prior model)
- Ultra-high-speed Internet beyond your streaming needs

20%: Savings

Finally, try to allocate 20% of your net income to savings and investments. You should have at least three months of emergency savings on hand in case you lose your job or an unforeseen event occurs. After that, focus on retirement and meeting more distant financial goals. Examples of savings could include:1

- Creating an emergency fund
- Making IRA contributions to a mutual fund account
- Investing in the stock market
- Setting aside funds to buy physical property for long-term holding
- Making debt repayments beyond minimum payments

If emergency funds are ever used, the first allocation of additional income should be to replenish the emergency fund account.

Importance of Savings

Americans are notoriously bad at saving, and the nation has extremely high levels of debt. As of December 2023, the average personal savings rate for individuals in the United States was just 3.7%.2

The 50-30-20 rule is intended to help individuals manage their after-tax income, primarily to have funds on hand for emergencies and savings for retirement. Every household should prioritize creating an emergency fund in case of job losses, unexpected medical expenses, or any other unforeseen monetary cost. If an emergency fund is used, a household should focus first on replenishing it.

Saving for retirement is also a critical step as individuals are living longer. Calculating how much you will need for retirement, beginning at a young age, and working towards that goal will ensure a comfortable retirement.

Benefits of the 50/30/20 Budget Rule

The 50/30/20 rule can guide individuals to financial prosperity in a number of different ways. Potential benefits of these guidelines include:

- **Ease of use:** The 50/30/20 rule offers a straightforward framework for budgeting, making it simple to comprehend and apply. You may distribute your income immediately without the need for intricate calculations. Even the least financially-savvy person can adhere to these rules.
- **Better money management:** By using a budget, you may manage your money in a balanced way. You can ensure that your necessary costs are covered, that you have money for discretionary spending, and

that you're actively saving for the future. In this way, you can save for current as well as future needs, and still have a little fun with your finances.

- **Prioritization of vital expenses:** You can make sure that you cover your fundamental needs without going over budget or taking on too much debt by giving these basics top priority. As these rules stipulate that half of your budget goes towards needs, this plan helps make sure your essentials are more likely to be met.
- **Emphasis on savings goals:** By allocating 20% of your income to savings, you can set up an emergency fund, prepare for retirement, pay off debt, invest, or pursue other financial goals. By consistently saving this amount, you establish sound financial practices and build a safety net for unforeseen costs or future goals.
- **Long-term financial security:** Using these rules, you prioritize your financial future by continuously setting aside 20% of your salary. This expenditure on savings can help you accumulate money, meet long-term financial objectives, and give yourself and your family a sense of security as you approach retirement in either the short-term or long-term timeframe.

The idea behind the 50/30/20 rule is that anyone can use these proportions, regardless of their income. However, if your income is low or you live in an area with a higher cost of living, you may need to adjust the percentages.

How to Adopt the 50/30/20 Budget Rule

No single way of tracking to a budget will work for everyone. However, here are some high-level tips on adopting a 50/30/20 budget that are relevant to all individuals.

Track Your Expenses

To better understand your spending habits, keep track of your expenses for a month or two. Analyze your spending to determine how well it adheres to the 50/30/20 breakdown by classifying it into needs, wants, and savings. This will set the groundwork for better understanding how far off from budget you will be at the outset. Also, the only way you'll know you're being successful at adhering to this budget is by tracking your actual spending. Most often, this can be done fairly easily using spreadsheet solutions such as Microsoft Excel.

Understand Your Income

The basis of the 50/30/20 budget is rooted in understanding what your income is. Take caution that your gross income may be vastly different from your net income as Federal income taxes reduce what you'll take home. By understanding what you earn and what actually hits your bank account each pay period, you'll be better positioned to establish the correct budget amounts for the three categories.

Identify Your Critical Costs

This includes expenses such as rent or mortgage payments, utilities, groceries, transportation expenses, insurance premiums, and debt repayments. These costs are non-negotiable, as they are the expenses necessary for your daily living. Because these expenses may take up the largest portion of your budget, it's important to be most mindful with this group. In addition, these expenses must be incurred, so you likely have the least amount of flexibility once you have committed to them.

Locking in a rental agreement may require a six-month or 12-month commitment.

Automate Your Savings

By automating the process, saving will be simpler. Set up monthly automated payments from your checking account to your investment or savings accounts. This guarantees that your funds increase steadily without requiring manual labor. With a lighter burden of administratively managing your savings, you may find it easier to regularly review your budget to make sure it is in line with your lifestyle and financial objectives.

Maintain Consistency

Adopting the 50/30/20 budget guidelines successfully requires maintaining consistency. Over time, stick to your spending strategy and resist the desire to go over budget or depart from your percentage allocations. Like any other form of budget, this plan is often most successful when there are clear guidelines that can be leveraged every month. Be mindful to reset your spending limits each month, and strive to maintain consistency from one period to the next.

Example of the 50/30/20 Budget Rule

Imagine Elaine, a woman who recently graduated from college and started her first full-time job. She wants to develop good financial habits from the beginning and has heard about the 50/30/20 budget rule. Eager to take control of her finances, she decides to set up a 50/30/20 budget.

To understand her spending patterns, Elaine starts tracking her expenses for a month. She uses a budgeting app that categorizes her expenses automatically into needs, wants, and savings. She also calculates her monthly after-tax income, which amounts to $3,500. This will be her basis for allocating her budget according to the 50/30/20 rule.

After analyzing her tracked expenses, Elaine realizes that her essential expenses like rent, utilities, groceries, transportation, and student loan payments add up to approximately $1,750 per month. She allocates exactly 50% of her income, which is $1,750, to cover these needs. She then allocates $1,050 to discretionary items and $700 each month to retirement and savings. And she sets up an automatic transfer from her checking account to her savings account on her payday.

Six months later, Elaine is promoted. Because her income has changed, she reevaluates each budget amount, reviews her overall budget, and adjusts as needed. She also realizes that her transportation expenses are higher than expected, so she decides to start carpooling with a colleague to reduce costs.

Elaine remains disciplined and consistent with her budgeting practice. She prioritizes financial well-being and regularly evaluates her progress toward her goals. As she progresses in her career, she continues to adjust her budget to reflect changes in her income and priorities. She has taken steps to not only have her current needs met but to also have sufficient funds available for her future.

If you're a millennial with your eyes on retirement, there are more resources here to help support your financial future.

Can I Modify the Percentages in the 50/30/20 Rule to Fit My Circumstances?

Yes, you can modify the percentages in the 50/30/20 rule based on your circumstances and priorities. Adjusting the percentages can help you tailor the rule to better suit your financial goals and needs. This is especially relevant for people living in places with a higher cost of living or for people who have higher long-term retirement saving goals.

Should I Include Taxes in the Calculation of the 50/30/20 Rule?

Taxes are typically excluded from the calculation of the 50%, 30%, 20% rule since it focuses on allocating income after taxes. You should consider your after-tax income when applying the rule. If you do decide to factor in taxes, be mindful to use gross income and appropriately forecast what your taxes will be.

How Can I Budget Effectively Using the 50/30/20 Rule?

To budget effectively using the 50%, 30%, 20% rule, track your expenses, prioritize essential needs, be mindful of wants, and consistently allocate savings or debt repayment within the designated percentage.

Can I Use the 50/30/20 Rule to Save for Long-Term Goals?

Yes, the 50/30/20 rule can be used to save for long-term goals. Allocate a portion of the 20% to savings specifically for your long-term goals, such as a down payment on a house, education funds, or investments. The rule is intentionally meant to bring focus to savings.

The Bottom Line

Saving is difficult, and life often throws unexpected expenses at us. The 50-30-20 rule provides individuals with a plan for how to manage their after-tax income. If they find that their expenditures on wants are more than 30%, for example, they can find ways to reduce those expenses and direct funds to more important areas, such as emergency money and retirement.

Life should be enjoyed, and living like a Spartan isn't recommended, but having a plan and sticking to it will allow you to cover your expenses and save for retirement, all while doing the activities that make you happy.