

Why do People Overspend?

New research on why we break the budget and how to fix it

Our tendency to break the bank is as much hard-wired into our psyches as it's learned from friends and family. Why is this so?

We fail to consider future expenses that come with future income

Our mental wiring is great at imagining future income, but very poor at projecting expenses.¹ Buying more car than one can afford is a good example, because we tend to de-emphasize the expected future costs of maintaining it. Set a realistic budget that forces you to spend no more than what you earn — and save regularly.



Collapse of willpower

Some people view willpower as something that is a limited resource that's fairly quickly depleted. Others see it as not easily used up. Which are you? People who believe willpower is finite make impulsive decisions, such as overspending, eating junk food, and procrastinating.² If you find yourself in this category, why not reward yourself after hard work by doing something that doesn't involve spending much, such as engaging in sports, taking nature walks, or meditating?

We think rising home equity equals wealth

Sometimes the more a house is worth, the more money people feel they have to spend.³ In reality, the only way to access wealth from a house that has increased in value is to sell it. But in all likelihood, a comparable house would have gone up in value as well, erasing any advantage unless the homeowner decides to downsize.

Saving while borrowing creates a false sense of security

Sometimes the sole element of a financial plan is socking away cash. But to achieve that level of savings, some borrow more than they need. A savings plan should allow spending to avoid expensive debt, such as a ballooning credit card balance.

1 Charles Wells, "The Hidden Reasons People Spend Too Much," *The Wall Street Journal*, November 2, 2015.

2 Veronika Job, Gregory Walton and Katharina Bernecker, "Implicit Theories About Willpower Predict Self-Regulation and Grades in Everyday Life," *Journal of Personality and Social Psychology*, April 2015.

3 John V. Duca, John Muellbauer and Anthony Murphy, "How Financial Innovations and Accelerators Drive U.S. Consumption Booms and Busts," *Dallas Federal Reserve Bank Economic Letter* (Vol. 11, No. 3), April 2016; <http://www.dallasfed.org/assets/documents/research/ecllett/2016/el1603.pdf>.



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