

How to Break the Paycheck-to-Paycheck Treadmill

Are you living paycheck to paycheck? Do you have your fingers crossed that you can dodge yet another month without a financial crisis that could put you under — a major car repair, a medical emergency, loss of a job?

The number of households living paycheck-to-paycheck is staggering. Nearly 60 percent of the households in America with children under 18 and over half of those nearing retirement depend on their latest paycheck to meet expenses, according to a 2009 survey by MetLife. And this isn't a problem just for the nation's poorest. The same survey found that one-third of workers earning \$75,000 or more a year live from one paycheck to the next.

There's no magic way out of this predicament. It takes hard work and it's not fun. But it's even less fun living on the edge, waiting for a crisis to destroy what remaining financial safety you have.

One key, beyond finding better-paying work, is to spend less than you earn and sock away that extra money to help cover a financial emergency. The ideal is to build a reserve of three to six months' worth of bare-bones living expenses. That's a tough assignment for households barely making it to the end of the month, so start small. A one-month reserve or even a few hundred extra dollars would be a big step. How can you build a small financial reserve?

Start with a plan. Few families living paycheck to paycheck have any kind of financial plan, budget or spending plan. They stumble from one month to the next without a clue where their paycheck goes, often running out of cash before the month runs out.

A formal spending plan tracks one's spending and establishes a list of priorities so that essentials get paid first and nonessentials get paid only if there is enough money left. A spending plan requires perseverance and diligence, especially tracking small cash expenditures, such as coffee, lottery tickets or entertainment. But you'll be surprised where your money is going each month and how much of it is going there (I spent how much on lunches out last month?).

Set up an emergency fund. With a budget in hand, it's time to open a bank savings account or money market where you can stash your savings, however small they may be at first. Don't leave emergency funds lying around at home in a cookie jar. It's not only vulnerable to theft, but it's also far more vulnerable to impulsive spending.

The easiest method is to have the money automatically taken out of your paycheck every month (three percent, five percent, ten percent — whatever you can afford) and deposited in a savings account or money market. The question, naturally, is where do you scrape up the extra dollars?

Little items add up. Look again at where you're spending your money, starting with the little things. How much are you spending on lattes, lunch out, magazines, cigarettes, drinks, movies and so on? You don't want to deprive yourself of all fun, but surely some small luxuries can be cut back or eliminated. Each item may seem small, but they add up. A three-dollar coffee every day is \$90 bucks a month. Put together several items like that and you're talking real money.

Big items add up even more. Don't stop with the little stuff. Amazingly, people will cut small expenses and use coupons and shop around to save \$25 on an item, yet they overlook larger expenses where they can save bigger bucks. For example, when was the last time you shopped for cheaper car insurance? Do you really need \$100 worth of cable a month? Cut it back to \$40 and you save \$720 a year — enough to pay for an emergency car repair or make a month's rent if you're out of work.

Reduce the number of credit cards you have. It's easier to lose track of how much and where you're spending when you use several cards. Or get rid of them altogether until you're back on your feet.

Breaking the paycheck-to-paycheck treadmill isn't easy. But most households can do it with smart planning and a little will power.