October 21, 2017
(August Letter)

Dear Samantha,

Fran and I were thinking about some of the ways we handled money the other day, so I thought I would pass some examples on to you for your amusement and/or thoughts. It's strange how little we talk about money except in crisis mode, so some of these anecdotes might help to alleviate this reluctance.

When we were just starting out as a young married couple, we were living off a tight budget – both when we were on our own and after, when the kids started arriving. I had money from my PhD Fellowship ($11,000/yr) and Fran had an income from various jobs (including her community worker job at First United). Later, when we moved to Montréal, my income came from my teaching salary and Fran's from part-time teaching. The amounts were still relatively small.

In these circumstances, we identified a budget for spending each month, then set up a series of envelopes into which we put the appropriate amounts. I remember that we include one envelope for "Entertainment" that became very important. This method got us through most of the tight months – sometimes by moving money from one envelope to another as our needs changed. The biggest challenges with this method was when something relatively major would occur (like a car breakdown) that needed a relatively big chunk of money in a rush. That was when we established a "buffer" envelope (and later account) into which we would put money for such surprises. With the arrival of kids, this became even more important.

Another "lesson" we learned was when we were living in Cap-St-Ignace during my sabbatical. At that point, Jim and Marilyn were living with us for an extended period (September to December). When it came to the issue of sharing costs for the period, we offered to split the costs as two-thirds for us and one-third for them (since we had our two children with us at the time). We assumed that they would counter-offer with an increase in their share to that offer, since our two kids were very young, wouldn`t use things like the telephone, and wouldn`t eat as much as two adults.

This approach on our behalf was what we came to refer to as "reverse bargaining" – where instead of offering the option which gives you the highest value on the assumption that the other person will try to talk you down, you give a lower option on the assumption that the other person will generously offer to raise it. We discovered that there were several occasions where we operated on this basis – especially among family and friends. On the few occasions where the other person accepted our lower option, we would be surprised, but have to accept the result.

This tendency to generosity also extends to the management of loans to family and friends. When we were buying our first house, we asked for loans from our parents in order to cover the down payment. In both cases, they offered us some help – and offered to charge us the interest rate that they would receive from the bank if they simply left the money in the account (probably something like 1 or 2%). We also borrowed money from the bank using a mortgage, but this was charged at an interest rate which was much higher (like 5 or 6%).

When we began to pay these loans back, we chose to pay the loans to our parents before the one to the bank. Of course, this made no sense from a financial point of view, since we should have paid off the higher interest loan first in order to pay less over the long term, but we felt that paying off our family debt was more important since it was a greater burden for them than for the bank – and was a fitting response to their generosity.

Perhaps this sentiment arises from the conditions in which we were raised. Our parents came through a period identified as the "Great Depression" when jobs and money were scarce and people were often living from hand to mouth if there was any money available. Under these conditions, purchases were only made once the funds had been collected and sharing among family and friends was necessary. This experience led to an approach where any loans made (from family, friends, or the bank) were treated as things to be paid off as quickly as possible and one saved up the full amount before big item purchases were made. There were no credit cards, of course. I expect that we picked this up as well, and it coloured our approach to handling money: don`t go into debt for consumer items except house and car and give priority to family and friends.

This has also strongly coloured our approach to providing loans for family and friends. In general, we do not provide loans unless we are willing and able to consider them as gifts. This helps to protect the relationship since it is more important than the loan – and we usually cannot count on the borrower being able to pay back the loan. If we weren't able to treat them as gifts, then the relationship would suffer as we grew more annoyed that they did not pay us back.

We have used this principle on the outstanding loans to our kids, to you, and to the few other family and friends who owe us money. Of course, we don't make this an obvious part of the loan agreement to the borrower, but we assume the "noble lie" that they will pay back the loan in a manner that is respectful and as quick as they can (including delaying luxury items in order to pay back the loan). This doesn`t always happen, but our "don`t loan if you can't treat it as a gift" approach protects us to some extent from this turning into a relationship issue. In addition, we typically take the approach which our parents took to us: offering the loans as very low interest rates.

We have been impressed with the way in which our kids have responded to this approach. In spite of the difficulty they have faced in paying back the loans, they have set up payback schemes which are regular even if they are very modest (e.g. under $100 per month). Although it does not reduce the loan by much, it lets us know that they are aware of the debt, respect our willingness to provide it, and makes a contribution to its payment. Even though they have occasionally had to borrow other small amounts along the way, we are comforted by knowing that they recognize the debt and have given its payback a priority as they manage their finances.

JP also has a nice story to tell about his reliance on this principle with a neighbour. One day that neighbour came to his door to ask for a $400 loan until the following Friday. JP did not know this neighbour well, having met him occasionally for a chat in the workshop/garage or on the street, so the uncertainty and risk were relatively high. On the other hand, he liked the man and knew he was struggling with some financial challenges while caring for his children (I think he was a single parent). In the end, JP decided to offer the man the loan – using the "don`t loan if you can't treat it as a gift" principle.

The man not only returned on the Friday with the repayment in hand, but he also offered JP some lovely wood cut-offs for woodworking. It turned out that the man worked for a lumber company which often had cut-off ends and rejected pieces of some specialty woods that could be used for furniture and other wood products. As a result of his generosity and risk-taking, JP continued to receive the wood pieces for many months after that.

Our experience is that loaning money doesn't always end up this way, but the "don`t loan if you can't treat it as a gift" principle seems to have worked for us even when the result is less positive.

What systems do you use to manage your finances? Where do they work well? Where do they not work well?

Love,
Bill