The Smart Way to Save for Retirement and Pay Down Debt

It can be difficult, but not impossible, to save for retirement while paying down your credit card bills and student loans. Even small steps now can make a big difference later.

You might think it's best to pay off debt first. But this will cut you off from the power of compound interest. If at all possible, you should try to save and pay down debt at the same time.

Understand compound interest. Compound interest is the interest you earn on your original deposit and on the interest you continue to accumulate. When you save, compound interest means you earn interest on interest. This action builds up your balance over time. Saving small amounts earlier can build your savings over time. That's why small amounts saved are much better than nothing saved.

Start with a budget. If you think you don't have enough money to make it worthwhile to create a budget, think again. You'll probably be surprised how random small expenditures add up each month. With a budget, you can figure where to make cuts that will leave some money for saving.

Prioritize your debt repayments. Some credit cards can carry a hefty interest rate. You'll save the most money by paying these off first. However, if the balance on a high-interest card is large, you might want to pay off low-balance cards first so that you don't have to make any more minimum payments to them. This frees up more money to attack higher-interest debt.

Consider an Individual Retirement Account (IRA) to start investing. Interest paid on credit card debt is no longer tax deductible, but your Traditional IRA contributions are. By using a Traditional IRA, you get the potential for earnings to compound and a tax deduction that may increase your tax refund. If so, you can apply that extra refund to your debt. This creates a virtuous circle that may help accelerate your climb out of debt.

Traditional IRAs are funded with tax deductible contributions in which any earnings are tax deferred until withdrawn, usually after retirement age. Unless certain criteria are met, IRS penalties and income taxes may apply on any withdrawals taken from Traditional IRAs prior to age 59½. RMDs (required minimum distributions) must generally be taken by the account holder within the year after turning 70½ .

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