Paying debts tops investing – but should it?

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It looks like Canadians have come to a consensus in answering the perennial personal-finance question of whether to pay down debt or invest.

Debt wins, by a kilometre. A recent survey by Manulife Bank asked 2,003 people this question: "If you were given an extra $1,000 a month, what would you be most likely to use it for?" Fifty-two per cent of survey participants said paying off debt or a mortgage, while 30 per cent picked saving. Travelling was the next most popular choice at 22 per cent, followed by investing at 16 per cent. Lesser choices included buying presents for family or themselves and home renovations. Total answers add up to more than 100 because participants were allowed to make two choices.

I have urged people to pay down their debts, and suggested their forgo RRSP or TFSA contributions temporarily to find the money. But I'm starting to wonder whether people are so addled by their high debt loads that they're losing their focus on the ever-important goal of investing for the future.

Debt repayment should always come ahead of investing if you owe money on a credit card (interest rates close to 20 per cent in many cases) or a loan or line of credit with an interest rate in the high digit range or more.

There's a good case for making debt a priority even for mortgages and home-equity lines of credit that have interest rates in the 2-per-cent to 5-per-cent range. While you might do better as an investor, debt repayment is a guaranteed return on your money.

The problem with prioritizing debt repayment and neglecting investing is that you lose the opportunity to build savings. While you're fighting the good fight against your debts, you're not putting money into stocks and bonds and benefiting from long-term compounding. You end up debt free, but with impoverished savings.

When your debts are paid off or under control, you might plan to reroute your debt repayment money into your investments. But will you actually follow through?

Some people will end up taking on new debt, and others will find new demands for the money that used to go for debt repayments.

It's not hard to image a situation where the money that was going to go into RRSPs or TFSAs instead gets routed into a kitchen reno.

Here's a suggestion if you somehow luck into an extra $1,000 a week – $450 to debt repayment and $450 to investments. The other $100 goes to a travel fund.

You gotta live, right?