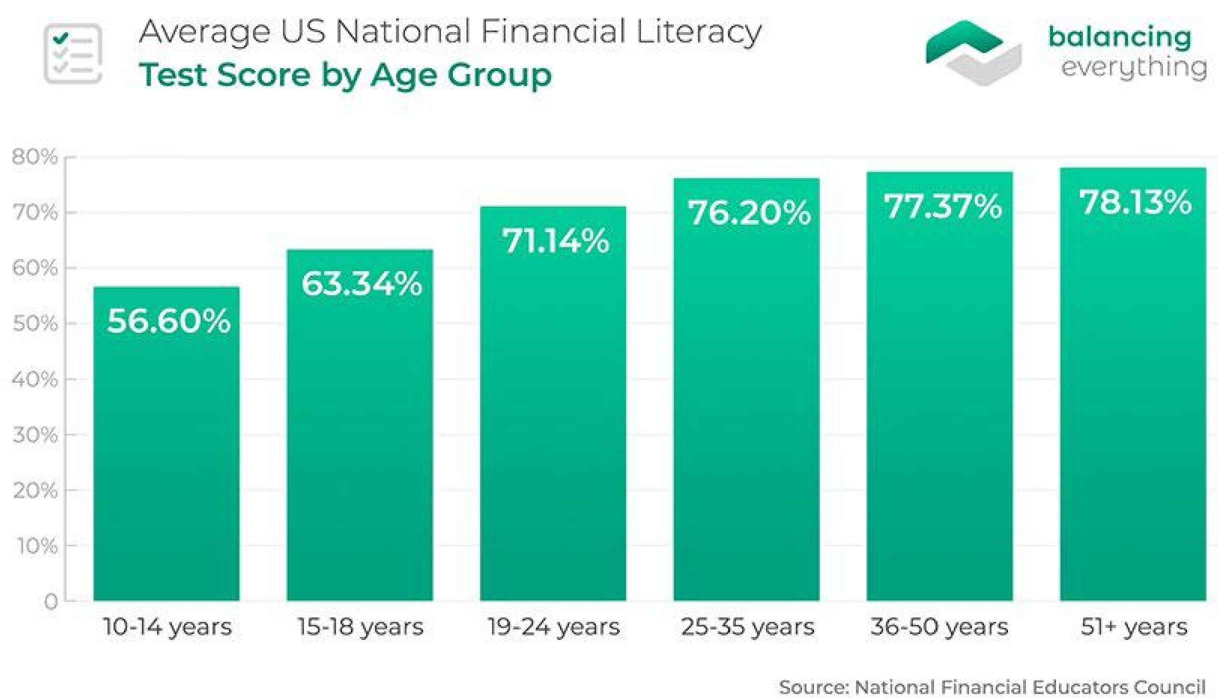
How Do I Teach My Children About Money?

If you don't teach your kids about money, they'll have to learn themselves—the hard way. The reality is that US financial literacy and education leave a lot to be desired.

In the U.S., only 35% of people aged 15–35 are financially literate, according to an S&P Global Financial Literacy Survey. That means nearly 2 in 3 young adults are failing to create good habits and build strong financial foundations.

The average score on the national financial literacy test for teenagers aged 15–18 was 67.93% (just short of a failing grade), according to the National Financial Educators Council.



Source

It's no surprise that, at the end of 2020, 36% of people in the United States couldn't cover a $400 emergency expense. Worse yet, many are overconfident in just how much money they're putting away for retirement, giving them a false sense of security.

This is disappointing because, when our children's brains are most plastic and malleable, when they can learn things most easily, they *aren't* learning about personal finance or money management. We're missing a golden opportunity to instill good habits from a young age.

But the situation isn't hopeless. There are many ways for us to better share financial education with our children.

Here are four ways you can start effectively teaching your kids about money management.

1. Start really young with visual aids and hands-on practice

According to The University of Cambridge, children's money habits are largely formed by the age of seven—which is far younger than most parents expect.

As with everything a child learns from their parents, actions speak much louder than words. According to PBS news, children begin to form a concept of money by age three, much of which they pick up from their parents' behaviors. Whether consciously or unconsciously, children watch their parents' money-spending closely.

Think about it this way. You're acting as a financial role model to your children *before they can use the bathroom on their own*.

Consider your own behaviors: if you pay a lot with credit or barely check price tags before paying, they'll notice. If you pay a lot with cash and are frugal, they'll also notice. That's why it's essential to start teaching money management at a very young age. And the best way to teach young kids is with visual aids and hands-on practice.

The age-old piggy bank is a great starter, but it's even better if it's transparent (like a clear jar). When children can visually see their money growing, it puts saving on their minds.

Another great idea is to give your kid a small amount of money and take them to their favorite store, say a candy shop. Let them figure out on their own how much all the candy they want costs, and how much they can afford with their budget. Let them explore options ("You can get two big candy bars or a bag of ten small ones, which would you prefer?") and determine what makes sense for them.

Whether they choose the two big bars or the ten small ones is less important than making sure they stay within their budget.

2. Teach opportunity costs and how to avoid impulse buying

Many parents (especially Americans) are guilty of impulse buying using credit because we're largely a credit-driven nation. But as we've learned the hard way in the past few decades, relying too much on credit to live the lifestyle you want can have serious long-term consequences.

Let's look at the stats:

- Avg. American credit card debt: $5,668
- Avg. American student loan debt: $39,351 ($393 avg. monthly payment)
- Avg. American auto debt: $644 per month (for new vehicles)
- Avg. American mortgage debt: $208,185 (44% of US adults have mortgage debt)
- Avg. American total debt: $16,043 (Gen Z), $87,448 (Millennials), $140,643 (Gen X), $97,290 (Baby Boomers), $41,281 (Silent Gen.)

Kids need to learn that life is expensive—especially when you're in debt. So how can you teach kids to have a healthy relationship with debt *before* they start taking it on themselves? A great way to do this is to compare and contrast.

Let's say your kid is interested in something more expensive (like a pair of sneakers or a video game console). They want to buy it themselves using their savings—this is an excellent teaching opportunity for understanding budgeting.

Again, present them with situations. Maybe they're keen to take part in an impulse buy (even though they're saving up for something bigger). If they go ahead with an impulse purchase, what are the repercussions? Help them to learn that buying one impulse thing now means that it will take even longer to buy the thing they've been saving up for.

The idea is to connect impulse buying to debt accumulation/over-reliance on credit cards and that smart saving means delayed gratification.

3. Hammer home the magic (and misery) of compound interest

Let's face it—even people who are decently good at math aren't good at math over the long term. Human brains aren't really equipped to deal with concepts like compound interest over multiple decades.

Take Ronald Read, a janitor, who according to CNBC passed away with an *$8 million fortune*, largely due to smart, consistent saving and investing (i.e., compound interest at work).

Or Warren Buffett, who became the world's most successful individual investor through the power of compound interest as well. In fact, 98% of Warren Buffet's current wealth came after the age of 50 due mostly to compound interest during some very good bull runs.

Compound interest calculators can make all the difference. Just by playing around with these calculators, you can teach your kids a whole lot about the magic of saving and investing. It's important to explore different scenarios: "If you save $100 per month and it grows at a 5% interest rate, how much will you have when you're 40?" Questions like these can open their eyes to the power of consistent saving and compound interest.

For example, you can have your children build out various savings scenarios for retirement or even for specific savings goals (like the car they want in a few years).

Have them see how far their current earnings will take them into retirement (not too far). Then ask them to figure out how much they'd need to save each month if they want to retire by a certain age with a certain lifestyle, or for a specific savings goal.

If you make them guess what monthly savings they'd need to accomplish their goals, the impact of this lesson will stay with them for a long time (because there's almost no way they'd get it right). This will give them a healthy appreciation for the importance of earning and saving money throughout life.

On the flip side, learning about compound interest is important because you can also use compound interest calculators to figure out how much interest rates will affect loans by plugging in APYs.

If your kid is old enough to have a credit card or you already gave them one, ask them to use the compound interest calculator to figure out how much their interest will grow on credit cards/loans if they don't pay off what they owe each month.

You can repeat this exercise throughout life. As your kids get older, do the same exercise with auto loans, college loans, mortgage loans, and so on.

4. Give them a bank account and a credit card

Once your kid is a bit older, it's time to put them behind the steering wheel. That means giving them their own bank account and a credit card to start building credit.

A bank account gives your kid a real way to see their money pile get bigger (or smaller) on a daily and monthly basis. This is a great visualization and a serious reality check at a young age. Not to mention that savings accounts for children are linked to later financial success. Not surprising.

There are a wealth of financial apps and software that can be linked to your kid's bank account to provide visualizations, projections, and insights. Give them an opportunity to see something that is wholly theirs—and see the potential of saving and spending responsibly from a young age.

Special-purpose bank accounts are also a great way for kids to save for their first big purchases in life—likely a car followed by college. Start planning years in advance. Ask them—"How much do they need for these expenses? How much do they need to start saving now to meet those goals in time?" This is another great application of the compound interest calculator.

After they establish a bank account, the next step is to start building credit. The age of credit accounts has a big impact on overall credit scores.

All other things being equal, if two people spend the same amount each month, have the same credit utilization rate, and always pay back their credit on time and in full, the age at which they started building credit greatly affects their overall credit score (by up to 15% or more, which for many people is around 60–100 points of credit).

Of course, you won't respect saving and budgeting unless you're actually working hard to make your own money. Start paying your kids to take out the trash, mow the lawn, walk the dogs, get good grades, etc.—it's up to you. Or encourage them to get a part-time job after school or on weekends (if it doesn't interfere with their schoolwork).

Money management should be required learning

While the stock market and investing, in general, are outside the scope of this article, we'd also recommend introducing your children to stocks if and when you think they are ready to learn about that, too.

Whatever you do, it's vitally important that your children learn the basics of financial literacy covered in this article before they even ponder stocks. You need to learn to crawl and walk before you can run (much less run a marathon).

Read our next article once you think your kids are ready to learn about investing in the market