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Everything You Know About Kids and Money is Wrong

CLASSES THAT TEACH KIDS ABOUT MONEY ARE FAILING. HERE'S WHAT PARENTS AND TEACHERS MUST DO NOW.

BYLINE: Stephen Gandel

AMERICAN STUDENTS MAY BE POOR AT MATH, but when it comes to understanding the money in their lives, they are positively bankrupt. A recent national surveytesting high school seniors about basic financial facts tells the story: The average score was a dismal 52%--the fifth time in a row that students overall have flunked the exam.

Disappointing results like these, coupled with a national savings rate below zero, have galvanized educators and legislators to push hard for financial literacy programs to teach kids how to manage money. More than 40 resolutions and bills were introduced in state legislatures last year promoting money courses in the classroom. Nonprofits such as Junior Achievement and the National Endowment for Financial Education have rolled out programs to schools throughout the country. The Treasury Department even has a deputy assistant secretary devoted to financial education. All told, at least $50 million is spent a year teaching kids about money, to help ensure they'll be better savers and smarter investors as adults.

There's just one problem with this noble effort: Financial education doesn't seem to work. High school seniors who have taken financial literacy classes don't do any better on the personal-finance test than students who haven't taken a course. Now new research from Lewis Mandell, a leading scholar in the financial education movement, suggests that taking finance classes doesn't make kids better spenders or savers either, and may increase the likelihood that they'll pick up some harmful habits, such as running up credit-card debt. "As an educator, I'd like to believe you can teach people to do everything," says Mandell. "But clearly, the way we are going about it needs to be improved."

Coming from Mandell, this is no less startling a pronouncement than if Sigmund Freud had renounced the id. The SUNY-Buffalo professor and former business school dean has been an outspoken advocate of financial education for a decade. He sits on the boards of both the JumpStart Coalition for Personal Financial Literacy and the American Financial Services Association Education Foundation. And, yes, he's the author of that financial survey of high school students that has served as the basis for much of our understanding about what kids know and don't know about money.

No one, including Mandell, is ready to write off financial literacy efforts before far more research has been done. But at a time when financial education is increasingly seen as the solution to everything from Americans' growing problem with debt to the high incidence of consumer fraud, Mandell's studies raise an important question: What if everything we're teaching our kids about money is wrong?

Mandell's research may also help point the way toward getting it right. His most significant findings, detailed below, offer strong hints about a more successful approach to teaching kids about money--and maybe, in the process, making the rest of us smarter about money too.

FINDING NO. 1: Money classes don't make kids smarter

So you think one nationwide test about personal finance doesn't prove anything? Try five, given to more than 15,000 high school students over the past decade. Each time, the results were the same: Seniors who had taken a course in money management scored no better on the 30-question exam than students who hadn't taken a course. And the same held true even when the literacy program was topnotch. In a study this year of high school graduates from a midwestern town with a highly regarded finance program, Mandell found that students who took the course scored 69% vs. 70% for grads who hadn't taken it.

Part of the problem may be that high school is too late to start teaching finance. Before they even get to kindergarten, kids receive thousands of indirect lessons about money by observing their parents at the bank, at the supermarket, at the mall and at home. So their understanding of money matters--even if what they know is wrong--may be too ingrained by the time they go to high school for financial classes to effect much change. Earlier research suggests children may be more receptive to learning financial concepts from eight to 12. And Mandell's work supports this notion: In a study of Chicago middle school students, Mandell found that a financial education program was much more likely to change sixth graders' attitudes about money than those of seventh or eighth graders.

SOLUTION: Start financial education sooner, at home and at school.

If most personal finance courses are given in high school, but kids learn better about money before the teen years, it's up to Mom and Dad to bridge the gap. Look for everyday opportunities to slip in money lessons. If you pay with a credit card, explain to your child that the bill will be mailed to you and that if you don't pay in full, you'll be charged more. Introduce the concept of taxes when garbage collectors pick up your trash, by explaining that you have to give money to the government to pay for those kinds of services. Be sure to keep your comments short; otherwise, your kid will just tune out the message.

A few innovative schools are trying to introduce financial lessons at an earlier age as well. Students at Chicago's Ariel Capital Academy, which is named after the local mutual fund firm that helped create it, get at least one lesson a week in managing money starting in kindergarten. The approach works, at least for recent graduate Mario Gage, 14. "I save 40% of the money I get," says Gage. "My friends from other schools spend everything. They come to me to borrow."

FINDING NO. 2: Money classes don't change behavior

Most of us know that fatty foods are bad for our health. But that doesn't stop us from eating fried chicken and ice cream. By the same token, even children who have mastered the magic of compound interest and understand the evils of high-rate credit cards don't necessarily become better savers and spenders as a result.

In a 2005 study, Mandell found that kids with higher personal-finance scores were more likely to describe themselves as big spenders and bad savers than most kids with lower scores. And those midwestern students who took the well-regarded money-management class were just as likely (and in some cases more likely) to carry a credit-card balance, miss payments and bounce checks as students who didn't. "When it comes to actual behavior, financial education doesn't seem to make a difference," says Mandell.

The reason may have less to do with the curriculum than with the cerebrum. New research into the brain suggests it is not likely that just knowing the benefits of saving would cause anyone, let alone kids, to take their money to the bank instead of the mall. The problem is that there are two parts of the brain that are often in conflict, notes David Laibson, an economics professor at Harvard who has studied neurology and savings. The first part acts principally on habit and loves instant gratification. The second part likes to weigh choices and look for the best solution. But that part is the weaker half.

SOLUTION: Make saving a habit.

In a study of college students, economics professor Angela Lyons of the University of Illinois at Urbana-Champaign found one striking similarity among those who had good financial skills: Nearly all said their parents had gotten them into the habit of saving as young children, suggesting saving is a behavior that comes from experience, not knowledge. Her advice? Make your kids put part of any money they get or earn in a savings account. Then provide further encouragement by matching the amount they put in.

Giving kids hands-on experience with everyday money decisions is the idea behind Junior Achievement's Financial Park, an education program for eighth graders. Each "park" is set up as a mock village with a car dealership, a home builder, a bank and so on. Students come for the day and are assigned an imaginary profession, salary and family, then have to construct a household budget. At each store they try to balance what they want against what they can afford--a big house vs. a small one, for example, or a new car vs. a used vehicle. They quickly learn the essential lesson: They can't afford it all. " Kids learn by doing," says Junior Achievement CEO David Chernow. "By getting them out of the classroom, we are able to change attitudes and behaviors."

FINDING NO. 3: An allowance can make things worse

An allowance is supposedly a great tool to teach kids how to manage money. But in Mandell's study, only 36% of the students who'd gotten an allowance as a child described themselves as good savers vs. 52% of those who hadn't gotten money on a regular basis. "In the child's mind, knowing they'll get money every week no matter what they do removes an incentive to save," Mandell believes.

Allowance proponents, like University of Minnesota economics professor Sharon Danes, disagree. She cites other studies that show, for example, that paying kids for chores doesn't instill good financial habits. But what Danes, Mandell and other experts agree on is that an allowance alone doesn't promote good behavior with money. Says Danes: "You can't just put cash in kids' hands and expect them to know how to manage it."

SOLUTION: Set goals, not doles.

The problem may be less with allowances themselves and more with how they are administered. Rather than just providing a weekly handout, Danes suggests talking with your kids about what you expect them to pay for and what they hope to buy. Then help them prioritize their goals. To boost their budgeting skills, Danes also advises lengthening the time between payments as they get older--sticking with a weekly schedule while they're in grade school, moving to biweekly payments in middle school, then to monthly ones in high school. The hard part: not bailing out your teen when, inevitably, he runs out of cash long before payday and whines about how your stinginess is ruining his life.

FINDING NO. 4: Stock market games are for losers

The stock market game, a tool some educators use to teach the basics of investing, has students pick stocks for a hypothetical portfolio, then try to beat the market over a short period. Mandell found that playing the game improved students' scores on his financial literacy test. But those junior investors turned out to be the worst savers of any kids who'd taken a financial education course.

How could that be? Mandell guesses that the interactive nature of the stock market game keeps kids engaged, so they learn investing concepts. But because the kids play with fake money, the game does a poor job of teaching about risk. And if the students' picks do well, the stock market game, like an allowance, makes the need to save money seem less urgent.

SOLUTION: Let children learn from real mistakes, made over time.

Teachers need to stress long-term results over short-term gains, says Mandell. And some new programs are trying to do that. At Ariel Capital Academy, for instance, which runs from kindergarten through eighth grade, each incoming class is given $20,000 to invest. For the first few years, professionals manage the money, and the students simply monitor changes in the portfolio. In the last two years, students choose their own investments. The payoff: When they graduate, they're given the option of pocketing their share of the profits (nearly $200 this year) or receiving a gift of $1,000 for their college fund.

You can reinforce lessons about the risks and benefits of investing by talking with your kids about both your losing and winning stock picks. "Kids can learn from our mistakes," says Susan Beacham, CEO of the education company Money Savvy Generation. "That's how they become better investors than we are."

If your kids don't seem to get the message, don't give up. Mandell acknowledges that the benefits of financial education may take longer to manifest than the period of time that he has studied. So far he has followed students for only five years after their graduation from high school--a period, he notes, when most people have not yet formed true adult behavior patterns. In the only study so far with a longer time frame, Stanford University economics professor Douglas Bernheim found that people who received a course in financial education in high school were, in fact, better than average savers by the time they reached middle age.

So don't despair if your child seems more into MTV than mutual funds. There's still hope that by the time she's 30, she'll prefer Vanguard to Vegas.

BOX STORY:

What parents must do

To help your child grow up to be smart about money, take these steps:

* Start young Finance courses are typically taught in high school. But children learn best about money from ages eight to 12. So talk with yours about managing money at an early age as everyday opportunities arise.

* Push your kids to save Saving is a behavior best learned by doing. Press your children to regularly put away part of their allowance, gift money and any income they earn from summer or afterschool jobs.

* Help them set goals It's easier for kids to save when they have something concrete to save for. Talk with your kids about what they would like to buy, what it will cost and what they'd be willing to forgo to get it.