

Financial Capability—Why It Matters

In-depth Information for Educators



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Money issues dominate the news these days. Many families have faced difficult economic challenges in recent years as they tried to cope with reduced incomes, job loss, debt, foreclosure, or a higher cost of living. Many parents worry about making ends meet, and some parents are genuinely concerned about whether they will ever be able to afford to send their children to college. Money issues at home can drive a wedge between relationships and can frighten young children when there are disagreements or arguments.

Unfortunately, money doesn't come with a set of instructions on how to use it wisely! Throughout life, starting almost from infancy, we absorb ideas and attitudes about money from many sources: our families, our friends, other people we may or may not know, the advertising and other media we are exposed to, and our first-hand, personal experiences with money. Our personal money knowledge, attitudes, and experiences influence our financial be-

havior and ultimately how we live our lives.

Countless surveys and studies confirm that American youth and adults lack basic financial knowledge and skills. Several states now require the teaching of financial education in high school and even elementary school as one way to address the knowledge gap, though Kentucky is not one of them. But clearly the schools cannot do it alone. Parents can be the key to raising financially capable children.

This new term, *financial capability*, is coming into common use. But just what is meant by financial capability? The President's Advisory Council on Financial Capability defines it as *knowledge-based action*—in other words, taking appropriate financial actions based on one's knowledge.

Financial capability begins with parents in the family setting. Parents can simply talk with their children about money and take children along when they make purchases and use their bank or credit union. They can also be models of

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wise financial management. Families make up communities, and your family's choices affect your community. When many people make poor financial decisions, the effects ripple throughout the nation, not just their in communities, and lead to higher prices and strains on social networks. However, when people make wise financial decisions, they help build monetary assets and financial stability overall.

Goals that many parents have for their children's economic success as adults

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concepts need to be evaluated to see if they move children toward relevant outcomes. Such concepts are suggested later in this publication.

Developmental characteristics in the preschool period relative to managing money

To determine how preschool children think about managing money, we must look at their general abilities to think logically and to understand concepts such as number, time, categorizing, comparative quantities, planning ahead, and delay of gratification. All those concepts and more are involved in growing financial capability. They develop gradually as

a result of brain maturation and children's experiences.

Infants and toddlers take in information about the world around them through their five senses. As they develop the ability to use language, which is a system of words that are symbols for real objects, they gradually get better at forming images in their minds. They can thus begin to understand that money—coins and paper bills—represent, or symbolize, the value of things that they may want to own. As they develop into preschoolers and become socially involved with their families, friends, and others in child-care and the larger community, they are exposed to



more opportunities to learn about being consumers.

Developmentally, preschoolers are moving from complete reliance on their senses for information to mental representations. Jean Piaget, a well-known Swiss psychologist of the early to mid-20th Century, labeled this period of cognitive development the Preoperational Stage, or the period prior to full mental operations. Children between the approximate ages of 2 and 7 tend to experience and interpret events from a self-centered point of view and to perceive only one feature of a situation at a time. For example, if they are shown 10 pennies laid out in a row and also one dime, they are likely to reason that the 10 pennies represent more money than the dime because there are more coins in the row of pennies. The end of this stage comes when they understand without doubt that the 10 pennies equal a dime, or that there is the same quantity of water (that they measured themselves) in two glasses of different shapes.

Between about ages 7 to 11, children have progressed to the Concrete Operational Stage. They can now understand equivalencies that they can see but still have problems understanding events in history or reasoning about non-tangible ideas. The ability to think abstractly begins about age 12

or later, in the period Piaget called Formal Operations. It is then that young people can think in terms of cause and effect or fully develop an experiment in some aspect in science by logically planning and testing a hypothesis as true or false.

Applying this sequence of cognitive development to preschoolers' capacity to understand the use of money, we are interested in the Preoperational Stage. Other theorists have pointed out that preschoolers are capable of greater reasoning abilities than Piaget gave them credit for. If they have intentional learning experiences, they can correctly use concrete objects, such as money or items to purchase, as opposed to children who have not had those experiences. In any case, it seems clear that preschool children are mostly interested in money situations that directly involve them and their own interests. They also are only able to figure out one aspect of a transaction involving money at a time. Because of their lack of understanding of the future, they might also have trouble saving their money for a future purchase instead of spending it now.

Another issue affecting preschoolers' capacity to learn and act upon concepts of money management is their strong urge to be social, which also gives them emotional satisfaction. So, if

children are involved in an intentional learning activity in which they are having fun and being coached with people they are attached to, they are likely to learn more and retain their learning for a longer time.

What does brain science tell us about children's cognitive capacities? In recent years, brain scientists have found that neurological development confirms what child and adolescent scholars have long observed. In particular, the development of executive function—the ability to plan, focus, and direct attention to particular topics of thought—is dependent on the formation of myelin, a substance that allows more and faster connections to develop in the brain. Myelin gradually forms as children mature into youth. The frontal lobes, in which executive function occurs, do not become myelinated until late adolescence.

It is clear, then, that brain development is a sequence of maturation for the capabilities of logical, abstract thinking. We cannot expect preschoolers to be able to reason like teenagers. However, brain science also tells us that the more developmentally appropriate, hands-on experiences young children have with real objects and money, along with satisfying social contacts in the process, the stronger their neural connections become in relation

to basic money management and the more solidly built are their foundations of financial capability.

Experts on child development have determined that most young children can learn the following specific ideas through real experiences. The following concepts are taught by eight parent-child activities contained in the resource, *Thrive by Five™: Teaching Your Preschooler about Spending and Saving*. Parents and children's caregivers could use these activities with preschool children to start them on the road to developing financial capability.

Spending and saving

- Spending, saving, and sharing are ways to use money.
- Money has value because you can trade (exchange or spend) it for what you want or need.
- Putting money aside to spend later is called saving.
- Saving allows you to buy something in the future when you do not have enough money now.
- You can keep track of money by putting it in a special holder at home.
- Saving money is a way to get something you want by yourself instead of hoping that someone will give it to you.

Shopping

- You can decide how and when to spend money before you go to the store, which helps you make better choices.
- You do not have to spend all the money in your holder. What you do not spend in one day you can save and spend another day.
- Shopping means making choices.
- Deciding to buy something at a later date, or not buying something at all, are also shopping choices.
- People make shopping lists to remember what they need to buy.
- Shopping is a chore in which family members help each other.
- Good shoppers compare prices and choose items that cost less or are on sale.

Working for pay

- Work is often paid for with money.
- Different jobs pay different amounts of money.
- A calendar is a good way to keep track of future payments and events.

Value of money and using it to purchase items

- The amount of money needed to buy something is called its *price*.
- Different items have different prices.

- Coins and paper money have different values.
- Buying something means giving up money for an item.
- Money you spend is gone for good.
- Buying something means making a careful choice.
- You cannot buy everything you want.

Activities that do not have to cost money

- Family members do things for each other every day without being paid.
- Fun, free activities can be done at home, alone, with family, or with friends.
- Some things that seem to be free, such as food, really cost money.
- Love, hugs, and friendship are also free and feel good to give and receive.
- Many gifts can be made at home and do not cost any money.
- Doing something fun with someone can be a special gift.
- Helping someone with a chore can be a gift.
- Giving a cost-free gift can express love as well as, or better than, a gift bought with money.
- Doing something for someone can feel as good as having someone do something for you.

In Summary

The ability to manage money well is key to financial stability for families. When families are financially stable, they are more likely to feel relaxed and capable, and to do a better job of childrearing. Stable families create healthy communities that improve the functioning of the whole nation. Researchers now believe that, as in so many other areas of life learning, parents are their children's first and most important teachers of the basic concepts of spending and saving money. Moreover, starting young is best. As their brains rapidly develop, preschool children are well able to absorb such concepts from the adults they love and trust most. By using the simple actions listed above, parents can do a great job of setting their young children on a wise path toward youth and adult financial capability.

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