Perfectcents

A family's guide to teaching children to be money smart

Number 3

Waging the battle – spending & saving

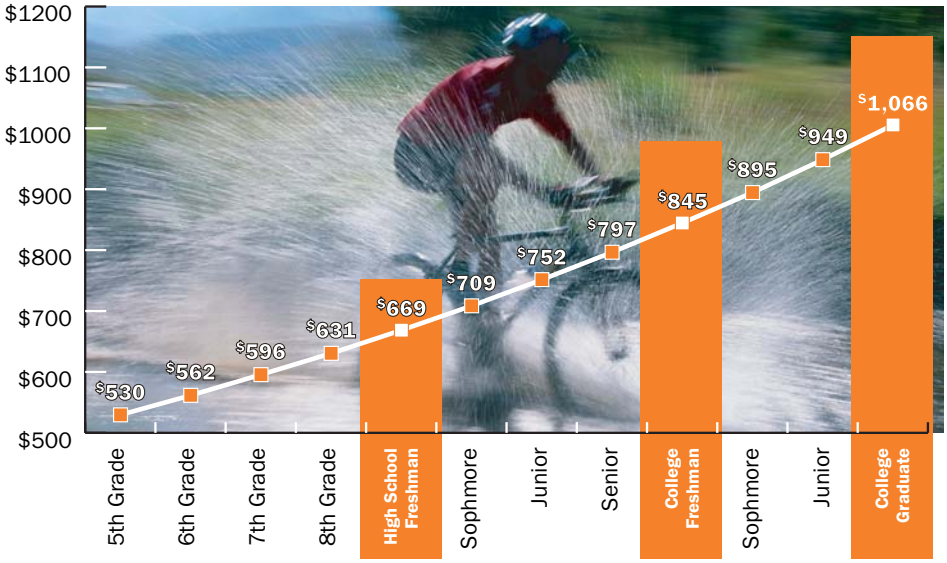
It's an age-old conflict. "I see it. I want it. I have to have it." versus "I don't really need it. I only want it. I can put my money to a better use."

Oh, man, that mountain bike is soooooo cool. It's a great color – an awesome new model. Plus, it's got a better derailleur and two more speeds than your old bike. Temptation begins. Wouldn't it be great to have this bike?

There's a term for that pull you feel to buy the bike. It's called *immediate gratification*. It's an important-sounding phrase that means buying something you like – just because you want it. And most of the time, you want it **NOW**, immediately.

Do you need it?
What's wrong with your old bike? Nothing, really. This one's just new and cooler and better. The bike just gleams in the magazine ad. You think of your old bike in the garage. It runs fine, but the grips are worn, one of the brake levers is bent slightly, and you've scraped the paint off the frame in a couple of places from that time you wiped out.

The price tag on the new bike reads $499.99. So it comes down to spending $500 for two more speeds, a straight brake lever, a flawless paint job, and a newer model. Do you still want the bike? Yes! Do you want the bike badly enough to spend $500? Probably. You'd be off to the bank like a shot if you could make the withdrawal on your own.



*As a 5th grader, you resist spending $500 on a mountain bike. Instead, you keep your money in a type of savings that earns 6% compound interest. Look at how your $500 will grow! Your money more than doubles by the time you are a college senior.**

But you can't withdraw the money on your own. You need your parents to approve the withdrawal. And you know what they'll say: *You don't need a new bike. And $500 is a lot of money.* It doesn't seem so much to you when you think it can buy that bike.

Mom raises yet another reason not to buy the bike: *If you spend the $500 now, you won't have it later when the next cool thing flashes on your radar screen. You'll have burned up your savings on the bike.*

What the experts say
According to Mark Schug, PhD, Director of the Center for Economic Education at the University of Wisconsin-Milwaukee, *the urge to spend* vs. *the need to save* can be a long battle. While it's often waged between parents and offspring, it's not a war that anyone ever entirely outgrows. Most adults find themselves still fighting the spend/save war. They just wage this war in their minds.

Why such a battle? Mark Schug says that the *immediate* good usually seems more exciting than the *distant* good. The bike is real – you can touch it and see it gleam right now. On the other hand, saving the money and letting it grow is not something you can touch, see, and admire in the same way. Saving is not naturally visual. You look at a bunch of numbers in a bankbook or on an investment statement. How exciting is that? One way to fight the urge to splurge is to be able to "see" your money – and its possibilities – better. Let's take a look. *(See back.)*

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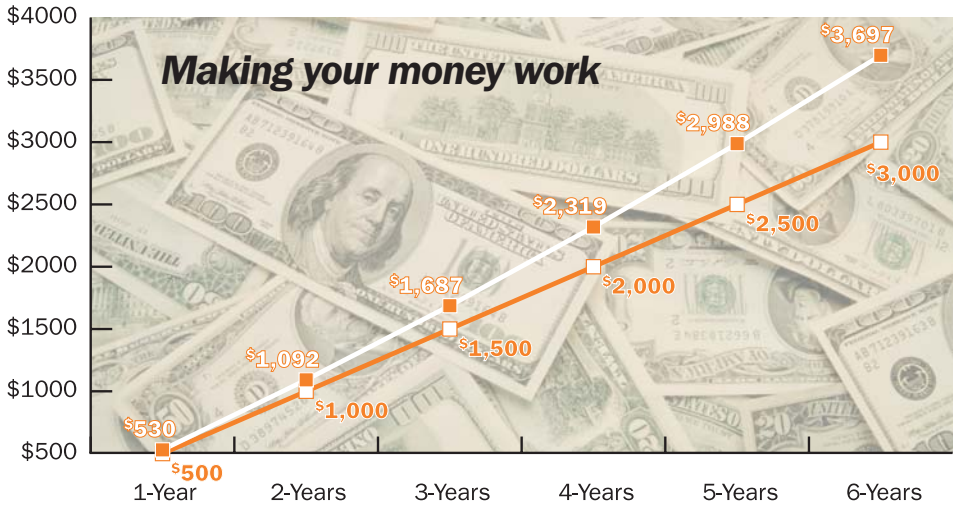
Seeing the money

Let's say you earn $25 bagging groceries on Saturday afternoons. Your parents say you have to save 70% of your earnings. That's $17.50 a weekend, $70 a month, $840 a year. You've got the $500 to buy the bike. But what happens to the $500 if you don't spend it and it stays in your savings plan?

The chart on the front page shows you what your $500 does when it earns 6% interest compounded monthly. Your money more than doubles itself.

Let's say that you begin to like the idea of your money working for you. You resist the urge to splurge on major purchases and save $500 every year for 6 years. Look what happens to your savings now! *(See the chart at the right.)*



The white line shows what heights you can reach at year's end by saving $500 every year for 6 years – and saving the interest. This is the way people build wealth. The orange line shows how your money grows if you spend the interest you earn.*

What a sight!
How amazing is this? What's going on here? It's called *compound interest*. You not only earn interest on the money you're saving, you're also earning interest on *interest already earned*.

This is called *making your money work for you*. All you have to do is resist the temptation to withdraw it so that it can keep growing.

the mint

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Tips for parents

John Whitcomb, author of The Sink or Swim Money Program, a book about teaching children financial responsibility, goes to the heart of the spend/save issue.

He points out that the only way people can save is by living slightly below their means and by feeling content to do so.

To save, we all must choose between usefulness and prestige, value and status. It's a tough choice in an "image-driven society… which tempts us to live for the moment… to consume for the purpose of prestige."

How do parents offset such strong messages? John Whitcomb promotes a program that gives kids control of limited amounts of money, beginning in about 6th grade. Spending and saving are tied to contracts, binding agreements between parents and children. As children grow older, the amounts and scope of the contracts expand, *gradually* enabling kids to learn to handle greater and greater financial responsibility.

It's called a "sink or swim" program because it enables young people to learn (often the hard way) from the consequences of their actions. And kids learn while they're still at home, where their mistakes are not too serious. John has dozens of stories about kids who "got" the savings message and watched their small mountains of money grow into larger ones.

The Doubling Game

Which would you rather have? A million dollars in one lump? Or start out with a penny at the beginning of the month and double it every day for the next 31 days? *Well, the cool million, of course! The second choice sounds like small change.* If that's your answer, you're in for a surprise. Grab a calculator and start figuring. Keep doubling so you can fill in the highlighted square. (Answer: $10.4 Million.)

The last four squares show how your money keeps growing. That's how money makes money. That's how to build wealth.*

$.01	$.02	$.04	$.08	$.16	$.32	$.64
$1.28	$2.56	$5.12		$20.48	$40.96	$81.92
	$327.68	$655.36	$1,310.72		$5,242.88	$10,485.76
$20,971.52		$83,886.09		$335,544.32	$671,088.64	$1.3 Mil.
			$20.8 Mil.	$41.6 Mil.	$83.2 Mil.	$166.4 Mil.

* These graphs are for illustration purposes only. They do not take into consideration fees, taxes, commissions, etc. and do not represent any specific product or investment. These graphs also do not take into account that a dollar received in the future may be worth more or less than a dollar received today.

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