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The Emergence of a Finance Culture in American Households, 1989-2007\*

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## Abstract

As the financial economy has expanded beginning in the mid 1980s, it has done so in part by selling more products to individuals and households, such as mortgages, second mortgages, mutual funds, student loans, car loans, insurance, and various forms of retirement products. This has allowed households access to new forms of assets and debts and new ways to fund their lifestyles. This giant expansion of the financial services sector occurred at the same time that income inequality and job insecurity increased dramatically in the U.S. This paper seeks to tease out empirically the relationship between these trends by examining data on the activities of households in the past 20 years. There are two views, one that focuses on how households reacted defensively to preserve their lifestyles and the other which focuses on households developing a more financial mindset to the management of their assets, debt, and consumption and thereby using the new opportunities to invest and borrow money to increase their consumption. We show some support for both views. The use of financial products and debt has increased at all levels of the income distribution. Attitudes toward risk and indebtedness have generally become more lax. But, there is also evidence that people at the top of the income distribution are using their growing income to consume more while people lower down are struggling to

keep up. The meaning of new financial culture is quite different depending on where you stand in the income hierarchy.

## **Introduction**

Financialization, broadly understood to mean the increasingly important role of financial markets, motives, actors, and institutions in the operation of the economy (Epstein 2005), has attracted a flood of attention in recent years (Krippner 2005; Orhangazi 2008; Dore 2008; Davis 2009). Scholars have produced a growing number of studies on the origins, dimensions, and effects of financialization across multiple domains, both in the U.S. and internationally (e.g. Zorn et al 2004; Krippner 2011; Tomaskovic-Devey and Lin 2011; Baud and Durand 2011).

One piece that has received less empirical attention is the role of households in financialization. As the financial economy has expanded, it has done so in part by selling more products to individuals and households, such as mortgages, second mortgages, mutual funds, stock trading accounts, student loans, car loans, insurance, and various forms of retirement products. The result has been a profound deepening of Americans' involvement in financial market activities over the previous two decades. This is apparent in credit markets, where real median household debt levels increased 179% from 1989-2007 as consumers took on an ever-wider array of credit card, home equity, mortgage, student, and payday loans (Wolff 2007; Goldstein 2012). It is also apparent in the widespread acquisition and trading of investment assets. The percentage of households with direct holdings of stock equities or equity mutual funds increased and the frequency of transactions more than tripled over this period (Kremp, 2010).

There is a sense among many social scientists that these trends are together indicative of a more fundamental underlying shift in economic culture and behavior toward financial activities (Martin 2002; Langley 2008; Davis 2009). For instance Akerlof and Shiller (2009, p.157) assert that the increasing prominence of the stock market during the 1990s made investment success a popularly understood indicator of intelligence. Davis goes even further, characterizing the U.S. in the early 21st century as a "portfolio society," in which "investment becomes the dominant metaphor to understand the individual's place in society" (2009, p.193). From this perspective, taking on greater debt, using house value appreciation to fund expenses such as education and current consumption, and frequent trading in the stock market all reflect a trend toward more active, entrepreneurial management of household finances.

But if there is general consensus that American households have, in the aggregate, become more attuned to and dependent upon financial markets and willing to enter them, we still know very little empirically about the contours and causes and of this transformation. Scholars have studied fragmentary pieces of this process, including changes in household portfolio mix; shifts in attitudes about risk, financial literacy, and the performance of retail stock investors (see e.g. Tufano 2009 for an overview). We also have studies of the evolving patterns of participation in particular financial markets, including credit cards, mortgage credit, and stock equities (Kremp 2010).

Yet we lack a panoramic analysis of the financialization of American households over the previous two decades. The purpose of the present paper is to

lay a conceptual and empirical groundwork for how sociologists might think about this multi-faceted issue: Who was becoming more financialized, how, and why?

Lurking behind these questions are several alternative accounts about how broader changes in the structure of the economy – wage stagnation, increasing inequality, job insecurity and risk culture – may have impelled different kinds of households to adapt by embracing financial activities in different sorts of ways. Economic changes placed new pressures on many Americans' lifestyles and valorized new forms of entrepreneurial risk-taking. At the same time, the giant expansion of the financial services sector has allowed households access to new forms of assets and debts and new ways to fund their lifestyles.

There are two views, one that focuses on how households reacted defensively to preserve their lifestyles and the other which focuses on households embracing the logic of the risk economy and developing a more financial mindset to the management of their assets and debt in order to increase their consumption. The expansion of both investing and credit would seem to be one way that households maintained their lifestyles in the face of stagnant, declining, or unstable employment incomes. Here we would expect that lower income households to have higher levels of indebtedness relative to their incomes. On the other hand, there is the view that some households wanted to expand their consumption and did so by active management of their assets. This created a new financial culture whereby households actively used their houses as assets to be leveraged and made riskier investments, particularly by holding more stocks.

We use triennial data from the Survey of Consumer Financial to chart changes in the financial activities and attitudes of households across an array of different indicators since 1989. We find partial support for both of the views above. There is a substantial increase in the holding of financial products of all kinds across the income distribution. This spread is more or less linear and across all income groups over time. This implies that the financial sector has sought out customers for its new products and they have extended their sale to people up and down the income distribution. Of course, those with the most money are always the most involved and their involvement has generally risen the most over time.

But for most segments of the social structure, there is little discernable evidence that increasing use of financial services has brought about a significant shift in cultural logics or economic repertoires. Financial orientations are mostly focused on the top 10-20% of the income distribution. It is here that we find people more actively managing their financial situations and taking on more risk. We have some evidence that those on the bottom by necessity had to become more financially savvy. But much of this appears to be defensive and in response to declining income opportunities. Finally, we can show that the pressure to increase indebtedness was felt most strongly by the upper-middle classes – those who were competing with those in the top 10% of the income distribution.

Our results extend and qualify previous arguments about the increasing integration of American households into the financial economy (Davis 2009). Our findings imply that household financialization is a mass phenomenon insofar as consumption of financial services increases significantly (and roughly evenly)



throughout the stratification structure. However, to the extent that we can discern a deepening financial culture of risk-taking and strategic deployment of assets, this is concentrated within those higher-income groups who were already most financialized.

### **Shareholder Value, Inequality, and Changes in Insecuritization for Households in the U.S. since the 1980s**

Households located in different parts of social structure have faced different challenges and opportunities as the larger economy has changed in the past 30 years. By understanding the nature and timing of these changes and connecting them to the stratification of the population, we will be in the position where we can then make some hypotheses about how households in various social positions had to change the way they saved, borrowed and invested in response to potential changes in their lifestyles.

The 1970s was a period of slow economic growth, high inflation, and high interest rates. Corporate America found itself at the end of the decade with lots of cash, low stock prices, and assets that were undervalued on their books because of the inflation of the value of those assets during the 1970s. In the late 1970s, the institutional investment community began to see this state of the corporate sector as an opportunity to make money. The remedy for this was for sitting managers to be replaced by managers whose main job would be to raise the stock price. Increasing the stock price meant undertaking corporate reorganization that resulted in a better looking balance sheet. Layoffs, selling off low performing divisions,

outsourcing, and buying back shares of stock were all seen as actions that would increase shareholder value (Fligstein and Shin, 2007).

The 1980s shareholder value led merger movement had a profound effect on the jobs of millions of Americans. One of the main outcomes of this process was the massive layoffs of blue collar workers and the closure of a large part of America's manufacturing capacity. Unionized blue collar workers who were predominantly male high school graduates who lost their jobs during the 1980s never recovered financially from those layoffs (Farber, 1996; 1997). The 1980s, not surprisingly witnessed a large growth in income inequality, at least part of which was caused by the lack of opportunities for those who were downsized and outsourced.

During the 1990s, the shareholder value ideology came to dominate both the discourse and practices of corporate America. The 1990s saw the return of generally better economic times, the technology boom, and a rapid run up in stock prices. The further growth of inequality during this period was driven predominantly by rising incomes in the top 10% and especially top 1% of the income distribution, coupled with continued stagnation below. CEO pay rose from about 80 times that of the average worker in 1990 to 300 times the average worker in 2000 (Mishel, et. al., 2006). After the stock market crash of 2001, this dropped to 143 times average workers, but during the economic recovery that followed, CEO pay rose back to over 340 times the average pay.

One side effect of increased attention to shareholder value issues was to increase labor market risks in all sorts of ways (for overviews see Fligstein and

Shin 2004; Kalleberg 2009; and Hollister 2011). During the 1980s and 1990s, corporate provision of benefits of all kinds decreased, especially for those in the bottom 40% of the income distribution. Employment also became more precarious throughout the occupational structure. As firms sought to adopt “lean and mean” organizational structures, there was a concomitant growth of contingent employment whereby work is temporary and based on discrete contracts rather than long-term commitment (Kalleberg 2009). During the 1990s, white collar workers became as susceptible to layoffs as blue collar workers. Aaronson and Sullivan (1998) document how rates of job loss increased for both blue and white collar workers and the traditional gap between the groups narrowed. Together, these processes resulted in marked increases in economic anxiety across the occupation structure, and most dramatically so amongst upper middle-class white-collar workers who had traditionally been insulated from dislocations in the labor market. They also spawned a variety of compensatory cultural discourses which framed the new risk economy as a brave new world in which entrepreneurial “free-agents” could advance themselves through active management of their human and financial capital (Sennet 1998; Langley 2008; Friedman 2011).

The main goal of our research is to examine how these larger changes echoed across the stratification system to shape the differential incorporation of households into the financial economy. Obviously, households were pushed to adjust their lifestyles on the basis of this new economic order at the same time that financial markets offered the prospect of new opportunities to enhance their lifestyles. We turn now to considering some alternative scenarios about how

households may have absorbed these changes in different ways using financial strategies.

### **Credit, Lifestyle, and the Changing Face of Income Inequality**

Most people's reaction to threats to their lifestyle and consumption involve trying to preserve their style of life (Elias, 1994). The obvious way to close the gap between what you were earning and what you needed to stay where you were was to borrow to fill the gap. This makes the role that credit played in funding the lifestyles in America over the past 20 years a matter of some interest. We know that credit became much more widely available after 1985 as the technology of securitization was used to securitize not just mortgages, but second mortgages, home loans, student loans, and credit card debt. Securitization heightened secondary market demand for consumer debt instruments, propelling a broad democratization of credit (Kendall, 1996). One of the main questions of this project is to empirically investigate how Americans faced with economic downsizing and increased income inequality funded their lifestyles. Obviously, different levels of the income and education distributions faced very different economic prospects and might have made quite different decisions.

In the aggregate, we know that consumption inequality increased less over this period than income inequality. This implies that households were using debt to keep up their lifestyles (Cynamon and Fazzari, 2008). There are two underlying views as to how this happened and what it meant. First, debt funded consumption

allowed the increasingly insecure middle class Americans to continue their lifestyles. In order to counter their growing insecurity caused by reduced pensions, more expensive health care, and higher college tuition bills, households in the middle of the income distribution who were anxious about downward mobility simply borrowed money (Hacker, 2006; Leicht and Fitzgerald, 2007). Second, there is also evidence that debt funded consumption for more expensive cars, homes, and other consumer products produced rising indebtedness. Schor's work (1996) focuses on how people are led to consume by an American culture that values defining who we are by what we buy. As inequality has increased and mass media has made reference groups less localized, Americans have sought to consume at an ever-higher level. Similarly, Frank (2007) argues that in the 2000s, an arms race for positional goods such as expensive cars and large houses in prime neighborhoods pushed households to increase their use of debt. These perspectives on consumption suggest that as income groups at the top were able to consume larger and more expensive things, groups below them were compelled to keep up with the rising bar.

Higher income inequality exacerbates this process because it allows those at the top to push for even more outrageous things. The only way that those lower down in the income distribution can keep up is to borrow ever more amounts of more money. Ironically, as inequality increased, it may have pushed indebtedness even higher.

So far, we have only discussed the idea that in order to protect their life styles various groups would pursue different strategies of taking on debt. But,

another provocative idea is that a new cultural frame emerged during this period. Such a frame emphasized that households should take more responsibility for their financial affairs. Davis (2009) goes so far as to argue that people have had to become their own “financial economists” in order to manage their consumption, investments, and debts. This provocative idea implies that savvy financially oriented households will learn to invest in the stock market for their retirement, use leverage to buy a bigger house and car, and take money out of their house either by refinancing or in the form of home equity loans as the value of the house increases. The research we do here examines the degree to which one can identify the existence of this new cultural frame across income groups.

There are two empirical questions that follow from this view. First, is the degree to which one can identify different income groups who appear to be engaging in more active financial management of their assets, debts, and large consumer purchases. Second, if such clusters actually exist, do their tactics spread across income groups? One might imagine that such financial sophistication would begin with the top 20% of the income distribution. Here, we have people who have money and knowledge and who are feeling the pressure to expand their consumption activities. They would pioneer the use of such instruments during the 1990s as credit became more available (particularly for home equity loans). The interesting empirical question is the degree to which such techniques moved down the income distribution. Did middle class Americans embrace financial logics as a way to expand their consumption to keep up with their declining fortunes? Is there

any evidence that these financial tactics spread to the lower part of the income distribution during the 2000s?

## **Hypotheses**

The above discussion implies that two basic changes in the features of their economic lives may have pushed Americans toward greater involvement in financial markets. First, the growing insecurity of work, the lack of growth in income for most people, and the growing burden of providing for health and pensions meant that households had to find a way to manage their assets and debt to maintain their styles of life. Second, for those fortunate to have been the beneficiaries of the changes in the American economy, more money frequently also came with more demands to use your wealth “smartly” and the associated diffusion of financially-oriented cultural frames. Newly wealthy groups found themselves battling over what Frank (2007) calls positional luxury goods in a bid to prove their newly found superior social status.

Another possibility, implied by Davis (2009), is that everyone became more financialized as they were encouraged to take responsibility for their economic futures. If this is true, one empirical implication is that we should observe a general increase in the holding of all kinds of financial assets and the use of debt and leverage for all levels of the stratification system. A related hypothesis is that we should also observe that people will engage in lots of these activities or none of them depending on the degree to which they have absorbed the view that they

should be actively managing their assets. The behaviors involved in making financial decisions should cluster together and people who are taken in by the financial culture will be more systematic in their deployment of their assets.

There are other possible alternatives to this general story of the spread of a finance perspective amongst American households that emphasize how such expertise and the opportunity to engage in such behavior was spread unevenly across households. The first begins with the well-known fact of increased income inequality in the U.S. since the early 1980s. It emphasizes that as American incomes stagnated and inequality increased, households came to use easier credit as a way to make up for what they were not able to earn. This hypothesis suggests that we ought to observe all households, but particularly lower income households using new forms of credit in order to make ends meet. For these households, credit card debt and subprime mortgages operated as ways to finance a better life even in the face of declining incomes. There is some evidence, for example, that consumption inequality increased more slowly than income inequality over this period as a result of the use of credit by lower income households (Heathcote, et. al. 2009).

An alternative version of this hypothesis views the inequality as not just affecting the bottom quartile of the income distribution, but also the middle 50% (and maybe all the way to the 95<sup>th</sup> percentile). Here, middle class and upper middle class people also faced more insecure employment, more rapid job turnover, and a shift from pensions as defined benefit to pensions where there were defined contributions. They experienced the intensification over the competition for status



goods more directly. In response, it was these individuals who had both the means but also the skills to begin to take more responsibility for their financial welfare. They began to see their houses as assets and their mortgages as ways to get financial leverage. As a result, they use debt more creatively to engage in status competition for positional goods, particularly housing.

## **Data and Methods**

In order to adjudicate amongst these hypotheses, one needs data over time that documents both socioeconomic characteristics, attitudes towards risk, and actual data on consumption, investment and debt. We are fortunate that the Federal Reserve has gathered comparable data every three years since 1989 (1989, 1992, 1995, 1998, 2001, 2004, and 2007 (the 2010 data was not be available until May 2012)). The SCF was collected before 1989, but the earlier surveys did not have the attitudinal questions and some of the other measures necessary for our project. While some of the changes we discussed in income inequality were well on their way by 1989, households were still figuring out how to adjust to the changing circumstances generated by the earlier parts of the 1980s. This is an early enough date to get leverage on many of the issues in which we are interested.

The Survey of Consumer Finances (hereafter, SCF) data reflects a series of snapshots of investment styles across socioeconomic groups over time. The SCF surveys around 4000 households with an oversample of high income households

(for more information on the surveys and sampling, see [www.federalreserve.gov/econresdata/scf/scfindex.htm](http://www.federalreserve.gov/econresdata/scf/scfindex.htm)).

The household is the unit at which both economists and sociologists agree that most consumption decisions are made. The SCF is the best data we have on household borrowing for real estate, health care, pensions, education, and vehicles. It also includes attitudes towards various kinds of financial risks, sources of financial information, an enumeration of all of the assets of the respondent and their family, and detailed information on sources of debt and investment.

The SCF is a repeated cross sectional survey rather than a household-level panel study. One might prefer data that is on a single set of families over a long period of time. But our goal here is to provide some baseline data on how households who were similarly situated in the income distribution change their attitudes and behavior over time. The information collected by the SCF makes it ideal as a site to explore how various social groups managed to support their styles of life by using credit and taking more financial risks. We think that it will eventually be important to find data that has a more longitudinal quality in order to settle some of these questions. But, the snapshots provided by the SCF are a good place to start.

On consumption, investment, and debt side, the SCF provides the greatest detail of any survey that exists. It is possible to tell if the household owns or rents, what type of dwelling they live in, and detailed information about their mortgage including interest rate and whether or not the rate floats. We also know if the home has been refinanced and if there is a line of equity credit on the house. The SCF

contains similarly detailed information about vehicle ownership including model, make and year. There are questions on household attitudes towards risk taking. Households are asked their feelings about risk and the conditions under which it is permissible to take on debt. The SCF explores if people have spent more or less than they have earned in the past year. These questions can be explored to construct how households thinking about risk and spending has changed over the past 20 years.

Our goal in this paper is to create descriptive measures of the spread amongst households of all kinds over time of the use of various kinds of financial instruments. The second goal is to try and understand the degree to which there is evidence for a financial culture at the level of the household developing over time. We hope to observe the spread of such tactics across socioeconomic groups at different historical moments. This exercise would hopefully give us a clear picture as to the degree to which various social groups learned how to become their own financial economists and how far this spread across the various socioeconomic groups in society.

Our basic strategy is to explore the descriptive results available in the SCF by breaking down various measures across different income groups. Here, we use 6 groups that index the positions of households in the income distribution income by percentiles: 0-20%, 20-40%, 40-60%, 60-80%, 80-90%, 90-100%. This measure groups together income levels that will roughly correspondent to household's position in being able to consume goods and services. While there is arbitrariness to using any income breaks, using income as a measure of position in consumption

has the huge advantage that those with more money simply can consume more and better things if they choose than those with less money. This means we have a good measure of where people stand in the competition for positional goods and services. Those in the top 10% of the income distribution are competing with each other for positional goods like luxury cars and second homes. Those in the next 10% of the income distribution are competing with each other plus worrying about trying to keep up with the 10% of the distribution above them (and so on). This is a crude measure of lifestyle group competition, but one worth exploring. We will show that there is some evidence for this kind of competition in terms of the need for households to take on debt in order to fund current lifestyle consumption.

We also break down various measures across three levels of a self reported answer to the following question: “Relative to the prices for things you buy, has your income increased in the past five years, remained constant, or decreased in the past five years”. This question indexes the degree to which a household feels itself a winner or loser in the recent economic race. Given the increases in income inequality that have occurred, how one feels about one’s trajectory in the past five years is an important way to gauge people’s subjective (and hopefully to some degree objective) sense of where they stand in terms of having gone up, held their own, or experienced downward mobility. This measure is related to income levels, but it offers us another way to measure the pressures households feel on trying to preserve their lifestyles. For example, households experiencing income declines might be more amenable to taking on debt to supporting their current lifestyle regardless of income.

## Results

It is useful to begin by examining how households view their changing income over time. This measure provides a baseline to understand if people are feeling pressure on their lifestyles because of decreased income or else an opportunity to expand their consumption. Figure 1 presents the degree to which households perceive their income growth over the past five years. A relatively stable 40-45% of households view their income as constant from 1989-2007. The main trend in the table is the relative increase in households who perceive their income as having gone down in the past five years. This percentage has risen from 32% to 42% over the period. The percentage of households who perceive their income has risen has dropped dramatically from 28% to 18%. This sobering fact implies that nearly half of American households are feeling pressure on their current style of life and consumption. We note that this does not include data from 2010 after the current financial meltdown when one could expect that household income would have dropped even further.

(Figure 1 about here)

When we break this down across income groups, we see a pattern that mirrors what we know has happened in terms of income inequality. The bottom 20% of the income distribution views its income growth in the past five years as negative and this increased from about 40 to about 50% over the period. The percentage of households in the bottom 20% of the income distribution who have

seen their income rise in the past five years has dropped from about 20% of those households to about 10%. At the other end of the income distribution, between 50-60% of households in the top ten percent of the income distribution feel that their income has increased in the past five years and around 90% view their income as having increased or been stable. Generally, as one goes up the income distribution, one finds the percentage of households whose income has been positive in the past five years to be larger.

(Figure 2 about here)

These results dramatically show the effects of 18 years of increasing income inequality in the U.S. Only in the top 10% of the income distribution do the majority of households report increasing income in the past 18 years. Since 2001, the bottom 90% of the income distribution reports a decrease in the levels of their income increasing and an increase in negative income growth. This is evidence that to the degree those households feel pressure to continue to consume, that pressure is being made worse by the fact that income prospects in the past five years are highly related to position in the income distribution. Poor families and middle class families alike face constant or declining income. The farther down the income distribution you go, the starker the pressures are on household lifestyle consumption brought about by declining incomes. This implies that competition with your own income group and the income group ahead of you for positional goods is made harder. Those above you make more money and their income has been more likely to have risen more in the past five years as well.

(Figure 3 about here)

In our theoretical discussion, we argued that in response to declining income, households might be more inclined to take on risks in their investments or take on more debt in order to support their lifestyles in the face of declining income. We also argued that willingness to take on risk might also reflect a more informed and aggressive financial attitude towards assuming risk. To index the degree that households are assuming more risk, we use the following question in the SCF:

Which of the following statements on this page comes closest to the amount of financial risk that you are willing to take when you save or make investments?

1. Take substantial financial risk expecting to earn substantial returns
2. Take above average financial risks expecting to earn above average returns
3. Take average financial risks expecting to earn average returns
4. Not willing to take any financial risk<sup>1</sup>

Figure 3 shows that during the 1990s, risk tolerance rose in American households, perhaps reflecting the rising stock market and the increased participation of households in that market. This supports the argument made by Akerlof and Schiller (2011) about how the rising stock market attracted investors in many households who wanted to take more risk and be part of the new economy. The percentage of households saying they take no financial risks drops from about 47% to 35% in 2001 and then rises back to about 40% by 2007. The percentage of households

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1 For a discussion of the meaning of this measure, see Grable and Lytton (2001).

taking above average or high risks rises from about 14% to 25% and then dips to about 22%. This is evidence that risk tolerance increased in the U.S. But, we note that the majority of households take on either average or no risk all through the period. Thus, if a culture of favoring risky investments is rising in the U.S., it is restricted to less than a quarter of households.

(Figure 4 about here)

The obvious question this raises, is which households were the most likely to take on higher levels of risk and how did this change over time? Figure 4 examines risk tolerance levels by income group. This figure dramatically shows a huge difference in risk tolerance for the top and bottom of the income distribution. At the bottom of the income distribution, 70-80% of all respondents say they take on no risk across all time periods. At the top of the income distribution, we see an increase in above average or high risk from about 20% of the households to 45% in 2001.

Risk tolerance is highly related to income. The majority of the bottom 40% of the income distribution takes on no risk and only 10% report taking on above average or high risk. The change in risk taking behavior is really a product of the top 60% of the income distribution and most of the rise occurs between 1989 and 2001. For the top 60% of the income distribution, we see little evidence of one group leading in taking riskier behavior and other groups lagging. Instead, we see across the board increases in households favoring more risk over time. This suggests a cultural shift for those in the middle and upper middle income households in their attitudes towards risk.



Having said that, it is clear that the top of the income distribution, which has experienced the most income growth in the past five years is also the part of the income distribution that has changed its attitudes towards risk most dramatically. This implies that if there has been a cultural shift towards a more open attitude towards risky investments, it has been led by those who have been most successful.

This could be explained in a couple of ways. First, people have to have money in order to make investments in the first place. Given that income is so highly related to risk, it is plausible to believe that lower income people do not take on risks simply because they do not have any money. Their resistance to taking on more risk could also be related to the fact that many of them have incomes that have dropped in the past five years, Since the winners in the economy have been concentrated in the top part of the income distribution, it follows that they have the money to take new risks and their rising income encourages them to do so. This might explain why high risk taking was so concentrated in the top 60% of the income distribution and most clearly in the top 10%. We will explore this issue a bit more in a moment.

(Figure 5 about here)

Given that so many households, particularly in the bottom part of the income distribution have experienced increasingly negative income growth over time, it is interesting to explore how their attitudes to using debt to support their lifestyles may have changed over time. The SCF contains the following question that appears to capture this attitude: “Is it right to borrow money when one’s income declines?” The question helps us get a handle on whether or not people feel it is

more acceptable over time to go into debt if there is pressure to decrease one's consumption caused by a decrease in income. In a world where households are struggling to maintain their consumption because of decreases in income and relative increases in inequality, attitudes towards taking on debt to support a current lifestyle would be a measure of how people thought it was an acceptable strategy to cope with the pressures on their consumption.

Figure 5 shows that there has been a substantial increase from about 45% to about 55% who feel it is all right to borrow to support their lifestyle if their income decreases over time. Interestingly, this increase holds over groups whose income has increased, remained constant or decreased over time. This implies that it is not the experience of having household income decrease that makes people feel it is ok to borrow when this happens. Indeed, those whose income has increased in the past five years have shifted their attitudes the most on this question. Instead, this appears to capture a more general norm shift where people consider it totally legitimate to take on debt to maintain lifestyle in the face of income decline.

(Figure 6 about here)

In order to get a sense of how broad this norm shift might be, we consider how people with different levels of household indebtedness might have changed their views on whether or not borrowing to make ends meet when income declines is ok. The top of figure 6 shows that the increase in the percentage of households who believes it is all right to do into debt holds over all levels of household indebtedness. The least indebted continue to hold a moral view that borrowing to

maintain consumption is not all right as the percentage of this group who approves such behavior goes from about 41% to 44% over the period. But the other 75% of the indebtedness distribution all have a majority supporting the new norm of borrowing to sustain their lifestyle in the face of declining income. The groups begin the period with somewhat different attitudes but they generally converge with a higher level of approval. This is evidence that over time, households became more accepting of using debt to maintain their lifestyle as their experience with those pressures intensified.

The bottom half of figure 6 shows the changes in this attitude across income groups from 1989-2007. We note that poorer people always are more accepting of going into debt to sustain their lifestyle. This reflects their more direct experience of sudden household drops in income that threaten their well being and their need to go into debt in order to keep going. But over time all income groups come to view going into debt to sustain current expenses when income declines as acceptable behavior. Not surprisingly, the highest income group remains the most disapproving reflecting the fact that 80-90% of these people have seen their incomes increase or remain stable over time. But even here, the percentage of households agreeing rises from 37% to 46%.

Taken together, our attitudinal measures provide evidence that American households are willing to take on more financial risk over time and that they accept that continuing to support a given lifestyle when household income decreases by borrowing, is acceptable. These results suggest some overall culture shift. But, these shifts also imply quite different social processes for different ends of the

income distribution. The top of the income distribution which has seen the most income gains from 1998-2007, is much more accepting of risk, and much less accepting of indebtedness in the face of declining incomes. The bottom of the income distribution rarely takes financial risks, but is willing to find borrowing acceptable to keep a lifestyle in place. Those who are most indebted have come over time to find their borrowing to maintain their current lifestyle acceptable. The losers of the inequality game have been pushed to shift their attitudes on borrowing to maintain their incomes. The winners have taken their gains and gotten used to higher levels of risk and reward. The attitudinal evidence implies support for our overarching narratives of how changes in inequality have affected household attitudes towards risk taking and indebtedness.

In order to explore the degree to which households have developed more financial savvy, we shift from attitudinal measures to a consideration of behavioral measures. We know that the financial services industry has greatly expanded its activities in the past 20 years. It follows that this supply side increase in all sorts of financial services and tools must trickle over to households. After all, someone is holding all of those mortgages, home equity loans, student loans, credit cards, debt, stocks and mutual funds. We are interested in two features of these changes. We expect that such changes will occur more in the higher than the lower income groups. We are interested in if all groups move up together reflecting a generally availability of financial products and tools or if some groups lead and others lag.

(Figure 7 about here)

The top of figure 7 presents data on whether or not households get professional advice when making investment or borrowing decisions. Seeking out financial advice implies that people are more likely to be involved in the financial economy and to be thinking financially. The question asks whether or not a household gets advice from a wide variety of sources and respondents can answer as many of the categories as apply. We consider the following responses to be a professional: lawyer, accountant, banker, broker, or financial planner. If the household identifies any one of these, they are coded as having used the services of a financial professional. The figure shows quite clearly that the use of such professionals is highly related to income. The top decile of the income distribution is 35-40% more likely than the bottom 20% to seek out such advice. But, it is clear that over time, all income groups are more likely to get some form of financial advice particularly from 2004-2007. One interesting result is that the gap between the top decile and the rest of the distribution appears to be opening up over time.

The bottom of figure 7 contains data on the average number of credit cards in each household by income group. Here, we see a similar pattern. Higher income groups have more credit cards per household and over time, all groups are increasing their numbers of credit cards. There appears to be a slight increase in the average number of credit cards per household between the top income groups and the bottom.

(Figure 8 about here)

The top half of figure 8 presents data on the number of accounts at all forms of financial institutions that households have. Once again we see a similar pattern.

Since 1995 (the data were not collected in earlier waves of the SCF), the average number of accounts have risen for all households across income levels. But, the highest income household had somewhere around 5 such accounts while the lowest income household only had 1. This implies that financial institutions were able to get households at all income levels to open up new kinds of accounts.

The bottom half of figure 8 presents data on the percentage of households that did business with their financial institution via the internet. We think this measure indicates both a higher degree of financial savvy and a level of comfort with paying bills, transferring payments, and generally managing their financial lives on line. In 1995, less than 10% of people at all income levels were using the internet to do banking. This of course reflects the fact that online banking was quite new and undeveloped at that point. But, in the ensuing 12 years, the percentage of people using the internet to bank increased dramatically. By 2007, 40-90% of the income groups were using the internet to do business with financial institutions. But, here we see, once again, a huge difference by income group. The highest three income groups had 80-90% of people doing banking online. This gap may say less about a financial mentality than it does about how income affects access to the internet. It is the case that people with incomes in the lowest 20% of the distribution only have access to the internet at the rate of about 40% (Martin and Robinson, 2007).

(Figure 9 about here)

Our last indicator of financial involvement is the percentage of households who hold stock or mutual funds. The measure we use does not include retirement

accounts or pension plans that invest in stocks. It only includes whether or not the household owned stocks or mutual funds as part of its investments. This is a good measure of the degree to which households are financialized because stock or mutual fund ownership outside of the context of pensions requires people to actively seek out stock brokers or brokerage firms. The top part of figure 9 shows that during the 1990s, the percentage of households that owned stock or mutual funds increased from about 20% to around 31% at the peak of the stock market in 2001. Thereafter, share and mutual fund ownership dropped back to 23%. A huge number of households were enticed to become stock or mutual fund owners during the run up in the market during the dotcom boom of the late 1990s.

The bottom half of figure 9 contains data on the spread of stock and mutual fund ownership across income levels. As in almost all of our previous attempts to measure financial involvement, there is a huge difference between stock and mutual fund ownership across income groups over time. All of the income groups follow similar patterns of increasing holdings during the stock bubble of the 1990s and early 2000s and some declines after 2001. But, obviously stock and mutual fund ownership are most highly related to income.

Taken together the results in this section imply that people became more involved in the financial system over time by seeking out the advice of professionals, and adding credit cards, bank accounts, and stock and mutual fund ownership to their households. But here, the biggest effects are not surprisingly related to income. The highest income groups consistently held more of all of these financial services and instruments and they ended up consuming more of them over

time. We offer two interpretations here. First, obviously one needed to have money to invest and save in order to consume financial products. The amount consumed seems to pretty straightforwardly be effected by income.

Second, the vast expansion of the financial services industry from 1989 to 2007 was felt at all income levels. That mostly all income groups rose over time and in tandem suggests that the supply of these instruments may have been the main cause of their expansion. Households might have stayed out of these markets had they decided not to take on risks by having multiple credit cards, bank accounts, or owning risky assets like stocks and mutual funds. One avenue to explore, is the degree to which the increases in the use of these products within income groups were restricted to people who had higher tolerance for risk. This is worth exploring in subsequent research.

(Figure 10 about here)

The last topic we take up in attempting to make sense of the relationship between inequality and financialization, is debt. The literature has shown quite clearly that debt has increased dramatically in the U.S. since 1989. It is useful to look at some of the data and trends in order to connect indebtedness to our main hypotheses. Figure 10 provides data on increases in indebtedness in U.S. households from 1989-2007. The top half of the figure shows a massive increase in household indebtedness. Most of this increase comes from three sources: mortgages on primary residences, home equity loans on those residences whereby people borrow money on the equity in those homes, and the purchase of other real estate including second homes and commercial property by households.



In the bottom half of the figure, we can see how the mix of debt has changed over time. Real estate accounts for between 78-84% of indebtedness of American households over this period. There is actually a slight decrease in the percentage of total indebtedness for primary residences. The largest increase is for home equity loans. This reflects the real estate bubble of the period 1998-2007 whereby housing prices increased dramatically. Many households decided to take advantage of these increases by borrowing money based on those increases. The relative size of the increases in indebtedness for housing and real estate was so large that it dwarfed any increases in indebtedness due to credit card debt, education loans, vehicle loans, or other debts. Indeed, all of these other sources of debt actually dropped as a percentage of all household debt over time.

(Figure 11 about here)

One reason that these other sources of debt decreased relatively over time can be accounted for by one of our two narratives about how financialization changed American households' spending patterns over time. Davis (2010) and others have argued that American households used their houses for cash machines to borrow money to finance a wide variety of items. This meant that they did not have to borrow money specifically for these items, but instead they used money taken out on a home equity loan to make these purchases. Figure 11 presents evidence on what households used the funds for that they took out from home equity lines. Over time, we see large increases in the use of these funds for two items: home improvement or renovation and paying daily living expenses, medical bills, and education expenses. The use of these funds to support "extravagant"

consumption like luxury auto purchases, televisions, vacations, weddings, and recreation was a relatively small fraction of these purchases and they did not rise over time. This casts some doubt on the view that home equity loans were being widely used as a cash machine to fund large luxury purchases.

This lends credence to the idea that financially savvy Americans did increase their indebtedness by cashing in on the increases in the worth of their houses. But, these funds were mostly used to improve the house. The fact that the second largest category and also expanding category was paying for ongoing household expenses and not luxury goods supports the view that American households were stretched and needed these funds to make ends meet. Goldstein (2012) shows that this was particularly true for households at the bottom of the income distribution.

(Figure 12 about here)

Figure 12 shows evidence on which groups took out additional money when a household refinanced a mortgage. We see clear effects of income levels on this practice. The highest income group is 20-30% more likely than the lowest income groups to engage in these practices. Over time, we see increases in the use of refinancing and home equity loans. But the largest increases are clearly for the top 20% of the income distribution.

The pattern of evidence supports the view that the top of the income distribution which has been the biggest beneficiary of economic growth in the past 18 years has also increased their financial activities significantly. They have become more comfortable taking on financial risks, use the services of financial professions at a high rate, and demonstrated that financial savvy by using the

equity in their homes to fund their other activities. While other income groups participated in this movement, it is clear that the most intensive financialization occurred amongst the most well off 20% of the population.

(Figure 13 about here)

One of the tropes in the popular media is that this increased indebtedness was somewhat reckless. That is to say, households put themselves at grave financial risk by expanding their financial activities and borrowing more money to support their lifestyles. In essence, this risky behavior reflected a culture of greed and a desire to keep up with the neighbors. The problem with this image is that it contradicts the idea that people became more financially savvy. As people became more familiar with credit and debt which they used to fund consumption and investments, they might have taken more financial risks, but they also had more financial savvy.

Figure 13 provides evidence on whether or not households got ahead of themselves by taking on too much debt. The top of 13 shows the link between one's five year income trend and indebtedness. There is evidence that all groups had increasing indebtedness over time. This could be taken of as a sign of overconfidence in being able to pay back debt. But, the group that increases its indebtedness the most is people whose incomes have increased in the past five years. In essence, people with increasing incomes are responding to their good fortune by taking on more debt as their incomes rise to pay for their more expanded lifestyles.

The bottom part of figure 13 looks at the change in the ratio of total debt to income over time. Again, we observe that all three groups, those whose incomes are positive, negative, and remain constant are increasing their levels of indebtedness over time. But, all three groups are increasing those levels at nearly the same rate. This implies that those whose incomes are rising are not being any more imprudent about increasing their indebtedness when one takes into account that their incomes are rising.

(Figure 14 about here)

There is another interpretation of figure 13. The convergence in levels of indebtedness for households with very different income trajectories may reflect what it is they are trying to accomplish by taking on debt. The increasing indebtedness for those whose incomes is rising (and remember they are primarily from the upper income groups) is being used to support expanded lifestyles commensurate with those income increases. But, this puts pressure on other income groups to try and keep up in the market for positional goods. For those whose incomes are constant or negative, they must go deeper into debt in order to continue to stay in a similar position in the consumption hierarchy.

Figure 14 is an attempt to look at indebtedness by income groups over time in order to see if we can see the effects of different income strata competing to maintain their relative position in the positional goods hierarchy by increasingly taking on debt. Figure 14 displays several interesting patterns. First, of course, we see an increase in all income groups in indebtedness over time. Mean debt to

income ratios increase from about .5 in 1989 to over 1.0 in 2007, doubling in the space of 18 years.

But the most interesting patterns in the table are across income groups. Here, we see quite clearly that the highest income groups are increasing their indebtedness but at nowhere near the rate of the income groups just below them. Indeed, the income groups that are increasing their indebtedness the most over time are those in the 70-90<sup>th</sup> percentiles. The groups below them are also struggling to keep up with a middle-class lifestyle, but obviously they have less ability to borrow. This is provocative evidence that implies competition between income groups for positional goods and is one of the perverse effects in the increase in income inequality. As the top of the distribution has more income, they bid up the prices for the best positional goods. This creates a problem for the next level of the income distribution whose income prospects are not improving as rapidly as not only have their incomes stagnated relatively, but the price of the valued positional goods have increased. If the next rung of the income table is going to compete, they can only do so by increasing their debt.

From figure 10, we know that most of what they were competing over was housing. One most likely mechanism by which housing required groups in the 70-90% of the income distribution to go deeper into debt is suggested by Frank (2007). As housing for the top 10% was bid up, households in the 70-90<sup>th</sup> percentile found themselves in competition with people who could pay more money for desirable houses. This pushed some people into the next tier of housing and that level of houses increased in price as well. This was also exacerbated by the fact that the

housing in the most expensive places in the country was going up the fastest. To keep up with the Joneses did not just require financial savvy, it required you to go farther into debt to obtain a good house as you could afford as housing prices increased.

## **Conclusions**

This paper was intended as an exploration of the link between income inequality, lifestyles, and financialization of household activities from 1989-2007. Our results are preliminary and mostly suggestive and not causal. It is useful to briefly summarize some of the main findings and then to suggest what steps should be taken to explore them more thoroughly.

One of the main results is that the income divide in the U.S. is the best predictor of the involvement of households in using the financial goods and services that have been radically expanded in the past 20 years. While all households have been involved in that financial expansion in some ways, the most well off households lead in every category of involvement. This is an expression of the accumulation of their advantages. They had the most money to begin with, their incomes rose the most, and they participated in the positional struggle over valued consumption items like houses, second houses, and luxury cars and won. They have been cognizant of their advantage and have come to take more financial risks precisely because their incomes have risen and give them the capital to withstand

downturns. It is within this relatively narrow group that the development of financial strategies is most apparent.

Everyone else has had to follow the consumption of those at the top. The households most affected by this are those who are in the 40<sup>th</sup>-80<sup>th</sup> percentiles of the income distribution, what might be called the middle class. These households find themselves with less expansion in their incomes over time, more constancy, and even some decline. They also face trying to compete for positional goods, particularly housing with those who are bidding up the best housing above them and at their level. Their main response has been to take on increasing levels of debt to support their housing needs.

Below the middle class is the 40% of households living at the bottom of the income distribution. Their life chances have declined dramatically in the past 20 years. Their income growth is negative, they are vulnerable to not having enough money to survive, and as a result tend to be risk averse to the maximum. When they borrow, they tend to use their borrowing for routine household expenses such as paying bills, medical expenses or financing education (Goldstein, 2012). Thus the aggressive expansion of credit availability to those in the bottom 40% has not really coincided with a more aggressive financial orientation.

These results present grist for both of the theories we discussed earlier. We have evidence that financial savvy and involvement in the financial markets has increased over time for all. The expanding financial sector worked to provide a supply of new financial products and services to whomever could afford them at whatever level of income. In terms of consumption of financial services, everyone

was becoming increasingly financialized. But, to the extent it occurred, the development of a financialized culture was much more heavily concentrated in the upper echelons of the income distribution. Those at the top were much more apt to be comfortable with expanding their risk, trading actively, and leveraging their assets. So, if there is a general increase in households becoming their own financial economists, it is heavily graded by income. The evidence is also strong that in the face of a squeeze on their incomes, households at all levels of the income distribution felt it was legitimate to take on more debt to support their existing lifestyle.

There is clear evidence for a squeeze on the middle class. The competition for positional goods has driven upper middle and middle income households to have to take on more debt in order to stay in desirable housing markets. This has pushed those below them to extend themselves in a similar fashion. Finally, income inequality is the main dimension about which all of these phenomena have played out. Increasing income inequality seems to matter most in the pricing of positional goods where different nearby income groups find themselves competing. The richest people will always be able to bid higher and those slightly lower will get less but have to go farther into debt in order to stay even.

Our results imply several obvious research opportunities. We have barely scratched the richness of the SCF. The SCF has amazing detail on a wide variety of consumer purchases, assets, and credit. Scholars can use that detail to get a handle on how income groups figured into the struggle for positional goods. Scholars can examine what kind of mortgages people got and what they did with money that they



secured through refinancing or using home equity loans. It is possible to examine closely the purchase of luxury cars, second houses, and many other high end possessions. We have not touched the questions on health care and pensions which have undergone drastic changes as a result of changes in employment and inequality.

In terms of the issues raised in this paper, it would be useful to be more fine grained analyses of these tables and examine more closely the ways in which changes in attitudes and the various behaviors we have discussed bundle together. So, for example, can we show that people who tend to consume many financial products and services and tend to have a more liberal attitude towards debt? It would be useful to factor analyze these measures and see if we can identify fractions of income or educational groups who embody them and perhaps change over time.

Second, it is important to explore the mechanisms by which inequality and competition over positional goods plays out. There are two story lines here. One is that people are trying to “keep up with the Jones”, i.e. people who are making more money than they are and thus, are tending to behave more financially recklessly than others. A second is that households find themselves in expansive housing markets where prices are going up. This means that if they want to stay in a particular community they have no choice but to take on more debt for housing. This is less keeping up with the Jones or maximizing your assets to maximize your consumption, and more a necessity forced on households by market conditions.

Third, in the financial crisis, the bottom part of the income distribution has been somewhat demonized as undeserving people who got subprime mortgages that they did not have the income to support (receiving what has been derided as NINJA loans, i.e. No Income, No Job). Our results show that the people most likely to go into debt for housing were those in the top half of the income distribution and their overall levels of indebtedness were the highest as well. Low income people had less access to credit and took on less debt in terms of the ratio between their debt level and income. If they were able to get credit through home equity loans, they were more likely to use credit to support the gap between what they were making and what they needed to survive (Goldstein, 2012). The attitudinal data show that they were quite risk averse in their investment strategies. Exploring the truth about who was really profligate here is a worthwhile question.

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Figure 1: Source: Survey of Consumer Finance, various years. +

Figure 2: Source: Survey of Consumer Finance, various years.



Figure 2: Continued.

Figure 3: Source: Survey of Consumer Finance, various years.

Figure 4: Source: Survey of Consumer Finance, various years.

Figure 4: Continued.

Figure 5: Source: Survey of Consumer Finances, various years.

Figure 6: Source: Survey of Consumer Finance, various years.

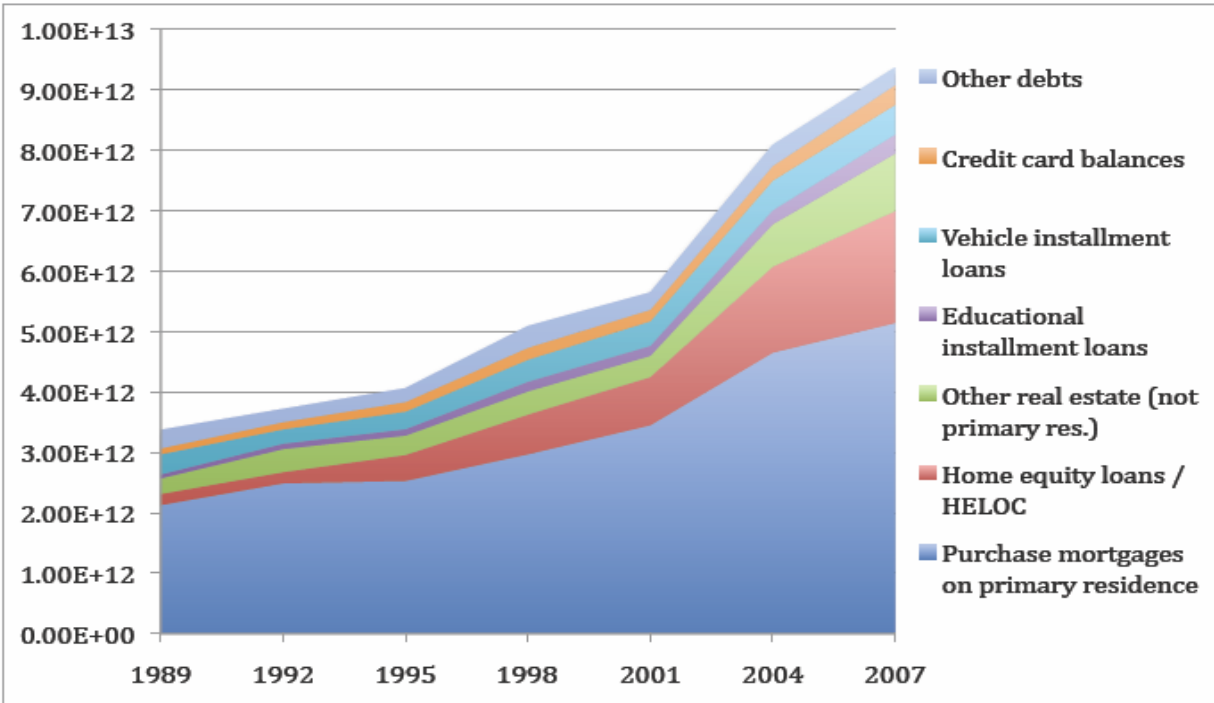
Figure 7: Source: Survey of Consumer Finance, various years

Figure 8: Source: Survey of Consumer Finance, various years



Figure 9: Source: Survey of Consumer Finance, various years

**Figure 1**



**Figure 1b**

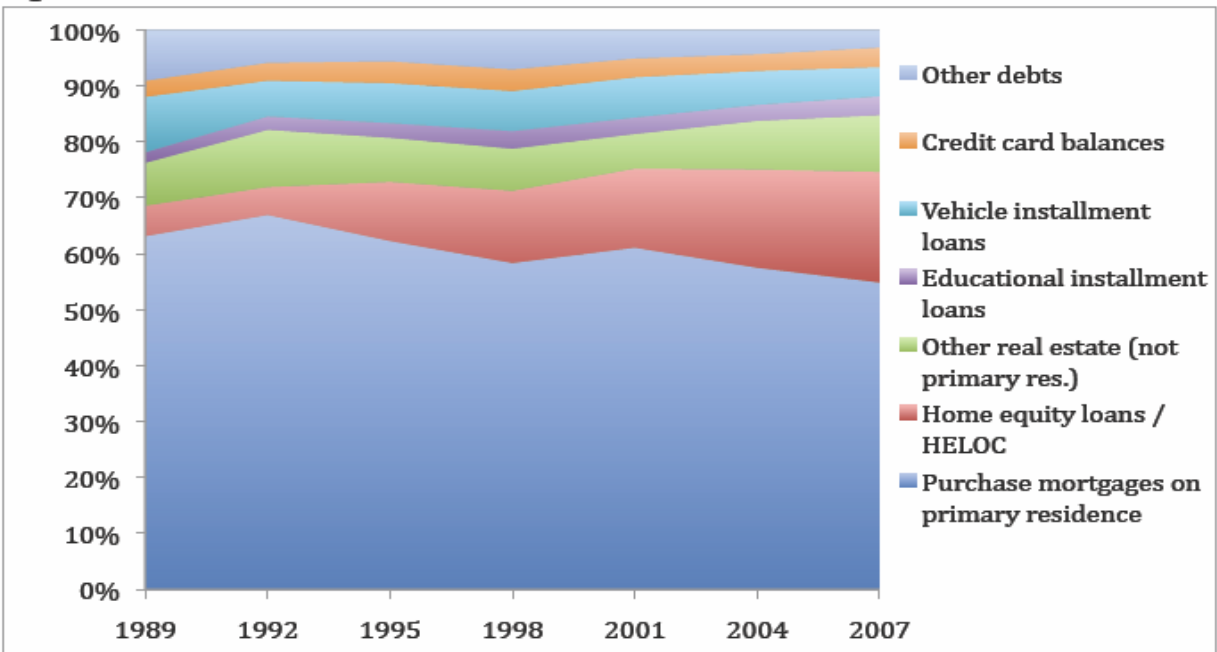


Figure 10: Source: Survey of Consumer Finances, various surveys.

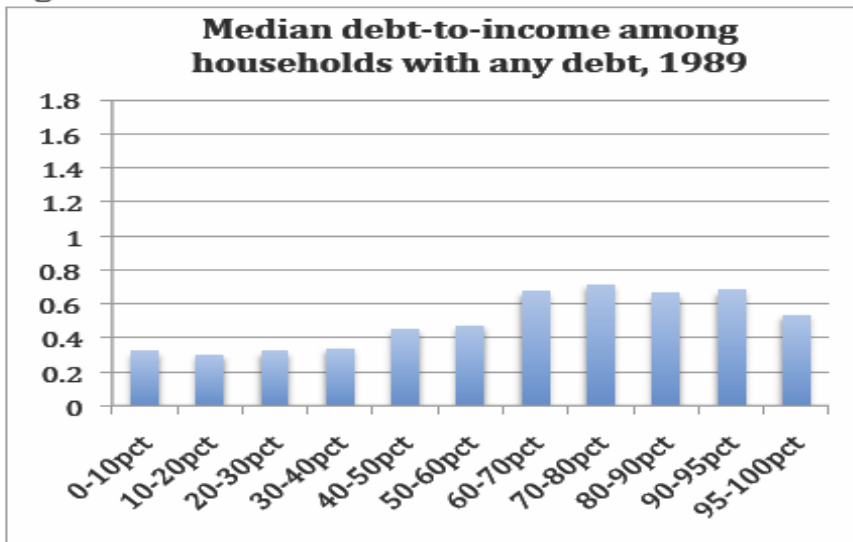


Figure 11: “Did you spend more than your income last year” by income groups,  
Source: Survey of Consumer Finances, various years.

Figure 12: Source: Survey of Consumer Finances, various surveys.

Figure 13: Source: Survey of Consumer Finances, various surveys.

**Figure 7a**



**Figure 7b**

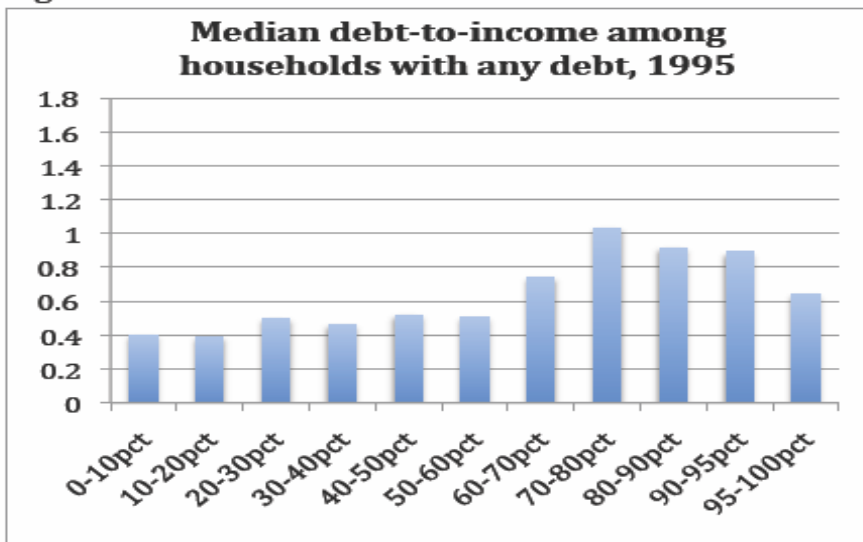
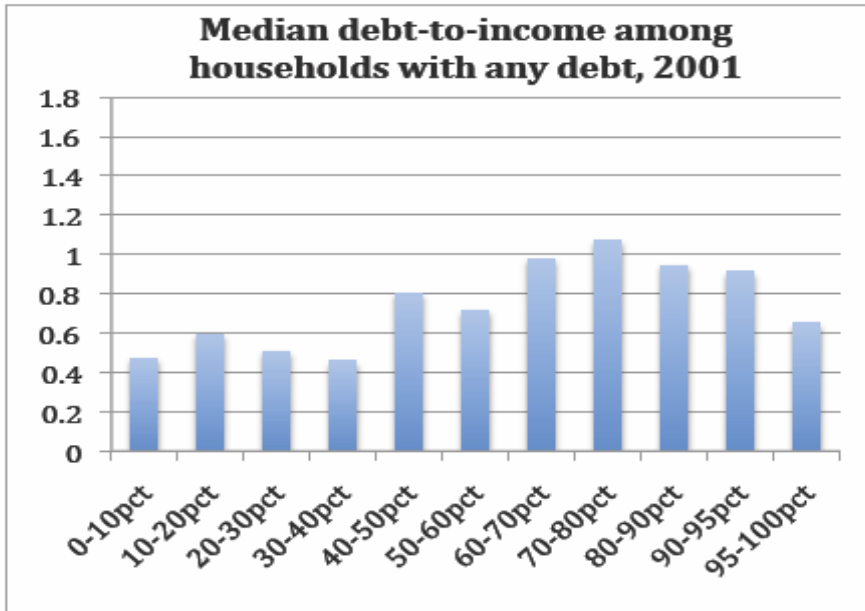


Figure 14: Source: Survey of Consumer Finances, various years.

**Figure 7c**



**Figure 7d**

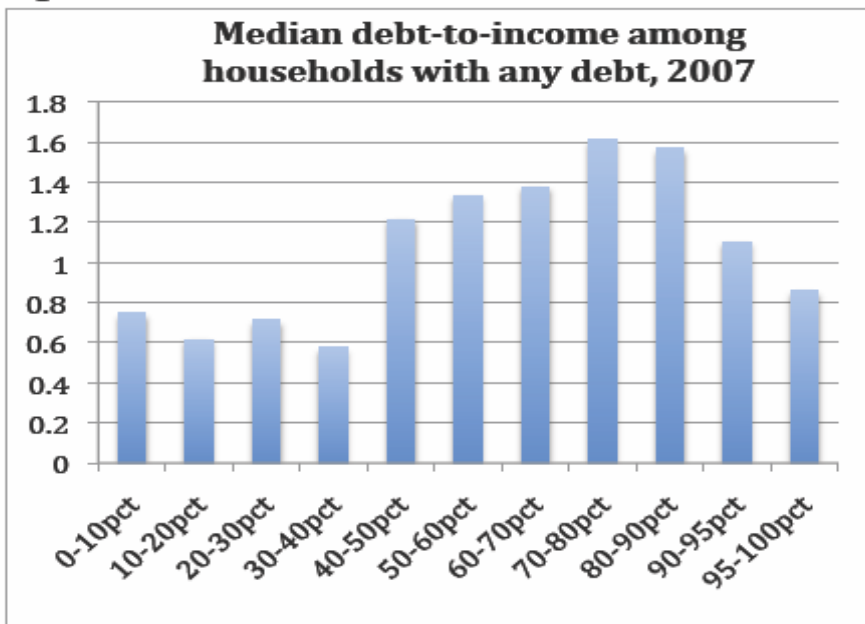


Figure 14: Continued.