

Household Financial Practices and Wealth Mobility
in the Era of Mass-Participatory Finance and Growing Inequality

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Abstract

Since the 1980s, American households have dramatically changed their financial behavior by increasing their use of consumer financial products and services. During the same period, wealth inequality in the United States soared. By its nature, household financial behavior (i.e., choices about how to command money) is likely to have profound implications for a household's financial well-being (i.e., the amount of money owned). Yet, little research has examined whether and how household financial behavior is linked to wealth. Another limitation of previous scholarship is its typically fragmented focus on one aspect of financial behavior (typically borrowing or investing). Using the Survey of Consumer Finances, this study extends prior scholarship in two primary ways: by analyzing a wide range of financial attitudes and behaviors and by examining how financial practices are related to wealth mobility, across social groups and over time. First, it identifies three distinctive patterns of use of financial products and services as well as personal finance management. Notably, financial practices remain stable over time. Second, household financial practices have distinctive effects on wealth mobility, above and beyond standard socio-economic variables usually considered in the inequality literature. The financial practices of the disadvantaged result in downward wealth mobility while the financial practices of the privileged may facilitate or inhibit upward wealth mobility, depending on the nature of involvement with consumer finance. The analyses cover the 1980s, when the trends of mass-participatory finance and growing wealth inequality had just begun, and the late 2000s, when both trends were well underway. Together, the findings provide a unique description of household financial practices in the era of mass-participatory finance and point to their role in wealth mobility processes as a new mechanism of inequality.

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INTRODUCTION

Since the 1980s, American households have dramatically changed their financial behavior, as manifested by increasing use of consumer financial products and services. As a managing director of Moody's put it recently, to rely on their old models of household financial behavior was "like observing 100 years of weather in Antarctica to forecast the weather in Hawaii" (Davis 2009: 226). For instance, whereas less than 5 percent owned stocks at mid-century, investing in stocks became a mass activity by the 2000s, involving over half of American households (Davis 2009). Overall, an estimated 94% of American households report using some sort of financial product and/or service, from a bank account to a credit card, to educational and other loans, to mortgage, lines of credit, 401(k) pensions plans, mutual funds, and even direct stock ownership (Tufano 2009), leading observers to proclaim the democratization of finance and welcome the era of mass-participatory finance. Furthermore, not only do American households confront an increasing variety of financial choices, but financial innovations make these choices increasingly more complex. For example, whereas in the post-war decades American homebuyers were typically offered ordinary thirty-year, fixed-rate amortizing mortgages, today they can choose between a fixed or floating rate of interest, whether the interest rate is locked in between the time of home mortgage application and house purchase, or when the mortgage rate resets, among other mortgage options (Green and Wachter 2005). Noteworthy, during the same period, the U.S. has witnessed the rise of the culture of prudent and proactive financial behavior (Fligstein and Goldstein 2014), as the bestsellers list of the 2000s

were full of personal finance guide titles with investment recommendations, credit use advice, and tips for prudent financial habits.

By its nature, household financial behavior (i.e., decisions and choices about how to command the money) is likely to have profound implications for a household's financial well-being (i.e., the amount of money owned), with important implications for wealth inequality. At the aggregate level, as Americans became increasingly involved in consumer finance, wealth inequality in the United States soared and surpassed all industrial societies in its extent. Noteworthy, disparities in wealth are even more extreme than in income. At the same time, wealth constitutes one of the most fundamental indicators of well-being, as it is related to a wide range of positive benefits and life outcomes (Keister and Moller 2000; Spilerman 2000).

However, little academic research has systematically examined patterns of household financial practices and the consequences for wealth processes and outcomes, in part because, until recently, detailed longitudinal data on both household finances and wealth holdings were virtually nonexistent. In the stratification and inequality literature, most studies of wealth have been focused on how socio-demographic attributes, income, religion, and inheritance flows account for the observed differences in wealth holdings across households. Importantly, empirical studies consistently find sizeable unexplained residual, suggesting that other factors are likely to be at play as well (Keister and Moller 2000; Spilerman 2000; Keister 2003). Although few studies point to household financial behavior as a potential explanation for disparities in wealth (Conley 2000; Keister 2003), thorough empirical investigations of this relationship remain sparse. In economics and finance, household finance in general has had a smaller footprint (Tufano 2009; Campbell 2006); although some aspects of individual financial decision-

making has been historically central to the discipline, most attention has been focused on its theoretical modeling rather than its wealth implications.

Most importantly, whether in the purview of sociology, economics, or finance, an important limitation of previous scholarship is its fragmented focus on usually one aspect of financial behavior (such as investment or borrowing), in isolation from the full range of financial decisions that households make. However, the democratization of finance has greatly expanded and complicated the repertoire of financial actions available to households, specifically with respect to the use of financial products and services. Thus, household financial lives are inherently multifaceted, involving engagement with consumer finance as well as other financial habits and attitudes. Uni-dimensional analyses of household financial behavior and its wealth consequences are likely to give an incomplete picture of the complexity of household finances and miss important insights. Although most studies treat various components of household finances as independent, whether and how financial attitudes and behaviors cohere seems to warrant further investigation.

This study pursues a theoretically guided empirical investigation of household financial practices and wealth mobility in the era of mass-participatory finance and growing inequality. Using the Survey of Consumer Finances (SCF), it reports four main findings. First, a wide range of financial attitudes and behaviors related to the use of consumer financial instruments and financial prudence habits cohere to form three distinctive patterns of financial practices. Importantly, these household financial practices remain relatively stable over time, even during the period of major economic turmoil. Second, household financial practices are socially stratified, that is, vary by socio-economic status. Third, household financial practices appear to have distinctive effects on household wealth mobility, above and beyond standard socio-

economic variables usually considered in the inequality literature. Specifically, the financial practices of the disadvantaged result in downward wealth mobility while the financial practices of the privileged facilitate upward wealth mobility. Finally, substantive conclusions remain similar for both the 1980s, when the trends of mass-participatory finance and growing wealth inequality had just originated, and late 2000s, when both trends were well underway. Together, the findings provide a unique description of household financial practices in the era of mass-participatory finance and point to their role in wealth mobility processes as a new mechanism of inequality.

BACKGROUND

HOUSEHOLD FINANCIAL BEHAVIOR IN THE ERA OF MASS-PARTICIPATORY FINANCE

Over the past three decades, the U.S. economy has undergone a fundamental reorientation from manufacturing and service production towards finance (Krippner 2011; Tomaskovic-Devey and Lin 2011). As part of this transformation, finance has spread from the corporate sector to the broader society and has played an increasingly important role in the economic lives of American households. The expansion of finance into the everyday lives of American households has been described by advocates at the Federal Reserve Bank and elsewhere as the “democratization” of finance, popular financialization, or the era of mass-participatory finance. Notably, at the aggregate level, the household sector trumps the corporate sector in the sheer amount of financial assets and liabilities held (Tufano 2009).

In credit markets, the share of households reporting some form of debt increased by 15 percentage points over the past half century, reaching 77% in 2007 (Dyanan 2009). The increase

in household indebtedness was even more pronounced, with real household debt holdings almost doubling (Goldstein 2013). Median household debt relative to income grew from 0.1 in 1962 and 1983 to 0.3 in 1995 to 0.6 in 2008, and the median debt to service ratio (i.e. the share of income devoted to required debt payments) increased from 5% in 1983 to 10% in 1995 to 13% in 2007 (Dyan 2009). Furthermore, home mortgage debts also sensitized Americans to financial markets. Since the sophisticated financial system in the U.S. allows homeowners to extract cash out of homes through refinancing and home equity, homeowners increasingly saw their houses as just another financial asset in their portfolios (Davis 2009). Similarly, the shift from the defined benefits to defined contributions pension plans further exposed Americans to financial markets. Whereas about 25% of households owned Individual Retirement Accounts (IRAs) or thrift-type pension accounts like 401(k) accounts in 1983, more than half had them by 2007 (Dyan 2009). The share of households holding equities is considerable even outside of 401(k) plans; the share increased from one-fifth to about one-third at its peak in the early 2000s, before declining to one-quarter more recently (Dyan 2009). Noteworthy, as American households became increasingly involved in the stock market, they moved their savings from low-return bank accounts, to money-market accounts, and later to equity mutual funds. From 1977 to 1989, the share of U.S. households with savings accounts declined from 77% to 44%. In short, “savers” became “investors” (Davis 2009: 18). Overall, an estimated 94% of American households report using some sort of financial product and/or service by the late 2000s.

WEALTH INEQUALITY

During the same period, inequality in the United States soared, reaching levels not seen since the Great Depression. Trends in wealth inequality are especially alarming given extreme

disparities in wealth holdings, rare upward wealth mobility (Keister 2007), and profound importance of wealth for well-being. Since the 1980s, wealth concentration and inequality in wealth have grown considerably (Spilerman 2000). By the early 2000s, the richest 1% of households held one-third of the total wealth, the next wealthiest 9% held another third, and the remaining 90% of the population the rest, with 16% of households having zero or negative net worth (Keister 2008; Neckerman and Torche 2007). While wealth inequalities were consistently higher in Europe over the course of the 20th century, the United States has recently surpassed all industrial countries in this dubious achievement (Keister and Moller 2000). The implications of this trend are apparent when the benefits of wealth ownership are considered. Wealth is a critical component of well-being because it is relatively enduring and it is related to other inequality outcomes. Among important advantages that wealth ownership provides are higher living standards, educational attainment, occupational opportunities including self-employment, political influence, and economic security (Keister and Moller 2000; Spilerman 2000; Keister 2003a; Keister 2003b; Keister 2008). Wealth can also be passed to future generations, thus contributing to intergenerational transmission of inequality (Spilerman 2000).

However, scholars, and sociologists in particular, have only begun to understand the causes of wealth inequality. Until recently, wealth inequality and its causes have been overshadowed in the inequality and stratification literature by the focus on income. As a result, the processes and causes that generate disparities in wealth are not well understood (Keister 2003a, 2003b). Existing studies have focused on how socio-demographic attributes, income, religion, and inheritance flows account for differences in wealth, and consistently find sizeable unexplained residual, suggesting that other factors are likely to be at play as well (Keister and Moller 2000; Spilerman 2000; Keister 2003). A few studies provide suggestive evidence that

financial behavior is potentially consequential for wealth accumulation (Conley 2000; Keister 2003). However, empirical investigations of the link between financial behavior and wealth remain limited, in part because, until recently, detailed longitudinal data on both household finances and wealth holdings were virtually nonexistent. Additionally, a substantial limitation of previous scholarship is its fragmented focus, usually on solely one aspect of financial behavior (mostly investment behavior), in isolation from the full range of financial choices that households make.

HOUSEHOLD FINANCIAL PRACTICES AND WEALTH

HOUSEHOLD FINANCIAL PRACTICES

Growing qualitative evidence shows that decisions about household finances comprise a substantial part of family life (Edin and Lein 1997; Zelizer 2007; Collins et al. 2009). A long line of interdisciplinary research offers valuable theoretical developments and empirical evidence on various aspects of household financial behaviors, including saving (Modigliani and Brumberg 1954; Friedman 1957), consumption (Veblen), investment (Nau 2013), borrowing (Goldstein 2013), search for financial information (Chang 2005), informal financial transfers (O'Brien 2012), budgeting (Edin and Lein 1997), and attitudes and dispositions toward economic calculation and financial risk-taking (Bourdieu). However, whether in the purview of economics, psychology, or sociology, a substantial limitation of previous research on household financial behavior is its fragmented focus, usually on solely one element of financial behavior (such as borrowing or investing), not the full range of financial decisions and actions that households make. At the same time, financialization greatly expanded the range of financial choices available to U.S. households, who increasingly utilize these new opportunities. From monthly

credit card payments, to home mortgages, to refinanced mortgages and lines of credit, to 401(k) pension plans, to mutual funds, to direct stock ownership, Americans increasingly incorporated a wide range of financial practices in their financial repertoires. Whereas households engage into a wide range of financial behaviors, the existing literature does not reveal the extent to which household financial behaviors are related to one another. For instance, do all households who are somehow invested in the stock market also use the credit market? On one hand, it seems reasonable to expect that households invested in the stock market are less likely to borrow due to higher budget constraints. However, empirical evidence shows that the aggregate increase in household debt in the U.S. was largely driven by upper-income households, who are also more likely to own stocks. As a first step of my empirical investigation, I explore whether and how household financial attitudes and behaviors cohere in meaningful patterns that reflect *distinctive financial practices*.

SOCIAL EMBEDDEDNESS OF HOUSEHOLD FINANCIAL PRACTICES

Several models have been proposed to explain household financial behavior. Whereas the classic microeconomic approach builds on the postulates of rationality and more recent models in behavioral economics draw on insights from psychology to acknowledge cognitive constraints in financial decisions, the central premise of sociological explanations is that financial behavior, like any other economic action, is embedded in the social context (Granovetter 1985). Previous literature suggests that household financial practices would be embedded within broader systems of social inequality. First and most obvious, differences in liquidity constraints, or constraints in available financial resources, would lead to different financial decisions and behaviors across the socioeconomic spectrum (Edin and Lein 1997). Second, socioeconomic differences in financial

practices may result from discrimination in access to and use of financial products and services. Audit studies of credit markets show that minorities receive less information about loan products, less assistance with financing, less favorable terms in securing mortgages, and overall face higher rejection rates (for a review, see Pager and Shepherd 2008). Finally, from a cultural perspective, financialization gave rise to “portfolio thinking” (Davis 2009), particularly among the wealthiest and upper-middle class households, who absorbed the cultural logic of the financial economy and adopted more aggressive dispositions toward financial risk and risky financial behavior (Harrington 2008; Davis 2009; Goldstein 2013). Cultural accounts also suggest that in the course of financialization, household consumption of financial instruments developed a social meaning and became status-relevant and fashionable behavior. As Davis (2009, p. 193) put it, involvement in the financial economy “becomes the dominant metaphor to understand the individual’s place in society”. In other words, in the era of mass-participatory finance, household financial practices in general and participation in finance in particular became a way to create and express social identity as well as to demonstrate and enhance one’s socioeconomic status. Therefore, one might expect that household financial practices, as any other economic action, are embedded in the social structure and vary by social location, as indicated by socioeconomic status.

HOUSEHOLD FINANCIAL PRACTICES AND WEALTH ACCUMULATION

Financial decisions that households make have important implications for wealth accumulation and ultimately for wealth inequality. As the financialization opened up the opportunities for nominally non-financial firms to generate increasingly more profits through

financial channels (rather than productive activities), it also created similar opportunities for households but simultaneously exposed them to higher financial risk.

On the one hand, households may benefit and even take advantage of the opportunities provided by the financial system, with important implications for economic well-being and wealth accumulation. For instance, over the past three decades, stocks and bonds had a substantially higher return rate than more conservative instruments such as certificates of deposit or interest-bearing bank accounts, which did not provide as much return and actually lost value over time (Krippner 2011; Nau 2013). As a result, those who invested in high-risk, high-return financial assets tended to accumulate more wealth. Keister (2003) argues that it is a relatively high propensity among Jews to invest in financial assets that contributes to their larger wealth holdings as compared to other religious groups. Nau (2013) and Volsho and Kelly (2012) find that income from investments comprise a growing share of total income among the top 1%, whereas the rest of the population benefitted little from the rise of financial markets. At the aggregate level, the American public was estimated to lose between \$30 to \$50 billion every year in interest by relying heavily on savings bank accounts rather than equally safe CDs or money-market deposit accounts in the early 2000s (Reuters 2000). The expansion of credit suggests that more households could smooth their consumption over time. Some scholars even linked it to significantly lower aggregate economic volatility among a wide range of indicators between the early 1980s and mid-2000s (Dynan 2009). During the periods of declining interest rates, such as in the 2000s, homeowners with mortgages could benefit from refinancing their mortgages (Lusardi and Mitchell 2014). Therefore, one might expect that higher involvement in finance is associated with higher rates of wealth accumulation.

On the other hand, one may not only simply forego financial opportunities opened up by financialization, but on top of that incur direct financial losses, as vividly demonstrated by the 2008 financial crisis. Although stock ownership provides investment income when the stock market is booming, the stock market crash has the exact opposite effect. As Davis (2009) puts it, “an investment of \$10,000 in the S&P 500 on the day that George Bush took office in 2001 was worth just \$6,000 on the day he returned home to Texas in 2009,” meaning that an average investor who had bought a standard index fund in the late 1990s would have been better off putting her funds into a government-insured savings account than into the stock market. Moreover, in an attempt to beat the market, “amateur” investors are estimated to have foregone substantial equity returns due to fees and other trading costs (Lusardi and Mitchell 2014). The housing boom encouraged many households to buy the biggest house they could afford, thus tying their economic well-being to a highly leveraged asset. Greater access to credit in general means that households could borrow beyond obligations they can sustain, especially in the event of (economic) emergency. This discussion suggests an opposite expectation, that financial practices characterized by higher involvement in finance would be associated with lower rates of wealth accumulation.

Finally, the consequences of financial practices for wealth accumulation may vary by social groups. In particular, previous literature suggests that the effect of financial practices on wealth accumulation may depend on household economic resources, financial expertise or access to it, and experience with discrimination, all of which are strongly associated with socioeconomic status. Most obviously, wealthier households would enjoy higher absolute returns on financial investment simply because they have more money to invest. For the same reason, it might be easier for them to meet their credit obligations, even in the case of economic

emergency such as a job loss. Additionally, more privileged households may make more sound financial decisions either because of higher levels of financial literacy (Lusardi and Mitchell 2014) or access to paid professional advice (Chang 2005). At the same time, less privileged households, and minorities especially, are more likely to receive financial products on worse terms as a result of discrimination (Pager and Shepherd 2008). Thus, one might expect that socioeconomic status moderates the effect of financial practices on wealth.

It is important to stress that this discussion does not suggest that certain social groups make faulty financial decisions. Rather, it suggests that financialization may have reshaped the economic lives of American households in such a way that some social groups benefitted from it while others were left behind.

DATA AND METHODS

DATA

The data in this study come from the Survey of Consumer Finances (SCF), a large-scale nationally-representative survey of U.S. households sponsored by the Federal Reserve Board of Governors and administered by the National Opinion Research Center at the University of Chicago. Considered gold standard for the study of household finances (Keister 2014: 350), the SCF has been widely used in sociology and economics, including studies on various aspects of household financial behavior. Considered gold standard for the study of household finances (Keister 2014: 350), the SCF is uniquely suitable, among other large-scale surveys, for the present study because it contains by far the richest variety of questions about financial attitudes and behaviors as well as thorough socio-demographic data. The survey's dual-frame sample design ensures an adequate representation of all households across the economic spectrum,

including high-income households. Additionally, extensive efforts to improve the accuracy of collected data and impute missing values make the SCF a particularly valuable source of data on household finances. Finally, the SCF panel component allows exploring the stability of household financial practices over time as well as examining the effects on wealth mobility.

The survey is collected triennially since 1983, and it also includes two panels in 1983-1989 and 2007-2009. The main empirical analyses in this study are based on the 2007-2009 (N=3,647) panel dataset, and I also replicate the analyses with the 1983-1989 (N=1,479) panel dataset¹. Although the 2007-2009 observation period represents a quite particular historic period in the economic history of the U.S. economy, the use of this observation period actually makes my estimates conservative, as discussed below. Additionally, this is the only panel of the SCF conducted after the 1980s.

Analytic Sample. I drop from the analyses the top 1 percent (based on income or net worth) and the poor and the near-poor (defined as those below 150% of the U.S. official poverty line, based on income or net worth). The rationale to focus on the broad middle range of the socio-economic distribution rests on several considerations. First, the nature of the SCF survey instrument is not particularly revealing the financial affairs of households at the extremes of the socio-economic distributions. Second, the focus on the broad middle part of the distribution allows me to alleviate the issue of financial constraints vs. choices, with the assumption that households in my sample face more comparable financial constraints and opportunity structures as compared if the analysis sample included all households across the entire socio-economic distribution.

¹ In both panels, the attrition rate is less than 10 percent.

VARIABLES

The variables used in the empirical analyses include measures of financial attitudes and behaviors, socioeconomic status, household wealth, and control variables.

Financial Attitudes and Behaviors. An important advantage of the SCF is that it involves a rich array of questions about household finances, including questions on investment (including direct stock equity and quasi-retirement financial assets), borrowing, saving, portfolio allocation, sources of financial information, attitudes toward financial risk-taking, use of financial institutions, financial planning and budgeting, financial prudence, and informal financial exchanges. I use $n=24$ measures of financial attitudes and behaviors constructed from the variables available in the SCF. The measures cover various areas of household financial lives in the era of mass-participatory finance, including asset allocation decisions and financial risk-taking, use of credit and attitudes toward borrowing, use of information in making financial decisions, and other financial attitudes and behaviors related to financial prudence. Table 1 shows the measures of financial attitudes and behaviors used in the empirical analyses.

Although these measures do not capture all important aspects of household financial life, they capture and incorporate core aspects of household financial practices in the era of mass-participatory finance. It is worth noting that the proposed empirical operationalization of household financial practices is also quite heavily based on the use of financial products and services. While there are other decisions involving money that households make in their everyday lives, these other economic decisions seem to be overshadowed by the use of financial instruments in the era of mass-participatory finance. Additionally, the proposed empirical operationalization is based on those elements of financial behavior that have been shown to be more consequential for economic well-being (as discussed in the literature review).

Socioeconomic Status. The indicators of socioeconomic status include education, occupation, income, and net worth. Education is measured as the highest level of educational attainment of the respondent, and includes three ordinal variables²: high school or less; some college; and college or more. Occupation is measured by the household head's occupation, if (s)he is employed, and is represented by three ordinal variables: managerial and/or professional; technical, sales, and/or services; and other, including production/craft/repair workers, operators, laborers, farmers, foresters, fishers. Non-employed is a reference category. Household income is measured by total income that the household receives in a "normal" year. Household net worth is measured as all household assets minus all household debts.

Household Wealth. In order to explore whether and how household financial practices affect wealth mobility over time, I use household's rank percentile in the overall distribution of net worth. An advantage of this measure is that it allows examining household wealth relative to the overall distribution. Additionally, it seems reasonable to use a relative measure for the observation period, e.g., 2007-2009, because the distribution of wealth in the SCF sample shifted downward across the entire range during this time period. A limitation associated with using the latter is that it is a measure of relative change and as such may not correspond to changes in absolute levels of wealth.

Control Variables. My models also control for other variables that may influence household financial practices or wealth accumulation over time. These control variables include a number of socio-demographic attributes: age; gender; race/ethnicity; family structure; and health. Consistent with the strategy used by other researchers (e.g., Keister 2014), age, gender, and race refer to the respondent in households consisting of one person and to the household head in households consisting of two people or more, where household head in the SCF is "taken

² The results are substantively similar when alternative ways to code education are used.

to be either the male in a mixed-sex couple or the older individual in the case of a same-sex couple.” Age is measured by a continuous variable. Gender is measured by a dichotomous variable, with 1=male. Race/ethnicity is measured by a dichotomous variable indicating whether the respondent is non-white. Family structure³ is measured by a series of dichotomous variables: single without children; single with children; married/partnered without children; and married/partnered with children. Health is measured as an average self-reported health of the respondent and spouse⁴, where 1 is poor and 4 is excellent.

METHODS

My analytical strategy proceeds in three steps and employs several statistical methods. First, to study whether and how financial attitudes and behaviors cohere to form distinctive financial practices, I use latent class analysis⁵ (LCA), a subset of structural equation modeling. LCA is premised on the idea that associations between the observed scores of a number of indicator variables, in this case measures of household financial behaviors, are caused by an unobserved latent variable, in this case financial practices. This procedure results in an assignment of all individuals into discrete categories, in essence, a classification or categorization pattern based on financial practices. Additionally, for each observation LCA produces a probability of belonging to each of the latent classes. The optimal solution for the number of latent classes was determined using the Bayesian Information Criterion (BIC), the Akaike Information Criterion (AIC), the Lo, Mendell, and Rubin (LMR) test (tests whether

³ The results are substantively similar when family structure is measured by two different variables, a dichotomous indicator of whether the respondent is married or partnered, and by a continuous variable of the number of children in the household.

⁴ If the respondent is not married or partnered, his or her self-rated health is used.

⁵ Implemented in MPlus.

adding one more latent class significantly improves the fit of the model), and entropy. The LCA analysis is performed on the 2007 cross-sectional wave of the SCF.

Second, to model the relationship between financial practices and socioeconomic status, I employ a regression framework. Using the 2007 cross-sectional wave of the SCF, I estimate a series of OLS regressions⁶ for each of identified financial practices (based on the LCA results), where the dependent variable is a probability of belonging to a latent class⁷ and the main predictors of theoretical interest are indicators of socioeconomic status⁸. I also control for other socio-demographic variables available in the SCF.

Third, to test whether and how household financial practices are associated with wealth accumulation over time, I use the 2007–2009 panel. I use a lagged model for this analysis, where the dependent variable is a measure of household wealth in 2009 and household wealth in 2007 is included as a control (for more details, see O’Brien 2012). The independent variable of interest, household financial practices (identified using LCA), can therefore be interpreted as the association between financial practices and a change in household wealth between 2007 and 2009, i.e., the rate of wealth accumulation over the observation period. This modeling strategy (i.e., inclusion of a lagged dependent variable in the model) allows controlling for potential sources of omitted variable bias that are associated with household wealth in 2007 and do not change over time.

⁶ Technically, it is not entirely appropriate to use OLS regression in this case because the dependent variables in my regression models are truncated (e.g., the probability of being in a latent class is bound between 0 and 1). However, the use of regression models for truncated dependent variable leads to substantively similar results. Also, an inspection of raw, standardized, and studentized (jack-knifed) residual plots does not reveal any discernible trend or pattern, suggesting no considerable violations of OLS regression assumptions due to truncated dependent variables.

⁷ The results are substantively similar if logit models are used, where the dependent variables are membership in each of the latent classes.

⁸ The OLS models with a probability of belonging to a latent class as the dependent variable does not take into account that probabilities of class membership are correlated across latent classes. However, the results are substantively similar when seemingly unrelated regressions (SUR) are used, that allow for the correlated error terms across the models.

To adjust for the SCF dual-frame survey design, I apply weights in all of my analyses. Additionally, because the SCF contains five imputed cases for each surveyed household, coefficients and standard errors presented are adjusted for multiple imputation.

RESULTS

HOUSEHOLD FINANCIAL PRACTICES

Empirical analysis suggests that household financial practices cohere to form distinctive financial practices. Table 1 shows the results of LCA models that categorize households into distinctive financial practices based on observed financial behaviors. The empirical analysis reveals three distinctive financial practices, which could be labeled as “sophisticated”, “indebted”, and “non-financialized” households. Based on the LCA estimates, roughly one-fifth of American households follow sophisticated financial practices, one third are indebted, and another one third of households remain “non-financialized.” (The percentage numbers are based on the entire sample.)

Several features uniquely characterize financially “sophisticated” households. First, sophisticated households tend to be involved in the financial system, as reflected in investment in the stock market and use of credit. Noteworthy, the sophisticated group is also the group where the largest proportion of households (almost half of them) reports that they are willing to take substantial financial risk in order to gain more returns. Also, the sophisticated tend to have more prudent financial habits than the rest of the population. For instance, the sophisticated tend to make the most extensive shopping efforts when making financial decisions; they use the largest number of sources of financial information; the vast majority in this group reports using advice from financial professionals (either paid or unpaid); they have the longest financial planning

horizon; are most likely to be follow a regular saving plan and make savings for foreseeable major future expenses; and are most likely to be enrolled in automatic payments but least likely to be late on loan or mortgage payments. Interestingly enough, although sophisticated households are also most likely to participate in formal financial operations, they are also most likely to be embedded in the networks of informal financial exchanges.

[Table 1 About Here]

Similarly to the “sophisticated,” households in the “indebted” group are also involved in the financial system (the stock and credit markets), however, the nature of their involvement with the financial products and services is notably different. In particular, although the “indebted” are invested in the stock market to the same extent as the “sophisticated,” they tend to use credit markets to a greater extent, as reflected in the highest leverage ratio in this group compared to the rest of the sample. Also, the “indebted” are most likely to approve borrowing for such purposes as covering living expenses when incomes goes down or buying a fur coat or jewelry. Additionally, indebted households are more likely to report that they would spend more if their assets appreciated in value. These findings suggest that financial behavior of the “indebted” is consistent with “keeping up with the Joneses.” However, empirical patterns of their financial behavior are also consistent with a distinctive financial strategy. In particular, highest leverage ratio in this group combined with the highest proportion of assets invested in home equity suggests that “indebted” households might have stretched out their budgets and borrowed as much as possible to buy as big houses as they could. In other words, it is possible that after witnessing the dot com bubble of the early 2000s followed by the housing bubble of the mid

2000s, the “indebted” thought that investing in home equity was a sound financial decision with promising financial returns. Notably, households in this group are less likely to report being willing to take substantial financial risk in order to gain greater returns, with less than one third of “indebted” households reporting so as compared to almost half among the “sophisticated.” Finally, it is worth noting that the “indebted” tend to have less prudent financial habits than the “sophisticated,” but only slightly so.

The third group, the “non-financialized,” is characterized by patterns of financial attitudes and behaviors that are substantially different from that of the “sophisticated” and “indebted.” In particular, households in this group make low use of financial products and services, either stock ownership or credit use. They also tend to have the least proactive or concerted financial habits. At the same time, the “non-financialized” spend the lowest proportion of food expenses on eating out, a usual measure of prudent financial budgeting in the literature. Noteworthy, the “non-financialized” are also risk averse, with less than 10 percent of households in this group willing to take high financial risk in order to generate substantial returns.

Some other findings are worth noting too. Interestingly enough, one-third of households hold negative attitudes towards use of credit, and this number does not vary by the type of financial practices. Half of all households approve leaving inheritance (e.g., think that in general it is important to leave an estate or inheritance to surviving heirs), and the number also does not vary by financial practices. One third of households hold optimistic expectations about the future of the economy, although the proportion is significantly lower among the non-financialized. Finally, the majority of American households consider themselves lucky in their financial affairs, although the proportion is again lower among the non-financialized.

Finally, Table 2 presents the criteria used for choosing the LCA class solution. Depending on the criterion used, the analysis points to the two (based on the VLMR and LMR criterion) or three (based on the percentage change in entropy) class solution. Importantly, both LCA class solutions identify the same households in the non-financialized group. However, the three-class solutions divides the larger "financialized" group identified by the two-class solution into two more fine-grained groups, which score similar on the financial prudence indicators but differ on the nature of their involvement with consumer finance. For this reason, the analyses in the study are based on the three-class solution.

[Table 2 About Here]

DO HOUSEHOLD FINANCIAL PRACTICES REMAIN STABLE OVER TIME?

Before examining the inequality consequences of household financial practices, it is worth exploring whether household financial practices remain stable over time. To answer this question, I explored whether households in 2009 followed reported similar financial attitudes and behaviors as in 2007. The results reported in Table 3 suggest that within each latent class of financial practices, households in 2009 showed similar financial attitudes and behaviors as in 2007, with two exceptions. First, Americans became more risk averse in 2009 as compared to 2007, with the largest decrease in willingness to take financial risk among the sophisticated, but significantly more optimistic about the future of the economy. The finding that household financial practices appear to be stable over time is especially noteworthy given that the observation period covers 2007 to 2009, the period of striking economic perturbations.

[Table 3 About Here]

SOCIOECONOMIC DIFFERENCES IN FINANCIAL PRACTICES

How do financial practices vary by socioeconomic status? Table 4 displays the results from a series of OLS regressions for each of the identified financial practices, where the dependent variable is the probability of membership in a latent class and the independent variables are indicators of socioeconomic status as well as control variables. Results show that financial practices vary by indicators of socioeconomic status. Sophisticated households are significantly more likely to be privileged, as reflected by positive coefficients on higher levels of educational attainment, more prestigious occupations, and higher income and net worth. Notably, the “indebted” are more likely to be college-educated, suggesting that the indebted are likely to be upwardly socially mobile. They also tend to have lower net worth; but this is because they tend to have more assets but their assets are funded by debts. Finally, the non-financialized tend to be disadvantaged, as the probability of being in this group is negatively and significantly associated with educational attainment, prestigious occupations, and income. (The coefficient on net worth in this group is positive, but the median net worth in this group is significantly lower than among the sophisticated.) It is worth emphasizing that the finding that financial practices are associated with not only income and net worth, but also education and occupation suggests that financial practices are associated with financial resources at hand, but are not reducible to merely budget constraints.

[Table 4 About Here]

HOUSEHOLD FINANCIAL PRACTICES AND WEALTH MOBILITY

Do household financial practices have an effect on wealth mobility? Table 4 displays OLS regression models estimating the effects of financial practices on changes in household rank percentile in the overall distribution of net worth over the observation period, 2007-2009. Two findings stand out. First, the coefficients on financial practices remain statistically significant even after the measures of socio-economic status and control variables are added to the model specification. This result suggests that household financial practices appear to have distinctive effects on household wealth mobility, above and beyond standard socio-economic variables usually considered in the literature. Second, the sophisticated appear to improve their financial standing compared to the non-financialized, whereas the indebted appear to fall behind over time. Thus, the financial practices of the disadvantaged result in downward wealth mobility while the financial practices of the privileged may facilitate or inhibit upward wealth mobility, depending on the nature of involvement with consumer finance. Importantly, this analysis shows that financially sophisticated households managed to get ahead even during the historic period when the rest of the population was losing ground as the financial system crumbled and the economy witnessed a downturn. This result suggests that the financial sophisticated household would continue to enjoy upward wealth mobility also in periods of macroeconomic stability and prosperity. With regards for the indebted, there is a possibility that their experience of downward wealth mobility (as compared with the sophisticated) was amplified by the historic period (e.g., financial crisis). Specifically, the effects of financial practices on wealth mobility for the indebted might be driven by foreclosures and/or job loss. However, controlling for whether the household experienced foreclosure or job loss of the household head or the spouse did not change the substantive conclusions. Similarly, dropping from the analyses households that

experienced foreclosure or job loss of the household head or the spouse led to the same conclusions. These findings (not shown in tables) suggest that the results for the indebted are not driven by the historic period of financial crisis.

[Table 5 About Here]

HOUSEHOLD FINANCIAL PRACTICES AND WEALTH ACCUMULATION IN THE 1980S

The results discussed above are based on the 2007-2009 panel dataset, which covers a very particular historic time period. Therefore, I replicated the analyses for the 1983-1989 SCF panel dataset, which covers the period when the trends of household financialization and growing inequality, apparent in the 2000s, just originated. Importantly, the substantive conclusions remain substantively similar⁹ (see Tables A1-A3 in the appendix), although a few findings are worth noting. First, the latent class analysis of the 1983 dataset also points to three distinctive types of financial practices. Two of the types identified in the 1980s are similar to those observed in the late 2000s, namely the sophisticated and non-financialized. However, the other latent class in 1983 could be characterized as that in between the sophisticated and non-financialized on the two-dimensional continuum of household financialization and financial prudence. I label this group as financially “moderate.” Second, the sophisticated in 1983 represented only 4 percent of the population, whereas by the late 2000s this group increased in relative size to one-fifth, suggesting that financial sophistication might have trickled down in the course of financialization. Second, in the 1980s, the non-financialized fall behind in terms of wealth mobility as compared to the other types of financial practices (sophisticated and

⁹ There were substantial changes in the survey instruments since 1989, so some of the variables are not available in the 1983 wave and others are coded differently.

moderate). This finding suggests that in the 1980s, when household financialization just started, non-financialized households were falling behind, whereas more financialized households improved their financial standing. However, by the late 2000s, non-financialized households fared better than those financialized households whose involvement in consumer finance was disproportionately through the use of credit. In other words, as the financialization progressed and unfolded, it benefitted some of the more privileged (as the sophisticated tend to be more advantaged) but not all (as the indebted tend to be college educated).

DISCUSSION AND CONCLUSION

This study provides a theoretically guided empirical description of household financial practices in the era of mass-participatory finance and reveals their role in wealth mobility as a novel mechanism of inequality. Using the Survey of Consumer Finances, it identifies three distinctive patterns of use of financial products and services as well as financial prudence habits. The financial practices of the disadvantaged result in downward wealth mobility while the financial practices of the privileged facilitate upward wealth mobility, above and beyond standard explanations considered in the literature.

Together, these findings suggest that in the historic period of financialization, less advantaged groups tend to adopt financial practices that stress bringing money to the family, whereas more privileged groups tend to undertake an approach that also stresses operations and actions with money after it enters the household. Stated in different terms, more privileged groups also emphasize bringing money to the family, but actions involving money after it enters the family are equally important if not overshadow the former. Thus, more privileged groups embark on new opportunities offered by financialization and deliberately try to manage money.

The economic challenges that less advantaged groups face imply that for them providing for the family financially requires ongoing substantial effort. But it stops short of the deliberate financial activities that take place in more privileged households. For the less advantaged, earning money and providing for the family is likely to be viewed as both necessary and sufficient. For the more privileged, earning money is likely to be complemented with engagement in active financial actions and operations, essentially banking on wealth. This is not to suggest that the less advantaged make faulty decisions or adhere to faulty financial reasoning. Rather, poor families are constrained in their financial decisions, which further locks them in the loop of disadvantage.

Furthermore, these results suggest that in the historic period of financialization, more privileged groups found ways to make use of the financial system in the ways that further improve their socioeconomic position through wealth accumulation, whereas less advantaged groups did not embark on the new opportunities offered by financialization. Moreover, contrary to what could be expected, those households which were more involved in the financial markets not only did not lose, but actually experienced gains as the financial system crashed and then recovered in 2007-2009. In other words, the economic order emerged in the era of financialization further facilitates upward mobility of the already privileged, while disadvantaged groups fall behind.

From a broader perspective, my research offers important theoretical contributions of interest to scholars of economic sociology and stratification and inequality, and also draws new disciplinary connections between economic sociology and the inequality literature. The findings reported in this study lend further evidence that household financial behavior, like any other economic action, is embedded in social structure. Moreover, whereas existing accounts of financial behavior developed in economics and finance focus on the mechanical exercise of

utility maximization or cognitive constraints, the findings reported here point to the importance of social location in explaining financial behavior. By showing the effects of financial practices on wealth accumulation, this study also points to the importance of household economic life in the (re)creation of (dis)advantage. Thus, this study points to the importance of the household as an important site of economic and inequality processes and outcomes.

This research also has important implications for public policy. Recent policy initiatives, including the creation of the Consumer Financial Protection Bureau (CFPB) under the Obama Administration, have emphasized the potential effects of consumer finance for household economic well-being. This study provides original and systematic empirical evidence about whether and how household use of financial products and services affect wealth accumulation (or depletion) and ultimately wealth inequality. Altogether, these findings might be of interest to policymakers working on designing interventions to assist Americans in the use of financial products and services and, more broadly, in promoting the economic well-being of American families.

Although my study offers important theoretical and policy implications, there are also limitations to my findings, which open up directions for future research. First, the findings of the present study are limited to the United States. However, comparative studies of household financial behavior suggest that there might be meaningful cross-national variations in household financial choices and decisions as well. More importantly, it does not take into account intra-household inequality in the access and use of financial and economic resources. At the same time, there is a growing empirical evidence points to inequality among household members in access and use of household resources based on age, gender, and other attributes. The analyses presented here are limited in revealing foundational relational work (Zelizer 2012) that stands

behind the observed patterns of household financial practices. In other words, while the findings presented here reveal the resultant patterns, they say little about the negotiations – relational work – that are involved in reaching, sustaining, or alternating the observed financial choices households make. For example, who is involved in the decision making? How are the decisions made when household members disagree? Answering these questions would offer important theoretical advancements as well as suggest avenues for possible policy interventions.

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TABLES

Table 1. Financial Practices from Latent Class Analysis, Survey of Consumer Finances, 2007 (cross-section)

Financial Attitudes and Behaviors	Sophisticated	Diff.	Indebted	Diff.	Non-fin
Diversification and Risk-Taking					
% assets invested in stocks	.145	=	.160	>	.050
% assets in home equity	.445	<	.556	>	.434
Willing to take high risk to gain returns	.429	>	.281	>	.079
Use of Credit					
Leverage ratio	.240	<	.484	>	.083
N different types of credit	3.286	>	2.966	>	1.490
Negative attitudes toward borrowing in general	.346	=	.334	=	.359
Approval of borrowing to cover living expenses	.478	<	.537	>	.438
Approval of borrowing to buy a fur coat or jewelry	.166	<	.202	>	.120
Shopping for Financial Information					
Shopping efforts when making financial decisions	7.239	>	6.325	>	5.826
N sources of financial information	4.493	>	3.230	>	2.561
Use of advice from financial professionals	.866	>	.668	=	.663
Financial Attitudes and Habits					
N financial institutions used	5.867	>	4.113	>	2.601
Length of financial planning horizon	7.549	>	5.556	>	4.409
Use of computer software to manage money	.421	>	.229	>	.093
Enrollment in automatic payments of bills	.716	>	.582	>	.386
Late on loan or mortgage payments	.075	<	.205	=	.193
Following a regular saving plan	.767	>	.467	>	.395
Making savings for foreseeable major future expenses	.441	>	.288	>	.229
Approval of leaving inheritance	.508	=	.517	=	.533
Would spend more if assets appreciated in value	.214	<	.262	>	.198
% food expenses spent on eating out	.318	>	.289	>	.250
Optimistic expectations about the future of economy	.290	=	.320	>	.277
Considering him/herself financially lucky	.818	>	.690	=	.724
Embedded in networks of informal financial exchanges	.309	>	.218	=	.200
N (%)	22%		40%		38%

Table 2. LCA Model Fit

N classes	LogLL	AIC	BIC	Sample-size Adjusted BIC	Entropy	% change entropy	VLMR p-value	LMR p-value
2	-51057.004	102230.007	102570.055	102385.772	.809		.000	.000
3	-50134.566	100435.133	100921.752	100658.038	.831	2.72%	.7653	.7656
4	-49434.105	99084.209	99717.401	99374.254	.849	2.16%	.7849	.7850
5	-49052.197	98370.394	99150.157	98727.578	.868	2.23%	.7741	.7741

Table 3. Conditional Means of the 2009 Measures of Financial Practices by 2007 Latent Class (e.g., how the 2009 measures of financial attitudes and behaviors describe 2007 classes)

Financial Attitudes and Behaviors	Sophisticated	Diff.	Indebted	Diff.	Non-fin
Diversification and Risk-Taking					
% assets invested in stocks	.126	=	.123	>	.071
% assets in home equity	.451	<	.549	>	.438
Willing to take high risk to gain returns	.255	>	.200	>	.067
Use of Credit					
Leverage ratio	.337	<	.501	>	.281
N different types of credit	3.153	=	3.186	>	1.791
Negative attitudes toward borrowing in general	.395	=	.393	=	.427
Shopping for Financial Information					
Shopping efforts when making financial decisions	7.074	>	6.301	>	5.683
N sources of financial information	3.606	>	2.917	>	2.370
Use of advice from financial professionals	.739	>	.624	=	.643
Financial Attitudes and Habits					
Length of financial planning horizon	6.363	>	4.906	>	4.015
Late on loan or mortgage payments	.125	<	.213	>	.106
Following a regular saving plan	.615	>	.401	=	.383
Making savings for foreseeable major future expenses	.410	>	.298	>	.238
Would spend more if assets appreciated in value	.240	=	.249	>	.182
Optimistic expectations about the future of economy	.585	=	.579	=	.518
Embedded in networks of informal financial exchanges	.308	>	.225	=	.250
N (%)	27%		43%		31%

Note: This analysis includes fewer variables than in 2007 because the 2009 SCF re-interview included fewer questions than in 2007.

Table 4. OLS Regression Results Predicting Household Financial Strategies by Socio-Economic Attributes, Survey of Consumer Finances, 2007

	Sophisticated	Indebted	Non-fin
Socioeconomic Status			
Some college	.073***	.032	-.106***
College or more	.112***	.057**	-.170***
Other occupation	.069***	.051	-.121***
Technical, sales, and/or services	.094***	.037	-.131***
Managerial/professional occupation	.134***	.030	-.164***
Net worth	.001***	-.001***	.001***
Income	.001***	.001	-.001***
Controls			
Age	.001	-.006***	.005***
Male	-.042*	.023	.018
Non-white	-.025	-.019	.044*
Single, with children	-.022	.123***	-.100***
Married, no children	.006	.078*	-.084**
Married, with children	.061*	.097**	-.159***
Average health	.014**	-.016*	.001
Constant	-.093*	.703***	.390***

* $P < .10$

** $P < .05$

*** $P < .01$

N=

Table 5. OLS Regression Results the Effects of Financial Practices on Changes in Household Wealth (Rank Percentile), Survey of Consumer Finances, 2007-2009

	(1)	(2)	(3)
Financial Practices			
Non-fin (ref.)			
Indebted		-10.914***	-3.349***
Sophisticated		15.262***	1.949**
Socioeconomic Status			
Some college	1.867*		1.885*
College or more	3.251***		3.445***
Other occupation	-.659		-.706
Technical, sales, and/or services	-.349		-.507
Managerial/professional occupation	1.068		.898
Net worth (Rank percentile)	.821***		.782***
Income	.001*		.001**
Controls			
Age	.166***		.164***
Male	1.563		1.756
Non-white	-4.405***		-4.522***
Single, with children	-1.593		-1.192
Married, no children	-1.641		-1.593
Married, with children	-.492		-.408
Average health	.101		.120
Constant	-2.053	60.629***	1.014

* $P < .10$ ** $P < .05$ *** $P < .01$

N=3,647

Appendix

Table 1. Financial Practices from Latent Class Analysis, Survey of Consumer Finances, 1983

Financial Attitudes and Behaviors	Sophisticated	Diff.	Moderate	Diff.	Non-fin
Diversification and Risk-Taking					
% assets invested in stocks	.021	=	.043	>	.013
% assets in home equity	.323	=	.442	<	.518
Willing to take high risk to gain returns	.408	>	.204	>	.135
Willing to take low liquidity to gain returns	.613	=	.598	>	.266
Use of Credit					
Leverage ratio	.246	=	.171	<	.219
N different types of credit	3.445	=	2.896	>	2.420
Negative attitudes toward borrowing in general	.069	=	.165	=	.219
Approval of borrowing to cover living expenses	.396	=	.415	=	.429
Approval of borrowing to buy a fur coat or jewelry	.113	=	.052	=	.036
Shopping for Financial Information					
N sources of financial information	4.015	>	.895	>	.481
Use of advice from financial professionals	1.000	>	.425	>	.152
Financial Attitudes and Habits					
N financial institutions used	2.078	=	2.078	>	1.405
Late on loan or mortgage payments	.170	=	.055	<	.144
Embedded in networks of informal financial exchanges	.029	=	.017	=	.019
N (%)	4%		43%		54%
					N=823

Table 2. OLS Regression Results Predicting Household Financial Strategies by Socio-Economic Attributes, Survey of Consumer Finances, 1983

	Sophisticated	Moderate	Non-fin
Socioeconomic Status			
Some college	.016	.108***	-.125***
College or more	.050***	.258***	-.308***
Other occupation	-.021	.031	-.010
Professional, technical, sales, clerical	-.017	.149***	-.132***
Managerial/administrative occupation	-.016	.215***	-.198***
Net worth	.006	-.010	.003
Income	.018**	.058***	-.077***
Controls			
Age	-.001	.006***	-.006***
Male	.026	-.007	-.018
Non-white	-.004	-.108***	.113***
Single, with children	-.019	.001	.017
Married, no children	-.028	.171***	-.143***
Married, with children	-.030	.152***	-.121***
Constant	.038	-.291***	1.252***

* $P < .10$

** $P < .05$

*** $P < .01$

N=827

Table 3. OLS Regression Results the Effects of Financial Practices on Changes in Household Wealth (Rank Percentile), Survey of Consumer Finances, 1983-1989

	(1)	(2)	(3)
Financial Practices			
Non-fin (ref.)			
Moderate		32.908***	7.295***
Conservative		36.804***	10.238***
Socioeconomic Status			
Some college	4.268**		3.669*
College or more	8.103***		6.132***
Other occupation	-.873		-.597
Technical, sales, and/or services	3.686		3.198
Managerial/professional occupation	6.533***		5.904**
Net worth (Rank percentile)	.613***		.563***
Income	1.102**		.737*
Controls			
Age	.046		.052
Male	-.729		-.364
Non-white	-4.714**		-4.398**
Single, with children	-3.474		-3.128
Married, no children	9.023**		8.310*
Married, with children	8.617**		8.255**
Constant	8.487*	39.526***	9.159**

* $P < .10$

** $P < .05$

*** $P < .01$

N=827