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The Growth of Finance Is Not Remarkable

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The financial sector's share of total compensation in the U.S. economy declined by over 60 percent during the Great Depression but then expanded rapidly, growing by more than 250 percent in the second half of the 20th century. The post–World War II (WWII) growth in finance's income share has attracted considerable attention (and, in some cases, concern) largely because of its perceived uniqueness. For example, past research emphasizes that because finance income grows faster than income for the broad services sector after WWII, explanations for the rise of the services sector are not sufficient to explain the growth of the financial sector. Other research argues that health care is the only other fast-growing service industry in the second part of the 20th century. We show that the growth and evolution of the finance income share is not nearly as remarkable as this research suggests.

We begin by highlighting the sharp and persistent differences in skill-intensity across different segments of the broad services sector. We divide services into "high-skill" and "low-skill" groups based on the share of labor hours accounted for by college-educated workers. By this metric, finance is similar to other skill-intensive service industries, such as legal services, educational services, and professional business services, but very dissimilar to a large fraction of the service sector, which is characterized by persistently low-skill intensity (e.g., hotels, retail trade, automobile services, etc.). The distinction between the high-skill and low-skill segments of services is important because the two segments have vastly different growth trajectories over the course of the 20th century. For example, between 1940 and 2018, high-skill services' share of economy-wide compensation increases by nearly 300 percent, while low-skill services' share of income declines substantially. This structural shift within services suggests that comparing the growth of finance to the overall service sector (the commonly used benchmark) is not appropriate.

To illustrate how different benchmarks matter, we compare the growth of income in financial services with economy-wide income, income in the broad services sector, and

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income in the set of other (nonfinance) high-skill service industries. Benchmarking against other high-skill service industries shows that the growth of the finance income share after WWII is not exceptional. In fact, nonfinance high-skill services grew faster than finance, and several individual high-skill service industries grew *much* faster than finance in both absolute and percentage terms. Consequently, relative to the set of high-skill service industries, finance's income share has steadily declined since the early 20th century. Specifically, between 1929 and 2018, the finance share of compensation in high-skill services fell from around 40 percent to 18 percent. These broad trends in the growth of finance relative to high-skill services also hold in other developed economies: between 1970 and 2017, the finance share of income in high-skill services declined in 10 of the 11 European countries for which reliable data exists.

While the evolution of the finance income share over the 20th century closely tracks that of other high-skill service industries, there are notable differences. Following the 1929 stock market crash, both finance and nonfinance high-skill services shrank as a share of the economy. This trend away from skilled services continued through WWII as economic activity shifted to manufacturing. In the decades following WWII, there was a sharp increase in the economy's share of high-skill services, and in this postwar period, finance actually grew much slower (as a share of the economy) than other high-skill service industries. Most notably, whereas nonfinance high-skill services reached its 1932 share of the economy by 1960, finance does not reattain its 1932 peak until 1985. Moreover, finance's share of the economy stopped growing after the 2007–2008 financial crisis, while the rest of high-skill services continued to grow.

Several studies focus specifically on the high wages in finance relative to the rest of the economy. We show that the magnitude of finance's relative wage, and particularly its evolution over the 20th century, is not unusual compared to other high-skill service industries. For example, in 2018, finance wages were 83 percent higher, on average, than wages in the rest of the economy. This wage premium is above the average for high-skill services but in line with the wage premiums in legal services (64 percent) and professional business services (88 percent). More importantly, between 1940 and 2018, finance wages grew *slower* than wages in several other high-skill service industries, including legal services, professional business services, and health services.

We also explore differences within the financial services sector. The Bureau of Economic Analysis reports disaggregated data for three finance subsectors: credit intermediation, insurance, and securities trading. Securities is the most skill-intensive subsector in finance and, as of 2018, is among the most skill-intensive industries in the economy. Between 1940 and 2018, credit intermediation and insurance grew much slower than the typical high-skill service industry. Securities, though, grew faster than the average high-skill service industry but slower than professional business services and health services, the two largest high-skill service industries as of 2018. Our findings highlight that the growth of securities drove most of the growth in finance's share of economy-wide income in the second half of the 20th century. Moreover, most of the growth in the securities income share is driven by wage growth, particularly between 1980 and 2000, rather than employment: as of 2018, securities accounts for 2.3 percent of economy-wide compensation but only 0.7 percent of economy-wide employment.

We show that the long-run evolution of the finance income share over the course of the 20th century is not exceptional. Rather, our findings suggest that the rise of modern finance is part of a much broader global shift to high-skill services. Our analysis does not address the optimal size of finance or whether the growth of finance has been desirable.

NOTE

This research brief is based on James R. Brown, Gustav Martinsson, and Bruce C. Petersen, "The Growth of Finance Is Not Remarkable," Swedish House of Finance Research Paper no. 20-27, last revised April 13, 2023.

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