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THE OUTLOOK**Has the Financial Industry's Heyday Come and Gone?**

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For the past three decades, finance has claimed a growing share of the U.S. stock market, profits and the overall economy.

But the role of finance -- the businesses of borrowing, lending, investing and all the middlemen in between -- may be ebbing, a shift that would redefine the U.S. economy. "The role of finance in the economy is going to come down significantly in the coming years," says Carlos Asilis, chief investment officer at Glovista Investments, a New Jersey money manager. "From a societal standpoint, we got carried away with finance."

The trend already has hurt companies beyond banks and Wall Street firms. General Electric Co.'s first-quarter profits at its financial-services businesses were 21% lower than a year earlier. Retailer Target Corp., which got 13% of its before-tax profit last year from credit cards, last month wrote off \$55.5 million in credit-card loans, 8.1% of its total portfolio at an annualized rate.

"I think you're seeing a clear inflection point," says Tom Gallagher, an ISI Group analyst. "Whether it's financials as a share of the stock market or financials as a share of GDP, we've peaked."

Finance was lifted by deregulation, globalization and technological innovation. Combined, these forces allowed capital to flow far more freely around the globe, brought flexibility to the economy and made finance lucrative.


Domestic financial-sector profits accounted for 13% of pretax profits in 1980, the Federal Reserve says. Last year, they accounted for 27%. In 1980, GE garnered 92% of its profit from manufacturing. In the first quarter, profit from GE's financial businesses, which extend credit from personal loans to factory purchases, represented 56% of profit.

As finance rose, financial workers took a bigger chunk of total U.S. pay. And as technology allowed financial firms to do more with fewer people, individual paychecks got fatter. Finance was a major factor in the widening gap between the very rich and the middle class. In 1980, finance workers made about 10% more than comparable workers in other fields, estimates New York University economist Thomas Philippon. By 2005, that premium was 50%.

That money diverted some of the brightest minds from other pursuits. "We're seeing significantly more of our students going into the financial sector," says Vincent Poor, dean of Princeton's engineering school. "Traditionally, engineering students had not followed that path."

The creation of securities backed by mortgages and other loans and other innovations made it easier for

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financial firms to spread risk, and thus they became more willing to lend to households to fuel spending. Household debt including mortgages and credit cards went from 13% of household assets in 1980 to 19% last year. During that period, personal savings rates fell to nearly zero.

In the 2000s, finance went into overdrive, creating an alphabet soup of derivatives that, it turned out, didn't have the risk-reducing properties they were supposed to have. Mr. Philippon compares some to "sheep with fifth legs -- something you would see in a zoo and wonder what Nature was thinking."

For finance workers, this shift could resemble the 1980s, when manufacturing lost its pole position in the U.S. labor market and thousands found that skills they had honed over the years were less marketable. The Bureau of Labor Statistics already counts 60,000 fewer people working in finance than a year ago. **Merrill Lynch & Co.** is cutting 4,000 jobs, and **Lehman Brothers Holdings Inc.** is cutting 1,425. Many of **Bear Stearns Cos.**' 14,000 employees are expected to lose their jobs when **J.P. Morgan Chase & Co.** swallows the firm.

Mr. Philippon argues that the surge of financial activity that began in 2002 created an employment bubble that is now busting. His model suggests total employment in finance and insurance has to fall to 6.3 million to get back to historical norms, and that means losing an additional 700,000 jobs in the sector.

Finance has seen job cuts before and bounced back. After the 1987 stock-market crash, E.F. Hutton & Co. was taken over by Shearson Lehman Brothers, then a division of **American Express Co.**, and shed 5,000 jobs. Among them was Jeffrey Applegate's job as a strategist. He spent the subsequent year doing carpentry and thinking he might make a career of it if financial jobs didn't come back. He got hired by Shearson Lehman, which evolved into the present-day Lehman Brothers.

Now chief investment officer for **Citigroup Inc.**'s Citi Global Wealth Management, Mr. Applegate thinks the damage to the financial sector this time will be more lasting than 1987. (Citigroup has announced 6,000 job cuts since the credit crisis began.)

But he doubts finance's role in the economy will ebb much. Globalization's demand for free-flowing capital will continue. And the process of turning loans into securities is too powerful a tool for risk management and credit creation to abandon. "Is securitization going to go away? I doubt it," he says. "Is it going to be more transparent? Are ratings going to be more robust? Is there going to be more regulation? Yeah."

Global governments are moving to require financial firms -- both commercial banks and investment firms like Bear Stearns -- to hold bigger capital cushions against the credit they extend so they are better able to withstand financial tornadoes. And that lower leverage, inevitably, means lower profits for finance.

But even before new regulations bite, investors are wary of the securities that ultimately are tied to mortgages and other loans made to consumers. And that could pinch American consumers long dependent on credit to spend, sometimes beyond their means.

Harley-Davidson Inc. last year earned about 15% of its operating income through its financial services division, which offers financing to its motorcycle customers; that's up from 5% a decade ago. In the first quarter, Harley had a hard time selling the loans it originated; its financial-services profits fell by 41%, as a result. With its customers feeling the economic downturn and less able to borrow to buy bikes, the company, which shipped 330,619 Harley-Davidson motorcycles last year, plans to ship between 23,000 and 27,000 fewer in 2008.

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