Expanding the Definition of Financial Intermediation Services in the US National Accounts

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Although banks are fulcrums of the financial system, the relative importance of markets for equities, bonds, and other credit instruments has grown over time in most advanced economies. This raises the question of whether the financial services provided by non-depository institutions and self-produced financial services are appropriately captured in the available measures of financial sector output. Is the current measurement approach invariant to the channel through which financial services were provided before and after the expansion of financial markets and evolution of corporate finance? Before and after the development of new mechanisms for transferring risk and internationalization of financial markets?

This paper addresses these questions from the perspective of analyzing economic growth and development. Our approach to answering these questions is to review how the financial system of the United States is measured and portrayed from the 1960s to present day, i.e., from when a relatively fixed financial universe prevailed to today's ever-changing terrain. We examine how well existing measures capture of borrower financial services used by business, households, and state and local governments, including the substitution of bank-supplied vs. own-produced financial services by large corporations. In contrast to most prior work on the subject, we take a borrower perspective using the sector data in the joint BEA/Federal Reserve Integrated Macroeconomic Accounts.

With existing methods, borrower services are likely to be considerably understated when savings are channelled to investment through markets and nonbank institutions. (In the United States, loan liabilities of household and nonfinancial business are three times the value of commercial bank loan assets held against these sectors.) The substitution of bank-supplied for own-produced services by nonfinancial corporations also results an understatement of an economy's production of financial services.

While our approach produces fairly straightforward conclusions for measuring nominal output of financial services, vexing question arise in designing comprehensive measures of real production of financial services. Accordingly, we consider alternative approaches to deflating financial services.