



The Role of Services in the Modern U.S. Economy

Office of Service Industries

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Throughout the latter half of the twentieth century, the service sector has been both the largest and the fastest growing component of the U.S. economy. Fifty years ago, the service sector accounted for about sixty percent of U.S. output and employment. Today, the service sector's share of the U.S. economy has risen to roughly 80 percent.

The remarkable economic prominence of services is no less impressive when the sector's various components are considered one by one:

- Wholesale trade, retail trade, and transportation & public utilities each contribute over half a trillion dollars to annual U.S. output.
- Construction, the smallest subsector, now accounts for a higher share of economic output than either agriculture or mining (construction is counted among the subsectors here because it is viewed as a service in the context of international trade).
- And each of the two largest subsectors -- finance, insurance, & real estate, and Services, the catchall category covering all other private services -- contributed over one and a half trillion dollars to GDP in 1997, i.e., more than the 1.4 trillion dollars in output produced by the manufacturing sector of the economy.

Aside from sheer size, the most crucial aspect of the service sector's ascendance is the thorough integration of services with virtually every other aspect of the present-day American economy. From Main Street to Wall Street, wherever business is conducted in the United States, services businesses are an essential component of the local economy -- a critical source of new local jobs, an essential ingredient in creating a commercial environment conducive to entrepreneurship, and a vital link to the wider U.S. and world economies.

At one end of the spectrum, small companies serve and prosper within communities both large and small all across America. By the mid-90s, nine of every ten firms with fewer than twenty employees were in the services sector, and these small services companies accounted for nine of every ten jobs at small firms -- nationwide, over 17 million jobs, or, on average, about 350 thousand jobs in each of the fifty states.

The relative importance of small services providers is most apparent when contrasted with the U.S. manufacturing sector. There, the 242 thousand firms with under twenty employees accounted for three out of every four manufacturing firms, but for only one of every fourteen manufacturing jobs -- for a nationwide total of about 1.3 million jobs, or, on average, about 27 thousand jobs in each of the fifty states.

While the importance of small services firms can hardly be overstated, it is no more than a part of the story of the modern services economy. For example, eight of the thirty firms that now make up the Dow Jones index of blue-chip stocks are in the service sector: American Express, which in 1982 became the first services firm to be added to the Dow, AT&T, Citigroup, Disney, McDonald's, JP Morgan, Sears, and Wal-Mart. Other firms on the Dow that began as, and that are commonly viewed as, manufacturing firms -- GE and IBM are prime examples -- also rank among the world's largest and most competitive services operations. And, of course, by design, not one of the firms listed among the Dow industrials is a transportation or a utilities concern: each of these key subsectors of the service economy is covered by its own market index.

Together, then, services firms large and small now provide more jobs -- and more new jobs -- than all other sectors of the economy combined. Service sector payrolls rose 65 percent over just the past twenty years, with almost 40 million more employees today than there were in 1978. Moreover, these new service sector jobs accounted for the entire net gain in nonfarm employment since the 1970s, a trend that is forecast to continue into the next decade. The result: 85 percent of all nonfarm workers hold jobs in the service sector. Even if the nation's 3 million

federal and 17 million state and local government employees are excluded, there were 87 million private sector jobs in the service sector in 1998, accounting for 82 percent of all private nonfarm employment.

A variety of forces underlie this inexorable economic shift to services. A century ago, structural economic shifts were viewed as the natural and inevitable result of rising per capita incomes, with the consumption of manufactured goods first eclipsing that of agricultural items, and with purchases of goods in turn eclipsed by the purchase of various services. Today, at the close of a century that history will almost certainly record as the dawn of the information age, it is clear that important *new* forces have also been driving the shift to a more services-oriented economy.

The rapid development and widespread deployment of powerful new information technologies is one such force for economic transformation. For example, when a recent study ranked U.S. industries according to the ratio of investment in information technology relative to total capital investment, the ten top-ranked industries were *all* services industries. Information is the fuel that keeps the services economy running.

Less widely recognized, but no less important, the reverse is also true: modern services industries are critical drivers of technical progress. Because they rely disproportionately on and invest disproportionately in advanced information technologies, services firms bring full circle the link between the economy's services-intensity and its information-intensity, creating a huge, growing market for the most advanced information technologies that the economy's goods-producing industries can deliver.

Looking ahead, it may well be this mutually reinforcing cycle of technical and commercial advances in the goods- and services-producing sectors that proves ultimately to be the truest gauge of the indispensable role of a modern service sector in the information economy of the next century. And, if the recent past is any guide, the service sector's role in that new information economy will match its unrivaled importance as measured today in terms of output and employment.