

HIGH PAY IN FINANCE HAS NOT CAUSED A BRAIN DRAIN: Evidence from Sweden

Salaries in the financial services sector have soared since the 1980s, but this has not caused a 'brain drain' of talented people from other industries. That is the main finding of research by **Michael Böhm**, to be presented at the annual congress of the European Economic Association in Mannheim in August 2015.

Analysing detailed information from Sweden on the talent of workers (including measures of cognitive and non-cognitive skills, from military service to degree subjects), his study finds that while top pay in the finance sector has risen dramatically, the level of talent in the industry has not changed much.

The proportion of skilled workers in the finance sector compared with the rest of the economy has not changed much either, which suggests that there has been no 'brain drain' of talented workers and specialists in STEM (science, technology, engineering and maths) subjects.

But while these findings alleviate concerns about a 'brain drain' into finance at the expense of other sectors, they also suggest that rents in finance are high, increasing and largely unexplained. The author concludes:

'In terms of current proposals in Sweden and elsewhere of introducing taxes on bonuses, my findings are consistent with the view that they might not affect the allocation of talent across sectors very much. But they could redistribute some rents from finance workers to society more broadly.'

More...

Since the 1980s, salaries in the finance industry have risen dramatically in many countries around the world. For example, in Sweden, the average premium that finance workers earn over workers in the rest of the private economy increased from 30% to 70% over the last two decades. Top 1% earners in finance nowadays earn almost three times as much as their counterparts in the rest of the private economy.

Finance practitioners as well as some academics have justified these trends by arguing that work in the financial sector has become more complex and skill-intensive, and that therefore the extraordinary pay simply reflects a compensation for extraordinary talent.

Against this backdrop and the concern that the high salaries may indeed have attracted a lot of very talented workers into the financial sector, policy-makers and other academics have voiced the concern that there is a 'brain drain' of highly talented individuals into finance and out of 'more productive' activities such as innovation.

This paper uses detailed information on the talent of workers in Sweden to examine these questions. The measures of talent include cognitive and non-cognitive ability from compulsory military enlistment tests, information from performance in high school, university specialisations and graduation from elite colleges.

Despite finance wages having increased dramatically in Sweden during the period 1991-2010, particularly at the top of the wage distribution, the researchers do not find

any contemporaneous increase of talent in the financial sector. Both average talent in finance and the relative fraction of top talented workers in finance remain roughly constant over this period.

At the same time, the finance sector's share of the overall labour force is constant, implying that there is no inflow of low-talent individuals that offsets an increase in the talent of the average finance worker.

The study further tests how far a different composition of talent in finance and increasing returns to talent can explain the rising finance wages. It does not find that they do so to a meaningful degree.

The researchers also examine whether a higher fraction of high-talent science, technology, engineering and mathematics (STEM) graduates and graduates from Sweden's top business and economics school are entering finance. They do not find any substantive increases.

Overall, these findings therefore alleviate concerns about a 'brain drain' into finance at the expense of other sectors, but they also suggest that rents in finance are high, increasing and largely unexplained. In terms of current proposals in Sweden (and other countries) of introducing taxes on bonuses, the findings are consistent with the view that they might not affect the allocation of talent across sectors very much and that they could redistribute some rents from finance workers to society more broadly.

ENDS

Michael Böhm
University of Bonn
+49-173-2307767
michael.boehm1@gmail.com