

# **FINANCIAL RECKONING DAY**

## **SURVIVING THE SOFT DEPRESSION OF THE 21ST CENTURY**

**William Bonner**  
with Addison Wiggin



**WILEY**

John Wiley & Sons, Inc.



**Praise for**  
***Financial Reckoning Day***

“What a pleasant surprise! I could not put this book down and enjoyed it immensely. With all its metaphors, anecdotes, historical excursions, investment principles, warnings about investment buffoons like George Gilder, and financial parallels, this book, because of the ease with which you can read it, is an investment book that will not only enlarge your investment horizon, but also make you laugh and thoroughly entertain you for a few hours.”

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“The authors have crammed so much thought-power into the pages of this book it’s a challenge to describe or summarize. . . . They explain how the world *doesn’t* work, quite remarkably, which helps us see how it *does* work, perhaps. Markets are judgmental, they say, not mechanistic. Amen! They say Japan’s decades-long bust proves both the major economic theories are wrong and that the West is destined to follow. They rightly, in my view, claim this is a crisis point in modern history. This book just might help us cope with it. *Worth a try!*”

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—John Mauldin, Millennium Wave Advisors,  
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“Forwards and backwards in time, up the alleyways of one theory and down another, often soiled by the sorry sludge of historical missteps . . . the often-disastrous results of the hopes and dreams, needs and wants of all the people in all of history coalesce into a Grand Unified Theory that one cannot adequately define or explain, but by the end of the last sentence, on the last page, of the last chapter, one knows that, surely, this book is something to behold.”

—Richard Daughy, editor of *The Mogambo Guru Economic Newsletter*

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Published by John Wiley & Sons, Inc., Hoboken, New Jersey.

Published simultaneously in Canada.

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***Library of Congress Cataloging-in-Publication Data:***

Bonner, William, 1948–

Financial reckoning day: surviving the soft depression of the 21st century / William Bonner, Addison Wiggin.

p. cm.

“Published simultaneously in Canada.”

Includes index.

ISBN 0-471-44973-3

1. Financial crises—United States. 2. Stocks—United States. 3. Business cycles—United States. I. Wiggin, Addison. II. Title.

HB3722.B66 2003

330.973—dc21

2003007459

Printed in the United States of America.

10 9 8 7 6 5 4 3 2 1

**S**ome people want to buy baseball teams or chase women, but I'm told the number one dream that comes to mind when young people are asked is: "I want to see the world."

I've been around the world twice now: Once on a motorcycle. Once in a Mercedes. So I guess that means I'm crazier than most people.

The reason that I love doing it, other than the sense of adventure, and I certainly love the adventure, is it's the only way I can figure out what's going on in the world. I don't trust the newspapers, TV stations, or government pronouncements. That's what everyone else knows. I want to see it for myself, close to the ground.

You learn much more about a society by crossing a remote border, finding the black market, and changing money or talking to the local madam than by talking to bureaucrats or economists at the IMF and the World Bank . . . or by watching CNBC.

By the time I cross the border in the jungle, I know 25 percent to 30 percent of what I need to know about a country. I know the bureaucracy. I know the infrastructure. I know the corruption. I know the status of the economy and its currency. And I know whether I stand to make money investing there or not.

The only other way to know what's going on is to study history. When I teach or speak at universities, young people always ask me: "I want to be successful and travel around the world; what should I study?"

I always tell them the same thing: "Study history."

And they always look at me very perplexed and say, "What are you talking about . . . what about economics, what about marketing?"

“If you want to be successful,” I always say, “you’ve got to understand history. You’ll see how the world is always changing. You’ll see how a lot of the things we see today have happened before. Believe it or not, the stock market didn’t begin the day you graduated from school. The stock market’s been around for centuries. All markets have. These things have happened before. And will happen again.”

Alan Greenspan has gone on record to say he had never seen a bubble before. I know in his lifetime, in his adult lifetime, there have been several bubbles. There was a bubble in the late 1960s in the U.S. stock market. There was the oil bubble. The gold bubble. The bubble in Kuwait. The bubble in Japan. The bubble in real estate in Texas. So what is he talking about? Had he not seen those things, he could have at least read some histories . . . all these things and others have been written about repeatedly.

The current bubble that Greenspan does not see is the consumption bubble he is causing. He has the lunatic idea that a nation can consume its way to prosperity although it has never been done in history.

In America, if you have a job, you pay taxes. If you save some money, you pay taxes on the interest. If you buy a stock and you get a dividend, you pay taxes. If you have a capital gain, you pay taxes again. And when you die, your estate pays taxes. If you live long enough to get social security, they tax your social security income. Remember: You paid taxes on all this money when you earned it originally yet they tax it again and again.

These policies are not very conducive to encouraging saving or investing. They promote consumption.

By contrast, the countries that have been doing well the last 30 or 40 years, are the countries that encourage saving and investing. Singapore is one of the most astonishing cities in the whole world. Forty years ago it was a slum. Now, in terms of per capita reserves, it’s one of the richest countries in the world.

One of the reasons Singapore was so successful is its dictator, Lee Kwan Yu, insisted that everyone save and invest a large part of their income. There are many other dictators or politicians you can condemn, but they have nothing to show for it, and in fact they’ve been worse. Whatever Lee’s policies toward personal freedom, at least he forced people to save and invest.

History shows that people who save and invest grow and prosper, and the others deteriorate and collapse.

As the book you hold in your hands demonstrates, artificially low interest rates and rapid credit creation policies set by Alan Greenspan and the Federal Reserve caused the bubble in U.S. stocks of the late 1990s.

Now, policies being pursued at the Fed are making the bubble worse. They are changing it from a stock market bubble to a consumption and housing bubble.

And when those bubbles burst, it's going to be worse than the stock market bubble, because there are many more people who are involved in consumption and housing. When all these people find out that house prices don't go up forever, with very high credit card debt, there are going to be a lot of angry people.

No one, of course, wants to hear it. They want the quick fix. They want to buy the stock and watch it go up 25 percent because that's what happened last year, and that's what they say on TV. They want another interest rate cut, because they've heard that that's what will make the economy boom.

Bill Bonner wrote me early on to tell me that "a lot of the stuff you write about in *Adventure Capitalist* (Random House) is in my book—except for the travel in the international countries."

I'd go a step further and say it's almost as though he wrote parts of my book and I wrote some of his—approaching the same subject from two completely different angles . . . and arriving at the same place. From the lack of government policies encouraging saving and investing to the dramatic effect demography will have on the global economy in the 21st century, I kept coming across things in this book that I had seen in my travels. He discovered them by reading history books and studying economics. I saw them up close, on the ground.

"Needless to say, you're a genius," I wrote back, "You think like I do, which means we're both going to go broke together."

JIM ROGERS



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## ACKNOWLEDGMENTS

We would like to say a few words to thank the many people whose ideas and insights helped contribute to the final version of this book. Our thanks go to Rebecca Kramer, without whose persistence this project would never have gotten off the ground. Thank you to Philippa Michel-Finch for her diligent research, writing, and editing throughout the project. Philippa helped us understand the causes and consequences of Japan's boom, bust, and persisting economic malaise and took the lead as we waded through the minutiae of detail that comprise the area of demographic and aging studies. We would also like to thank Steve Sjuggerud and John Forde for their help—and understanding—as they produced the charts and graphs you'll find in the book.

Many thanks, too, to Jennifer Marie Westerfield who held down the fort at [www.dailyreckoning.com](http://www.dailyreckoning.com) during the three months in which the book was written.

Finally, we would like to thank Kurt Richebächer, Gary North, James Grant, Marc Faber, Richard Russell, David Tice, Frank Shostak, Richard Daughty, John Mauldin, Doug Casey, James Davidson, Uncle Harry Schultz, George Gilder, Francis Fukuyama, Robert Prechter, Martin Weiss, Porter Stansberry, Eric Fry, and Dan Denning for their helpful and entertaining insights; and Thom Hickling for his fine guitar work.



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## INTRODUCTION

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It had all seemed so logical, obvious, and agreeable back in the last five years of the 20th century. Stocks went up year after year. The Cold War had been won. There was a new “Information Age” making everything and everybody so much smarter—and richer, too. The world was a happy place and Americans were its happiest people. American consumer capitalism was the envy of all mankind. The United States guaranteed the peace and freedom of the entire species, if not with goodness, intelligence, and foresight—at least with its military arsenal, which could blow any adversary to kingdom come. People believed that Francis Fukuyama’s “The End of History” had indeed arrived, for it scarcely seemed possible that there could be any major improvement.

But “it’s a funny old world,” as Maggie Thatcher once remarked. She might have meant “funny” in the sense that it is amusing; more likely, she meant that it is peculiar. In both senses, she was right. What makes the world funny is that it refuses to cooperate; it seldom does what people want or expect it to do. In fact, it often does the exact opposite.

People do not always act as they “should.” Other people seem ‘irrational’ to us—especially those with whom we disagree. Nor do we always follow a logical and reasonable course of action. Instead, we are all swayed by tides of emotion . . . and occasionally swamped by them.

This book was written to underline the point that the world is funnier than you think. And the more you think about it, the funnier it gets. Close inspection reveals the ironies, contradictions, and confusions that make life interesting, but also frustrating. A rational person could do

rational things all day long, but then how boring life would be. Fortunately, real people are only rational about things that do not matter.

People of action despise thinking of any sort, and rightly so, because the more they think, the more their actions are beset by doubts and *arrière-pensées*. The more man thinks, the slower he moves. Thought uncovers the limitations of his plans. Exploring the possibilities, he sees yet more potential outcomes, a greater number of problems . . . and he increasingly recognizes how little he actually knows. If he keeps thinking long and hard enough, he is practically paralyzed . . . a person of action no more.

Will the stock market rise?

“I don’t know,” replies the thinking fund manager.

Can we win the war?

“It depends on what you mean by ‘win,’” answers the thoughtful general.

This book has been written in a spirit of runaway modesty. The more we think, the more we realize how little we know. In fact, it is a good thing that the book came to an end when it did . . . or we would know nothing at all, or less than nothing.

We are, frankly, in far too much awe of the world, and too deeply entertained by it, to think that we can understand it today or foretell tomorrow. Life’s most attractive components—love and money—are far too complex for reliable soothsaying. Still, we can’t resist taking a guess.

We may not know how the world works, but we are immodest enough to think we can know how it does not work. The stock market is not, for example, a simple mechanism like an ATM machine, where you merely tap in the right numbers to get cash out when you need it. Instead, the investment markets—like life itself—are always complicated, often perverse, and occasionally absurd. But that does not mean that they are completely random; though unexpected, life’s surprises may not always be undeserved. Delusions have consequences. And, sooner or later, the reckoning day comes and the bills must be paid.

In this sense, the investment markets are not mechanistic at all, but judgmental. As we will see, they reward virtue and punish sin.

Our approach in this book is a little different from that of the typical economics tome or investment advisory. Instead, it is an exercise in what is known, derisively, as “literary economics.” Although you will find statistics and facts, the metaphors and the principles that we provide are more important. Facts have a way of yielding to nuance like a jury to a

trial lawyer. Under the right influence, they will go along with anything. But the metaphors remain . . . and continue to give useful service long after the facts have changed.

What's more, metaphors help people understand the world and its workings. As Norman Mailer recently put it, "There is much more truth in a metaphor than in a fact." But the trouble with metaphors is that no matter how true they may be when they are fresh and clever, when the multitudes pick them up, they almost immediately become worn out and false. For the whole truth is always complex to the point of being unknowable, even to the world's greatest geniuses.

The world never works the way people think it does. That is not to say that every idea about how the world works is wrong, but that often particular ideas about how it works will prove to be wrong if they are held in common. For only simple ideas can be held by large groups of people. Commonly held ideas are almost always dumbed down until they are practically lies . . . and often dangerous ones. Once vast numbers of people have come to believe the lie, they adjust their own behavior to bring themselves into sync with it, and thereby change the world itself. The world, then, no longer resembles the one that gave rise to the original insight. Soon, a person's situation is so at odds with the world as it really is that a crisis develops, and he or she must seek a new metaphor for explanation and guidance.

Thus, the authors of the present work cannot help but notice an insidious and entertaining dynamic . . . a dialectic of the heart, where greed and fear, confidence and desperation confront each other with the subtle elegance of women mudwrestlers.

In the financial markets, this pattern is well-known and frequently described.

In the late 1990s, those who were sure that stocks would always go up, despite having already reached absurd levels, gave countless explanations for their belief, but the main reason was simply that it was just the way the world worked. But after investors had moved their money into stocks, to take advantage of the insight, few buyers were left and prices had risen so high that neither profits nor growth could support them.

Investors were deeply disappointed in the early 2000s when stocks fell three years in a row. How could this be, they asked themselves? What is going on, they wanted to know?

As we write this book, in the summer of 2003, we still do not know. And even mainstream economists find it difficult to come up with an

answer. Paul Samuelson, popularizer of the economic profession for *Newsweek*, has admitted that he and his colleagues do not even have words to describe this “baffling economy.”

Nor has Alan Greenspan been much help. In the late summer of 2002, the most celebrated economist in the world addressed an audience in Jackson Hole, Wyoming. He explained that he did not know what had gone wrong. He would not know a bubble if it blew up right in front of him; he would have to wait, he told his fellow economists and check the mirror for bruise marks—for only after the event could a bubble be detected.

And what difference would it make anyway? America’s favorite bureaucrat explained that it made none: Even if he had known, he said, he could not have done anything about it.

But we do not write this book to carp or complain. Instead, we offer it in the spirit of constructive criticism, or at least in the spirit of benign mischief. We do not know any better than Alan Greenspan what the future holds. We only guess that we are at one of history’s crisis points—one of its reckoning days—where the metaphors of yesterday no longer seem to describe the way the world works today. The financial markets are not the congenial ATM machines of investors’ fantasies, after all. Nor is the political world as safe and as comfortable as people had come to believe.

That is another aspect of our book that readers may find unusual. We dip into military history and market history as if passing from a hot-tub to a pool. Both illustrate the lively influence of group dynamics; the currents of mass sentiment are similar. Readers will note, however, that political episodes tend to have tragic endings . . . whereas markets typically end in farce.

Readers may also be curious as to our focus on European history. We make no excuses or apologies for it. Our office in Paris is surrounded by reminders of Europe’s past. Can we not help but learn from it?

Finally, we have not included the typical formulas or recommendations of an investment book, nor the detailed expositions of a book on economics. Instead, we offer only a few simple ideas—including our Trade of the Decade—that readers may well find helpful in the years ahead.

Readers who wish to keep up with the progress of the Trade of the Decade or get our most recent commentary, are invited to visit us at [www.dailyreckoning.com](http://www.dailyreckoning.com) and sign up.



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## The Gilded Age

*The real trouble with this world of ours is not that it is an unreasonable world, nor even that it is a reasonable one. The commonest kind of trouble is that it is nearly reasonable, but not quite. Life is not an illogicality; yet it is a trap for logicians. It looks just a little more mathematical and regular than it is; its exactitude is obvious, but its inexactitude is hidden; its wildness lies in wait.*

—G. K. Chesterton

Sometime in the late 1990s, Gary Winnick—chairman of the then \$47 billion enterprise, Global Crossing (GC)—did something unusual. He decided to take time off from touring art galleries with David Rockefeller, playing golf with Bill Clinton, and enjoying the Malibu beach to learn a little about the business he was in: He bought a video describing how undersea cable was laid. The video was all Winnick needed to know about laying cable. For he understood what business he was really in, and it had nothing to do with ships or optic fiber. Winnick was doing nature’s work: separating fools from their money. And he was good at it.

Supposedly, Winnick knew the undersea cable business well. Likewise, the people from whom he raised money were the “best pros” on Wall Street and were supposed to be capable of managing big bucks. After all, if they did not know how to place money to get a decent return, what did they know? And those who provided these “best pros” with money were

also supposed to know what they were doing. As it turned out, no one had a clue.

One of the great marvels of life is not that fools and their money are soon parted, but that they ever get together in the first place. Life goes on, we note, for no particular reason other than the vanity of it all. One lie replaces another like cars along a Paris street (where a parking spot rarely remains vacant for long).

Not only does life imitate art, but it slavishly tries to model itself on science, too. In the course of the 20th century, a simple idea had become stuck in investors' minds. Everything worked like a machine, they thought, especially the economy. If the economy was growing too fast, Alan Greenspan would "put on the brakes" by raising interest rates. If it was growing too slowly, he would "open up the throttle" by lowering interest rates. It was so simple. The mechanical image seemed to describe perfectly how the Fed worked. There was no experience in the last two decades to contradict it. It had worked so well for so long: It was almost as if it were true.

In his book, *A Random Walk Down Wall Street*, Burton Malkiel popularized the *efficient market hypothesis*, claiming that stock prices moved in a random fashion. The best you can do, he proposed, was to buy the indexes and stay in the market. Over time, the market goes up . . . and you get rich. According to this view, the market is a benign, mechanistic instrument that merely distributes wealth evenly to those who participate: As long as you are "in the market," all the riches of capitalism will flow in your direction.

The trouble is that the market may look mechanistic, but it is not. The market is an unbounded, organic system; mastering it is a human science, not a hard science. The financial markets reflect the activity of the human economy; they are unbounded chaotic systems. The best metaphor for understanding such a system is the nature of which they are a part—infinitely complex and ultimately uncontrollable. Markets are neither kind nor forgiving. If markets do the work of God, as has been suggested, it is the God of the Old Testament, not the New.

But in the late 1990s, we lived in a wonderful world. It was rich and lush . . . the sun shone every day. Progress seemed inevitable and unstoppable, and compiling information in digital form was thought to hold the secret to an ever-increasing abundance of resources for mankind. It seemed so simple: Computers and telecommunications would provide people with increasing amounts of information, and this in turn would allow goods to be produced faster and at lower costs. Humans, hitherto

Neanderthals in a low cave hunched in ignorance and darkness, would now be able to stand upright and edge a little closer to perfection every day. There was no chance that they would slip up, as they had always done in the past, we were told, for this was a more fully evolved species, better adapted to the Information Age. This really was a “New Era,” we were assured.

At the dawn of the 21st century, a half-century of progress and a 25-year-long bull market had created a race of geniuses. Americans were on top of the world. Their armies were unbeatable. Their currency was accepted everywhere as though it had real value. Dollars were the United States’ most successful export, with a net outflow of nearly \$1.5 billion per day. And dollars were the product on which the nation enjoyed its biggest profit margin. It cost less than a cent to produce one, and each one was valued at par.

But America’s greatest strength was its economy. It was not only the strongest in the world, but the strongest the world had ever seen. The United States had increased its economic lead over the competition in the 10 years running up to the end of the century. In the minds of many, the U.S. economy was unstoppable, and its continued success inevitable. They believed that the nation’s leadership position was not merely cyclical, but eternal. It had achieved a state so nearly perfect that improvement was hardly imaginable. American music, art, films, democracy, and American-style market capitalism were everywhere triumphant.

“America is the world’s only surviving model of human progress,” President George W. Bush told the graduating class of West Point in June 2002. America has its faults, wrote Thomas L. Friedman in the *New York Times* at about the same time, but without it, “nothing good happens.”

Oddly, during this golden era of silicon chips and Internet domain names, no one was able to explain why the Information Age never made its way across the Pacific to Japan. No one even bothered to ask the question. But that is one of the comforts of a great boom; question marks disappear. Societies, like markets and individual humans, are infinitely complex. The harder you look, the more you see. When things go well, people are content not to ask questions and not to look too hard. They think they know how the world works and are happy with the jingles and simple metaphors that explain it.

The new information technology, it was claimed, would boost productivity and the growth rate. Few people doubted it. More information would make things better; it seemed as simple as that. For question

marks, like winter clothes after Easter, get packed away during a bull market. Not until a chill autumn wind blows do they come back out.

And at the end of September 2001, the drafts of cold weather were just beginning. The Nasdaq was down 73 percent from its high. The Dow was down 32 percent. A recession had begun in March. Although, at first it was reported to have ended after a single quarter, later revisions showed that it lasted through the end of the year. Investors had no way of knowing, for they had no crystal balls, but they were in for a spell of bad weather. Yet only a few people began rummaging through their cupboards for their coats and mittens.

We humans understand things by analogy. Indeed, since before Noah built his Ark, humans have tried to understand the world by extrapolating from the known to the unknown. Comparison was the only tool they had to explain what they observed. Once upon a time, a bear might have been said to run “as fast as a lion,” for example, or “like a holy hellcat” because it was not possible to time an animal’s running speed precisely. After a period without rain, villagers might have remarked that it “was just like the Great Drought” of a few years earlier. They had no way of knowing what might happen, of course, but the analogy warned them to conserve their food. By comparing one thing we don’t really understand to another we understand only slightly better, we think we understand both. We imagine Alan Greenspan, for example, pulling levers and turning knobs as if the economy really could be run like a machine.

Yet, strangely, in the new world at the close of the 20th century, the analogies from years ago or from across the wide Pacific did not seem to matter. Things were different. Not only did the old rules and old lessons no longer apply, analogies themselves were now out of fashion. The New Era was “digital.” It was widely presumed that nearly all of life would soon be digitized and that mankind would grow better informed, richer, and morally superior every day. That was . . . until the weather changed.

## Gurus of the New Era

**T**he history of the New Era will record that it was Robert Metcalfe and Gordon Moore who, like Moses and Aaron, led their followers out of the bondage of the Old Economy and into the land of stock options and caffe lattes. Metcalfe and Moore handed down the laws by which the people of Silicon Valley in the 1990s lived.

Metcalfe described a well-known phenomenon: Each element of a system or collectivity becomes more valuable as it expands. You can see this

by thinking about the phone system. When the Bell Telephone Company was founded in May 1877, its products were almost useless. Subscribers could not call anyone because no one had a telephone. But three years later, there were 30,000 phones in use.

This led to the further insight that the company could afford to spend a great deal of money selling and installing telephones because it would earn a profit later on. What's more, it was critical that people purchased Bell telephones rather than a competitor's. Ultimately, the most valuable, and presumably the most profitable, service would be the one that was most ubiquitous.

This insight cleared the way for the popular Internet business plan: Do not worry about profits—fight for market share. Few noticed the flaw: The telephone system was a quasi-monopoly. It made sense to pay a lot of money to put it in place, because the company could expect monopoly-level profits for a very long time. Bell Telephone and its derivatives are still in business. But Amazon.com, the Globe.com, Webvan.com, and thousands of other Internet start-ups had no hope of ever getting a monopoly or anything close to it.

Moore, meanwhile, handed down his own law: He stated that computational power would double every 18 months—which, thus far, it had. This growth rate astonished everyone and led to the other major delusion of Internet investors—that just because computer power increases exponentially, so should Internet businesses and stock prices. Moore's law only applies to the speed at which computers process information. Government quants assumed, wrongly, that this was equivalent to an increase in the nation's wealth, as expressed by gross domestic product (GDP). As we'll see later on, this in turn led to distortions in other measures, such as productivity and inflation levels.

If Moore and Metcalfe were the Old Testament prophets of the New Era, George Gilder was its messiah. Every revolution needs its intellectuals, its firebrands, its executioners, and its victims. One-third visionary, one-third fool, one-third incomprehensible—Gilder was all of these things, and more. A speechwriter for Romney, Rockefeller, and Nixon, he authored several well-read books, including *Wealth and Poverty* and *The Spirit of Enterprise*. He was quoted more often by Ronald Reagan, the record shows, than any other writer. His book, *Microcosm*, took him farther than anyone had ever gone into the distant reaches of new technology and the enterprising spirit. Since then, some would say he has drifted a bit too far.

Gilder's articles in *Forbes* ASAP were not merely hard to read; they were incomprehensible. But never mind. He was a genius, and he was

right about a great many things. His reports were followed by many of the shrewdest investors of our time . . . to such an extent that this “pale, nervous Yankee” was seen as a semi-god or “John the Baptist of the Digital Age,” as one article put it. But he had worked himself into such a state of rapture over the possibilities of the Internet that he seemed to have gone a little mad.

One caveat, “I don’t do price,”<sup>1</sup> Gilder commented. Too bad. Because, as investors would discover later, prices are important. A technology may be spectacular; the company that owns it may be a great company; but the stock is only a good investment at the right price.

### ***Star-Crossed***

“Listen to the technology!” Gilder’s Caltech physics professor, Carver Mead, had advised the New Era messiah. Listening carefully, Gilder had believed that, if he strained his ears enough, he could almost hear the cosmos speaking. “Buy Global Crossing!” he thought he had heard.

Gilder did not usually buy, and judging from the press reports, he had little interest in picking stocks. But this Ulysses of the Telecosm had forgotten to plug his ears or have himself lashed to the mast. Thus, the sirens at Global Crossing got him . . . and drove him crazy. Nowhere was this more manifest than in his book, *Telecosm*, in which he announced the emergence of a new economy, “based on a new sphere of cornucopian radiance—reality unmassed and unmasked, leaving only the promethean light.” To this day, we do not know what that sentence was supposed to mean. It was all very well to blather about how Global Crossing helped to bring “a new epoch of spirit and faith” with its “majestic cumulative power, truth, and transcendence of contemporary science and wealth.” But with a profit/earnings (P/E) ratio of negative 130, an investor would have been a fool to bet money on it. Yet even in June 2001, George Gilder continued to praise Global Crossing, qualifying the stock as “no surer bet in the Telecosm.”<sup>2</sup>

Oh, but we forgot—Gilder didn’t “do price.”

### ***Master of the Bandwidth Universe***

Gary Winnick had been a former Drexel Burnham bond trader before he got into the optic-fiber business almost by accident. He had seen the possibilities of bandwidth after financing an undersea cable for AT&T in 1997. His first cable took 14 months to lay, but it was extremely profitable.

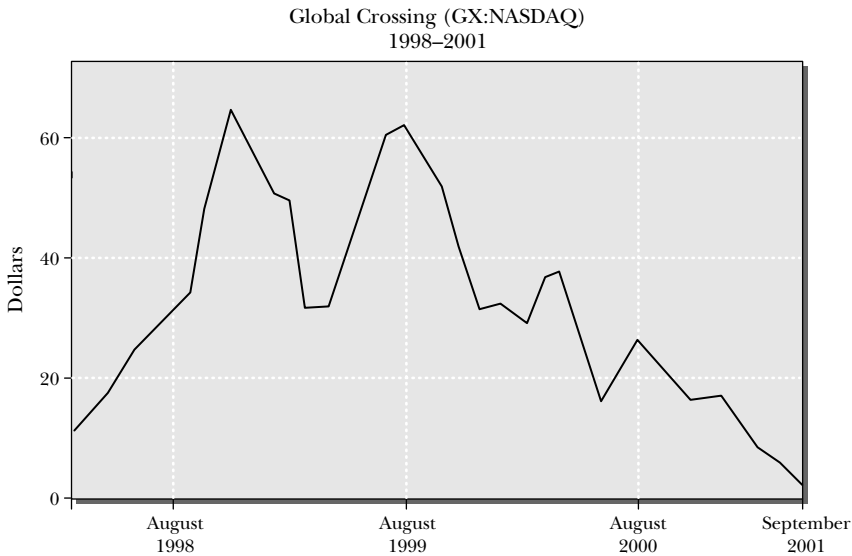
Thus, did the simple business plan for Global Crossing emerge—raise money and lay fiber-optic cable! Early estimates of construction costs were around \$2.7 billion. The money was soon coming into the Hamilton, Bermuda, headquarters of Global Crossing at the speed of light. The stock went public in August 1998 at \$9.50. Eight months later, it hit \$60 a share, giving the company a market capitalization of \$54 billion. Winnick's personal stake in the company rose to \$4.7 billion. He was soon having dreams of building an undersea broadband network that would link continents and serve global carriers like Deutsche Telekom and AT&T.

Three years later, in November 2001, Global Crossing “shocked and angered” investors by reporting a loss of \$3.35 billion, more than six times greater than the loss from the same quarter a year earlier. Included in the loss was a \$2 billion write-down of its stake in another star-crossed company from the Gilded Age, Exodus Communications, then operating under protection of the U.S. Bankruptcy Code. Global Crossing common stock traded at only \$1.24 in mid-November—up from the 38 cents rate of October 9, but down from the \$13.30 level set in June, when George Gilder believed it to be a sure thing. In a year and a half, investors had lost about \$52.9 billion on the stock.

Still Gilder, the New Era hallucinatory, held on. “If you bought Global Crossing in 1998,” he had written just a few months earlier (in June 2001), “you bought one 5,000-mile cable. Today you are buying a 102,000-mile network. If you bought Global Crossing in 1998, you bought \$400 million in revenue. Today, you are buying over \$5 billion in sales and more than a billion dollars in adjusted cash flow, growing at 40 percent a year. If you bought Global Crossing in 1998, you bought into static transatlantic STM-1 sales. Today you are buying an IP backbone with traffic growing at 450 percent a year and 20 percent ownership of Exodus (the Web's key hub for exafloods of content, storage, and services) which almost doubled year-to-year revenues in the March quarter. If you bought Global Crossing in 1998, you bought the dream of a global web of glass and light. Today you are buying that web.”<sup>3</sup>

“If you bought Global Crossing in 1998,” a cynic might have retorted, “you would have lost 98 percent of your money.” (See Figure 1.1 for Global Crossing losses.)

The dream turned out to be a better investment than the web itself. As Global Crossing raised an increasing amount of money and laid ever more cable, it hastened its day of reckoning. Instead of Gilder's “exaflood” of profitable content, the cable companies were soon swamped with excess supply: They were soon so deeply underwater financially that



**Figure 1.1 The New Era's Promethean Light.** Global Crossing was George Gilder's favorite stock. Unfortunately for investors, Gilder did not "do price." Global Crossing declared bankruptcy in January 2002. Founder Gary Winnick banked some \$700 million before resigning as CEO. On resignation, he stated: "I deeply regret that so many good people involved with Global Crossing also suffered significant financial loss."

they had no hope of escape. While Gilder watched the stars of the Telecom, smart industry insiders turned their own eyes earthward and saw the deluge coming.

Thus, in November 2001, investors were not the same warm-hearted, generous naïfs who lent money to Global Crossing and other wunderkinder at the height of the tech boom. After all, lenders had marked Global Crossing's bonds down to a suspicious 18 cents on the dollar. Its secured bank debt traded at 67 cents on the dollar. Preferred shares were priced to yield 177 percent—if they yielded anything at all.

Bandwidth had seemed like a good investment when investors had a lot of money and little bandwidth. But soon, investors had less money and lots of bandwidth to choose from. Prices of bandwidth plummeted. Meanwhile, according to experts, less than 10 percent of fiber-optic cable was used or "lit." And, despite this fiber glut, Global Crossing continued to spend \$500 million every quarter to finance more construction. Adding

more capacity at this stage was akin to a drunken partygoer opening another bottle of wine.

Not surprisingly, on January 28, 2002, Global Crossing declared bankruptcy, leaving lenders with losses of nearly \$4 billion.

More surprisingly, many were those who still believed: A *Fortune* article published June 9, 2002, for example, lamented the collapse claiming that the company had a “decent shot at survival.”

Whose fault was it? Winnick who had had the gumption to ask for the money, or the patsies who had given it to him? They might have ponied up the \$2.7 billion, and maybe Global Crossing would still be in business. Instead, they kept shoving big bills in Winnick’s pockets until he had raised \$20 billion. By the time his company had folded, its long-term debt had swelled to \$7.6 billion (with total liabilities of \$14 billion), and it simply did not have the cash to make its interest payments.

But what happened to the \$20 billion that Winnick had raised? He had spread the money around—acquiring other overpriced telecoms, giving Wall Street a way to earn massive fees by keeping the money coming his way. From 1998 through 2001, the top Wall Street firms earned more than \$13 billion in telecom underwriting and investment-banking fees.

And so both the juice and hokum whirled around. Salomon’s technology analyst, Jack Grubman, talked up the stock. Investors bought it for more than it was worth. Winnick bought other telecoms for more than they were worth. Everybody made money.

But it was an empty vanity. People do not really get rich by spending money on things they do not need and cannot afford, at prices that are too high. All they do is move money around . . . and waste a great deal of it. In the telecom sector alone, far more dark fibers were put down than the world really wanted. And when the end of the bubble finally came, Global Crossing alone had torn a \$54 billion hole in investors’ pockets.

Yet not all that money disappeared. By the time Global Crossing declared bankruptcy, Winnick had sold \$735 million of stock, and received another \$15.8 million in other emoluments. Winnick must have felt pretty smart. He had done what he had set out to do: Winnick and family had pocketed more than \$600 million by cashing in stock during 2000 and 2002, even as Global Crossing struggled with a severe debt load, falling prices, and an industry in upheaval. Winnick also arranged to sell 10 million shares at \$12 in May 2002, a decision wryly qualified by *Forbes* as “good timing” when it saw the company’s shares drop below the 2 cent-level at the end of 2002.

There are some things, as Mae West observed, of which a man can have too much and suffer no harm. But too much money is a clear and present danger to a man . . . or even to an entire economy. Telecom was not the first, nor will it be the last industry to be ruined by an excess of good fortune.

### *Moses Returns*

Michael Malone, editor of *Forbes ASAP* and author of several books on business and the new economy, grew rich in Silicon Valley by accident. He received founders' shares from both Tom Siebel, founder and CEO of Siebel Systems Inc., with whom he co-authored *Virtual Selling*, and Pierre Omidyar, founder of eBay. He had no idea what the shares were worth and was astonished to find himself a wealthy man. But he lacked faith; he sold his shares as soon as he could.

For the new economy bubble did not seem real or right to him. "Most of us know, intuitively, that these young web companies minted by the hour, will not survive and prosper," he wrote. He predicted moreover that, in the "coming reckoning," investors' money would be lost, retirement funds would be erased, and that the valuations ruling the stock market would come back down to earth from their irrational heights.

By the late 1990s, Metcalfe and Moore shared this sentiment. It was as if they had returned to the Valley and found that their tribesmen had turned the Internet Age into an absurd parody. Instead of using the power of the silicon chip and the Internet to launch real businesses and create real wealth, they found investors dancing recklessly around the graven image of enterprise—the initial public offering (IPO).

Metcalfe described himself as hung up on the stock market bubble: "There's stuff going on out there that I just don't get yet," he explained. He considered the bubble "distorted," and expressed concerns that this distortion would eventually "blow up." His writings show a concern for entrepreneurial obsession with IPOs: "I'm frequently asking [entrepreneurs] the question, 'So, what's your company going to be?' The answer these days usually contains the letters I-P-O. That's the wrong phrase to have in the first five sentences explaining what your new business is going to be about. If you're thinking IPO, you've got your eye on the wrong ball . . . These people think that an IPO is a significant event. I view it as a minor financial event. They view it as what life is all about."<sup>4</sup>

Would there be a day of reckoning coming? "The [venture capitalists] get in on the ground floor," Metcalfe continued, "and they get out early.