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In Defense of the Boom

By MICHAEL LEWIS

. Wall Street Didn't Do It

A few weeks ago, on "Moneyline," a guest who didn't fully understand just how much times have changed invoked some corporation's ability to beat Wall Street's forecasts for its quarterly earnings. Before you could say "market manipulation," the program's host, Lou Dobbs, said, "Do you really think anybody's paying attention to that silly expectation stuff anymore?" He dismissed forecasts as "the game of the late 90's." And he had a point. For many years, Wall Street analysts have low-balled their earnings estimates so that their corporate customers could announce to the press that they had "beaten" those estimates. This particular game was exposed beginning in the late 1990's by fledgling Web sites, which routinely published more accurate earnings forecasts than the Wall Street pros. By the middle of 1998 the stock market began to trade off the Web estimates rather than the Street estimates -- which tells you how fully understood this quarterly forecast game had become even before the boom reached its turn-of-the-century heights.

But so long as the stock market rose, Lou Dobbs was happy to listen to Wall Street and corporate big shots blather on about how they had beaten their earnings forecasts. He didn't scorn them; like every other serious reporter, he treated them as useful informants (when he wasn't distracted by his bid to make his Internet fortune in a doomed start-up called Space.com). And yet now, somehow, Lou Dobbs, like every other serious reporter, knows enough to raise his eyebrows and harshen his tone when anyone mentions earnings estimates. As wide-eyed as he was three years ago, he is narrow-eyed now. You can't put one over Lou Dobbs!

And that, in a way, is the point. If you can't put one over on Lou Dobbs, whom can you put one over on?

The markets, having tasted skepticism, are beginning to overdose. The bust likes to think of itself as a radical departure from the boom, but it has in common with it one big thing: a mob mentality. When the markets were rising and everyone was getting rich, it was rare to hear a word against the system -- or the people making lots of money from it. Now that the markets are falling and everyone is feeling poor, or, at any rate, less rich, it is rare to hear a word on behalf of either the system or the rich. The same herd instinct that fueled the boom fuels the bust. And the bust has created market distortions as bizarre -- and

maybe more harmful -- as anything associated with the boom.

The recent wave of outrage about Wall Street's behavior began, you may recall, when New York State Attorney General Eliot Spitzer deployed an obscure state law to shoehorn out of Merrill Lynch every e-mail message Merrill employees had ever sent relating to the Internet boom. It was easy to see why Spitzer chose Merrill Lynch as his target. He has political ambitions (he wants to be governor of New York, at least), and unlike Goldman, Sachs or Morgan Stanley or one of the other big investment banks more central to the Internet bubble, Merrill actually serviced lots of small customers. It's a firm that voters can relate to.

What I didn't understand was Spitzer's hunger for Merrill's old e-mail. If the New York attorney general wanted to prove that the firm's analysts had been wildly optimistic about the Internet, and that their optimism helped the firm's investment bankers attract Internet business, and that there was, therefore, a deep conflict of interest on Wall Street, all he needed was an Internet search engine.

If you go back and read the public record, you can see clearly what people on Wall Street did between April 1995, when Netscape invented the Internet Initial Public Offering, or I.P.O., and the spring of 2000, when Internet stocks crashed. The story was never hidden, because Wall Street never tried to hide it. Indeed, you can pinpoint the very moment when Merrill Lynch signed on to the boom, and in what spirit they joined the party.

Until late in 1998, which was three years or so into the boom, Merrill and its brokers actually fought a rearguard action against Internet stocks. The Internet looked as if it would all but eliminate the commissions investors paid to buy and sell stocks and gut the already weakened core business of Merrill Lynch. The head of Merrill's stockbrokers, John Steffens, actually said that the Internet was "a serious threat to Americans' financial lives." Partly as a result of this self-serving truculence, Merrill had lagged badly behind Goldman, Sachs and Morgan Stanley and the other up-market firms in its ability to rake in fees from Internet stock offerings. At the same time, Merrill Lynch was also -- and this is the key point -- becoming ridiculous to the nearly five million account holders who kept their money at Merrill Lynch. You couldn't be running ads on TV saying you were "bullish on America" and at the same time be telling your customers they should be ignoring or dumping the hottest sector the U.S. stock market had ever seen.

On Dec. 16, 1998, the contradiction finally became too much for Merrill Lynch to bear. On that day, the share price of Amazon.com touched \$242. Merrill Lynch's Internet analyst, Jonathan Cohen, announced that the shares were worth at best \$50 and that it was time to sell. Across town, Henry Blodget, a 32-year-old freelance-magazine-writer-turned-Internet-analyst for an obscure, second-tier firm called CIBC Oppenheimer, was saying that Amazon's stock would reach \$400 a share. Sure enough, Amazon promptly rose to a split-adjusted high of \$678. Cohen was wrong, and Blodget was right, and Merrill Lynch was the laughingstock of the market. And so Merrill fired Cohen, hired Blodget and, in effect, bought into Amazon.com at four hundred bucks a share.

It occurred to no one at the time that Merrill Lynch was conspiring to drive up Internet stocks. They were simply giving their brokerage customers what they wanted. Internet stocks had been rising too fast for too long for Merrill Lynch to be saying anything other than that Internet stocks would continue to rise. Merrill's investment bankers, theretofore incidental victims of their Internet analyst's bearish views, became incidental beneficiaries of the firm's new bullishness. They were quite open about this. They were happy to tell reporters, on the record, precisely what Eliot Spitzer would later claim he had uncovered as he pored over old e-mail. For instance, on April 13, 1999, Scott Ryles, the head of Merrill's technology banking division, explained his new success to Bloomberg News. "It's difficult to take companies public when your analyst has a less-than-constructive view on some of the biggest companies out there," Ryles said. Having Blodget on board was great, he said, because Blodget "has been unabashedly bullish and has been proved right. . . . It's clear the Internet stocks have been some of the best-performing stocks, and retail investors as well as institutional investors want that product."

The old e-mail was unnecessary to expose the absence of fire walls between bankers and analysts on Wall Street. Their overlapping interests were hidden in plain sight. Spitzer's investigation did not expose a clearer picture of the inner workings of Wall Street during the boom. What it did give investors, who had no problem at all with banker-analyst conflicts of interest as stocks soared, were villains to blame after stocks tanked. And Spitzer also used this e-mail to suggest to an angry investing public that he had discovered some previously unknown dark truth: *Henry Blodget hadn't believed a word he had said.*

But to anyone who had followed Henry Blodget in real time, this was obviously not quite right. Go back and read what Blodget said and when he said it. From the start of his astonishing Wall Street career, he had a very specific conviction about the future of the Internet. He thought that Internet companies would displace their real-world counterparts. He saw that businesses with high fixed costs were at extreme peril. He looked at Barnes & Noble, for instance, and saw that it would go out of business if an online competitor stole even 20 percent of its revenues.

Even back when he first expressed these views, in early 1997, they weren't earth-shatteringly original. All sorts of respectable people thought the Internet would transform American commerce much faster than it ultimately did. And in the context of this sensational belief, Blodget behaved almost prudently. Many times he declined opportunities to pump stocks even higher than they were. Many times he cautioned investors against being too optimistic about e-commerce revenue forecasts. Many times he acknowledged that what he did for a living was largely guesswork. Around the time of his name-making, correct prediction that Amazon's stock would rise to \$400 a share, a radio interviewer asked him what he thought of Merrill Lynch's more pessimistic view. "We are all looking into the future," he said. "We all have the same information, and we're just making different conclusions about what the future will hold." But what investor wanted to hear any of this? By the time Henry Blodget went to work for Merrill Lynch, the market was actually running ahead of Henry Blodget. By the end of the boom, he had gone from leading the market to trying to keep pace with it.

The most embarrassing thing about Henry Blodget was not that he was lying but that he was speaking his mind. He actually believed Amazon.com was a good long-term buy at \$400 a share. He actually believed the Internet would be an engine for corporate profits.

No matter. The supply of scandal on Wall Street always rises to meet the demand, and Spitzer found what he was looking for. From the tens of thousands of Merrill Lynch e-mail messages, he culled one of Henry Blodget's written toward the end of 2000, which, when released to the media, did the job he -- Spitzer -- needed it to do. In it Blodget responds to e-mail from a Merrill Lynch banker who wanted him to express greater optimism about some Internet company. He writes:

The more I read of these, the less willing I am to cut companies any slack, regardless of the predictable temper tantrums, threats and/or relationship damage that are likely to follow. If there is no new e-mail forthcoming from [Merrill management] on how the instructions below should be applied to sensitive banking clients/situations, we are going to just start calling the stocks . . . like we see them, no matter what the ancillary business consequences are.

Out of context, during a crash, that sounds pretty damning. It sounds as if Henry Blodget never called a stock as he saw it. But in context, at the end of a boom that has made Henry Blodget a little god, who knows? It's hardly uncommon on Wall Street for analysts to play head games with their firm's bankers and brokers. To me, knowing Blodget's record, it sounds as if the young analyst is simply flexing his muscles. He's saying: if you mess with my turf, I'll mess with yours. It's hard to say. And that's the point: motives in any company, let alone a Wall Street one, are far too messy to be honestly discerned from a handful of carefully selected e-mail messages. The notion that they're more revealing of Blodget's true feelings than the public record is risible.

The Spitzer investigation is a curious exercise. It doesn't clarify history so much as distort it. It portrays the financial losses of countless madly greedy, very knowledgeable speculators as a kind of theft by a handful of people who acted in bad faith. Just enough of the texture of the financial 1990's has been (conveniently) forgotten to allow for this new, bizarre interpretation of the boom. At any rate, to judge from both the newspapers and the court filings, a lot of people have come to believe this story, and it's not hard to see why. It pays. It pays Eliot Spitzer, who gets credit for cleaning up Wall Street -- which neither he nor anyone else will ever do. (Just wait till the next boom.) It pays investors who lost money, along with their ambulance-chasing attorneys, who now have fresh ammo in their lawsuits against Merrill Lynch. And, oddly enough, it pays Merrill Lynch. By forcing Merrill Lynch to agree that its advice was corrupt, Eliot Spitzer helped the firm avoid saying something much more damning and much more true: that its advice on the direction of stock prices is useless. Always. By leading the firm to the conclusion that it had misled the American investor, Spitzer helped it to avoid the much more embarrassing conclusion that the American investor had misled Merrill Lynch.

The whole of the muckraking machinery is designed to facilitate this simple inversion: the culprits of the 1990's, reckless speculators, are being recast as the victims. What the various investigations appear to be doing is cleaning up the markets and making it safe for sober investors. What they are actually doing is warping the immediate past and preserving investors' dignity along with their capacity to behave madly with their money the next time the opportunity presents itself. The rewriters of the boom are able to do this as well as they have because, for both legal and political reasons, all sorts of people who might resist

the distortions are discouraged from speaking out. Certainly no one on Wall Street can defend himself without the risk of incurring legal bills far greater than he already has. Certainly, no public figure of any sort is going to stand up and take the position that the rich guys who have gotten themselves exposed and pawed over by the New York attorney general should be left alone. And so the attorney general, in effect, has the stage to himself.

At this very moment, Merrill Lynch is behaving just as it behaved during the boom: scrambling to get out in front of the mob. It has coughed up the \$100 million it was fined by Eliot Spitzer, has run huge ads apologizing to American investors for its behavior, has publicly humiliated Henry Blodget and has said it will never again promote stocks it doesn't truly believe in. It's a pity Merrill didn't try a bit harder to defend itself. There is a lot to say, if not exactly on behalf of Wall Street, then at least on behalf of the recent boom Wall Street helped to fuel.

II. Silicon Valley Was Not a Bubble

The first good thing to say about the boom is what it did to the value system of the ordinary business schlep. It turned him from a person who complained about the company he worked for to a person who wondered, albeit for one brief moment, if maybe he didn't have his own better idea of how to do things. If he did, he went to Silicon Valley. What distinguished Silicon Valley from every place else on the planet was a) it had lots of start-up capital and b) the people who controlled that capital understood that, if you wanted to win big, you had to be willing to fail. Failure on Wall Street has always been construed as a crime. Failure in the valley was more honestly and bravely understood as the first cousin of success.

It's odd that their quest for justice has led the various regulators and prosecutors to big Wall Street firms. The striking fact about the boom, as it happened, was the insignificance of big Wall Street firms. The big Wall Street firms would never have had the nerve. The people who drove the stock market in the 1990's did not work on Wall Street. They worked as venture capitalists; they created companies. If in 1998 you told a venture capitalist that Henry Blodget -- or any Wall Street analyst -- would ultimately be held responsible for anything, he would have wondered what you had been smoking. You might as well blame the waiter for the size of the restaurant: the Wall Street people were the help. It might have been one of the most delightful aspects of the boom -- the way it inverted the old financial status structure. All sorts of unlikely characters -- seemingly half the population of India, for instance -- now had a shot at fame and fortune.

Enron. WorldCom. Global Crossing. Adelphia Communications. Tyco. Bad things happened inside these places, no doubt about it, but these places were afterthoughts: the boom could have just as easily happened without them. The emblematic character of the boom was not Kenneth Lay or Bernie Ebbers or Dennis Kozlowski. The emblematic character was Jeff Bezos. Bezos was the original big-time Internet entrepreneur. He famously quit his job on Wall Street, threw his chattels in his car and drove across country to Seattle, with a view to transforming the book business. He thought it would take him 10 years. It took him 3, in large part because a Silicon Valley venture capitalist named John Doerr made sure Bezos had the capital to do it.

Three years ago Bezos was a hero and Doerr was the most vocal, eloquent champion of the Internet entrepreneur. By 1999 people in Silicon Valley actually wore campaign buttons that said "Gore and Doerr in 2004." Today Doerr has vanished from the public stage -- "could not be reached for comment," they usually write, of a man who was just a few years ago impossible not to reach. Bezos has become something like an antihero, one of those Internet hypesters who was given a lot more capital than he deserved to create an Internet business that still -- a full eight years later -- has made only very small profits.

Many investors are trying to forget that they ever sank money into Amazon, and why. Various editors are trying to forget that they made Bezos their Person of the Year or their Most Influential Man of the Internet. Anyone on Wall Street who plugged Amazon.com is now a defendant, alongside Bezos and Doerr, in lawsuits brought by small shareholders who lost money on Amazon stock. There's now even a stage play, Off Broadway, called "21 Dog Years," in which a former Amazon employee named Mike Daisey takes full advantage of other people's willingness to believe the stupidest cliches about the Internet boom. "Daisey fears that he lost his soul when he was blinded by talk of stock options and strike prices and started to believe the myth of uncountable riches for all as soon as the options mature," reads an ad for the show. "He wonders if he, too, stopped being about something real." (It is convenient how people seem to discover the need to be "about something real" only after the money dries up.)

There are two things to say about all of this. More than two things, probably, but I'll control myself. The first is: look what Jeff Bezos did. That a Princeton graduate with a bright future on Wall Street would quit his lucrative, prestigious but socially pointless job to create a company -- well, that was a kind of miracle. That his company would actually realize its original ambition: how could that happen? But it did. Nearly \$2.5 billion worth of books a year are now sold over the Internet, and some huge percentage of those are sold by Amazon. And even skeptics understand that those numbers are merely the beginning of a powerful trend. But who in 1996 had ever heard of Amazon.com? It was a silly name on a plaque of a small house in a bad neighborhood in Seattle. The very best a reasonable person might have hoped for in 1996 was that the oddly named Amazon.com would be acquired by Barnes & Noble and then ruined, to prevent Barnes & Noble from having to compete with it. Instead Amazon.com has lowered book prices, made it far easier for readers to buy books and thus increased the chances that an author will make a living. Is that a bad thing? (Nobody suggests that Barnes & Noble is unsound. But whose future would you rather have, Barnes & Noble's or Amazon.com's? Whose name?)

The other thing to say about the excessive ambition of Amazon.com is: was it so completely unreasonable for Jeff Bezos -- or, for that matter, any other Internet entrepreneur -- to behave as he did? It's easy to say so in retrospect but, really, at the time, what should he have done differently? He expanded as fast as he could because a) the market threw capital at him and b) he believed, rightly, that if he didn't he would be swallowed up by the competition. The job of the entrepreneur isn't to act prudently, to err on the side of caution. It's to err on the side of reckless ambition. It is to take the risk that the market allows him to take. What distinguishes a robust market economy like ours from a less robust one like, say, France's, is that it encourages energetic, ambitious people to take a flier -- and that they respond to that encouragement. It encourages nerve, and that is a beautiful thing. As the business writer George Anders puts it, "The personality that allows you to be Jeff Bezos in the first place does not have a shutoff

valve." If it did, Amazon.com wouldn't exist.

On June 3, 2002, Merrill Lynch published its first new, improved research report about the Internet. It was, as you might expect, designed to debunk all of the stuff Merrill Lynch was saying about the Internet two years before. In addition to the usual disclaimers, this one came with a little box on the cover that said, "Investors should assume that Merrill Lynch is seeking or will seek investment banking or other business relationships with the companies in this report." The report, which promised to poke holes "in various Internet myths," focused on the academic work of Dr. Andrew Odlyzko, formerly of AT&T Labs Research and currently the director of the Digital Technology Center at the University of Minnesota. It quoted, derisively, both *Business Week* and the former chairman of the Federal Communications Commission, Reed Hundt, for saying that (in *Business Week*'s words) "Internet traffic is doubling every three months." The problem with all that was said and written about the Internet, according to Dr. Odlyzko, was that "there wasn't any hard data behind it." The doubling of traffic every three months? "In every single instance that I tried to investigate, I always ended up with statements by people from WorldCom's UUNet unit. . . . I did not hear anybody else make authoritative statements that their traffic was growing at this rate. My management at AT&T would often talk about such growth rates, but they were always careful to say Internet traffic, not our Internet traffic."

The point was: all sorts of seemingly reliable sources were assuming that Internet traffic was growing at a rate that amounted to 1,000 percent or more a year, when it was actually growing at somewhere between 70-150 percent a year. (It still is.) This is the assumption that underpinned Amazon's mad expansion, and, for that matter, the entire Internet boom. Many Internet businesses that failed would certainly have succeeded if more customers were online. Internet businesses that succeeded would have done better, more quickly. If Internet usage had grown the way people were saying it was growing, back in 1996, all that unused pipe laid by Global Crossing and WorldCom would look inadequate to meet the demand. If that many more people had come online that quickly, Amazon might indeed have put Barnes & Noble out of business in those first few years.

And so Dr. Odlyzko makes an interesting point. But in doing it he makes another, even more interesting one, albeit without meaning to, that helps to explain the exuberance of the late 1990's. That feeling of fantastic possibility everyone seemed to have by early 1997 wasn't just manufactured out of whole cloth. Between December 1994 and December 1996 Internet traffic had grown at an unthinkable rapid rate. "During those two years," says Dr. Odlyzko, "the annual growth rate was about 1,000 percent per year, doubling about every 100 days. . . . That really was a period of manic growth." It wasn't until the end of 1997 that traffic-growth rates began to slow, and no one noticed.

In short, the financial climate the manic adoption of the Internet had given rise to persisted for several years after the manic growth slowed. In retrospect, this is hardly surprising, as by 1997 all manner of social and financial interests had aligned themselves with the growth rates of the previous two years. And, really, what happened technologically in this country between 1994 and 1996 was a kind of miracle. At the time who could honestly foresee what was going to happen next? Everyone was guessing; and if even Alan Greenspan couldn't exactly figure out what was going on, you and I can be forgiven our lack of prescience. It wasn't a question of whether this technology was going to transform many aspects

of American business. It was only a question of how quickly it was going to do it.

A year or so ago a reporter who covers Silicon Valley for The Wall Street Journal sat in on a new technology company's conference call. Back when success was fashionable, they used to do this a lot, to get the feel of the thing, to write a "color" piece that served as a kind of invitation to investors interested in the I.P.O. The Journal's reporter had given the impression to the company's founders that she was sincerely interested in the company, but only on the condition that one of its investors, Jim Clark, the founder of Silicon Graphics, Netscape and Healthon/WebMD, join the discussion. (Disclosure: My book "The New New Thing" was about Clark.) The reporter was shrewd. Had she called Clark directly, he would have no doubt avoided her. Like everyone else in Silicon Valley, Clark seems to have figured out that the media were happy to hold everyone but themselves accountable for the Internet frenzy, and so the best thing to do in these dark times is to hide in some well-stocked cellar. And sure enough, the minute Clark came on the line, the Journal reporter turned the conversation from the matter at hand into a grilling about Clark's behavior during the 1990's.

Of course, this very same journalist was, just a few years ago, a great fan of Internet companies. Like every other newspaper, The Journal was once interested mainly in fantastic success and added its share of fuel to the Internet boom. Now, like every other newspaper, The Journal is interested mainly in failure. Failure, even in Silicon Valley, is suddenly a form of corruption. And that's a pity. Because the other, earlier attitude actually produced some real, measurable returns.

III. Throwing Out the Boom With the Bath Water

If your measure of social progress is corporate profits, it is easy to take a dim view of the boom. It is more difficult to do so if you step back a bit and survey the bigger economic picture.

An obvious point about stock market downturns always seems to get lost right after one of them occurs. Stock market losses are not losses to society. They are transfers from one person to another. For instance, at the end of 1999, I sank a bunch of money into an Internet company called Exodus Communications. I was a greedy fool to have done it, but I had been to a Merrill Lynch conference (them again!) that featured Exodus Communications, and the story Henry Blodget and a few other people told was so good that I figured that even if Exodus Communications didn't wind up being a big success, enough people would believe in the thing to drive the stock price even higher and allow me to get out with a quick profit. Everyone else was getting rich without working; why not me? I should have sensed that the moment I finally decided Internet stocks were a buy is precisely when they became a sell. Instead, I jumped into Exodus Communications at \$160 a share and watched it run up a few points -- and then collapse.

What happened to my money? It didn't simply vanish. It was pocketed by the person who sold me the shares. The suspects, in order of likelihood: a) some Exodus employee; b) a well-connected mutual fund that got in early at the I.P.O. price ;or c) a day trader who bought it at \$150.

About the trillions that have been shaved off the stock market in the past two and a half years, the more

general question is: from whom did it come and to whom did it go? A coming book, "In the Company of Owners," written by the sociologist Joseph Blasi and the economist Douglas Kruse with the Business Week reporter Aaron Bernstein, ingeniously answers this second question. The professors combed through the record of stock-option sales by ordinary employees of the 100 biggest New Economy-type companies. And they found that, while the executives of these companies made off with great wads of cash, the ordinary employees, as a group, did far better. Through the boom, investors forked over \$78 billion to the regular employees of 100 start-ups. The grunts of the bankrupt Excite@Home, for instance, made off with an estimated \$660 million before their company went under.

The astonishing thing, to the authors, was the egalitarian structure of boom companies. "No other industry," they write, "has ever attempted, much less achieved, the depth, breadth and extent of wealth-sharing found among these firms." Of course, the recriminations of the bust imply that the "wealth sharing" was mainly a giant con game. But to anyone who thinks about it for even a moment, this obviously was not true. The people who worked for these companies, in the main, believed in what they were doing and proved it by holding on to many outstanding shares until the bitter end. Employees of Exodus Communications held some huge numbers of Exodus Communications shares at its moment of doom.

Back in 1984, an economist named Martin Weitzman wrote what should have been a world-changing book called "The Share Economy." In it he described, as a kind of economic utopia, what would come to be the innovative corporate structure of the 1990's. Weitzman pointed out that recessions may be inevitable, but that their most tragic consequence, unemployment, don't have to be. The layoffs that came with recessions occurred because wages tended to be "sticky," i.e., companies couldn't persuade their workers to accept lower wages in bad times. Unable to trim payrolls, companies instead laid off workers.

In bad times, in effect, labor overpriced its services. The solution Weitzman proposed was breathtakingly simple: make some part of what workers are paid a function of the company's fortunes. Give them stock instead of cash. In good times the stock would have more value and be the equivalent of a raise. In bad times the stock would lose value and be the equivalent of a pay cut.

For more than a decade Weitzman's idea was hailed as brilliant by his profession and went ignored by the wider world. Then, in spectacular fashion, it took hold. Suddenly a more rational structure -- in which workers had a stake in their enterprise -- gained popular acceptance. And now, just as suddenly, it is thought to be discredited. Why?

I don't imagine that stock market trauma is ever, in and of itself, a good thing for an economy. But this most recent one was not nearly so bad, economically or even morally, as advertised. The most forward-looking companies in America experimented with a corporate structure based on worker ownership. It made a lot more sense than the old-fashioned corporate structure. People like me who played craps with some hot stock received an expensive lesson about playing craps in the stock market. Our punishment was swift and just. It was the rewards of the boom that seemed, in retrospect, wacky and arbitrary.

But were they? Compare the boom, as many amateur historians now seem to want to do, to the early-17th-century tulip craze in Holland. If speculators drive up the price of tulip bulbs to ridiculous heights, a result is a lot of rotting tulip bulbs. But if speculators drive up the price of tech stocks to ridiculous heights, a result is vast numbers of young people with technical training and a lust for entrepreneurship, a higher social status for the entrepreneur and, uncoincidentally, many interesting business ideas that are at the moment ahead of their time but one day may well be right on it. A result is also, in this case, hundreds of thousands of miles of surplus optical fiber, which is a bit wasteful -- we don't need it yet -- but not a total waste: we will need it one day soon. Another result, finally, is a lot of formerly sleepy big companies that had the living hell scared out of them by upstarts -- and scrambled to make themselves more efficient. Say what you will about the boom: it kept people on their toes.

The massive transfer of greenbacks into the engineering department of American society had some useful side effects. Or, if you want to argue that it hasn't, you have some explaining to do. You need to explain, for instance, the continuing rapid growth of a great many of the companies created during the boom. "From the end of 1999 to the end of 2001," write the authors of "In the Company of Owners," employment in the top 100 boom-era companies climbed 26 percent. That's 177,000 jobs. These companies have real customers and real sales, which have continued to grow after the high-tech bust and the demise of the dot-coms. As of July of this year, just 8 of the 100 have failed. Only 3 more beyond these experienced falling revenues. According to the authors, the rest are growing and have accounted for an increase of \$59 billion in combined sales in the past three full years.

And what is to be made of the robust productivity numbers that began to roll in 1995 and continue to roll in to this day? "Productivity," which is the measure of output per worker hour, is by far the best measure of the health of the economy. It is the closest that economic statistics come to capturing the wealth of the nation. A coming paper written by Prof. William Nordhaus of Yale, to be published by the Brookings Institution, shows that, beginning in 1995, there was a mysterious surge in worker productivity. Mysterious because ultimately no one can say precisely where it or any other surge in productivity comes from, or why. But ultimately, Nordhaus would argue, "it comes from technological change. People find better ways to do the same things."

What were the late 1990's all about if not about using new tools to find new, better ways to do the same things? Indeed one way of viewing this entire financial period is as an attempt by the market to pay people for innovation rather than for profits, on the assumption that innovation, in the long run, would lead inevitably to greater profits.

The disjuncture between corporate profits and economic productivity suggests a couple of intriguing questions. The first is: Are corporate profits overrated? Not long ago Professor Nordhaus (who is, I should say, more of a New Economy agnostic than an apologist) asked a similar question: Do industries with high rates of productivity growth also enjoy high rates of growth in corporate profits? No. Just the opposite. That is, the industries of the future, the fast-growing ones, the ones in which people are most rapidly becoming more productive, are among the least profitable. American economic life tends always to conform to the interests of investors, but that doesn't mean that it always should. The Internet-Telecom boom is one of many examples of an extremely useful technology bursting upon the scene that failed to

make corporate profits. There are huge, immeasurable social and economic benefits to improving the speed and availability of information; and yet companies have had, to put it mildly, some trouble making money by speeding up information or making it more widely available.

But the same charge might be made against a lot of other new technologies, starting with, say, the airplane. Warren Buffett, who got himself badly singed by US Airways stock, is fond of introducing air travel as an example of a technology that has regularly failed to make investors a penny. But what's bad for Warren Buffett isn't bad for America. We're not better off economically without air travel. Investors are simply better off steering clear of companies that sell it. The sad truth, for investors, seems to be that most of the benefits of new technologies are passed right through to consumers free of charge. (Microsoft, thanks to its monopoly powers, is the main exception.)

For this reason, sane, cautious investors like Warren Buffett make a point of avoiding high technology investments. For this reason, too, a sane, rational stock market channels less than the socially optimal amounts of capital into innovation. Good new technologies are a bit like good new roads: their social benefits far exceed what any one person or company can get paid for creating them. Even the laissez-faire wing of the economics professions has long agreed that government might profitably subsidize innovation by, for instance, financing university engineering departments. Government has obviously done this, albeit in a haphazard fashion. Still, there remains a huge gap between the optimum investment in technical progress and the amount we usually invest to achieve it. In this respect, the late 1990's were an exception.

That suggests another interesting question. Not: Were the late 1990's a great disaster for the U.S. economy? But: As a social policy, might we try to recreate the late 1990's?

IV. The Old Old Thing Is Back

A few months ago there was a vivid illustration of the price we pay, not for the boom, but for the irrational reaction against it. It had to do with a money manager named Bill Gross. For the past 30 years Gross has run a very conservative bond fund in Southern California called Pimco; more recently he has also written a monthly online investment column. The column is an outlet for Gross's literary ambition. His articles are nicely written and fun to read. They were also generally ignored, until recently. That changed when a) Pimco, the closest place in the financial markets to that space beneath your mattress, swelled from \$230 billion in assets to \$301 billion and replaced Fidelity's Magellan Fund as the world's biggest mutual fund, and b) Gross decided he wanted to write about the integrity of American commerce.

Casting about for material for his March column, his eye fell upon an item in the "Credit Markets" column buried in the back of Section 3 of The Wall Street Journal. A woman at GE Capital was quoted saying that G.E. had decided to sell \$11 billion in bonds because "absolute yield levels are at historic lows . . . so we think now is the right time to be doing an offering like this." That struck Gross as an outrageous lie.

Now at this point in the story any ordinary person might wonder, "He got upset by that?" Yes, he did. "Historic lows?" Gross thundered in his column. Then he proceeded to talk bond talk. "Maybe three

months and 100 basis points ago, but not now, I'm afraid." He then went on to explain to his readers what G.E. was actually doing: shoring up its balance sheet on the sly. During the boom G.E. had taken advantage of low short-term interest rates and investor lassitude to borrow a lot of money short term, and less money long term. It was like the owner of a house who had opted for the 30-day floating-rate instead of the 30-year fixed-rate mortgage: it was exposed to rising interest rates. At any moment, investors might change their minds about the company and cease to lend it money; if they weren't going to do it on their own, Gross was going to help them. "GE Capital," wrote Gross, "has been allowed to accumulate \$50 billion of unbacked commercial paper" -- short-term loans -- "because of the lack of market discipline. By issuing \$11 billion in debt, G.E. was sensing its vulnerability." Gross concluded by charging G.E. with dishonesty, and saying that "Pimco will own no G.E. commercial paper in the foreseeable future."

A few hours after Gross hit "send" and posted his column, G.E.'s stock began what would be a quick 10 percent drop, G.E.'s financial officers were on the phone to Gross making hysterical sounds and reporters on G.E.-owned CNBC were accusing Gross of talking down G.E. bonds so that he might snap them up cheaply for himself. By the time Gross finished explaining himself in late April, G.E. had lost a quarter of its market value, and the company was holding hastily thrown together conference calls to reassure investors. In the end, G.E. announced that it would restructure its operations. Gross had written his thousand words or so to slake his literary vanity and chosen, pretty much arbitrarily, G.E. for his material. He himself could not quite believe how much trouble he was able to cause. "My point was a general one about corporate honesty," he says, more than a little sheepishly, "and I wound up hitting G.E. And I really didn't give a darn about G.E."

It's hard not to take pleasure in the misfortune of others, especially when those others are rich and powerful. Who does not squeal with delight when he sees yet another article about Jack Welch's divorce? But still: this is absurd. The country's biggest company, sensing its balance sheet is out of whack, goes and tries to do something about it and, for its troubles, gets swatted around by a bond guy in need of material for his column.

At any rate, when a bond guy can terrorize G.E., it isn't G.E. who suffers. Not really. Raise the cost of capital to G.E., and G.E. can live with it. G.E. doesn't like it, but G.E. can live with it. The person who really suffers from terror in the financial markets is the person who needs capital and who is on the brink of not getting it. The capital markets are a game of crack the whip: the gentle curve experienced by the big guy at the front is felt by the little guy in the rear as a back-snapping hairpin turn. When G.E. can be terrorized by a single mutual fund is when the venture capitalists of Silicon Valley start giving back the \$100 billion of capital to its original owners, rather than invest it in start-ups.

That's the odd thing about the present moment: it is widely understood as a populist uprising against business elites. It's closer to an elitist uprising against popular capitalism. It's a backlash against the excessive opportunity afforded the masses. (No more free capital!)

The big issue in capitalism is who gets capital, and on what terms. And when the little guy does not get

capital, the big guy usually benefits. Look around. Who is winning the bust? The old guard. Corporate authority of the ancient, hoary kind, bond traders, leveraged-buyout firms, regulated utilities. There's no more talk of the need to break up Microsoft. Instead there's new talk about letting AT&T get back together again. Even the big Wall Street firms, beleaguered as they might seem, have probably actually improved their positions relative to online brokers.

V. The Virtues of Vice

There's plenty to criticize about American financial life, but the problems are less with rule-breaking than with the game itself. Even in the most fastidious of times it is boorishly single-minded. It elevates the desire to make money over other, nobler desires. It's more than a little nuts for a man who has a billion dollars to devote his life to making another billion, but that's what some of our most exalted citizens do, over and over again. That's who we are; that's how we seem to like to spend our time. Americans are incapable of hating the rich; certainly they will always prefer them to the poor. The boom and everything that went with it -- the hype, the hope, the mad scramble for a piece of the action, the ever escalating definition of "rich," the grotesque ratcheting up of executive pay -- is much closer to our hearts than the bust and everything that goes with it. People who view us from a distance understand this. That's why when they want to attack us, they blow up the World Trade Center and not the Securities and Exchange Commission. Why don't we understand this about ourselves?

It is deplorable that some executives fiddled their books and stole from their companies. But their behavior was, in the grand scheme of things, trivial. Less than trivial: expected. A boom without crooks is like a dog without fleas. It doesn't happen. Why is that? Why do periods of great prosperity always wind up being periods of great scandal? It's not that it happens occasionally. It happens every time. The railroad boom makes the Internet boom look clean. The Wall Street boom of the 1980's, the conglomerate boom of the 1960's, when they came to an end, had their evil villains and were followed by regulatory zeal that appears to have had exactly zero effect the next time the stock market went up.

Is it possible that scandal is somehow an essential ingredient in capitalism? That a healthy free-market economy must tempt a certain number of people to behave corruptly, and that a certain number of these will do so? That the crooks are not a sign that something is rotten but that something is working more or less as it was meant to work? After all, a market economy is premised on a system of incentives designed to encourage an ignoble human trait: self-interest. Is it all that shocking that, when this system undergoes an exciting positive transformation, self-interest spins out of control?

Of course, it is good that the crooks are rounded up. We can all move on feeling as if justice was done, and perhaps the next time around fewer people will succumb to temptation. But in the meantime it's worth asking: how did the crooks get away with it in the first place? Where were the bold regulators and the fire-breathing journalists five years ago, when it actually would have been a little brave, possibly even a little useful, to inveigh against the excesses of the boom? Where in the stock market of five years ago was Eliot Spitzer? (Fully invested with Jim Cramer, who wrote the book about how to use the media to juice one's own portfolio.) Where was the press? Egging on the very people they now seek to humiliate. The very people who are now baying so loudly for blood were in most cases creating the climate that rewarded corrupt practices.

Around the time the Enron scandal broke last October, there was a good example of just how effortlessly the celebration of the 1990's became the retribution of the 2000's. As gleefully reported by Forbes magazine, Fortune magazine was about to go to press with a cover article for its Nov. 26 issue about the post-9/11 economy in which "the smartest people we know" were consulted. As it happened, one of those people was Kenneth Lay, the chairman and chief executive of Enron Corporation. The issue was laid out, with Lay's picture right there on the cover when the Enron scandal broke. You might think that would pose a big problem for Fortune magazine, but if it did, the magazine didn't show it. Using a nifty 1990's piece of photo-editing software, the editors were able to erase Ken Lay. Fortune published on schedule and, ignoring all the flattery it had lavished on Enron over the past few years, piled right onto the scandal. It took only a few months before two of Fortune's writers had sold their Enron book for \$1.4 million.

Good for them, I say. We all have to earn a living. But the next time some editor, or regulator, or politician seeking re-election, begins to shriek about the iniquities of the boom, someone needs to turn to him and ask: where were you when it was happening? And if the answer happens to be, "Making the boom work for me," the best thing you can do is forgive him for it. Really, it wasn't such a bad way to spend your time.

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