

## CHAPTER 1

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# THE OLD “NEW ECONOMY”

When we began to tell this story, we were writing on an old Compaq laptop with a cracked screen and a faulty battery the size of your forearm. Our internet was “dial-up” and totally unreliable. We were living and working in Paris, France. The entire country only had one T1 line. Our email address was @compuserve.com. Some readers may not even know what a compuserve is.

Our story was intertwined with Gary Winnick, chairman of the then \$47 billion enterprise Global Crossing, which was engaged in laying fiber-optic cable across the Atlantic Ocean from the East Coast to Europe. Nobody knows him anymore. His story is important, however, to the problems presented in this book.

At the time, Winnick 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 fiber-optic cable. 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.

We tell the forgotten story of Global Crossing now as a cautionary tale; a look inside the minds and motives of the chief executive officers (CEOs), traders, and analysts of the first great boom and bust of the twenty-first century. There are, of course—and will always be!—others.

Let us set the stage of the turn of the "New Era," a couple of decades ago. There are so many parallels in our current market to the "dot com bubble," it feels almost foolish to be writing about the same subject. At the same time, we dove back into history then, in the original manuscripts. And we will do it again now, to provide perspective and depth to what has amounted to a whole lot of confusion in the markets.

## THE END OF HISTORY

It was in 1806 that Wilhelm Friedrich Hegel first proclaimed history to be at an end. He saw in Napoleon's defeat of Prussia at the battle of Jena the same victory Fukuyama thought he saw in the summer of 1989—the triumph of the ideals of the French Revolution. Mass participation in government, both Hegel and Fukuyama believed, brought permanent peace and prosperity. History must be over.

But history did not end in 1806 . . . (nor in 1989). Instead, in 1806, "history" in the sense that we know it today had barely begun. Never before were so many people caught up in the collective exercises that fascinate historians. As the nineteenth century developed, more and more people—by fits and starts—became involved in

politics through the growth of democratic assemblies and parliaments. This democratization of the Western world threw no obstacle in history's path. To the contrary, it cleared the way and paved the road for the most historical century in mankind's experience. It was in the twentieth century that the world became saturated with politics, democracy, and, not coincidentally, war.

For the first time, armies of citizen soldiers were available to almost all European powers . . . along with the full resources of thoroughly collectivized societies. Thanks to modern communications—railroads, telegraphs, telephone, newspaper, television—the mobs, which had heretofore been limited by the range of voice and rumor, spanned time zones. As we have already seen, whole nations became engaged in mob sentiments and took up adventures that even the lowest village idiot might have previously regarded as hopeless.

Fukuyama was as wrong about economics and democracy as he was about history. The popular view—which he took up—was that the demise of communism signaled the total defeat of Marx's ideas.

"The century that began full of self-confidence in the ultimate triumph of Western liberal democracy seems at its close to be returning full circle to where it started," he wrote, "not to an 'end of ideology,' or a convergence between capitalism and socialism, as earlier predicted, but to an unabashed victory of economic and political liberalism." National socialism was destroyed in World War II, he pointed out. The Union of Soviet Socialist Republics fell apart in the late 1980s.

## RAGING BULL

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).

Over the course of the twentieth century, and trudging on and into the first two decades of the twenty-first, a simple idea stuck in investors' minds: everything worked like a machine, especially the economy.

If the economy was growing too fast, Chairman of the Federal Reserve Alan Greenspan would “put on the brakes” by raising interest rates. If the economy was growing too slowly, he would “open up the throttle” by lowering interest rates. The idea was so simple, almost anyone could understand it. The mechanical metaphor seemed to describe perfectly how the Fed—and the economy as a whole—worked. There were no experiences in the prior two decades to contradict it. The metaphor had worked so well for so long: it was almost as if it were true.

The trouble is, 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 order of things; they are unbounded, chaotic systems.

The best metaphor for understanding such a system is the nature of which they are a part—infinately complex and ultimately uncontrollable. Markets are neither kind nor forgiving. If they do the work of God, as has been suggested, it is the unforgiving Him of the Old Testament, not the New.

But by the turn of the twenty-first century, 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. A massive increase in productivity would lead to more prosperity and leisure time for everyone.

It seemed so simple: computers and telecommunications would provide people with increasing amounts of “information.” Information in turn would allow goods to be produced faster and at lower costs. The whole system would benefit.

Humans, once Neanderthals in a low cave hunched over in darkness and ignorance, 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 is a “New Era,” we were assured.

By the year 2000, fifty years of progress and a 3-decade-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 and remain<sup>1</sup> the United States’ most successful export, with a net outflow of nearly \$3.5 trillion in 2022, up from \$1 trillion in 2000. Dollars are the product on which the nation enjoys its biggest profit margin. It costs less than a cent to produce a dollar. Yet, each one is valued at par.

America’s perceived greatest strength at the beginning of the New Era was its economy. It was not only the strongest in the world, but the strongest the modern 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 US 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 boasted to 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,” he continued, “nothing good happens.”

No one even bothered to ask any questions. You’ll find that is one of the comforts of a great boom; question marks disappear.

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 jingoisms and dumbed down metaphors that explain it.

And at the end of September 2001, ominous drafts of cold weather came in like a front. Sifting through the debris of the dot .com bust, we find the Nasdaq down 73% from its high. The Dow had dropped 32%. A recession had begun in March. And America lost 2,996 innocent lives to an act of terrorism.

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 ugliness.

Yet only a few people began rummaging through their cupboards for their coats and mittens. Such was the climate when we began following the booms and busts of the modern era.

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.

Back then, we imagined Alan Greenspan, for example, pulling levers and turning knobs as if the economy really could be run like a machine. The metaphor is the easiest way for the financial scrivener to get his point across.

Yet, curiously, in the early years of the New Era, the metaphors 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 and metaphors themselves were now out of fashion.

This was the New Era indeed. But it was so much more than just “digital.” It was deeply human. Deeply emotional. Deeply flawed and cumbersome and confusing. At the dawn of the new millennia, the people of the world were optimistic, truly believing that nearly all of life would soon be digitized and that mankind would grow better informed, richer, and morally superior every day. Its wildness lied in wait.<sup>2</sup>

## GURUS OF THE NEW MILLENIUM

The history of the New Era will read that Robert Metcalfe and Gordon Moore, like Moses and Aaron, led their followers out of the

bondage of the Old Economy and into the land of stock options and mocha lattes. Who wouldn't want to follow?

We know Robert Metcalfe now for inventing “ethernet.” Gordon Moore gave his name to “Moore's Law”—that immutable fact about the proliferation of computing technology in the 1970s and 1980s.<sup>3</sup> Metcalfe and Moore handed down the laws by which the people of Silicon Valley lived by so fruitfully in the 1990s.

For his part, Metcalfe envisioned an easy-to-understand 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 because subscribers could not call anyone who did not also have a telephone. But 3 years later, there were 30,000 phones in use. And everyone wanted one.

This led to the further insight by Bell that his 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 New Era insight cleared the way for a new and popular business plan: do not worry about profits—fight for market share.

At the time, 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 many of its derivatives are still in business; we know them by their new name, AT&T.

In the early 2000s there were thousands and thousands of internet start-ups that had no hope of getting a monopoly—or anything close to it.

Globe.com, launched by the *Boston Globe* never reached anywhere near the market share promised by first mover status. Soon every publisher of any genre had a website. Webvan.com went the way of the dodo bird. One barely remembers their business model. Most readers probably don't even remember these companies. Amazon.com, however, proved to be the “unicorn”—a company that succeeds despite insurmountable odds.

During the more heady days of the tech boom, Moore 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 see later on, this in turn led to distortions in other measures, such as productivity and inflation levels.

## JOHN THE BAPTIST OF THE DIGITAL AGE

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.

A speechwriter for Romney, Rockefeller, and Nixon, Gilder authored several well-read books, including *Wealth and Poverty* and *Life After Television*. He was quoted more often by Ronald Reagan, the record shows, than any other writer. His book, *Microcosm*, took him further than anyone had ever gone into the distant reaches of new technology and the enterprising spirit.

Gilder's articles in *Forbes ASAP* were hard to read, and often 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 the time. . . to such an extent that this "pale, nervous Yankee" was seen as a demigod 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 important caveat: "I don't do price," Gilder commented. Too bad, the hubris of man. As investors would discover later, price is important. A novel 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.

"Listen to the technology!" Gilder's Caltech physics professor, Carver Mead, had advised the New Era messiah. Listening carefully, Gilder 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 Telecom had forgotten to plug his ears or have himself lashed to the mast. Thus, the sirens at Global Crossing got him. . . and drove him mad with euphoria. 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 gush about how Global Crossing helped to bring about "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 in June 2001, George Gilder continued to praise Global Crossing, qualifying the stock as "no surer bet in the Telecom." Remember, Gilder didn't "do price."<sup>4</sup>

## "NO SURER BET" IN THE TELECOSM

Our friend Gary Winnick had been a former Drexel Burnham bond trader before he got into the fiber-optic business almost by accident.

He had seen the possibilities of bandwidth after financing an under-sea cable for AT&T in 1997. His first cable took 14 months to lay; it was extremely profitable. Thus the business plan for Global Crossing emerged: raise money and lay fiber-optic cable! Simple enough.

Early estimates of construction costs were around \$2.7 billion. The money was soon coming into Global Crossing's Bermuda headquarters at the speed of light (pun intended). 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 dreaming of

building an undersea broadband network that would link continents and serve global carriers like Deutsche Telekom and Bell's legendary AT&T.

Just 3 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 of the new economy, Exodus Communications, then operating under protection of the US 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.

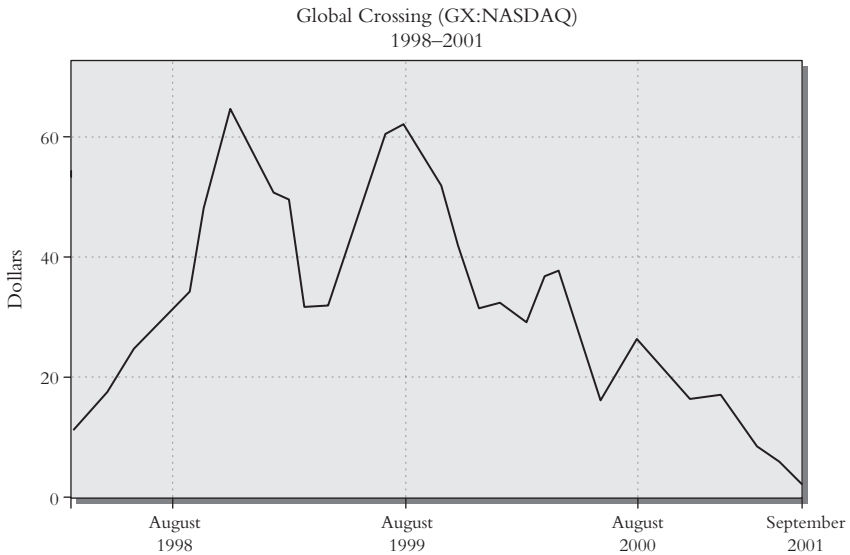
Still Gilder held on. "If you bought Global Crossing in 1998," he had written just a few months earlier (in June 2001), "you bought one 5,000-mile cable. Today you are buying a 102,000-mile network." He continued in reverence:

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% a year. If you bought Global Crossing in 1998, you bought into static transatlantic STM1 sales. Today you are buying an IP backbone with traffic growing at 450% a year and 20% 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>5</sup>

"If you bought Global Crossing in 1998," a cynic—like us—might have retorted, "you would have lost 98% of your money." (See Figure 1.1.)

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.

With Gilder's "exaflood" of profitable content, the cable companies were soon swamped with excess supply, and they were so deeply underwater financially that they had no hope of escape.



**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.”

While Gilder watched the stars of the Telecosm, 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%—if they yielded anything at all.

“Bandwidth”—that great promise of Metcalfe and Moore—had seemed like a good investment . . . when investors had a lot of money and little bandwidth. But soon, investors had less money and more bandwidth to choose from. Global Crossing was, as they say, “in a pickle.”

Prices of bandwidth plummeted because of their availability. Meanwhile, according to experts, less than 10% 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.

Not surprisingly, on January 28, 2002, Global Crossing declared bankruptcy, leaving lenders with losses of nearly \$4 billion. Adding more capacity at this stage was akin to a drunken partygoer opening another bottle of wine.

More surprisingly, many still believed. A *Fortune* article published June 9, 2002, for example, lamented the collapse of Global Crossing, claiming the company had a “decent shot at survival.”

So 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; maybe then 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.

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. Gilder talked up the stock. Investors bought it for more than it was worth. Winnick continued to buy other telecoms for more than they were worth. Everybody made money. But it was a vanity. People do not 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 time.

At the time, and in the telecom sector alone, far more dark fibers were put down than the world really wanted. And when the bust finally came, Global Crossing alone had torn a \$54 billion hole in investors’ pockets.

By the time Global Crossing declared bankruptcy, Winnick had sold \$735 million of stock and received another \$15.8 million in other emoluments. He 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. He had 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.

“As of 2015,” our quick search of Wikipedia reports, “Winnick was chairman and chief executive officer of Winnick & Company, a Los Angeles-based private investment firm founded in 1985. In 1999, Winnick was listed by the *Los Angeles Business Journal* as the wealthiest Angeleno with a net worth of more than \$6 billion; as of 2002 his net worth was listed at \$550 million.”<sup>6</sup>

There are some things, as Mae West observed, of which a man can have too much and suffer no harm. But too much money can be a clear and present danger to a man . . . or even to an entire economy. Telecom in the early 2000s was not the first, nor will it be the last industry to be ruined by an excess of good fortune.

“Most of us know, intuitively, that these young web companies minted by the hour will not survive and prosper,” Michael Malone, then editor of *Forbes ASAP* and author of several books on business and the new economy, wrote. It seems obvious a couple decades and a few financial panics later, but what Malone was writing, especially for a leading tech publication, was blasphemous at the time. The “new economy” bubble did not seem real or right to him.

Malone had even received founders’ shares from both Tom Siebel, founder and CEO of Siebel Systems Inc., with whom he coauthored *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.

Malone 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. We remember getting hate (e)mail at the time for having expressed our own skepticism.

In hindsight we know 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): gain money before the company actually does anything.

Metcalfé 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>7</sup>

Would there be a day of reckoning coming?

“The [venture capitalists] get in on the ground floor,” Metcalfé continued, “and they get out early. [But] these poor schmucks in the public markets. . . They are going to start looking for profits and they’re not going to find them. It’s all going to come crashing down.”<sup>8</sup>

According to the popular thinking of the time, Malone, Metcalfé, and Moore had become out of touch.

Reading our words about these events today—the New Era! Unicorns! The world connected!—we are left with a strange feeling, like craving a baguette with brie and some *jambon* while motivating through the dusty dirt roads of Phoenix, Arizona. That is, nostalgia for a life that was and could be but is not. As they say, *C’est la vie*.