

Key Findings

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Economics, the Tech Industry, and the Election

Forget for a moment your opinions of the presidential candidates, your views on the war, taxes or social issues. Which party's policies are likely to result in better times in the technology sector? The last technology run up might offer some clues.

The big technology bubble was driven at least in part by an enormous amount of venture capital injected into young companies — some with good ideas, some with barely a business plan. But where did that money come from and why was it so available for such risky investments?

It's an old truism that money goes where it is treated best and depending on the times good treatment is generally understood to mean either safety of the principal — in bad times — or high potential return on investment when conditions are better. In rocky times money seeks safety in good times it courts risk in order to capture high returns.

The early 1990s were rocky times in which capital sought safety but as the decade proceeded, good times returned and money flowed into riskier investments bent on capturing big gains.

Low inflation, low interest rates

The late 1990's were a time of low inflation and lower borrowing by the federal government due to the surpluses that were generated in the later part of the Clinton administration. Lower borrowing in the form of reduced issuance of government bonds led to lowering interest rates because demand for money slackened. The spread between interest rates and the inflation rate — the real return on a bond investment — meant investors in bonds and other bond denominated investments like bank CDs were not being treated very well. That spread, combined with an improving economic outlook, and the reduced number of safe investments helped encourage risk taking which further improved the economy.

Also, while interest rates and inflation were low, the top tax rates were a bit higher (around 39.5% in 1999 vs. 35% today) meaning that individuals with swelling incomes found themselves in positions where they could sit on their safe returns and pay higher taxes or find riskier investments — such as venture funds — for some of their assets that would either pay off with higher returns or in the worst case the investment might be lost. But in the case of a loss in a high risk investment of marginal income the practical effect for the individual would be the same as paying the money to the government as taxes. In other

words, there was little downside risk in the choice of either paying the taxes or taking on the risk of making a high return. As they say, it was a nice problem to have.

Macro effect

Of course the effect on the broader economy was a bit different. All that money looking for an investment home spurred company creation and job growth especially in the tech sector but also in allied fields from PR and advertising agencies, to print shops, to trendy restaurants. In total more than 20 million jobs were created. The term “Internet millionaire” gained currency and foreign sports cars became ubiquitous symbols of success in Silicon Valley. For once the economic benefits really did trickle down to regular people, in part because government economic policy made it advantageous to invest in something other than a mattress, which, metaphorically, is what a bond is.

Irrational exuberance

The party got out of hand as such things frequently do. Too much money eventually chasing too few really good investment ideas meant that share prices of public companies escalated beyond the level any sane investor would contemplate. Share prices were so out of synch with reality that companies were using their stock as if it were currency in mergers and acquisitions. Eventually what Allan Greenspan described as “irrational exuberance” ended with a crash and many investments became worthless or nearly so as many Internet startups went out of business.

The net positives

But the wake of the boom is not simply littered with wreckage and it would be a mistake to think that nothing positive came out of the experience. As a matter of fact, quite a lot of positive developments emerged that went well beyond Silicon Valley. For example:

- The government estimates that 23 million jobs were created in the 1990s and while at the depths of the post 2001 recession more than 2 million jobs had been lost. The net gain still looks pretty good though if the economy had stayed on that job creation clip we would have more than 8 million net new jobs today.
- The Internet developed into an important new piece of communications and commerce infrastructure that influenced business formation at many levels.
- Companies like Amazon and eBay and countless others made their appearances while inventing whole new ways to buy and sell. And the fears of “brick and mortar” retailers proved overdone as we discovered the net effect of these innovations was truly additive.
- National courier services like FedEx and UPS benefited from the new style of retail as their businesses expanded from overnight letter delivery to delivering the increasing mountain of items bought through Internet commerce. UPS later had one of the biggest IPO’s in history.
- The ubiquitous availability of information cut out “middle-men” everywhere and made the marketplace more democratic by greatly reducing the prices some vendors could charge simply because they held all the information about costs, availability, and prices.

- Time-sharing made a comeback in the form of application hosting as enterprises realized they could significantly reduce their IT costs and the risk of embracing new applications by subscribing to these new services.
- Email, once an application for intra-organizational communications, became one of the fastest and least expensive means of connecting with colleagues in the next office or on the other side of the planet.

The list goes on and it is a long one. But even this short examination shows that the benefits of investment in technology have significant follow through in the rest of the economy.

Will the economy reignite after the election with growth in good new jobs at aspiring companies intent on inventing the future? That's hard to say and there are myriad variables that need to align to make that happen. But one thing is certain; government policy in the form of carrots and sticks that encourage investors to risk their capital on new ideas, new markets, and new solutions is an essential element of any recovery.

Personally, I am looking for the candidate who can best articulate that vision.

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