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PROTECTING PEOPLE AND THE ECONOMY WHEN THE AI BUBBLE BURSTS



MATTHEW U. SCHERER

OPEN MARKETS INSTITUTE

MAYA JENKINS

AMERICANS FOR FINANCIAL REFORM EDUCATION FUND

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AUTHORS

Matthew U. Scherer, Fellow, Open Markets Institute

Maya Jenkins, Senior Policy Analyst, Americans for Financial Reform Education Fund

PROJECT DIRECTORS AND EDITORS

Courtney Radsch, Open Markets Institute

Lisa Donner, Americans for Financial Reform Education Fund

COPY EDITOR

Anita Jain

COVER ART

Naomi Pleasure-Park

GRAPHIC DESIGN

Jonty Young

AUDIO VERSION ENGINEER

Todd Hoyer

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“Never before or since have so many become so wondrously, so effortlessly, and so quickly rich.”

— JOHN KENNETH GALBRAITH

The Great Crash, 1929

Executive Summary

Executive Summary

The artificial intelligence (AI) boom represents one of the largest speculative frenzies in history. The ten most valuable U.S. companies are all tech giants. And most U.S. tech giants — including Alphabet, Amazon, Meta, Microsoft, Oracle, and SpaceX — are at the center of a multi-trillion-dollar spending spree on data centers and related infrastructure to train and run generative AI models. With tech companies spending drastically more on AI infrastructure than they are earning from selling AI products and services, however, even the biggest AI companies have begun borrowing heavily to cover AI's extraordinarily high costs.

That skyrocketing debt means that AI giants will need to earn multiples more in revenue than they are earning now to cover their spending. If the AI industry can't pay back its mounting debts, a financial crash could follow — and it could spread well beyond the tech sector.

Speculative data center debt is being repackaged and sold to pension and retirement funds, university endowments, and other institutional investors in a manner eerily reminiscent of the subprime bubble. Private equity firms have purchased life insurers and loaded them with risky debt, exposing policyholders and the public to losses and raising the threat of financial contagion.

Rather than address these mounting risks, the Trump administration and federal financial regulators are ripping up regulatory guardrails and exacerbating the harms a potential crisis would cause. They must dramatically reverse course to reduce the likelihood of disaster. Regulators, Congress, and state policymakers should instead act swiftly to shine a light on the AI industry's murky finances, stop contributing to the inflation of the bubble with subsidies and regulatory giveaways, better protect working people's retirement savings from outsized risk exposure, and strengthen the resilience of the financial system to protect households' economic security and the broader economy's stability.

This report's purpose is not to predict a specific sequence of events or portray an economic crisis as inevitable. It is instead to argue that the ingredients for a serious crisis are in place, explain why inaction regarding the growing risks would be a dangerous mistake, and describe the steps that policymakers should take to mitigate the growing threats to economic stability. Time is running short.

PART I: BUBBLE TROUBLES

With more than a third of the S&P 500's valuation residing in a handful of tightly interconnected tech companies laden with trillions of dollars in debt, the AI bubble is unique in recent history in its size, scope, and risk.

- As of September 2026, the U.S. stock market is:
  - o More overvalued by most traditional metrics than it has been since at least the peak of the dot-com bubble (see Figure ES-1).
  - o More concentrated in its largest companies (see Figure ES-2) than it has been since the 1960s.
  - o More concentrated in a single sector (see Figure ES-3) than it has been since the 1890s.
  - o Larger relative to the total economy (see Figure ES-4) than it has ever been.
- AI companies are spending over a trillion dollars in 2026 on generative AI infrastructure but bringing in only a small fraction of that amount in sales of generative AI products and services.
- To cover that gap, AI companies have taken on enormous quantities of increasingly risky debt and are using dubious accounting tactics, including the extensive use of circular financing arrangements to inflate earnings and shell companies to hide off-balance-sheet debt.
- These factors, together with other pockets of risk building up in the economy, mean that the odds of a deep and severe AI crash are rapidly increasing.

Figure Sources: Multpl.com (ES-1); MacroMicro/Slickcharts (ES-2); S&P Global (ES-3); LongtermTrends (ES-4).

Figure ES-1: Stock prices are historically overvalued compared to companies' cyclically adjusted earnings

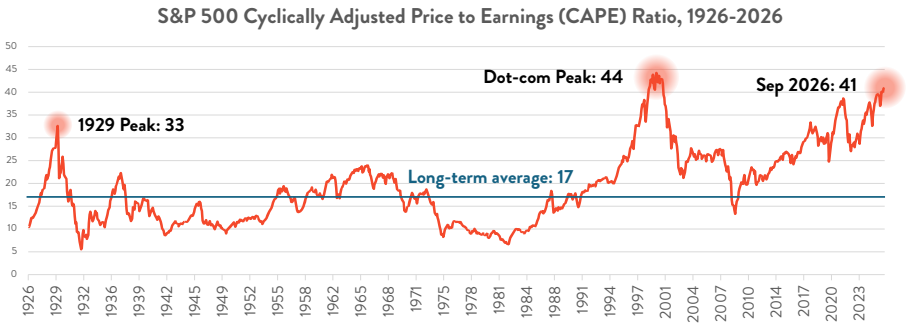


Figure ES-2: The stock market is highly concentrated in its largest companies

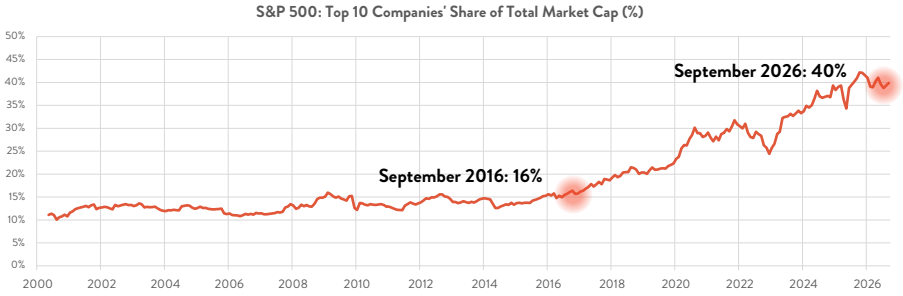


Figure ES-3: Unlike the last era of blue-chip dominance, the biggest companies are all from the same sector



Figure ES-4: The U.S. stock market is larger than ever relative to the U.S. economy



PART II: HOW AN AI CRASH COULD START AND SPREAD

The risk is rising that AI companies will be unable to meet their fast-growing debt obligations. Regardless of where market stress originates, the industry's extensive circular financial arrangements mean that turmoil could easily spread and devastate the entire tech sector.

- AI companies need to quickly achieve immense profits to pay their mounting debts, but several forces are making it difficult for them to do so (see Figure ES-5):
  - o Questionable demand for generative AI products and services
  - o Fierce competition among model developers
  - o Persistent high costs, resource constraints, and community opposition to data centers
- The industry's smaller and more precarious players are most vulnerable to these forces, but the various players in the AI ecosystem are deeply interconnected, as the complex corporate arrangements for a massive data center in Abilene, Texas illustrate (see Figure ES-6). As a result, a crash affecting any one part of the industry would likely spread.
- Even the tech giants would be vulnerable to a deep AI downturn because of their huge amounts of debt (most of it hidden off their balance sheets), weakening cash flows (see Figure ES-7), and revenues that appear to be artificially inflated by the AI industry's web of circular financing.

Figure ES-5: Key forces squeezing the AI industry's margins

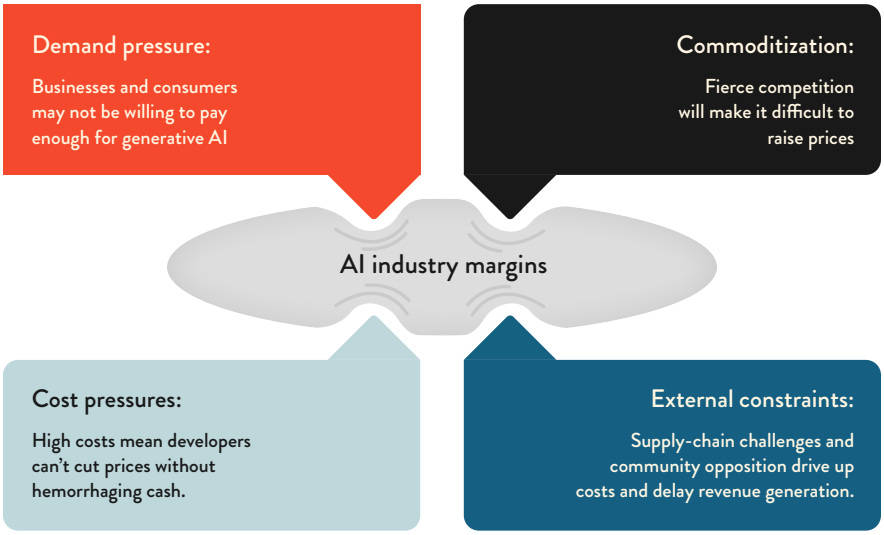
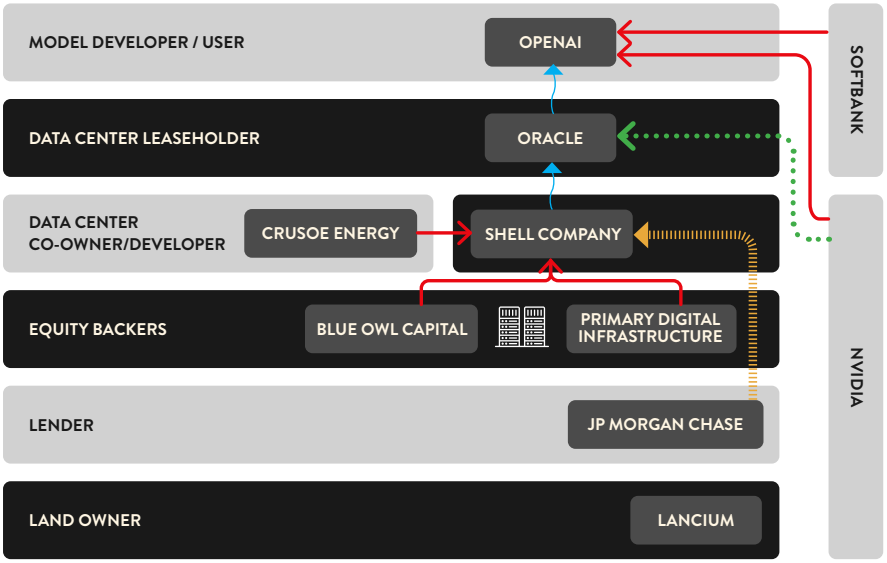


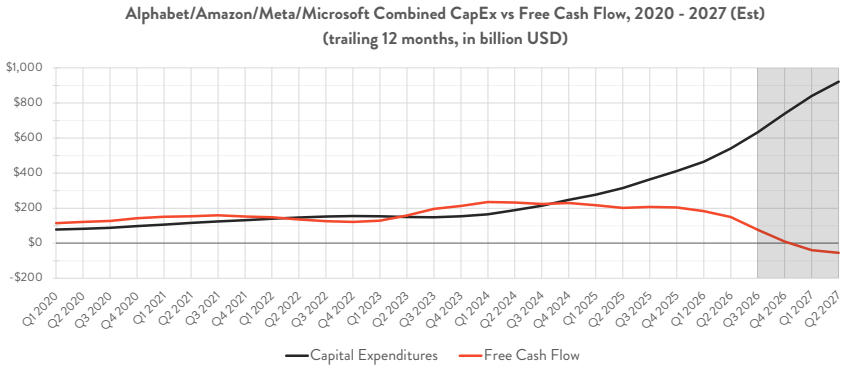
Figure ES-6: The Abilene, Texas data center's corporate layer cake



Note: Arrows run from seller to buyer, lessor to lessee, investor to share issuer, lender to borrower.

Figure ES-7: The hyperscalers' cash flows are turning negative as their AI spending accelerates

Source: Bloomberg. Figures from Q3 2026 onward are based on analyst estimates.



PART III: WHY AN AI CRASH WOULD POSE SERIOUS MACROECONOMIC RISKS

The outsized role of the tech sector in equity and credit markets means that any crash originating in the tech sector would be exceedingly difficult to contain.

- The high levels of leverage (see Figure ES-8) and the prominent role of passive index funds in the current market could amplify an AI market crash and accelerate its spread to the rest of the stock market.
- Both private investment funds and life insurers have significant exposure to AI-linked debt, including Big Tech's huge pile of off-balance-sheet debt (see Figure ES-9), and numerous touchpoints with the U.S. banking system, providing paths for the widespread amplification of financial stress in the event of an AI crash. Commercial banks' own exposure to AI-linked debt and ties to the rest of the shadow banking system increase the risk of contagion.
- With more Americans' wealth tied up in the stock market than ever before (see Figure ES-10), an AI crash could destroy trillions (and perhaps tens of trillions) of dollars in wealth, wiping out millions of Americans' pensions and retirement savings and threatening downward spirals in the real economy.
- An AI crash would have a serious negative effect on economic investment as well, particularly because many specialized AI chips and data centers could become stranded, toxic assets.
- The economic threat comes not from any one of these factors, but from the fact that the economy would have to navigate all these challenges in the aftermath of an AI crash.

Figure ES-8: Margin debt hit a record $1.5 trillion in the summer of 2026

Source: FINRA.

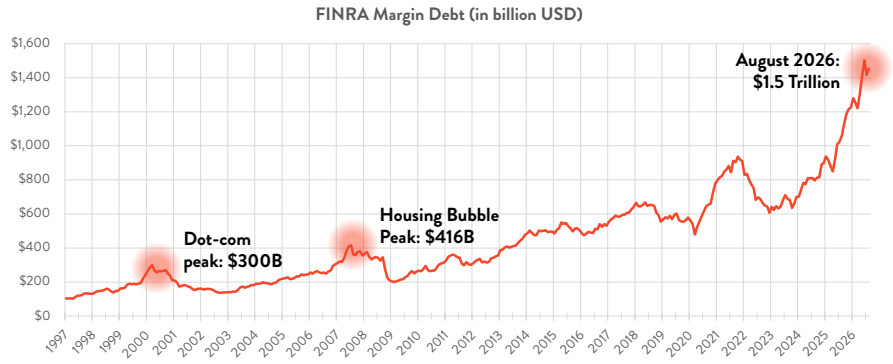


Figure ES-9: Just nine hyperscalers and chipmakers have a combined $3.1 trillion in off-balance-sheet debt

Sources: Wall Street Journal, Company Filings

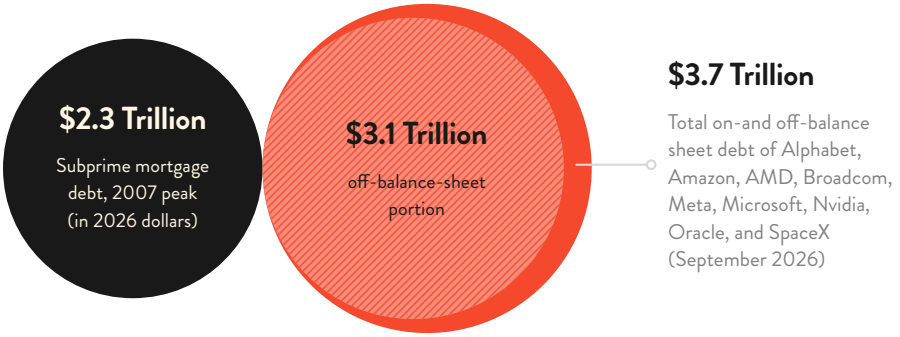
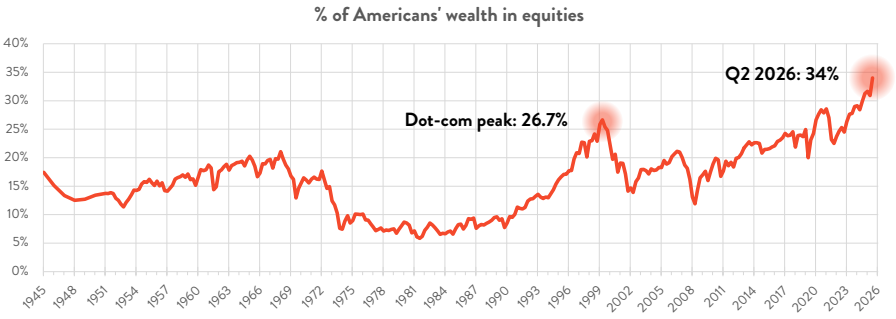


Figure ES-10: More American wealth is tied up in stocks than at any time since records began

Source: Federal Reserve Bank of St. Louis



PART IV: WHAT CAN BE DONE?

The AI bubble poses serious threats to economic security and financial stability. But, while the threat is grave, there are steps that policymakers can and should take to lessen the severity of a potential AI crash and limit the harm an AI crash would inflict on everyday people.

Unfortunately, the Trump administration and federal regulators are instead *weakening* safeguards intended to bolster our financial stability — lowering capital standards, increasing everyday investors' exposure to risk, reducing market transparency, and slashing oversight and risk management requirements — even as financial risks are fast accumulating.

What's more, tax subsidies and federal tax breaks for data center construction (see ES-11) represent a not-insignificant amount of public dollars being thrown into the growing bubble.

In addition to reversing those dangerous policy changes, federal regulators, Congress, and state and local governments should swiftly take proactive steps to:

- Demand true financial transparency across the entire AI ecosystem, including the AI infrastructure buildout.
- Close statutory and regulatory loopholes that enable deceptive accounting and financial practices across the industry.
- Deter further reckless lending and speculative investments that threaten to transfer downside AI investment risk from wealthy insiders to everyday investors and retirement savers.
- Strengthen the regulation and supervision of the AI industry's Wall Street financiers — banks and shadow banks alike.

In the event of an AI bubble-induced financial crisis:

- The federal government must refuse to bail out AI firms and financiers who profited from the AI bubble.
- Congress and the executive must prioritize the recovery and protection of workers and families by directing federal assistance to workers, households, and communities harmed by the crisis.
- AI firms, Wall Street financiers, and executives across both industries must be investigated for their roles in the AI bubble's inflation and held accountable for any and all unlawful activities.

After any such crisis, policymakers should focus on reforming the financial system to prevent a recurrence, including by establishing strong safeguards that support the movement of capital towards productive ends and guarantee economic security for the many.

Figure ES-11: **The five biggest hyperscalers received nearly $27 billion in depreciation tax breaks in 2025**

Dollar amounts in miillions

Company	US income	Current federal tax	Effective tax rate	Total tax breaks	Depreciation tax breaks
Alphabet	$144,359	$11,345	7.9%	$18,970	$3,324
Amazon	$89,041	$1,220	1.4%	$17,479	$6,549
Meta	$79,399	$2,820	3.6%	$13,854	$4,942
Microsoft	$100,934	$2,461	2.4%	$18,735	$11,976
Oracle	$8,638	$1,072	12.4%	$742	N/A
These 5 companies	**$422,370**	**$18,918**	**4.5%**	**$69,780**	**$26,791**

Source: Institute on Taxation and Economic Policy

Introduction

Introduction

John Kenneth Galbraith's *The Great Crash, 1929* is one of the great works of economic history and analysis. Though it was written more than 70 years ago about events nearly 100 years ago, it remains strikingly salient.

The rapid technological change of the late 19th and early 20th centuries created the largest and most valuable corporations the world had yet seen. During the Roaring Twenties, new technologies like radio and aviation captivated investors who saw the potential for further technological transformation. With Corporate America promising a high-tech future marked by unprecedented prosperity, investors tried to grab a slice of that future by pouring money into the stock market as never before, driving it to levels that became increasingly difficult to justify in light of the companies' underlying earnings. After the economy wobbled in the summer and early fall of 1929, however, investors lost their nerve, and the U.S. stock market experienced what remains the most devastating crash in its history.

Galbraith argued that, severe as it was, the stock market crash alone did not lead to the Great Depression. Rather, the crash exposed and amplified other weaknesses in the economy that, together with the stock market rout, sent the U.S. economy into its darkest era. In the final chapter of *The Great Crash*, Galbraith focused on five weaknesses in particular:

- "The bad distribution of income," which made the economy heavily dependent on spending by the wealthy.
- "The bad corporate structure," particularly fragile, overleveraged arrangements where a single company's failure to pay its bills could impose heavy losses on several other companies.
- "The bad banking structure" in the form of interconnected financial institutions making risky loans in a manner that left them vulnerable to cascading bank runs.
- "The dubious state of the foreign balance," that is, an unequal balance of trade.
- "The poor state of economic intelligence," particularly policymakers who fundamentally misunderstood the nature and scale of the economic challenges before them and spent their time obsessing over shrinking the government rather than addressing the growing threat to the economy.[1]

Ninety-seven years after the crash, history is rhyming. Investors are once again captivated by promises of a technological revolution and are pouring money into the stock market. Thanks to an enormous bubble focused on the AI-obsessed tech industry, the U.S. stock market is, by most metrics, even frothier and more untethered from economic fundamentals than it was in 1929.[2] Each of the five macroeconomic weaknesses that Galbraith highlighted in *The Great Crash* has an eerie echo today:

- Income and wealth inequality now matches or exceeds, depending on the measure, the levels from the Roaring Twenties.[3]
- Complex, opaque, and fragile corporate arrangements have become endemic, particularly through the AI industry's extensive circular financing deals[4] and the precarious financing structures at the base of the multi-trillion-dollar data center boom.[5]
- Banks are bigger and more interconnected than ever, and much lending activity now occurs in the opaque, uninsured, and teetering realm of private credit, which has experienced the equivalent of bank runs in recent months.[6]
- The U.S. suffers from a deep imbalance of trade; today it is a trade deficit whereas a century ago it was a trade surplus, but a serious imbalance in either direction can amplify economic stress.[7]
- Policymakers, ideologically wedded to the belief that the greatest threat to the economy is regulation rather than reckless lending and speculation, are making things worse rather than better, with the Federal Reserve pushing to loosen bank capital requirements and the Trump administration moving to open workers' 401(k)s to risky private credit and make financial markets less transparent.[8]

As if these were not enough, the current economic landscape contains hazardous features that were either absent or not as prominent a century ago. Today's stock market is larger than it has ever been as a percentage of GDP, and more Americans' wealth is tied up in stocks than ever before. The stock market today is not only overvalued by traditional metrics; a historically disproportionate share of its value is tied up in a handful of tightly interconnected companies from the same industry. Those interconnected companies have taken on trillions of dollars' worth of debt, much of it hidden off their balance sheets and distributed throughout shadow banks and institutional investors that have numerous connections to the commercial banks at the heart of the financial system.

Because of these factors, the economy would be dangerously exposed if the AI market fails to fulfill the extraordinary expectations that Silicon Valley and Wall Street have set for it. With tech companies spending drastically more on AI infrastructure than they are earning from selling AI products and services, the risk of an AI crash is increasing by the day. Given the outsized role that the AI industry plays in both equity and credit markets, such a crash could have impacts that go well beyond the AI industry — and well beyond those of a typical stock market crash.

As it stands, regulators, markets, and finance experts alike seem almost cavalier about these mounting risks. The reasons for their lack of concern vary. Many in the tech industry and Wall Street argue that the market is not overvalued or headed for a correction at all. Despite the AI industry's dubious finances,[9] they see not a bubble but an investment "super-cycle" that will lead to immense economic growth.[10] Some observers acknowledge that there is a bubble but argue that if it bursts, only the tech industry's weaker players would be at risk; the Big Tech giants would survive and the data centers they are building will, they claim, return value for years to come.[11] Others acknowledge that even the tech giants could be at risk in a steep enough downturn but posit that any crash would stay mostly contained to the tech sector without spilling over to the financial system or broader economy.[12] Still others believe the usual monetary and fiscal policy toolkit could defuse a crisis before it spirals, implying that urgent action to prevent a crisis is not necessary.[13]

This report explains why we believe such views to be too sanguine. The issue is not whether AI is or will be transformative. After all, radio and aviation *did* revolutionize our economy and society. But when it became clear that the returns would take far longer to materialize than investors and lenders expected,[14] the early waves of investors were crushed, and they eventually dragged the economy down with it, devastating the lives of tens of millions of workers and consumers.

To be sure, the purpose of this report is not to predict a specific sequence of events or to convince readers that another Great Crash, much less another Great Depression, is the inevitable result of the fast-accumulating economic risks. It is, rather, to argue that the ingredients for a severe economic crisis are in place, explain why excuses for inaction have become untenable, describe the steps that policymakers should take to defuse the growing threats to economic stability, and lay out some initial principles for responding to an AI crash. In so doing, we describe and explore various scenarios for how the bursting of the AI bubble could start and how its effects might spread.

The risks are numerous and complex, and entire reports could (and should) be written analyzing many of the issues discussed in greater depth and detail. This report provides an overview, presenting the issues and risks in an order intended to enable readers to see not only their scale, but how they relate to each other and could make the bursting of the AI bubble difficult to contain if policymakers do not act decisively.

Part I explores the characteristics of the AI boom that pose increasing and potentially systemic risks to the financial system and economy. It analyzes the unprecedented scale of the AI bubble, the deep interconnectedness of the companies at the bubble's epicenter, and the dubious tactics that AI companies have adopted to present a misleading picture of the industry's financial health. It also provides an overview of the other trouble spots in the financial system and economy that an AI market rout could expose or exacerbate.

Part II analyzes the forces that will make it extremely challenging for the AI industry to pay its fast-mounting debts and explains that those forces mean that a crash would threaten not just the newer and weaker AI companies, but, due to the AI ecosystem's interconnectedness, the tech sector as a whole.

Part III explains how a sufficiently severe AI market reversal could spiral into a severe economic crisis by triggering a broader stock market crash, damaging the financial system, and creating negative feedback loops in the real economy as businesses and consumers pull back on spending and investment.

Part IV discusses steps that policymakers should take now to reduce the likelihood and severity of a dangerous AI crash and lays out some principles to guide action during and after such a crash to minimize the potential harm to the real economy and to working people.

The AI bubble poses serious economic risks that are rising rapidly. But, disturbingly, federal policymakers are taking steps that make a crisis more likely and its consequences likely more severe. Time is running out to reverse course and head off a potential economic crisis on a scale the United States has not experienced in nearly a century.

PART ONE

Bubble troubles

Part I: Bubble troubles

The AI bubble is unprecedented in its size, its scope, and the degree to which it involves massive, tightly linked corporations, which have resorted to massive borrowing and dubious accounting to fuel their spending spree (Section A). Worse, the bubble is inflating in a climate rife with other significant economic trouble spots that would likely be exposed in an AI crash, including the precarious private credit sector, speculative cryptocurrency markets, and weaknesses arising from the AI industry's voracious appetite for crucial resources (Section B).

A. THE HISTORIC SCALE AND DUBIOUS ECONOMICS OF THE AI BUBBLE

Nearly $33 trillion in market value has been added to the S&P 500 since ChatGPT's release in late 2022, with the vast majority going to shares in companies whose futures are tethered to the AI boom.[15]

> *The money flooding into AI stocks has resulted in an overvalued market that is more concentrated in its largest companies than it has been since the 1960s, more concentrated in a single sector than it has been since the 1890s, and larger relative to the total economy than it has ever been. (Subsection 1).*

AI companies have taken on massive and still-rising quantities of debt because their collective revenues are only a small fraction of what is needed to support their exorbitant spending (Subsection 2). The AI industry is papering over this gap through circular financing arrangements and other accounting chicanery that obscures the industry's shaky finances (Subsection 3).

1. The stock market: Overvalued, overconcentrated, and oversized

a. The stock market is historically overvalued

The stock market reaching new all-time highs, as it has repeatedly over the last few years, may seem like a welcome sight — and when stock prices reflect drivers of real economic growth, it is. But when share prices rise far above what companies' economic fundamentals justify, they are a sign of a speculative bubble.

Today, a wide variety of metrics show that the current U.S. stock market is overvalued to a historic degree, with several overvaluation signals approaching or exceeding their all-time highs. The Cyclically Adjusted Price to Earnings (CAPE) ratio is one such signal. The CAPE ratio compares the value of S&P 500 stocks to companies' average profits over the preceding 10 years.[16] The higher the ratio, the more expensive large corporations' stocks are relative to their underlying profits. An unusually high CAPE ratio is thus a sign that stocks are overvalued.

As of September 2026, the CAPE ratio is 41, nearly two and a half times its long-term average of 17. That is just below its all-time peak of 44 at the height of the dot-com bubble in December 1999, which is the only other time that the ratio exceeded 40.[17] Aside from the current tech boom and the dot-com bubble, the ratio exceeded 30 only once in the past 150 years — in the summer of 1929 (see Figure 1).

FIGURE 1: Stock prices are historically overvalued compared to companies' cyclically adjusted earnings
Source: Multpl.com

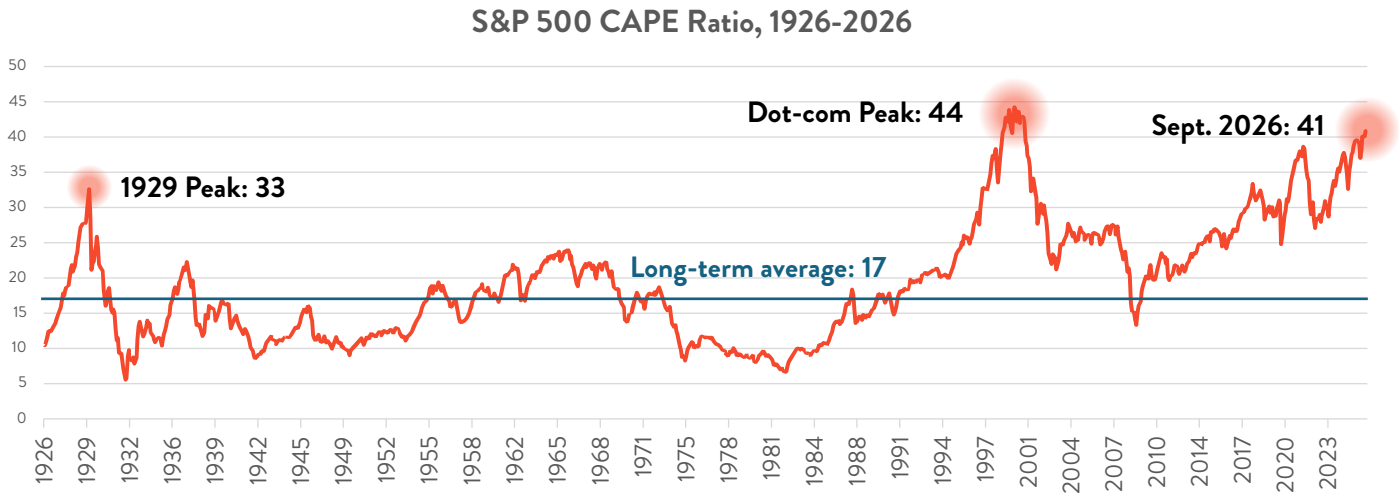


FIGURE 2: **Stock prices are more expensive than ever compared to companies' assets**

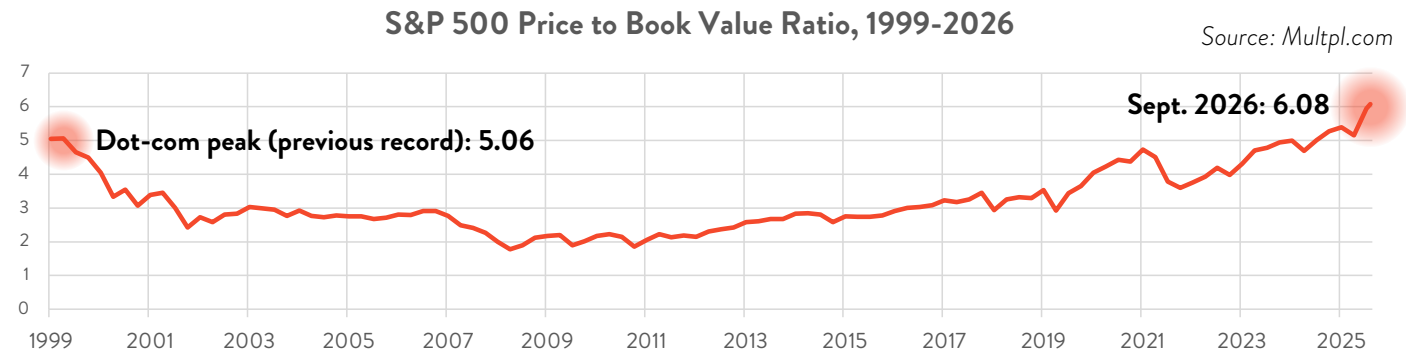
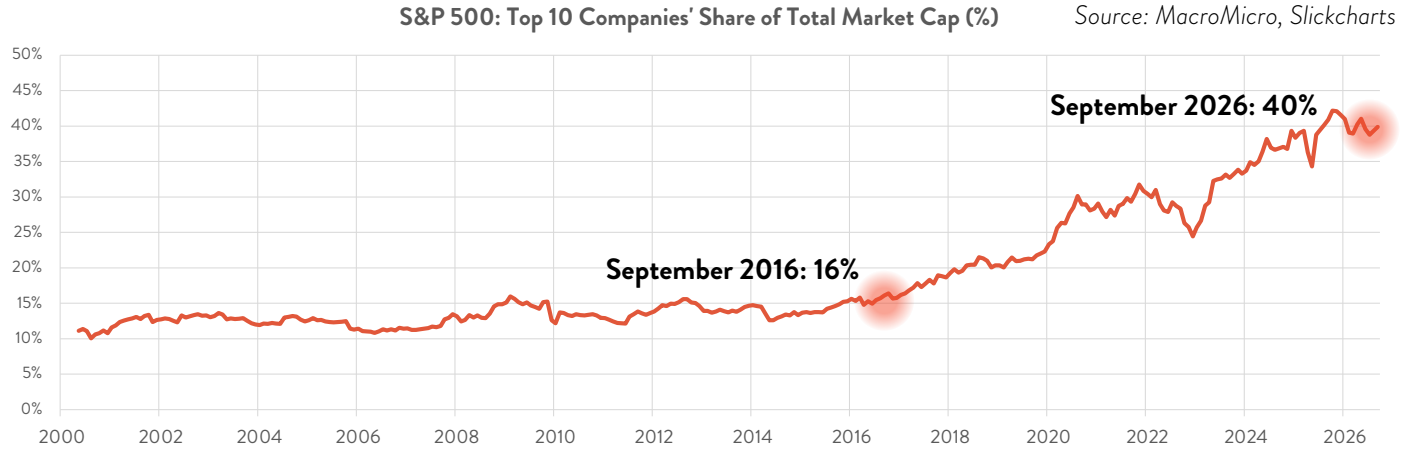


FIGURE 3: **The S&P 500 is highly concentrated in its largest companies**



Other valuation metrics include the Price-to-Sales (P/S) and Price-to-Book (P/B) ratios, which compare companies' share prices to their recent revenues (as opposed to profits) and to the current book value of their assets, respectively. These ratios are interpreted similarly to the CAPE ratio: unusually high ratios suggest that a company or index is overvalued relative to important metrics of its financial health. Both the P/S and P/B ratios for the S&P 500 are at all-time highs (see Figure 2), with records going back to 1955 for the P/S ratio and World War II for the P/B ratio.[18]

Even these indications of froth might not fully reflect the extent of overvaluation, because leading companies' current earnings and asset values appear to be inflated by circular transactions, a problem discussed further below.

b. The stock market is historically overconcentrated

Rather than being spread out over the stock market as a whole, equity values have become historically overconcentrated in a handful of tightly connected mega-cap tech companies. In September 2026, the ten most valuable companies in the United States accounted for nearly 40% of the S&P 500, up from 15% as recently as 2016 (see Figure 3), when the top 10 companies also included Alphabet, Amazon, Apple, Meta (then Facebook), and Microsoft.[19]

Not since the mid-1960s has so much of the market been so concentrated in so few companies.

The current top-heavy market is even more concentrated than that previous era of blue-chip dominance in another crucial respect. The top ten stocks in 1965 (AT&T, GM, Standard Oil (Exxon's predecessor), IBM, DuPont, Texaco, Sears, GE, Eastman Kodak, and Gulf Oil) represented a fairly broad cross-section of the economy. The most-represented sectors were energy and industrials, with each sector taking three of the top 10 spots.[20]

FIGURE 4: Top 10 companies in S&P 500 by Sector, June 1965 vs September 2026



By contrast, the top nine companies in the S&P 500 as of September 2026 — Nvidia, Apple, Alphabet, Microsoft, Amazon, Broadcom, Meta, Tesla, and Micron* — are *all* tech companies, comprising 37% of the S&P 500's market cap between them (see Figure 4). Add in smaller AI-related companies, and over half of the index's value is tied up in AI-related stocks.[21] The AI boom's scale means that even seemingly unrelated stocks have become correlated with the tech sector, leading a JPMorgan Chase (JPMC) analyst to comment in July 2026 that "everything is becoming an AI trade."[22]

Recent AI-linked share issuances have added fuel to the fire. In May, Alphabet issued $85 billion in new shares to help fund its AI expansion plans.[23] In June, SpaceX went public with the largest stock market debut in history, with Elon Musk's rocketry-cum-AI company issuing $70 billion worth of listed shares. With Anthropic set to make its own mega-cap stock market debut in the fall of 2026 and OpenAI in 2027, the AI industry's stock market dominance will likely increase still further. The IPOs of these companies, which, as discussed further below, are among the most precarious in the AI ecosystem, are transferring substantial risks to workers and consumers, many of whom are effectively being forced to purchase their shares through retirement accounts, pension funds, and index funds due to changes to both federal policy and rules set by powerful financial intermediaries.[24]

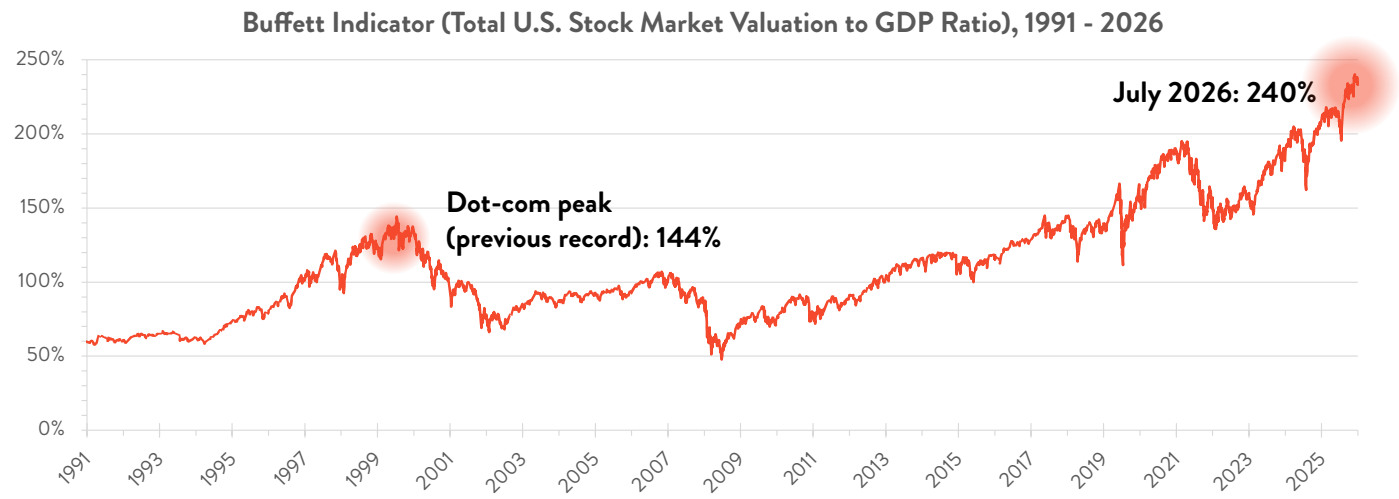
The last time the stock market was so concentrated in a single sector was the 19th century railroad boom.[25] But, as noted in *1873*, Liaquat Ahamed's recent book on that crisis, "[t]he stock market was too small at the time to pose a direct threat to the U.S. economy."[26] That is not the case today.

c. The stock market is historically oversized

The size of the U.S. stock market compared to the U.S. economy as a whole has trended upward over time, with notable spikes occurring just before previous market

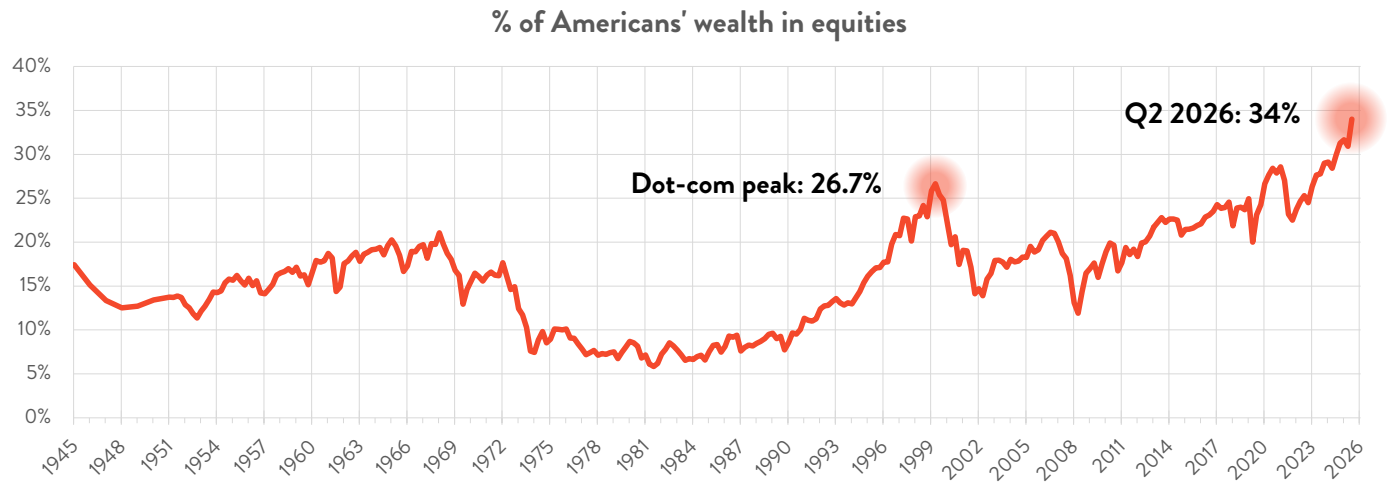
* Notably, these figures do not account for the valuation of SpaceX, which is currently the sixth largest company by market capitalization as of September 2026 but is not an S&P 500 component because of its recent listing date and lack of profitability. Were SpaceX included in the S&P 500, it would push Berkshire Hathaway to 11th place (meaning that the top *ten* component companies would all be from the tech sector) and its roughly $1.9 trillion market capitalization would modestly increase the concentration figures included above.

FIGURE 5: **The U.S. stock market is larger than ever relative to the U.S. economy**



Source: Yahoo Finance and Federal Reserve Bank of St. Louis, via LongtermTrends

FIGURE 6: **More American wealth is tied up in stocks than at any time since records began**



Source: Households and Nonprofit Organizations; Directly and Indirectly Held Corporate Equities as a Percentage of Total Assets (Federal Reserve Bank of St. Louis)

crashes. In 1873, the total market capitalization of U.S. stocks amounted to roughly half of U.S. GDP.[27] That ratio exceeded 100% for the first time during the run-up to the 1929 crash and reached a new high of 144% at the peak of the dot-com bubble.[28]

In August 2026, the ratio hit an all-time record of 240% (it stands at 235% as of September 2026),[29] vastly higher than its previous tech-induced peaks and more than quadruple its level during the railroad bubble (see Figure 5).[30]

More American wealth is also tied up in stocks today than at any time since records began (see Figure 6).[31] During the summer of 2026, the amount of wealth that Americans held in equities surpassed the amount held in real estate for the first time since World War II.[32] While stock ownership is concentrated among the wealthy, roughly one-third of equities are held in workers' retirement accounts and pension funds, and many of those workers are relying on or will rely on those assets for economic security.[33]

With a third of Americans' wealth tied up in the stock market and nearly 40% of the market's value sitting with just a handful of AI-focused giants, an AI-centered stock market crash would pose exceptional risk to millions of people's economic security and to the broader economy.

2. Data center arithmetic: Too much spending + Too little revenue = Skyrocketing debt

The stratospheric stock-market valuations of AI-linked tech companies are matched by, and inextricably linked to, those companies' skyrocketing spending on chips, data centers, and other AI infrastructure. The AI data center boom already represents the largest private sector capital investment project in history, with spending on AI infrastructure in 2026 accounting for a larger share of GDP than "the Manhattan Project, the expansion of electricity, the Apollo space program, building the interstate highway system, broadband buildout during the dot-com bubble, and every other capital effort in U.S. history, except for the Louisiana Purchase and maybe the peak of railroad construction."[34] But AI capital expenditures far exceed, and have been growing much more quickly than, revenues from AI products and services, and AI companies are borrowing heavily to make up the difference.

a. Tech companies are spending trillions of dollars on AI infrastructure

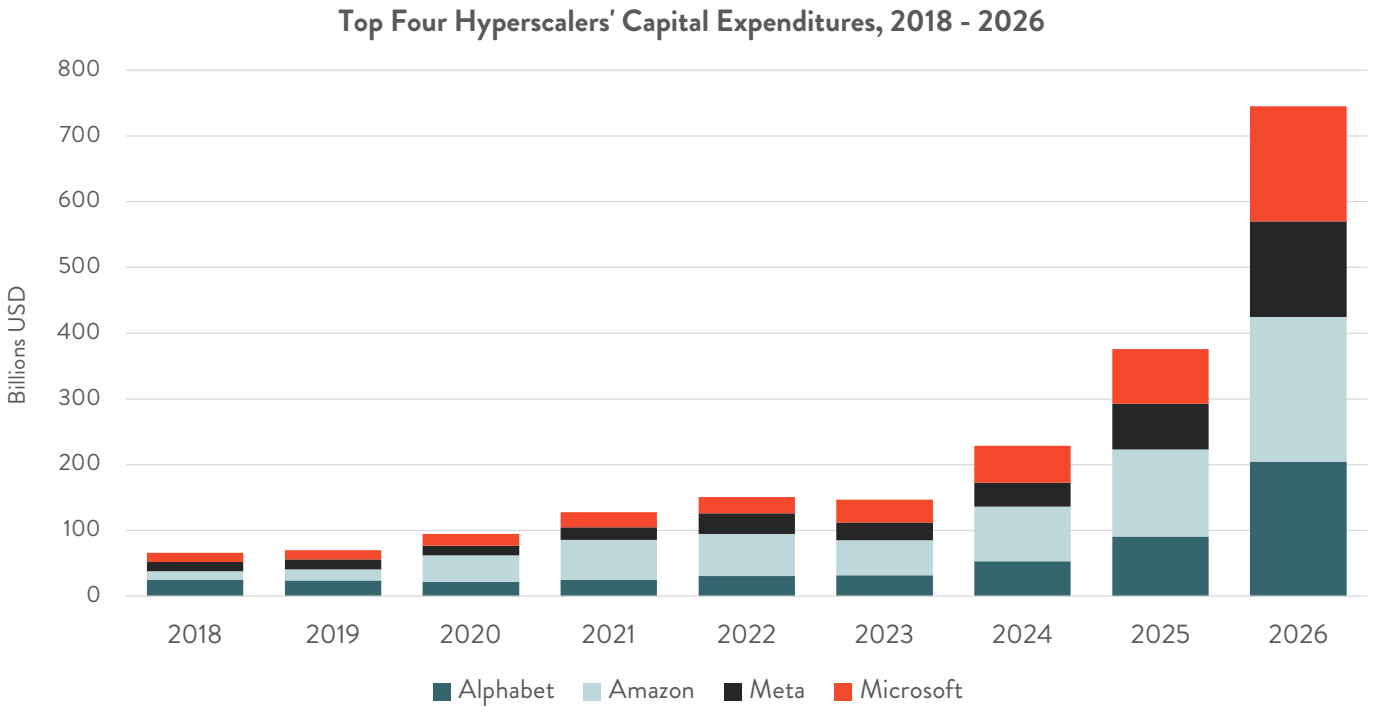
Most consumers access generative AI chatbots and image generators from their personal phone or laptop for free, which might make the technology seem costless.

Far from it.

The leading models are trained on tens of thousands of specialized *AI chips* that cost tens of thousands of dollars each. Those chips (mostly *graphics processing units*, or GPUs) are housed in data centers, each of which is designed to meet the needs of a specific generation of AI chips.[35] AI chips require vast amounts of energy to operate and significant additional energy or water to cool.

All this computation requires enormous upfront spending to purchase AI chips and build the highly specialized data centers and related infrastructure needed to house, power, and cool those chips. According to Goldman Sachs, global AI capital expenditures will exceed $1 trillion this year.[36] The biggest spenders on this infrastructure are called *hyperscalers*. The four biggest hyperscalers — tech giants Alphabet, Amazon, Meta, and Microsoft — are expected to spend $745 billion this year on capital expenditures (see Figure 7), quintuple their spending from

FIGURE 7: Hyperscalers' infrastructure spending exploded after the release of ChatGPT



Source: Company filings, via Bloomberg. 2026 figures based on company guidance.

2023, double the figure from 2025, and nearly three-quarters of the global total in 2026.[37] Further spending increases are expected in the coming years, with the hyperscalers alone expected to spend well over $1 trillion on capital expenditures in 2027 and a total of more than $5 trillion between 2026 and 2030.[38]

b. AI revenues are only a small fraction of AI spending

Trillions of dollars in spending is not necessarily a problem if the resulting products and services generate enough revenue to cover the costs. That is not what is happening with generative AI, however.

To pay their mounting bills, AI companies will need to generate at least hundreds of billions[39] and most likely trillions of dollars[40] *per year* in bona fide revenues — that is, revenues from sales to enterprise customers, governments, and consumers as opposed to circular "revenues" AI companies earn from selling products and services to each other.

The industry's murky finances make precise figures hard to come by, but Gartner estimates that global "end-user spending on AI models and platforms" was $39 billion in 2025 and will be $64 billion in 2026.[41] Gartner's figure for 2025 generative AI end-user sales ($39 billion) is notably consistent with Menlo Ventures' estimate of enterprise generative AI spending in 2025 ($37 billion).[42] *The Economist* estimates $150 billion to $200 billion in "world revenues from AI services" in 2026, but that estimate appears to be based on sources such as Ramp that include all sales of AI services, including those to other tech companies that are not end users but rather are developing their own AI products and services.[43] This matters because, as Ramp's data shows, the bulk of the AI sales it tracks goes to a small number of companies, most of which are tech companies that may be developing their own generative AI products rather than acting as true end users and thus may not represent money actually flowing into the AI ecosystem.[44]

Revenues from generative AI products and services from outside the generative AI ecosystem thus appear to be at most 20%, and quite possibly less than 10%, of the more than $1 trillion companies are spending this year on the technology's infrastructure and an even smaller fraction of the trillions per year they likely will need to generate annually in the near future.

> *The revenue gap only appears to be widening, with an Allianz research report finding that AI investment spending was growing 46% faster than sales as of March 2026, significantly worse than the 32% divergence measured when the dot-com bubble burst.*[45]

Anthropic and OpenAI appear to account for the vast majority of generative AI sales; the August 2026 Ramp AI Index indicated that Anthropic and OpenAI models accounted for over 98% of businesses' API spending on generative AI.[46] Despite their dominance of commercial AI, the two model developers have burned through stunning amounts of money over the course of their existence. OpenAI reportedly lost more than $38 billion on just $13 billion in revenue in 2025. Anthropic reportedly lost a staggering $42 billion in 2025.[47] While Amazon also famously lost money for nine years before its first profit in 2003, Amazon's cumulative losses totaled "just" $3 billion over those nine years. Anthropic has reported significantly improved revenues in 2026 but, as discussed further below in subsection 3, the industry's circular revenues and dubious accounting practices provide ample reason to question the rosy financial picture both Anthropic and OpenAI have sought to project.

The two developers have, nevertheless, been financial world-beaters compared to xAI, Elon Musk's model development company that was merged into SpaceX in early 2026 in part to cover the former company's high costs.[48] xAI lost $2.4 billion on just $208 million in sales in the first nine months of 2025, the last period for which xAI's standalone financials were reported, for a profit margin of *negative 1,100%*.[49]

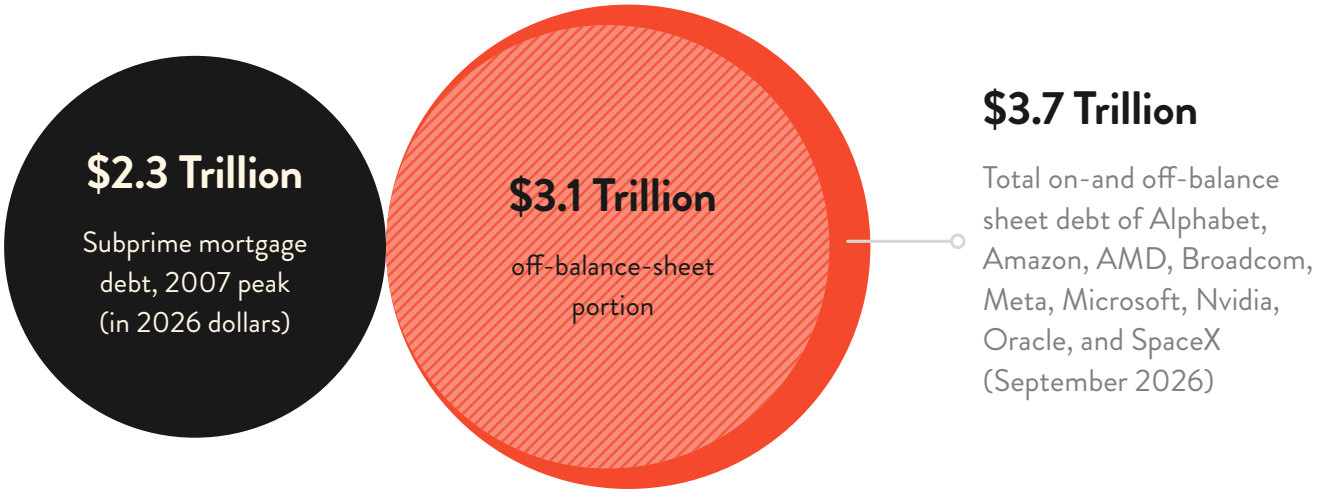
c. Trillions of dollars in debt, with more coming every day

How is the AI industry paying for roughly a trillion dollars per year in infrastructure while bringing in only a fraction of that amount in sales? At first, the AI spending boom was financed primarily through the non-AI cash flows of Big Tech giants, with venture capital and private equity investments providing an additional boost. This generated little economic concern because it was principally the tech giants' own money at risk. But as the costs of the AI infrastructure boom continued to balloon, the companies at its center started ramping up their borrowing in mid-2025, leading to an explosion in AI-linked debt over the past year. With the hyperscalers' cash flows turning negative as of the summer of 2026, debt will be the lynchpin for AI infrastructure financing going forward — and its greatest source of risk.

In their most recent earnings statements, the nine biggest hyperscalers and chipmakers (Alphabet, Amazon, AMD, Broadcom, Meta, Microsoft, Nvidia, Oracle, and SpaceX) reported a total of $595 billion in long-term debt on their balance sheets. But far more debt lurks off the companies' balance sheets. In August, the *Wall Street Journal* calculated that the total off-balance-sheet commitments of those

FIGURE 8: Just nine hyperscalers and chipmakers have a combined $3.1 trillion in off-balance-sheet debt

Sources: Wall Street Journal, Company Filings



companies totaled at least $3.1 trillion.[50] (By comparison, the total size of the subprime mortgage market was $1.5 trillion, or $2.3 trillion in today's dollars, at its 2007 peak, as shown in Figure 7.[51])

Much of that off-balance-sheet debt underpins loans taken out by other companies involved in the data center construction boom. *Bloomberg* describes such AI-linked borrowing as "all-consuming" for credit markets, with AI companies turning to every corner of debt markets, from traditional corporate bonds to project finance to more exotic forms of debt, to finance their spending.[52]

The riskiest debts in the AI ecosystem may be those tied to the *neoclouds*, the term of art for companies like CoreWeave and Nebius that focus on developing data centers and leasing access to the GPUs they contain to generative AI model developers. Unable to obtain the investment-grade financing that the tech giants can access, neoclouds must pay steep interest rates, sometimes reaching well into the double digits.[53] To obtain additional financing, neoclouds are increasingly putting up AI chips as collateral.[54] But stagnating AI demand would both threaten the income streams that neoclouds are counting on to meet their loan obligations and drive down the value of the collateral — a combination that could create toxic debt in the wake of an AI downturn.[55] As described further below, the AI ecosystem's interconnectedness means that both tech giants and financial institutions have significant exposure to the debt that these weaker players in the AI industry are fast accumulating.

3. Funny accounting, incestuous financial arrangements, hidden debt, and other chicanery

Why would investors keep pouring money into a technology that is racking up huge amounts of debt while bringing in revenues that are only a fraction of its costs? Persistent hype surrounding AI is a key part of the answer; bubbles are irrational by nature, and the narratives that inflate them are often impervious to conflicting evidence while the bubble is intact. But another key feature of bubbles is that they often are inflated and sustained by dubious financial tactics that paint a deceptively rosy picture of the overvalued sector or asset class. That very much appears to be the case with generative AI.

a. Revenue games and circular financing

The leading generative AI model developers, Anthropic and OpenAI, are currently privately held. Such private companies, even if they have trillion-dollar valuations and hundreds of billions of dollars in off-balance-sheet obligations, are exempt from having to file audited financial statements showing the public their earnings and cash flows. That transparency gap has allowed OpenAI and Anthropic to make "revenue" announcements that do more to obfuscate than inform.

For example, a *New York Times* story published in September 2026, ahead of Anthropic's expected IPO, indicated that Anthropic had "annualized" revenues of $100 billion.[56] But this figure, often termed a revenue *run rate*, is a dubious projection that takes a company's performance over a recent period and calculates what the company's

revenues *would* be if it sustained that performance for a full year; it does not reflect the company's actual annual receipts.[57] That enables a company to, say, wait until they have an unusually lucrative month, multiply that month's revenues by 12, and represent the resulting figure as their "annualized" revenues — even if the company has not made close to that amount of money in any actual 12-month period.[58] To that point, Anthropic announced a run rate of $9 billion at the end of 2025, but when forced to reveal its actual revenues in a court filing, Anthropic revealed that its revenues were closer to $5 billion over the course of 2023, 2024, and 2025 combined.[59]

Due to Securities and Exchange Commission (SEC) reporting requirements, the publicly traded hyperscalers cannot play the same revenue games as Anthropic and OpenAI, but the breadth and scale of Big Tech companies' operations nevertheless allow them to engage in "revenue washing" that obscures how much of their purported AI revenue actually comes from their own AI products and services. Microsoft's press releases about AI-related revenues, for example, appear to lump the revenues the company earns from its Copilot generative AI products with much of the revenues it earns from selling access to Microsoft's Azure cloud computing infrastructure to OpenAI under the generic heading of "Intelligent Cloud."[60]

More generally, the AI industry's extensive ecosystem of circular financing and purchase agreements makes it very hard for outsiders to determine how much *bona fide* revenue the technology is generating — and very easy for companies to artificially inflate the revenues and deflate the expenses they release to the public. For example, Nvidia has invested in OpenAI, Anthropic, xAI, and several neoclouds, each of which purchases or leases Nvidia chips in turn,[61] an arrangement commonly known as vendor financing. Similarly, Microsoft both invests in OpenAI and sells OpenAI subsidized cloud computing access, while Alphabet and Amazon both have similar relationships with Anthropic.[62]

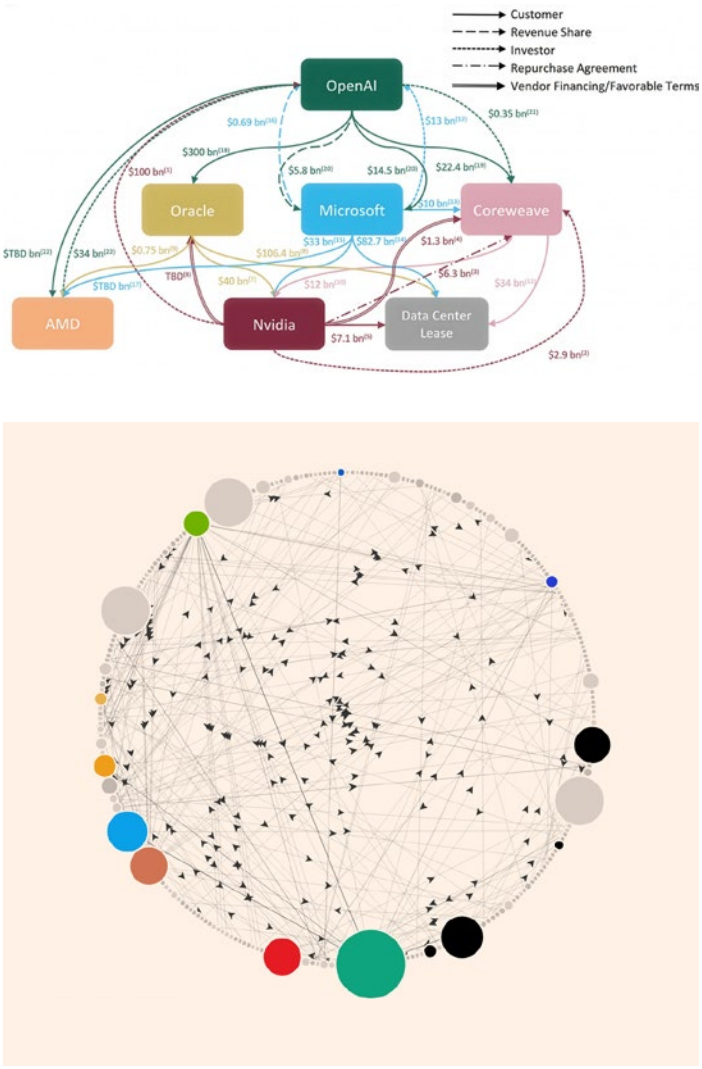
Such arrangements are not inherently unlawful; in form, vendor financing is comparable to a retailer extending store credit to a customer. But such deals can be used to create a false impression of strong demand and disguise the true state of the involved companies' finances, particularly when circular arrangements drive a substantial portion of the companies' revenues. Such deals can bear a more-than-passing resemblance to illegal *round tripping*, in which two or more companies agree to engage in a circular transaction with the purpose of creating a misleading picture of their finances rather than genuine economic value.

Vendor financing arrangements gained attention and infamy during the heyday of the dot-com bubble.[63] Those deals did help accelerate the build-out of digital telecommunications infrastructure, but they also disguised the fact that *bona fide* sales were growing far more slowly than investors expected. When credit tightened, the circular flows unraveled, which contributed to and accelerated the dot-com crash.[64]

The incestuous financial relationships that constitute the AI ecosystem are far more extensive and involve far more money than those that arose during the dot-com bubble, and they include nearly every major player from every corner of the AI industry. The web of financial arrangements is so extensive that attempts to represent them graphically are almost comical (see Figure 9).

TABLE: AI companies' questionable revenue tactics

Metric / tactic	Description	Potential to mislead
Circular financing / vendor financing	Company A invests in or buys products/services from Company B, which Company B uses to buy products/services from Company A.	Makes it appear that companies are generating new revenues when they are actually just passing the same money back and forth.
Revenue washing	"AI" revenue figures that lump AI revenues with revenues from non-AI sources or count other companies' AI sales as their own.	Artificially inflates AI revenues by combining them with revenues from other, more lucrative products and services or other companies' sales.
Run rate / "annualized" revenues	A (supposed) estimate of annual revenues based on taking a company's performance over a recent period and calculating what the company's revenues would be if it could sustain that performance for a full year.	Non-standardized metric that allows a company to multiply revenues from an unusually lucrative month by 12 and present them as estimated revenues for a full year.



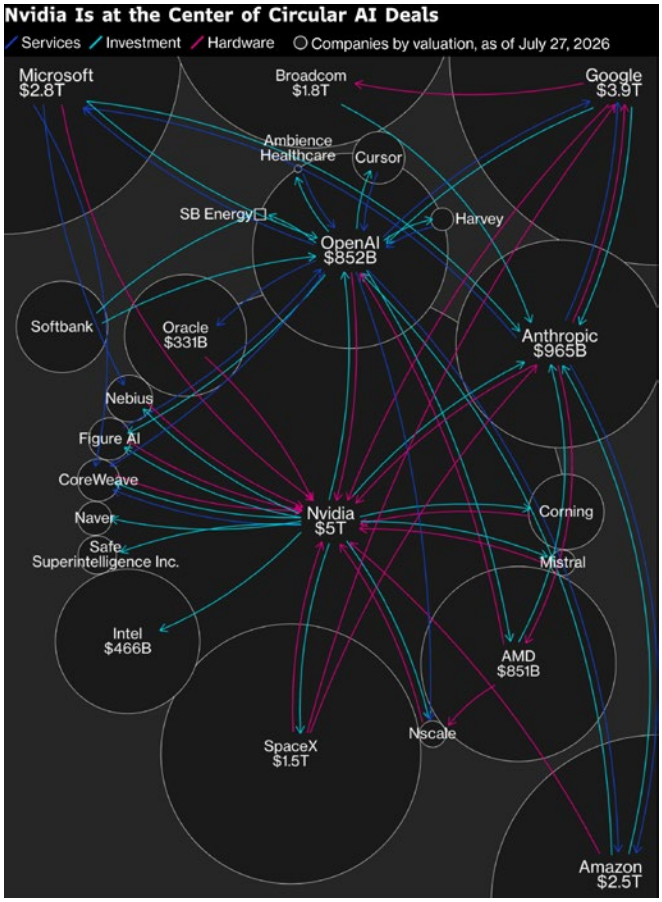


FIGURE 9: Visual depictions of the AI circular financing ecosystem

Sources (clockwise from top left): Morgan Stanley Research, Bloomberg, Financial Times.

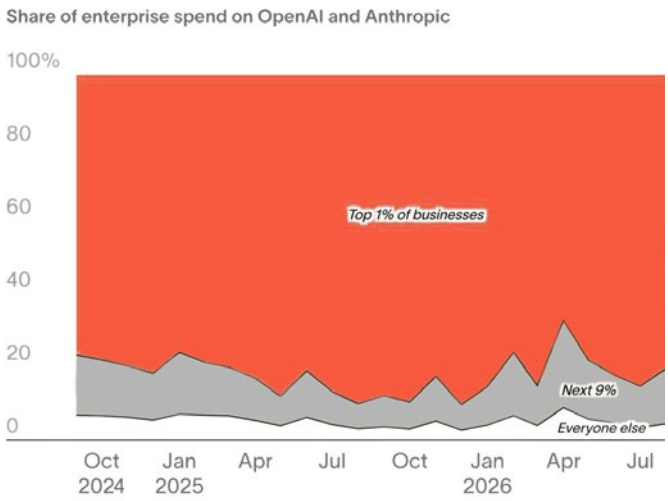
Circular arrangements in the AI ecosystem make the tech giants' revenues appear artificially high because a substantial portion of their sales come from customers whose money originally came, at least in part, from the tech giants themselves. Similarly, they make model developers' and neoclouds' expenses appear artificially low and their balance sheets more sustainable than they are because those companies need not rely on their operating revenues or take out additional debt to purchase chips or cloud access. More generally, these arrangements make it difficult to calculate how much of the industry's revenues are coming from outside the generative AI ecosystem and how much consists simply of companies within that ecosystem passing the same money back and forth.

These practices directly affect the hyperscalers' publicly reported earnings. The increasing valuations of Anthropic, OpenAI, and SpaceX have been a major source of the tech giants' recent "revenues." In the second quarter of 2026, $160 billion of Alphabet, Amazon, Meta, Microsoft, and Nvidia's $285 billion in profits came from increases in the paper valuations of their stakes in other AI companies, particularly Anthropic and SpaceX.[65]

The circularity inflates AI companies' sales figures as well. OpenAI accounts for "more than half, and likely about 70%" of Microsoft's AI sales.[66] Analysts have estimated that Anthropic and OpenAI likewise make up roughly 60 to 70% of Amazon's AI revenue.[67] Similarly, Anthropic and OpenAI's customer base appears to be dominated by other tech companies. According to an August 2026 analysis by Ara Kharazian, chief economist for the AI data firm Ramp, 80% of OpenAI and Anthropic's enterprise revenues come from just 1% of their customers, with that top 1% skewing heavily toward the tech sector and AI services (Figure 10). The next 9% of customers take up most of the model developers' remaining enterprise sales.[68] The same Ramp data set shows that companies that have venture capital backing spend roughly 10 times as much per employee on AI ($81) as non-VC companies ($8).[69]

FIGURE 10: 80% of Anthropic and OpenAI's enterprise revenues come from just 1% of their customers, with that 1% skewed heavily towards tech companies and AI services

Source: Ramp. Reproduced with permission.



Because of poor transparency, it is, again, difficult to attach a total dollar amount to the circular financing in the AI ecosystem. A late 2025 estimate placed the total amount of announced agreements at $1 trillion,[70] and 2026 has seen a further explosion in such arrangements. Alphabet is facilitating $200 billion in financing for Anthropic, which will use the funds (routed through a shell company) to purchase access to AI chips that Google co-develops with Broadcom, which effectively guarantees Anthropic's debt.[71] In August, Nvidia announced that it would guarantee $105 billion of OpenAI's lease commitments at an Ohio data center.[72]

Whatever the total amount of such circular deals, the more money that is circulating between the same companies, the more overstated those companies' revenues are, and the greater the gap between the cost of the AI infrastructure buildout and the earnings needed to cover it.

The implicit theory behind such circular financing arrangements is that they are a stopgap measure to prop up the ecosystem until model developers can earn enough independent revenues to cover their costs. Once businesses and consumers are hooked on generative AI, this theory goes, they will generate enough genuine sales to replace the industry's circular revenues. That theory assumes that generative AI companies will be able to quickly and dramatically increase their sales of AI products and services to non-AI companies. As discussed in greater detail in Part II.A, however, that is a speculative and increasingly dubious bet — one that could threaten the entire tech sector, and from there the whole economy, if it goes bust.

b. Hidden liabilities: Depreciation trickery and off-balance-sheet debt

AI companies are also using highly dubious accounting techniques and opaque data center financing arrangements to obscure the full extent of their liabilities, particularly when it comes to their capital expenditures on chips and data center construction.

Hyperscalers are taking advantage of an accounting loophole that allows them to dramatically understate their expenses by claiming that their AI chips will last for five to six years even though their useful economic life appears to be significantly shorter, a tactic known as *understating depreciation*.[73] The rapid churn cycle of AI chips is a function both of the speed with which more advanced chips are developed and released, with Nvidia now releasing new chips every year, as well as the fact that GPUs can wear out in three years or less with heavy use.[74] Hyperscalers could be forced to collectively write down or write off tens or even hundreds of billions of dollars if their chips die or are retired significantly earlier than they are claiming on their balance sheets.[75]

AI companies are using other accounting tricks to keep the bulk of their AI obligations off their balance sheets altogether. Hyperscalers are increasingly parking debt tied to data center construction projects in shell companies called *special-purpose vehicles* (SPVs). For example, Meta and private credit giant Blue Owl Capital, partnering with investment fund giant PIMCO, set up an SPV that took out a $26 billion loan to begin construction on a massive data center complex in Louisiana.[76] Even though Meta is the data center's sole tenant[77] and has backstopped the debt on the shell company's behalf,[78] the arrangement does not appear as debt on Meta's balance sheet because, technically, it is the shell company that is taking out the loan. Similar arrangements played key roles in the Enron scandal[79] and in obscuring big banks' exposure to the subprime mortgage downturn that ultimately sparked the 2008 financial crisis.[80]

Future lease and purchase commitments represent a particularly large and rapidly growing source of off-balance-sheet AI commitments.[81] The process of designing chips, manufacturing them, and placing them in bespoke data centers requires years of planning, hundreds of millions to billions of dollars in capital outlays, coordination between several companies, and

layers of regulatory approvals. Each company's capital commitments could be wasted if another party reneges on an agreement or fails to complete its parts of the project on schedule. Due to these complexities, data center developers and the lenders that back them are increasingly requiring lease and purchase commitments years in advance — an arrangement that suits hyperscalers and model developers just fine because it allows them to put off the day until those liabilities start to weigh down their balance sheets.

For example, OpenAI committed in mid-2024 to lease a data center in Abilene, Texas from Oracle and train its models using Nvidia chips. Initial chip deliveries and data center activation did not begin until 2025, however, and full construction of the data center and delivery of the remaining chips won't be completed until later this year.[82] To reserve its place in line for Nvidia's highly in-demand chips, Oracle agreed in advance to purchase the chips from Nvidia as they were manufactured.[83] OpenAI thus has a multi-billion-dollar lease commitment to Oracle, which, in turn, has a multi-billion-dollar purchase commitment to Nvidia.

The bulk of the lease and purchase commitments are unconditional and cannot be canceled.[84] That is why they are considered a form of off-balance-sheet debt: they are payments that a company is contractually required to make in the future and for which it will be held liable if it does not pay. Structuring the arrangement as a future lease or purchase commitment merely delays the day the liabilities land on the company's balance sheet while making the company's current finances appear healthier than they are.[85]

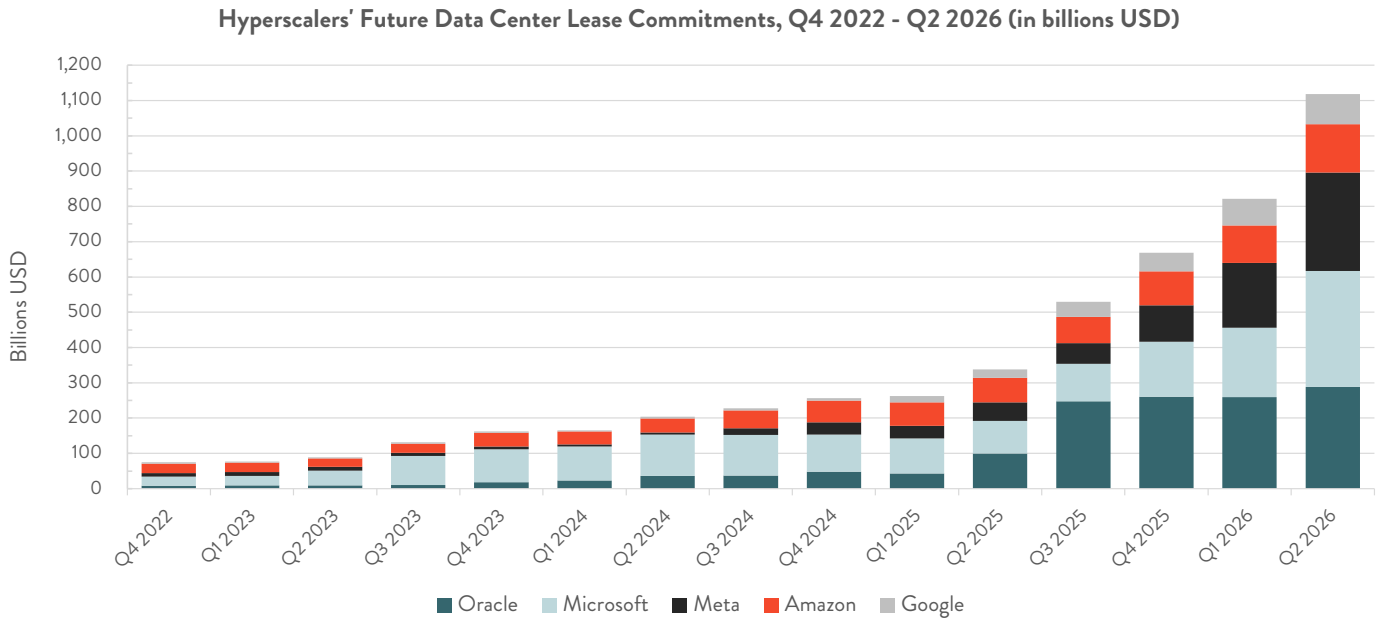
Such AI-linked financial commitments have ballooned over the past few years, which explains the explosion in Big Tech's off-balance-sheet debt. Lease commitments from the five largest hyperscalers (Alphabet, Amazon, Meta, Microsoft, and Oracle) stood at $1.1 trillion at the end of Q2 2026, triple the amount from just a year earlier and up more than fourteenfold from late 2022, when ChatGPT was released (Figure 11),[86] and the vast majority of obligations appear to be non-cancelable.[87]

Purchase commitments, particularly for AI chips and related components, represent another massive bucket of off-balance-sheet commitments for the hyperscalers. Alphabet alone reported having over $800 billion in future spending commitments in June 2026, more than double what it had reported just three months earlier.[88]

Nvidia likewise has a huge amount of quasi-debt tied to the manufacturing and sale of its chips, such as reserving fabrication capacity with TSMC and high-bandwidth memory manufacturers. In a footnote to its July 2026 earnings statement, Nvidia disclosed $279 billion of such off-balance-sheet "supply and capacity" commitments, more than double the figure from just three months earlier.[89] The rest of the footnote disclosed an additional $143 billion in other forms of off-balance-sheet cash flow commitments.[90]

FIGURE 11: Hyperscalers' data center lease commitments increased elevenfold in less than three years

Source: Company filings (via Bloomberg for data prior to Q2 2026)[91]



Even these figures do not reflect the full extent of Big Tech's off-balance-sheet exposure because the tech giants are also explicitly backstopping some smaller companies' obligations as part of the AI industry's circular financing arrangements. For example, Nvidia disclosed $109 billion in guarantees in a footnote to its July 2026 earnings statement,[92] and Alphabet has guaranteed $35 billion of Anthropic's lease payments at five data centers.[93]

These off-balance-sheet arrangements pile additional brittleness onto the AI infrastructure buildout while obscuring both the sources and landing spots of credit risk. Part II.C describes in greater detail how they could come back to haunt the tech giants — and the broader economy — in the case of an AI downturn.

B. RELATED ECONOMIC TROUBLE SPOTS

Given the scale of the AI bubble and the alarmingly fast-growing mass of debt attached to it, the economy could be headed for trouble even if the bubble were the only potential source of economic risk. Unfortunately, the economy has other trouble spots that are connected with, adjacent to, or potentially correlated with the AI bubble and that could accelerate and deepen an AI crash. The sprawling private credit ecosystem far predates the AI bubble but has become deeply intertwined with it (Subsection 1). Cryptocurrencies are speculative investments that tend to fall in value when tech stocks do (Subsection 2). The AI bubble itself has spawned new economic weak points that could worsen the fallout from an AI crash (Subsection 3).

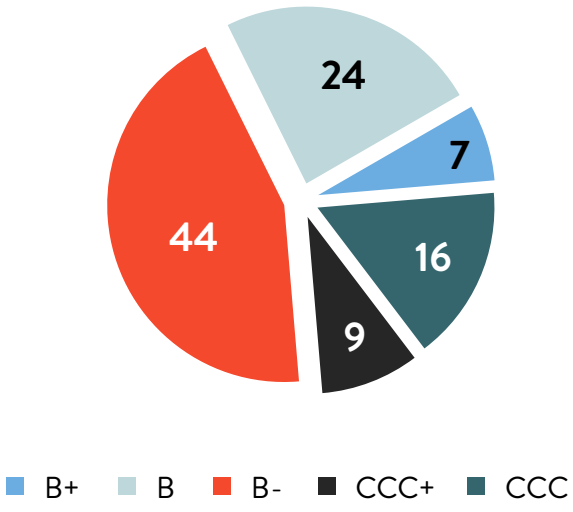
1. Private credit

When people think about sources of credit in the U.S. economy, they might first think of commercial loans provided by banks, which are regulated by the Federal Reserve (Fed), the Office of the Comptroller of the Currency (OCC), and/or the Federal Deposit Insurance Corporation (FDIC). But over the last decade, an increasing number of direct loans have been issued by non-bank lenders. This includes private equity firms, which have made lending through affiliated *private credit* funds an increasingly prominent part of their operations. Because many of the largest firms that purchase private ownership shares in companies (private equity) also engage in non-bank lending (private credit), we will use the umbrella term *private investment firms* to refer to the financial firms that focus on managing private capital funds.

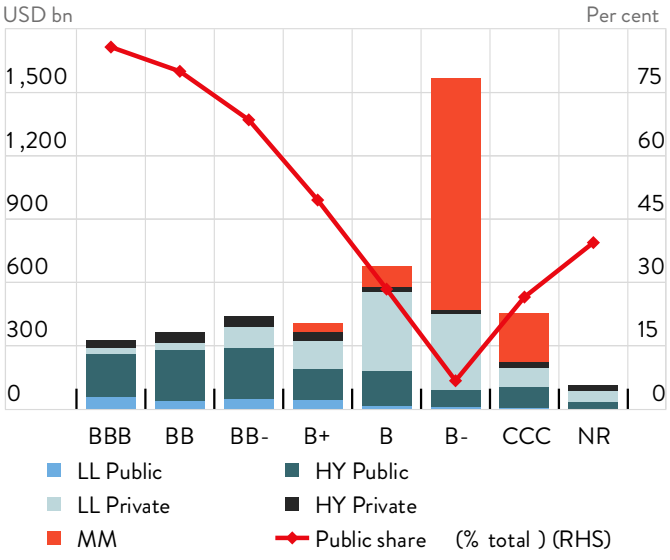
FIGURE 12: Distribution of credit ratings of private credit borrowers

Source: Fitch ratings, Bloomberg, UBS Credit Research, via Financial Stability Board[94]

A. Private credit rating distribution as of Q3 2025



B. Breakdown of public vs. private issuers in US leveraged credit markets (high yield, leveraged loans and private credit)



Much of the riskier lending activity occurring in the US credit markets is being undertaken through such private investment firms, which are neither required to provide regulators with comprehensive data on their exposure to or management of risky assets nor to adhere to regulatory standards designed to mitigate excessive risk. The exact size of the private credit market is difficult to determine because of the sector's poor transparency; estimates range from $1.8 trillion[95] to $3 trillion,[96] depending on how one defines private credit. Private funds' lending activities are highly concentrated among risky corporate borrowers (see Figure 12).[97]

Starting in late 2025, investors grew skeptical of the sector's loose lending standards, opaque valuations, and shaky outlook for returns and began attempting to withdraw the money they had invested in private credit funds.[98] In response, many of the private investment firms managing those funds were forced to limit withdrawals to keep the funds from collapsing, leading to a slow-rolling private credit crisis that remains ongoing,[99] as discussed further in Part III.B.

An AI crash would deal the private credit sector another major blow. Along with corporate bonds, private credit has been a leading source of debt financing for data center construction, AI chip purchases, and related AI infrastructure investments. Morgan Stanley projected that private credit funds could hold as much as $800 billion worth of data center debt by 2028.[100] Given the stress that private credit funds are already experiencing, it is unclear whether or how they could withstand an AI reversal.

As discussed further below, the danger extends beyond the private credit funds that made the loans. Private credit is also deeply interconnected with banks and life insurers. Banks finance private credit funds and their portfolio companies, while life insurers invest policyholder premiums in private credit funds and the loans they make. Banks, insurers, and private credit funds can therefore be exposed to the same borrowers and assets. If AI-linked loans default or lose value, losses could spread through these channels and expose several sectors within the financial system to heightened risk at once.

2. Crypto

There is evidence that cryptocurrencies tend to fall when tech stocks fall,[101] and the failure of a series of cryptocurrency-linked banks in 2023 demonstrated that crypto shocks can become a source of contagion in the financial system. The bursting of a crypto bubble and the subsequent collapse of Sam Bankman-Fried's FTX and other cryptocurrency firms contributed to three of the ten largest bank failures in U.S. history in 2023. The ensuing crypto winter erased $2 trillion in crypto value, with millions of investors wiped out.[102] Federal regulators backstopped the failed banks, which were deeply enmeshed with the crypto industry, including bailing out tech companies, wealthy investors, and executives who held deposits in those banks above the insured deposit limit.[103]

Stablecoins — a type of digital currency that has its price pegged to a specific value, typically the U.S. dollar — presents yet another source of financial risk. Most stablecoins are backed by highly liquid and stable assets like cash reserves or government securities that help to stabilize and maintain the asset's price. However, a 2023 Bank of International Settlements study found that not a single one of 68 stablecoins — including all major stablecoins — had been able to maintain their peg parity at all times, a fact that became especially apparent during the 2022-2023 crypto market turmoil.[104] A Federal Reserve Bank of New York study found that redemptions "accelerate significantly" when stablecoin values dip below $1.[105] J.P. Morgan Research noted that "the effects of a massive [stablecoin] liquidation could spill over to other markets, destabilizing the traditional banking system."[106]

The current administration's efforts to expand the crypto industry, insert it into mainstream financial products like workers' 401(k) retirement savings, and entwine stablecoins more deeply with the banking system are increasing these risks.

3. AI-driven brittleness

The AI boom itself is also creating new economic trouble spots, which could make the economy less able to absorb the shocks that would follow the bursting of the bubble. Most of these new pain points are outgrowths of the data center boom, which has cannibalized essential resources from other parts of the economy.

Data centers' insatiable energy appetite is straining consumers' pocketbooks and creating new risks for utilities and other companies tied to the electric grid.[107] Utilities and grid operators have issued tens of billions of dollars in bonds and contracted for hundreds of gigawatts' worth of new infrastructure to meet anticipated data center demand.[108] Those entities would face a crisis of their own if a substantial portion of that anticipated demand evaporated due to an AI crash, potentially leading utilities to either significantly increase rates on households and small businesses or risk defaulting on their debt.

AI is straining supplies of other crucial resources as well. Many data centers use enormous quantities of water for cooling. Unlike with electricity, it is often not even possible to scale up water supplies in regions near data centers, most of which are being built in areas where water supplies are already stretched, like the arid Southwestern U.S.[109] The data center boom is also leading to scarcity in supplies of key resources such as construction materials and semiconductors.[110] As the *Wall Street Journal* warned in June 2026, the AI buildout is "beginning to push up prices on everything from smartphones to electricity," fueling a "third wave of inflation."[111]

The sheer scale of the financial and material resources involved means that the AI boom may be creating other economic soft spots that will be difficult to detect or measure until after the bubble bursts. Economic shocks often expose weaknesses in the economy that were not readily apparent beforehand. We won't know the full extent of economic activity that would come under threat in the event of an AI crash unless and until such a crash occurs.

PART TWO

How an AI crash could start and spread

Part II: How an AI crash could start and spread

Having outlined the AI bubble's key characteristics and risks, we now turn to the question of why and how the bubble might burst as well as how the effects of an AI crash might ripple (or rip) through the rest of the economy.

By "crash," we do not necessarily mean that any specific company or companies will go bankrupt, although, as we explain, major firm failures are certainly a possibility. Rather, a crash occurs when the value of a particular class of assets — here, shares in AI companies as well as debt linked to those companies and to the chips and data centers they own, lease, and operate — falls precipitously.[112] While some crashes are dramatic and triggered by a specific event (such as the collapse of Lehman Brothers in 2008), they can also play out gradually over weeks or months as the market loses confidence in the industry (like the bursting of the dot-com bubble in 2000). In either event, they typically are due to risks that accumulated months or years before the crash. Regardless of the particular form it might take, the AI sector's dominance in both equity and credit markets means that an AI crash would likely be felt well beyond the AI industry.

While not intended to be a prediction of a specific sequence of events, Parts II and III are organized in a manner that allows us to describe how key sources of risk, contagion effects, and other aspects of a potential AI crash relate to each other. In brief outline: several forces are increasing the odds of a crash, which would likely start with weaker AI players; those players are deeply interconnected with the Big Tech companies; the Big Tech companies play a central role in the broader stock market, and AI-linked debt similarly dominates credit markets; and an AI-centered market crash thus could have severe effects on financial markets and the real economy.[113]

Part II will focus on why the likelihood of an AI crash is increasing and how the bursting of the AI bubble could devastate the tech sector. It proceeds as follows:

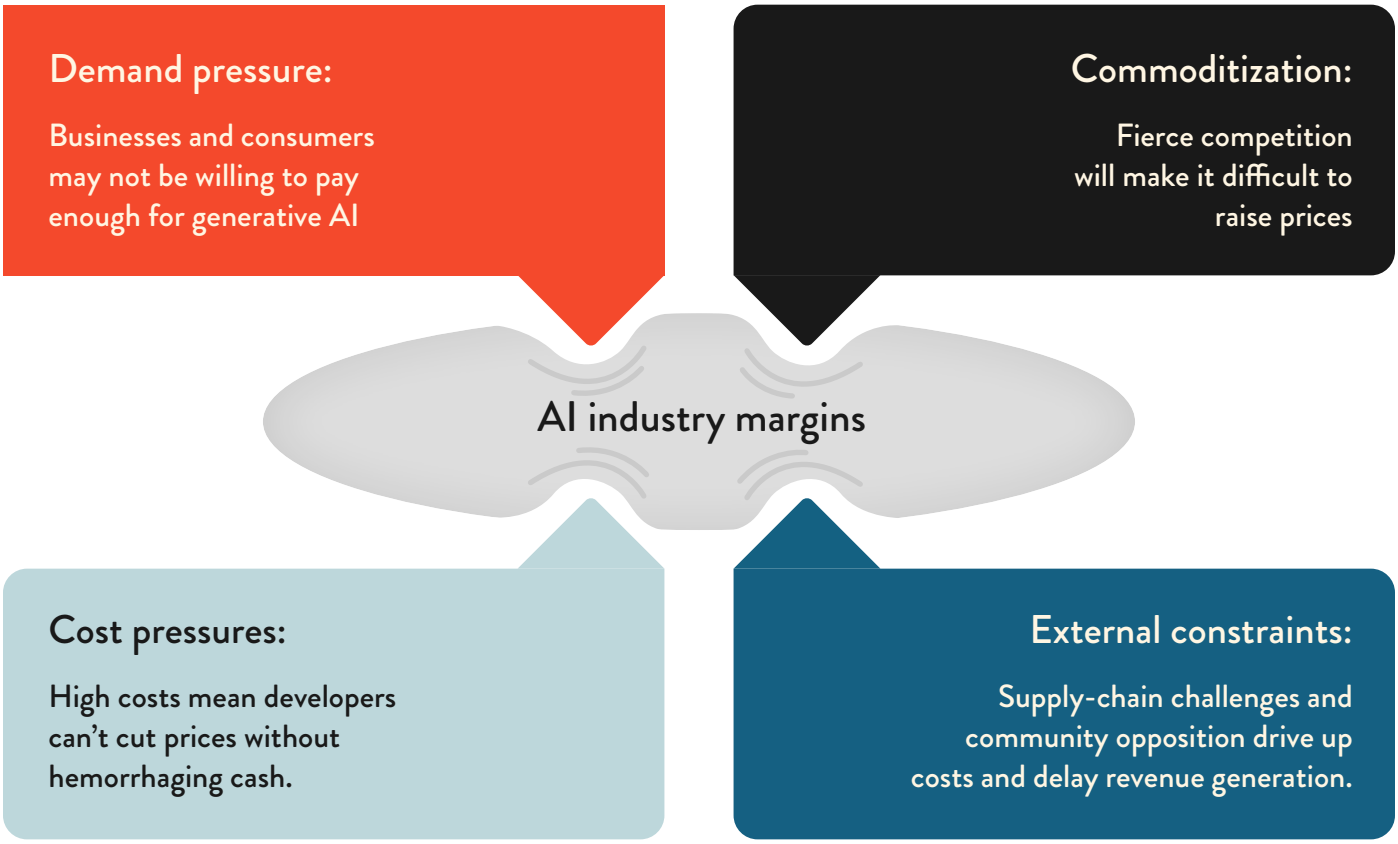
- AI companies will likely struggle to earn the returns necessary to meet their obligations due to a combination of forces that tend to increase the AI industry's costs and constrain its revenue growth (Section A).
- The most probable starting points for an AI sector crash are the most precarious AI model developers (OpenAI, Anthropic, and SpaceX), the fragile data center debt associated with the overstretched neoclouds, and the shaky hyperscaler Oracle (Section B).
- Regardless of where an AI crash might originate, the interconnectedness of the AI ecosystem means that a collapse would threaten to drag down the rest of the tech sector, including some of the largest tech companies (Section C).

A. WHY AI COMPANIES COULD STRUGGLE TO PAY THEIR MOUNTING BILLS

Thus far, AI companies have been able to cover the massive gap between their revenues and their spending by raising unprecedented amounts of money from investors in the form of both equity and debt. But one can only go on so long raising money from Peter to pay Paul (just ask Charles Ponzi and Bernie Madoff). Sooner or later, companies must be able to pay their bills from (actual, non-circular) revenues. Just as important, sustaining the infrastructure and stock market booms requires that financial market participants maintain their confidence in generative AI's path to profitability. As John Maynard Keynes observed, market sentiment is often driven less by rational assessment of financial prospects than by "animal spirits," and "if animal spirits are dimmed and spontaneous optimism falters, leaving us to depend on nothing but a mathematical expectation, enterprise will fade and die."[114] If it becomes apparent that tech companies will be unable to cover their costs or that lenders have lost confidence in their ability to do so, market optimism could turn quickly into pessimism, precipitating a crash.

With AI-related capital expenditures continuing to increase and large swaths of data center construction loans coming due over the next two to three years, markets will be watching the AI industry's financial trajectory closely. This section describes the imposing and possibly insurmountable obstacles that could prevent AI companies from increasing their collective revenues quickly enough to pay their bills and satisfy investors' expectations. The forces described in this section (see figure) tend to drive down revenues or increase costs, are already visible, interact with and reinforce each other, and seem poised to continue, if not worsen, over time.

FIGURE 13: Key forces squeezing the AI industry's margins



This section focuses on forces that are, in the main, endogenous or particular to the AI industry. Additional forces, particularly rising interest rates, are pressuring borrowers across the economy and could eventually squeeze companies on shakier financial footing into default, particularly those (like many tied to the data center boom) that will need to refinance in order to pay existing debts. Shortly before this paper went to press, the Federal Reserve raised interest rates for the first time since 2023 and signaled that further rate hikes were likely.[115] Such monetary tightening notably preceded the bursting of many speculative bubbles, including the dot-com bubble.[116]

1. There may not be trillions of dollars' worth of generative AI demand

It is an open question whether demand for generative-AI-based products and services will be strong enough or come fast enough to spur the revenue growth needed to justify AI industry spending. The additional demand required is unprecedented — no emerging technology has ever had a break-even point in the trillions of dollars per year in revenue. Whether sufficient demand emerges will depend on whether businesses (and, to a lesser degree, consumers) start seeing stronger returns on their investments in AI products and services and how quickly those returns materialize.

The guiding assumption of the AI boom is that generative AI will massively increase productivity, particularly by automating tasks typically performed by white-collar workers. So far, however, there is scant evidence that generative AI is driving significant productivity increases, much less transformational ones.[117] At the macroeconomic level, AI had no obvious impact on productivity in 2025[118] nor in the first half of 2026.[119] Zoom in to the level of individual businesses, and the picture is much the same.

> *Multiple studies, including from organizations otherwise notable for their bullishness on AI, suggest generative AI is not accelerating productivity or otherwise generating positive returns on investment for most businesses.[120] This may partly explain why the number of U.S. adults who said they were using AI at work declined noticeably between mid-2025 (46%) and mid-2026 (33%).[121]*

Even if dramatic productivity gains from AI do emerge at some point, their arrival may not come quickly enough to cover the industry's fast-mounting bills. Returns on tech-

nological revolutions do not always, or even usually, arrive quickly. Railroads and the internet were transformational technologies, but the speculative bubbles they generated burst because it took far longer than investors expected for businesses to reorganize their operations in ways that unlocked the technologies' commercial potential. To that point, a recent study by the Federal Reserve Bank of St. Louis found that while corporate executives frequently mention AI-driven productivity increases on earnings calls, 95% of those mentions are about expected future gains rather than gains that have already appeared.[122]

Some companies that attempted to replace their human workers with generative AI have actually had to reverse course because the technology simply was not up to the task.[123] For example, the Buy Now, Pay Later firm Klarna attempted to replace customer service representatives with chatbots en masse, only to discover that, "[w]hile AI may be efficient, it turns out it's not great at handling nuance, empathy, or angry customers yelling about missed payments."[124] The company ended up quietly hiring back hundreds of laid off workers and was considering hiring gig workers to fill the remaining roles.[125]

2. Fierce competition is pushing down the industry's margins

Even if demand for generative AI picks up, the AI industry's frenzied competition will put downward pressure on AI revenues. Because none of the core technologies underpinning generative AI enjoy intellectual property protection, no company has an effective "moat" to keep competitors out. This has resulted in a crowded ecosystem where numerous well-capitalized corporations offer models that are comparable enough in their quality and capabilities that many customers switch between them based mainly on price differences,[126] a process called *commoditization*.

AI companies have proven that they can quickly offer competing products whenever a rival identifies a productive application of generative AI. Indeed, the firms pile in whenever a use case shows even a hint of commercial potential. Thus, when Anthropic successfully launched Claude Code in March 2025, it was followed just three months later by OpenAI's Codex and Google's Gemini Code Assist,[127] and it took mere hours for OpenAI to strike a deal with the Pentagon after the Trump administration banned the use of Anthropic's models.[128]

This summer, the industry began to descend into a brutal form of market competition: a price war. In early June, reporting indicated that Anthropic and OpenAI were considering drastic price cuts in an effort to win customers ahead of their anticipated IPOs. By July, Silicon Valley model developers were attempting to outdo each other by offering steep discounts of up to 75% for access to their models.[129] With Alphabet (Gemini), Amazon (Nova Act), Microsoft (Copilot), Meta (Llama and now Muse), SpaceX/xAI (Grok), and even Nvidia (Nemotron) offering their own models, Silicon Valley's AI behemoths are likely to continue to struggle to raise prices without losing customers to rivals.

Competition from Chinese model developers is putting further downward pressure on prices. In contrast to the mainly proprietary models of Silicon Valley model developers, most Chinese generative AI companies offer models on an open-weights basis, which allows businesses and individuals to access, modify, and build on models without paying a license fee. Open-weights models are particularly attractive for companies building their own AI tools, including the startups and large businesses that currently account for most commercial use of generative AI.[130] Chinese models have been rapidly gaining ground on their Silicon Valley rivals among commercial users.[131]

3. Generative AI is expensive at every point in its lifecycle

While demand and competition challenges make it difficult for model developers to raise prices, the technology's very high costs mean that they will not be able to keep prices low for long either. In addition to enormous upfront capital expenditures on chips, data centers, and supporting infrastructure, generative AI requires hefty costs throughout models' lifecycle. Model training requires electricity to power AI chips and additional energy and/or water to cool them. More sophisticated models require more computational power to train and thus more energy and water to power and cool the specialized chips. As a result, the costs of Anthropic and OpenAI's new frontier models have been increasing by orders of magnitude with each new generation, even as AI chips have become more efficient.[132] Each new generative AI model thus comes to market with a large bill already attached to it.

The costs continue to mount when customers access generative AI models. Each time someone asks a chatbot to answer a question or create an image, additional computational power, energy, and cooling are needed to process the query and generate a response, a process called *inference*. While the latest chips are more efficient at processing *tokens*, the technical term for the fragments of text and other data that generative AI models process and generate, more sophisticated "reasoning" and espe-

cially "agentic" models consume far more tokens when responding to queries, which can cause overall inference costs to rise even as the per-token cost falls.[133] The cost of key inputs is also increasing due to the memory chip shortage and other supply chain constraints, further increasing operational expenses.[134]

4. Resource constraints and infrastructure bottlenecks

In addition to internal price and cost challenges, there are numerous external factors that could delay or drive up the cost of the data centers and other infrastructure needed to train and run AI models or even stop projects from being completed at all. A fierce and still-rising backlash to AI in general and data centers in particular across the political spectrum has developed over the past year,[135] including in regions of the U.S. that are considered tech-friendly and/or pro-business.[136] Community opposition to data centers has scuttled a number of data center projects and delayed many others.[137] For projects that do get off the ground, supply chain challenges are leading to delays and higher prices on key inputs such as construction materials, power generation, and memory chips.[138] Utilities are also struggling to bring enough new power generation capacity online to meet data centers' enormous power needs, forcing many data center developers to install gas-powered power generators on-site.[139]

Navigating the logistics of data center construction is proving to be exceptionally challenging for many of the companies that have taken on these huge infrastructure projects. Several hyperscale data center projects have been canceled,[140] and only half of AI computing capacity scheduled to come online over the next two years is expected to do so by its target date.[141] These delays and cancelations will limit the computational capacity AI companies are counting on to generate the revenue that they will desperately need to cover their costs and convince lenders to continue extending credit to them.

5. The squeeze

The industry's brutal economics are not likely to improve anytime soon. Even if demand for generative AI were to pick up significantly, competition — both among the big U.S. companies and with their open-weights Chinese rivals — will continue to be intense. Those forces will apply unrelenting downward pressure on prices even as high costs and resource constraints squeeze companies from the opposite direction.

These factors are a dangerous mix for an industry that has accumulated trillions of dollars in on- and off-balance-sheet debt, a vast and immovable cost. With those costs continuing to accumulate far faster than revenues from generative AI products and services, a financial reckoning for the industry appears increasingly likely.

B. POINTS OF FRAGILITY IN THE AI ECOSYSTEM

It is impossible to tell when a speculative bubble will end, much less what might burst or deflate it or which companies will be the first to fall. That said, the generative AI ecosystem has a few particularly glaring points of fragility:

- Three *model developers*, namely Anthropic, OpenAI, and SpaceX, which have made ambitious financial commitments but are earning only a fraction of the revenues necessary to meet them (Subsection 1);
- *Neocloud-linked data center debt*, which is often financed through a brittle stack of leases and loans, the timely repayment of which depends on numerous factors beyond any one party's control (Subsection 2); and
- *Oracle*, a hyperscaler that has taken on more than $120 billion in long-term debt and $260 billion in off-balance sheet lease commitments in a gambit to become a dominant AI cloud provider (Subsection 3).

1. Anthropic, OpenAI, and SpaceX: The fragile model developers

While all model developers face the pressures described in Section A, the biggest hyperscalers — namely Alphabet, Amazon, Meta, and Microsoft — enjoy a considerable cushion thanks to the enormous profits they earn from their non-AI operations. Anthropic and OpenAI do not have that luxury. They are effectively "pure-play" AI companies whose continued existence depends on the commercial success of their generative AI products and services. They thus are at a high risk of insolvency if generative AI sales growth slows or investors lose confidence in the industry's steep path to profitability. Anthropic and OpenAI's hundreds of billions of dollars in future data center lease and chip purchase commitments give them little margin for error when it comes to meeting their extremely ambitious revenue growth projections.

SpaceX, unlike OpenAI and Anthropic, has notable non-AI revenue streams. But SpaceX is scarcely less vulnerable. Musk's company has deeply negative profit margins and a significant amount of long-term debt, including $25 billion

in bonds that the company issued shortly after its IPO.[142] The value of those bonds soon fell sharply, suggesting that investors doubt SpaceX's ultimate ability to repay them.[143]

SpaceX is also more of a generative AI pure-play than its name and reputation suggest. Its annual revenues, currently $19 billion, are a tiny fraction of the legacy tech giants', which range from $214 billion (Meta) to $743 billion (Amazon). Moreover, while SpaceX's current revenues come mostly from its rocket and satellite internet divisions, the company's prospectus makes clear that its future business plans center on generative AI, particularly building "orbital AI compute" — that is, data centers in space — and the company spent $40 billion to purchase the AI coding startup Cursor.[144] SpaceX's massive investments in AI mean that its future business, like those of Anthropic, OpenAI, and the neoclouds, depends on generative AI going from deeply unprofitable to wildly profitable within a few years.

The shaky financial position of Anthropic, OpenAI, and SpaceX leaves them especially vulnerable to the forces outlined in Section A. Model developers' biggest costs, namely purchases and leases of chips and data centers, are set years in advance through multi-year contracts. Any departure of cost-conscious customers would force model developers to try to squeeze an even larger profit margin out of each remaining customer to cover those effectively fixed costs. To do so, they may have to raise prices even more, which could cause still more customers to flee, forcing further price increases in a negative feedback loop.

A desire to avoid such a trap helps explain why model developers offered access to their models at a deep discount to their actual cost for several years, which for a long while meant that AI companies lost money on virtually all their users,[145] including those with premium subscriptions.[146] That is not a sustainable business model. Anthropic appeared to bow to that reality when it switched from subscriptions to usage-based pricing for enterprise customers earlier this year.[147] While this was not billed as a price increase, that is exactly what it was.

The move apparently succeeded in raising Anthropic's revenues for the quarter, but what unfolded thereafter was telling. Many customers, having gotten used to the industry's previous buffet-style pricing, got sticker shock when they had to pay *a la carte*. One company reportedly ran up a $500 million bill to Anthropic in just three months.[148] Unsurprisingly, several companies began to question whether it was worth paying the new, higher prices for access to leading AI models. Some Anthropic customers, including Microsoft and the crypto exchange Coinbase, quietly switched to in-house or open-weights models to cut costs.[149] Others, including Uber and Walmart, chose to cap their AI usage rather than pay more for it.[150] Weeks later, Anthropic and OpenAI reversed course, triggering the industry's burgeoning price war. Enterprise customers have gone from racking up huge, unexpected AI bills to receiving millions in free AI tokens.[151]

> ***Moreover, while Anthropic and OpenAI continue to sign chip and cloud contracts that commit them to train and run ever-more powerful and expensive models, there are growing signs that most businesses are not interested in paying for more powerful and expensive models.***

Anthropic's most recent commercially available frontier model, Fable, received a tepid commercial reception; two months after its release, the model had plateaued at about 11% of businesses' Anthropic token spending, with only 6% of its customers choosing to upgrade from the developer's older models.[152]

The lack of transparency into generative AI's baseline costs and true revenues makes it difficult to determine how financially sustainable model developers' operations are. But the events following the spring 2026 price increases suggest that they are struggling to find a sustainable path to profitability. Harsh choices thus may await the model developers: keep prices low and hemorrhage money, or raise them and watch customers flee, be it to cheaper models, to deeper-pocketed rivals who can better absorb losses, or to human workers.

2. Neoclouds and brittle data center debt

Vulnerable as the model developers are, the neoclouds and their data center development projects, both of which are showing signs of serious financial strain, could also become an origin point for a crisis. Most neoclouds' bonds are rated as junk and carry correspondingly high interest rates.[153] External pressures are hitting their data-center development efforts hard; rising energy costs, other resource constraints, and growing community opposition to data centers are delaying or outright blocking many projects.[154]

So far, the neoclouds have mostly been able to pay their bills thanks to circular financing arrangements, leases, and other deals with other generative AI ecosystem participants — particularly Nvidia, whose chips fill their data centers. But those data centers are being financed by exceptionally brittle debt, often involving consecutive loans that could easily go into default if there are construction

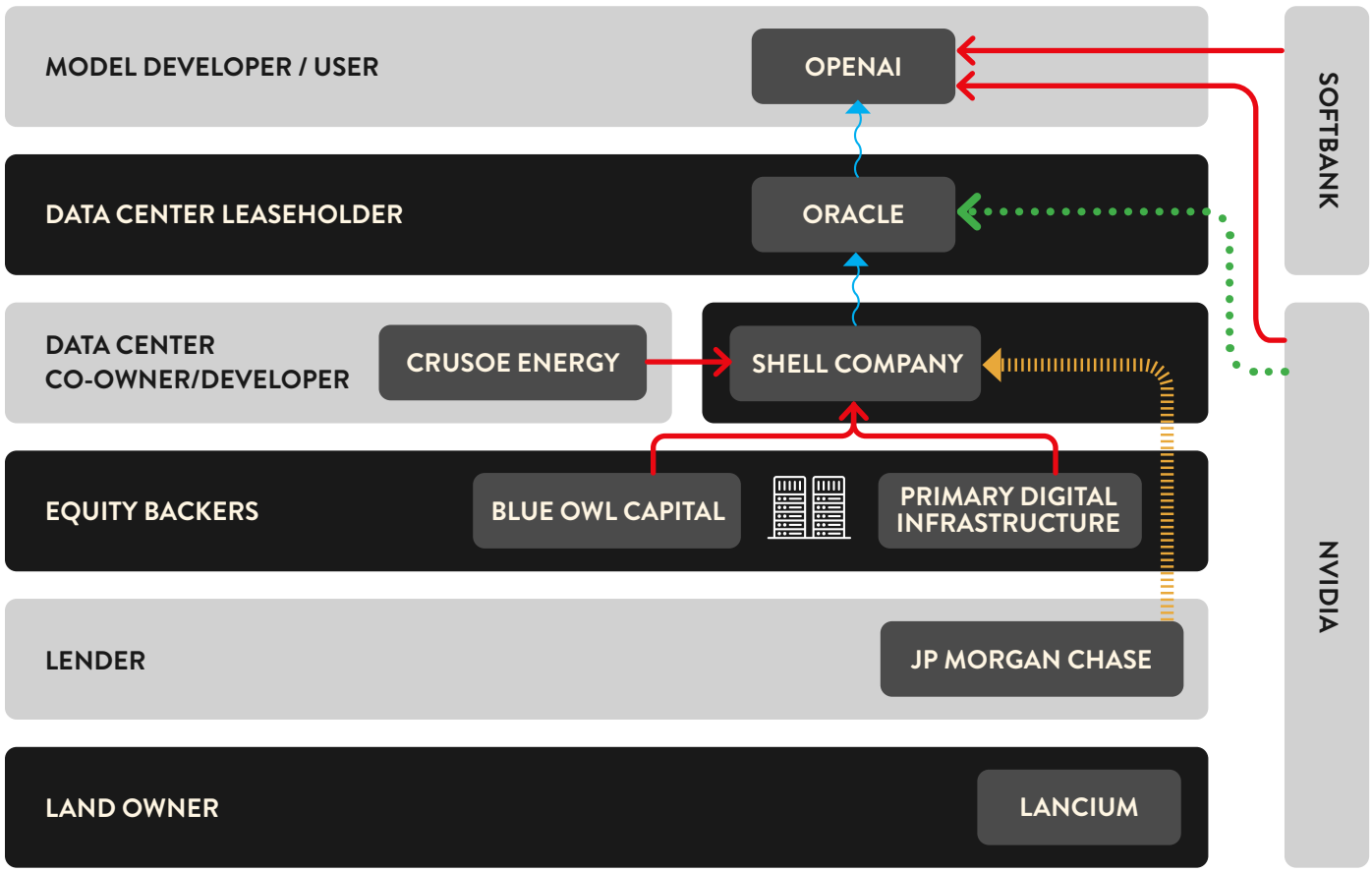
delays, cost overruns, or model developers who break or choose not to renew leases.[155]

The construction of major data centers often involves numerous entities, each of which has billions of dollars riding on every other entity fulfilling their responsibilities. For example, OpenAI is using the Nvidia chips at a huge data center in Abilene, Texas to train and run new generative AI models. But OpenAI does not own the data center or the chips. Rather, it is effectively leasing both from Oracle using money OpenAI has raised from its investors, including Softbank and Nvidia.

It only gets more complicated from there, because Oracle does not own the Abilene facility either. Oracle leases it from a neocloud, Crusoe Energy, but (wait for it) Crusoe doesn't fully own it either. Rather, it is co-developing the site with private investment firm Blue Owl Capital and an investment fund called Primary Digital Infrastructure (PDI). Together, the trio financed the site's development using $5 billion in cash and a $10 billion loan from JPMC taken out by a shell company sponsored by Crusoe, Blue Owl, and PDI.[156] Yet another entity, Lancium, owns the land on which the data center is being developed.

Such multilayered structures are precarious. If the model developer is unable to fulfill the terms of the lease or the neocloud cannot complete the construction of the data center, each of the other parties involved in the project would face billions in potential losses unless another entity can be roped in to fulfill the obligations of the delinquent party. If generative AI demand continues to rise and the other actors in this stack have the financing required to meet their demands, that is doable; indeed, when OpenAI pulled out of a planned extension of the Abilene complex, Microsoft leased it instead.[157] But if there is a wave of broken leases, as would likely occur after a broad stagnation in generative AI demand, replacement tenants would be hard to come by and huge amounts of data center debt could become toxic. Toxic debt would also become endemic if a large number of data center projects failed for other reasons, such as the cost overruns, delays, and community opposition that have

FIGURE 14: Visual of Abilene corporate layer cake



Legend: SALE ····→ LEASE ~~→ EQUITY STAKE ——→ LOAN ||||→

Note: Arrows run from seller to buyer, lessor to lessee, investor to share issuer, lender to borrower.

already scrambled many data center projects, or if rising interest rates cause credit to tighten and leave AI companies unable to refinance data center loans.[158]

The risk of a build-up of toxic data center debt is particularly high because many lenders have issued data center loans on a "booked-but-not-billing" basis, meaning that the loan is made based on a model developer's mere *promise* to lease the facility and make payments rather than the commencement of actual payments.[159] This illustrates that even where the model developers' and hyperscalers' off-balance-sheet commitments are cancelable, they often underpin risky debt elsewhere in the AI ecosystem.

Another feature that adds to the risk of a toxic debt buildup: these data center loans are often *securitized* — that is, sliced up and packaged into bonds that are sold to investors, often institutional investors such as insurers and pension funds. Through securitization, it is those investors, not the bank or private credit firm that originated the loan, that carry the risk of a model developer or neocloud's default. There is a clear parallel here with the subprime mortgage bubble, when mortgage originators issued a massive number of loans without sufficiently considering borrowers' ability to repay those loans because the subsequent securitization of the loans meant that someone else would bear the risk of default.

3. Oracle's all-or-nothing bet on rapid AI transformation

As the above description of the neoclouds' financial hurdles suggests, the finances of many companies in the AI ecosystem depend on the ability of OpenAI and Anthropic to pay their bills. Perhaps no company is more reliant on and exposed to the pure-play model developers, however, than deeply indebted Oracle.

Oracle's capital expenditures rival those of Microsoft, Amazon, Google, and Meta, but its revenues are only roughly 30% of Meta's, the smallest of Oracle's hyperscaler rivals. Consequently, Oracle has been forced to borrow heavily, racking up roughly $120 billion in long-term debt,[160] including $43 billion added in the past year,[161] on top of $260 billion in off-balance-sheet debt, mostly in the form of lease commitments.[162] Much of this debt is fueling a spending spree on chips and data center capacity that Oracle plans to sell or lease to OpenAI, which has committed to spend $300 billion to access Oracle's infrastructure.[163]

If OpenAI fails to grow its revenues fast enough and breaks a substantial number of its commitments, Larry Ellison's company would be hit especially hard. Markets already seem to think that Oracle's prospects have become shaky, with its credit ratings hovering just above junk and investors having to pay high premiums for Oracle's credit default swaps (essentially, insurance that is paid out if Oracle defaults on its debt).[164]

It would not take a full-on collapse of OpenAI to threaten Oracle's viability, as Oracle itself came close to admitting in its most recent annual financial report. The report acknowledged that the corporation's debt pile means that it faces a risk of being "locked into multi-year commitments for excess data center space and related capital expenditures, as well as associated financings, without receiving corresponding revenue" if Oracle "overestimate[s] customer demand or any of [its] key customers are unable to pay."[165]

Moreover, and similar to many neoclouds, Oracle faces risk from the mismatched time horizons of its long-term debt and model developers' shorter-term leases. In a generative AI downturn, as Oracle's financial report states, "if customers do not renew their contracts, [Oracle] may be unable to re-lease, repurpose or assign" its data center capacity "on acceptable terms, if at all."[166] Oracle is also exposed to data center construction delays and "cost increases related to design, engineering, permitting, construction, utility interconnection, equipment delivery and contractor performance."[167] While Oracle frames these challenges merely as threats to its "profitability," the high cost of insuring against an Oracle default suggests that markets fear they could leave the industry stalwart unable to pay its debts.[168]

C. BIG TECH'S DEEP EXPOSURE TO AN AI CRASH

How, and how much, an AI crash affects the tech giants depends on its nature and depth. If a crash is shallow or short-lived, the failure of smaller AI industry players might be a potential boon for the tech giants; Amazon, Google, and Microsoft would be eager to use the collapse of Oracle or the neoclouds to cement their cloud dominance, and any Big Tech behemoth would love to snap up OpenAI and Anthropic's AI products and market share on the cheap.

Such a series of events would mirror the outcome of the 2008 financial crisis, which ended with the biggest banks becoming still bigger, and the dot-com bubble, which not only spared but ultimately strengthened Amazon, Apple,

Google, and Microsoft as many of their potential rivals withered or died. If generative AI demand merely fails to meet loftiest expectations or takes slightly longer than expected to fulfill them, we could see a similar wave of consolidation where the surviving giants carve up the AI market between them.[169] (Though, as we note in Part IV, the federal government should block any such mergers and rein in anticompetitive practices across the industry).

But the tech giants may be more vulnerable than they seem. Despite their dominance, Nvidia and the hyperscalers' extensive web of connections with the rest of the AI ecosystem means that they would be deeply and directly affected by a severe crash originating with the ecosystem's smaller and weaker players (Subsection 1).

Moreover, Big Tech companies have placed their own massive bets on generative AI, as illustrated by their stakes in model developers and the trillions of dollars in on- and off-balance-sheet debt they have assumed to build data centers and purchase chips and compute capacity. The collapse of a major model developer or a series of failed data center projects would likely create a major shock affecting all those investments. Nvidia, which dominates the chip market, is deeply exposed to such a shock because of its massive forward purchase commitments and circular financing arrangements with model developers and neoclouds (Subsection 2). Similarly, the hyperscalers' huge pile of debt, much of it off-balance-sheet, and circular-financing-driven-revenues mean that they are far more exposed to stagnation in generative AI demand than their enormous profits suggest (Subsection 3).

1. Contagion within the AI ecosystem

As previously noted, the various players in the AI ecosystem are deeply interconnected with each other. Most of the Magnificent Seven's earnings growth in the second quarter of 2026 came not from increasing sales, but from the increasing value of their investments in other AI companies.[170] Nvidia and the hyperscalers have also directly guaranteed hundreds of billions of dollars in loans and lease payments by neoclouds and model developers. Nvidia alone is exposed to $297 billion in off-balance-sheet debt through its backstop guarantees and purchase commitments to other AI companies, leading *The Economist* to dub Nvidia "the central bank of AI."[171] But these liabilities do not appear on Nvidia's balance sheet.[172] Similarly, Alphabet has guaranteed $44 billion of Anthropic's leases but has marked the value of that potential liability at just $815 million on its balance sheet.[173]

The extensive web of equity stakes, cloud computing contracts, lease and purchase agreements, financing arrangements, and debt guarantees connecting chipmakers, hyperscalers, model developers, and neoclouds mean that a crash in any one corner of the AI ecosystem would likely spread to others.

2. Nvidia is deeply exposed to acute stress within the AI ecosystem

Nvidia is the most valuable company in history, but the company has hundreds of billions of dollars tied up in financing arrangements involving OpenAI, Anthropic, and the neoclouds. Those deals illustrate the degree to which the chip giant is counting on those companies as a source of future demand for its chips.

The greatest threat to Nvidia would arise if the demand for its chips experienced a reversal, which have historically been common in the chip industry.[174] The lengthy lead time, often a year or more,[175] between when a customer orders an Nvidia chip and when the chip is activated in a data center means that there is an enormous amount of GPU capacity moving through the manufacturing, packaging,[176] server integration, and data center construction pipeline at any given time. A stagnation or decline in generative AI demand, particularly if it leads to the collapse of Oracle, a major model developer, or a significant number of neoclouds, would create a volatile mix of demand and supply shocks in the AI chip market. Nvidia's customers could default on or cancel orders, reducing future demand, while GPUs already installed in data centers might be offered for rental or sale at distressed prices. Such a glut in GPU capacity would severely weaken the market for Nvidia's chips.

Nvidia's business model has left it increasingly vulnerable to such market shocks. Nvidia has a substantial stockpile of cash ($63 billion as of July 2026), but the company disclosed $511 billion worth of forward purchase commitments and debt guarantees on its Q2 2026 earnings statement[177] — and that does not include the additional guarantees Nvidia will provide under another 12-digit financing arrangement the company announced the following month.[178] If the demand for its AI chips were to plunge, Nvidia's cash flows would dry up, but those obligations would remain. In such a scenario, Nvidia could burn through its cash quickly.

3. The hyperscalers' hidden vulnerability

The hyperscalers' profitability seems as unassailable as Nvidia's, with Alphabet, Amazon, Meta, and Microsoft each boasting annual profits that approach or exceed $100 billion. But, like Nvidia, the hyperscalers are deeply vulnerable to an AI crash.

The hyperscalers' financial statements are already showing signs of strain. Over the past two years, the hyperscalers have gone from financing AI infrastructure spending from operating cash flows to issuing massive amounts of debt (and, more recently, equity) to cover their capital expenditures.[179]

Much like Nvidia, while the tech giants' market dominance has allowed them to accumulate a massive cash pile (a combined $533 billion as of the end of Q2 2026), their even larger debt obligations and breakneck spending have left them in a precarious position. This summer, Alphabet reported negative free cash flow for the first time in its two-plus decades as a publicly traded company.[180] Amazon likewise turned cash-flow negative earlier this year, and Meta and Microsoft are on the cusp of doing so.[181] By early 2027, the top four hyperscalers' combined free cash flow is expected to turn negative as their capital expenditures continue to increase (see figure).[182]

Much of the hyperscalers' skyrocketing obligations are accumulating off their balance sheets in the form of future lease and purchase commitments. In their Q2 2026 earnings statements, Alphabet ($896 billion),[183] Amazon ($267 billion),[184] Meta ($696 billion),[185] and Microsoft ($523 billion)[186] each reported future lease and purchase commitments far exceeding the annual revenues of nearly all (or all, in Alphabet's case) Fortune 500 companies.

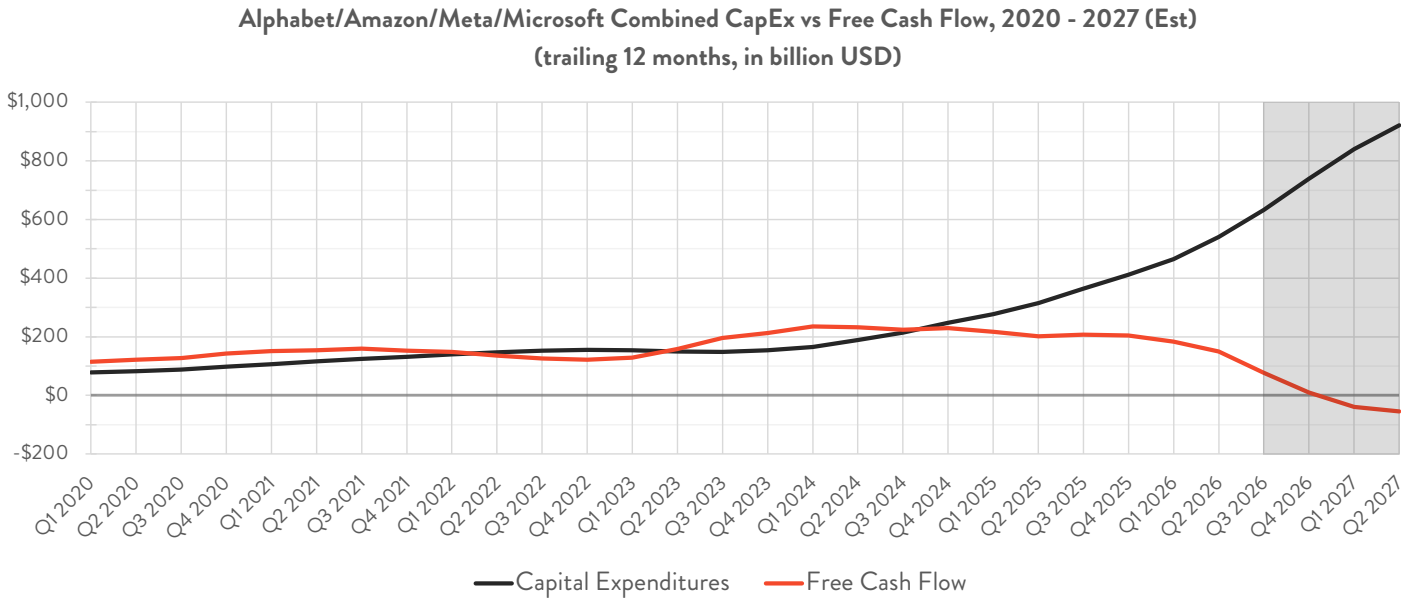
Add those nearly $2.4 trillion in off-balance-sheet commitments to the companies' $342 billion in balance-sheet debt, and the total obligations of Alphabet, Amazon, Meta, and Microsoft as of September 2026 stood at roughly $2.7 trillion. That is one and a half times their combined annual revenues and five times their combined annual profits — revenues and profits that, again, appear to be artificially inflated by dubious financial arrangements and accounting methods.

If demand growth for generative AI services were merely to slow significantly, narrowing the technology's path to profitability, the hyperscalers could be forced to cancel the construction of many of the data centers that they are rushing to build. If generative AI demand actually fell, the giants would likely have to mothball some existing data centers as well.

It is here that the hyperscalers' extensive use of shell companies and off-balance-sheet debt would face its toughest test. By structuring their future data center obligations as lease agreements with shell companies, the hyperscalers apparently hope that they will be able to walk away more easily if the generative AI market reverses (or, at least, they want to convince auditors and markets that they will be able to do so).

FIGURE 15: The hyperscalers' cash flows are turning negative as their AI spending accelerates

Source: *Bloomberg*. Figures from Q3 2026 onward are estimates.[187]



But when SPVs tied to a particular sponsoring company start going bankrupt, markets begin to question the creditworthiness of the sponsoring company itself. That is why Citi was forced to take shell companies holding underwater mortgage debt back onto its balance sheet in 2007 after the subprime bubble burst.[188]

Lease obligations provide an additional mechanism for shell companies' liabilities to come back onto hyperscalers' balance sheets. If a hyperscaler breaks a lease with an SPV and the SPV goes bankrupt as a result, the SPV's creditors could have a direct claim against the hyperscaler for the balance due under the lease agreement.[189] For these reasons, the hyperscalers would be hard-pressed to extract themselves from the bulk of their off-balance-sheet obligations.

Any downturn that leads to cancelation of hyperscale data center projects or the decommissioning of a significant number of chips could also force a day of reckoning on the tech giants' depreciation trickery.[190] Last fall, investor Michael Burry calculated what would happen if the true useful life of the tech giants' Nvidia chips turned out to be less than the tech giants claim. He estimated that Amazon, Google, Meta, and Microsoft would have to collectively write down *$207 billion* on their balance sheets through 2028, with each company being forced to take a hit of roughly $50 billion.[191]

Burry's calculation was made on the assumption that the chips would simply be replaced more quickly than the hyperscalers' balance sheets suggest. In the case of an AI crash, the chips' value could drop even more quickly and dramatically, making the losses still greater. The mechanics of corporate accounting would magnify the effects of such write-downs on the companies' books.[192] Their stock prices would almost certainly plunge, which, given their 13-digit valuations, would destroy trillions of dollars in paper wealth. The concentration of American wealth held in equity markets would make any such correction devastating, even if all of the Magnificent Seven survive the crash. None of the 10 most valuable companies in 1929 went bankrupt after that crash;[193] their falling stock prices still sent the market into the tailspin that ultimately culminated in the Great Depression.

If any of the tech giants did go bankrupt, the fallout would, of course, be far worse. A recent paper by Jessica and Jonathan Wachter argues that such Big Tech failures are a real risk.[194] According to the paper, hyperscalers' current investment spree implies that they believe that (1) generative AI triggered a rare productivity boom shortly after ChatGPT was released and (2) they will be able to profit from that boom in an amount commensurate with their skyrocketing spending.[195] But the productivity boom currently is only "in investment data [and] not yet in productivity data. If the boom fails to materialize, the current buildout will be *the largest misallocation of capital in history*."[196] In that case, "customers would be unwilling to pay for more AI usage," and the hyperscalers would face "declining stock valuations, failure to make interest payments on debt, and perhaps bankruptcy."[197]

While the tech giants' dominance makes such an outcome seem unlikely, the risk must be taken seriously, particularly given the recent deterioration of hyperscalers' cash flows. The downfall of a company with the size or market power of Alphabet, Amazon, Meta, Microsoft, or Nvidia would be unprecedented and the blast radius of such a collapse would be enormous.[198]

PART THREE

Why an AI crash would pose serious macroeconomic risks

Part III: Why an AI crash would pose serious macroeconomic risks

The bursting of speculative bubbles and resulting market downturns can spark broader economic crises, but they do not necessarily do so. If a crash stays largely contained within a single sector (as with the dot-com bubble) or the shock dissipates almost as quickly as it materialized (as with Black Monday in 1987), the economy may experience short-term pain but often will bounce back quickly. Unfortunately, the AI bubble's unprecedented size and AI companies' interconnectedness with the broader economy and financial system would make an AI crash exceedingly difficult to contain.

As financial journalist John Cassidy has explained, there are three main ways in which a stock market crash or other collapse in asset prices can damage the economy.[199] First, "it can damage the banking system, especially if banks have lent a lot of money against assets whose value has collapsed."[200] This was the primary force in the 2008 financial crisis. Second, "[i]t can reduce consumer spending by making people poorer."[201] This and closely related forces were key mechanisms through which the 1929 crash led to the Great Depression.[202] Finally, "it can hit investment spending because firms find it more difficult to raise money."[203] This force, which played out to particularly damaging effect in the aftermath of the Panic of 1873 and during Japan's "Lost Decade" of the 1990s, is even more severe if the crash involves a significant quantity of toxic debt or otherwise creates stranded assets, which act as a chronic drag on economic growth.

An AI crash would threaten heavy doses of all three types of economic damage. Big Tech's dominance of major indices means that turmoil in the AI sector would threaten a broader stock market crash, particularly given the growing amount of leverage in the stock market and the large share of stocks held through passive index funds (Section A). The deep, and still deepening, exposure of private credit firms and life insurers to AI-linked debt provide fast-growing pathways for an AI crash to spill over into the banking system, in addition to banks' growing direct exposure to AI risk (Section B). The size of the AI bubble means that a collapse in AI-connected asset prices would threaten downward spirals in the real economy (Section C). The effect on investment could be just as catastrophic, particularly if the crash leaves behind a significant amount of stranded chips and data centers (Section D). The accumulation of these factors has created a veritable minefield of economic hazards that markets and policymakers alike would struggle to navigate in the wake of an AI crash (Section E).

A. LEVERAGE, PASSIVE INVESTING, AND INTERCONNECTEDNESS MEAN THAT AN AI CRASH COULD TRIGGER A BROAD AND DAMAGING STOCK MARKET CRASH

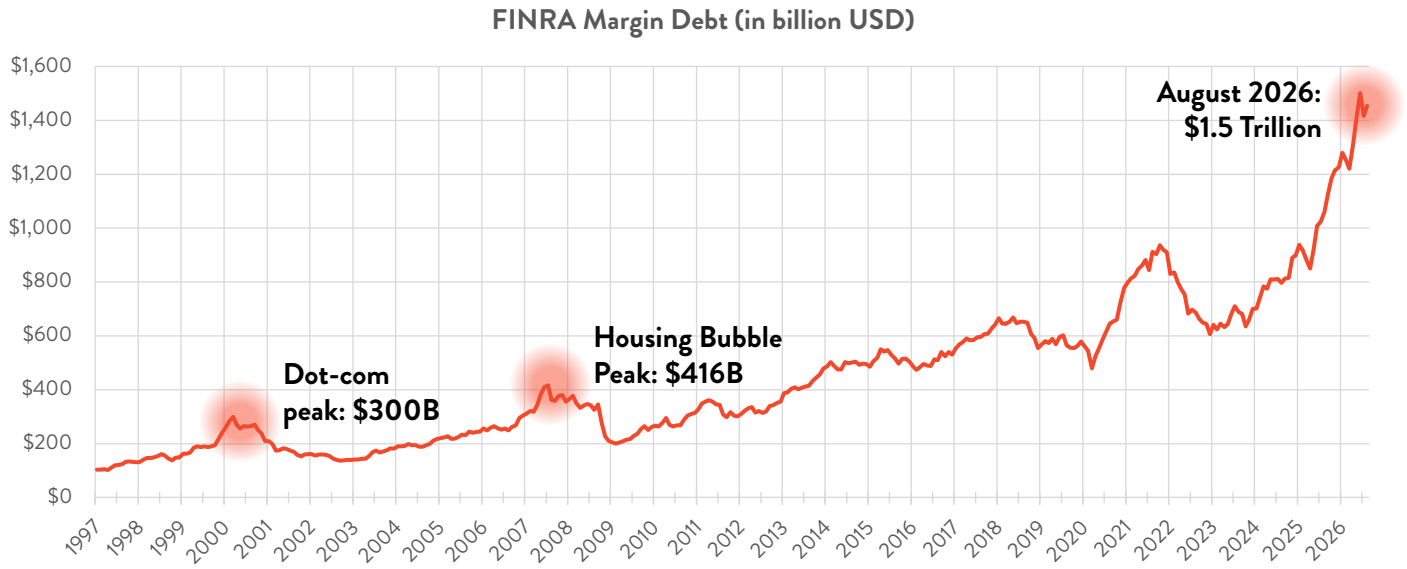
Because a handful of tightly interconnected tech companies consume roughly half of the S&P 500's market capitalization, a major fall in the value of AI-linked stocks would create a serious dent in the total value of the stock market even if all non-AI stocks remained unaffected. But a well-known economic adage is that in a crisis, all correlations go to one. That tendency for assets to fall together may be especially pronounced in the wake of an AI crash due to the sheer size of the AI boom.

Several features of modern equity markets would threaten to further spread and deepen any AI-driven stock market crash. The use of borrowed money, or *leverage*, to purchase and trade stocks is one well-known accelerant to market downturns. The best-known form of leverage is *margin loans*, in which a broker lends an investor money that the investor uses to buy stocks, bonds, or other securities. The securities in the investor's portfolio serve as collateral for the margin loan, and margin accounts have credit limits tied to the value of those securities. The amount of margin debt investors are allowed to have thus goes up when the market rises and down when the market falls.

During market downturns, investors who make heavy use of margin loans often face *margin calls* where the broker requires the investor to either pay down the margin loan or post additional collateral to secure it. To comply with the margin call, investors often are forced to liquidate parts of their portfolios. In a sharp downturn, many investors typically face margin calls at once, which creates a negative feedback loop if a large amount of margin debt has built up in the system: falling stock prices trigger margin calls; to satisfy those margin calls, investors liquidate parts of their portfolios; this additional selling accelerates the downward slide of stock prices, which triggers more margin calls, and so on. These dynamics played out to devastating effect during the 1929 stock market crash.[204]

FIGURE 16: Margin debt hit a record $1.5 trillion in the summer of 2026

Source: FINRA



The total amount of outstanding margin loans hit a new all-time record of $1.5 trillion in June 2026 and remained just below that peak at the end of August, up 40% from just a year earlier and having more than doubled since ChatGPT's debut.[205]

While margin lending is substantially below its all-time peak as a percentage of total stock market capitalization,[206] it is at a record high in absolute terms and as a share of currency in circulation[207] and GDP,[208] which increases the risk of collateral damage from a spate of margin calls.

The rise of *leveraged funds* could further accelerate any market downturn.[209] Leveraged funds use a combination of derivatives and debt to return multiples of daily changes in the value of stock indices and, increasingly, in individual companies' shares. While they still represent only a comparatively small share of the global equity market, leveraged funds have been growing rapidly in recent years and account for a disproportionate share of daily trading.[210] Such funds gained attention during the July 2026 South Korean stock market crash, which leveraged funds accelerated and deepened.[211]

An additional source of risk comes from the role of *index funds* in the modern stock market. Rather than investing in stocks selected by a fund manager, index funds tie themselves to the collective performance of all stocks in a particular pre-determined index such as the S&P 500 or the tech-heavy NASDAQ-100. Because such funds move mechanistically with their assigned basket of stocks, they may increase market volatility and accentuate the market's reflexive movements, making prices rise faster during booms but also fall more quickly during busts.[212] Today, more stocks are held in index funds and similar passive investment vehicles than at the time of any prior crash.[213]

Taken together, these factors mean that any crash within the tech sector would not likely stay confined there.

B. HOW AN AI CRASH COULD SPREAD TO THE FINANCIAL SYSTEM

There are several potential pathways through which an AI crash could threaten the stability of the financial system. Private credit firms, many of which are already reeling from poor fund performance, hold hundreds of billions of dollars in risky AI-linked debt (Subsection 1). Life insurers likewise play a large and growing role in data center financing, and many have been purchased by private equity firms that have weakened insurers' balance sheets (Subsection 2). Both the private credit sector and life insurers have close ties to commercial banks; if panic grips either sector, the risk of contagion to the rest of the financial system would be high. These dangers are exacerbated by banks' ties to the broader shadow banking system and their own holdings of AI-linked debt (Subsection 3).

1. A deeper private credit crash

If an AI-linked market crash were to occur, the private credit sector would find itself both heavily exposed to the

crash and in no position to withstand it. As a result, private credit could be an important amplification and transmission route.

The private credit crisis[214] remained ongoing as this report went to press. The crisis has forced private investment firms to turn to increasingly speculative and risky tactics to avoid realizing losses. One such tactic has been the rising use of "payment-in-kind" interest, where instead of making interest payments, borrowers are permitted to add the interest owed to the outstanding principal balance, effectively paying debt with more debt.[215] Private credit funds have also increasingly entered into agreements to purchase highly risky debt from "Buy Now, Pay Later" (BNPL) and consumer credit firms to access cash.[216] (That creates an additional layer of interconnection risk: in a broader economic downturn, whether triggered by an AI crash or other forces, an increasing number of consumers would be unable to pay their bills, and these investments in consumer debt would go south.)

The private credit sector is staggering through these difficulties in large part because private credit is also playing a major role in financing data center construction, and that market, where interest rates are high, is still booming.[217] But if the market for AI data centers were to falter, the private credit crisis could easily spiral.

As policymakers from Treasury Secretary Scott Bessent[218] and Fed Vice Chair for Supervision Michelle Bowman[219] to Senators Elizabeth Warren and Richard Blumenthal[220] have acknowledged, the poor transparency of private credit means that the sector occupies a regulatory blind spot. The opacity of private credit markets means that no one could be sure which funds (and the firms managing them) are solvent in a major crisis. Indeed, when transparency is poor, financial institutions may not even be sure of their *own* cash and financing needs, which can cause credit markets to freeze up, as happened with the markets tied to mortgage securities in 2007.[221]

Up to now, financial regulations have insulated retail investors and individual retirement accounts from direct exposure to ructions in private credit markets. The private investment industry has lobbied for years to change those regulations and gain access to the tens of trillions of dollars held in workers' individual retirement accounts and 401(k)s. Unfortunately, they are finally on the verge of success: the Trump administration is moving to unlock the doors that have protected working people, retirees, and middle-class savers from opaque private capital markets.[222] While institutional investors have borne the brunt of private credit's struggles thus far, individual workers and retirees could be increasingly and directly exposed going forward.

The opacity of private credit also exposes the traditional banks on which our economy depends to a largely unknown slew of financial risks. The murky definition of private credit and the opacity of the private investment ecosystem make it difficult to estimate the exact amount of exposure of commercial banks to private credit, but, as of the first quarter of 2026, U.S. banks carried $2.7 trillion in exposures to nonbank lenders in the form of drawn and undrawn loan commitments.[223] Consequently, as New York Fed researchers found earlier this year, troubles from private lenders "result in 'stress and strain' for banks," making the private credit ecosystem a potentially significant conduit through with an AI crash could spread to the banking system.[224]

In a downturn, private credit funds and their portfolio companies may draw down bank credit lines precisely when the value of their assets is falling and other sources of financing are drying up. Banks could therefore experience a simultaneous increase in funding demands and deterioration in the quality of the collateral and counterparties supporting those demands. If banks respond by tightening lending standards, canceling credit lines, or otherwise making it harder to borrow, they could intensify the private credit downturn and transmit the strain of tightened credit to households and businesses with no direct connection to the AI industry.

2. Mounting risks in the life insurance sector

An AI crash or a deepening private credit crisis — and certainly a combination of the two — would spell trouble for many life insurers, which fill key economic roles for both Main Street and Wall Street. For workers and consumers, life insurance is a way to access essential income in the case of catastrophic events. Increasingly, people have also turned to life insurers to provide them with annuities in retirement. For both traditional insurance and annuities, the purpose of life insurance is to provide a rock-solid guarantee of income for people when they need it most. Unfortunately, risky debt is becoming an increasingly central part of life insurers' portfolios.

Life insurers are now, to quote the *Financial Times*, the "lifeblood of private credit."[225] About 20% of life insurers' fixed-income assets are now tied to private and illiquid bonds,[226] and private credit holdings account for more than half of many life insurers' fixed-income portfolios.[227] The intertwining of insurance and private credit is set to accelerate further, with 65% of U.S. insurers and 57% of insurers globally planning to invest more in private credit funds in the next 12 to 24 months.[228]

A growing number of life insurers have been purchased by private investment firms, including private credit giants like Apollo. This is deepening the tie-ups between life insurers and the private credit sector. Life insurers owned by private investment firms are "gorging" on private credit,[229] including high-interest data center loans and purchases of phantom debt from BNPL firms.[230] Recent evidence suggests that insurers owned by private investment firms invest more money in illiquid, opaque, and high-yield (and thus high-risk) funds.[231] Such insurers also tend to be given the riskiest parts of private credit funds and buy identical assets at higher prices when the seller is another affiliate of the firm that owns the insurer.[232]

At the same time, private investment firms are increasingly having the insurers they own purchase reinsurance through "captive reinsurers" controlled by the same private investment firm. Such captive reinsurers are usually established offshore in jurisdictions with poor transparency laws, and many of the reinsurers appear to be invested in the same funds as the insurers.[233] That means a crash that threatens the solvency of a life insurer would also threaten the solvency of the reinsurer, which eliminates the whole purpose of reinsurance.

While insurers owned by private equity firms appear uniquely exposed, independently owned and operated insurers appear to be taking on increasing levels of risky debt as well. The SEC is investigating ratings by the private credit ratings agency Egan Jones, which has rated $40 billion in insurer debt, with TIAA, MassMutual, and Principal Financial Group being among the biggest holders of debt rated by the agency.[234] Several life insurers have already taken major hits from the slow-rolling meltdown of the private credit market.[235]

Life insurers are heavily involved in private lending to data center projects in particular and are increasingly exposed to AI-linked debt.[236] The opacity of these markets makes it, again, difficult to determine the amount of data center debt held by life insurers, but life insurers' holdings of private and illiquid debt has spiked over the past few years,[237] and much of the recent growth in that debt has gone towards financing AI infrastructure, with life insurers "pouring capital into data center projects."[238] This has led the National Association of Insurance Commissioners (NAIC) to open an inquiry into whether the credit ratings underpinning insurers' data center debt are justified.[239] Insurers' role in data center financing is set to increase further, including through the purchases of private placement bonds.[240]

The rapid growth in life insurers' exposure to private credit in general and data center debt in particular means that an AI crash could have disastrous effects for many working-class people. There is a state-level guaranty system that pays the obligations of insolvent life insurance companies through assessments on surviving insurers in each state, but that system works slowly and has caps, making the failure of a life insurer devastating for its policyholders, particularly older Americans and their families and those who rely on annuities for economic security.

Moreover, the structure of the guaranty system may make the U.S. life insurance sector more susceptible to contagion than is generally understood.[241] Under the guaranty system, surviving insurers are generally able to recoup any assessments through tax credits over five years, making the guaranty system an institutionalized form of publicly funded bailout.[242] Even leaving aside its dubiousness as a matter of policy, that bailout mechanism may not even be effective in a sharp crash that destabilizes several insurers at once — a distinct possibility in the case of an AI crash, given how widely AI-linked investments are held. If insurers already facing acute distress get hit with an assessment, the fact that they could *eventually* get that money back would be cold comfort. As explained in a recent article by legal scholars Pranjaj Drall and Andrew Granato, "[a] tipping point of distress exists where each wave of insolvencies would trigger assessments, in turn triggering further financial distress and contagion, and therefore another wave of insolvencies, creating a vicious cycle."[243] Because 90 million American families rely on life insurance policies for financial security and retirement income,[244] a crisis in the life insurance sector would be an economic security disaster.

Life insurers also play a key role in the financial system. Insurers have massive pools of long-term capital that are constantly replenished by the premiums paid by policyholders. The biggest payments from life insurers, namely payouts after a policyholder dies, often happen decades after the policyholder starts paying premiums. This makes life insurers attractive counterparties for financial institutions that need short-term funding.[245] Insurers' involvement in debt markets and extensive counterparty relationships with other financial institutions is one reason the collapse of AIG posed a potential systemic risk during the 2008 financial crisis. Today, life insurers' accumulation of opaque and illiquid assets means that they are becoming more likely to be a source of additional risk rather than a source of stability during a market crash. Consequently, serious contagion within the life insurance sector could quickly spread beyond it.

3. Exposure of the banking system

The most emergent phase of an economic crisis typically comes when financial institutions stop lending money. When credit markets freeze, as happened in August 2007 and (with even greater severity) September 2008, the basic plumbing of the modern financial system stops working. The exposure of life insurers and private credit funds to the AI sector, combined with the increased role of the *shadow banking system* — which includes private investment funds and insurers as well as other non-bank financial institutions such as hedge funds, mutual funds, and brokerages — means that many credit markets may be vulnerable even in the early stages of an AI crash.

The worst effects on the real economy, however, come if a crisis reaches the banking system, which consists of commercial banks, credit unions, and other financial institutions that accept deposits from and lend money to the general public. Households and businesses rely on the banking system to pay their bills, meet payroll, and perform the other basic functions of the real economy. Today, banks are exposed to mounting risks both through their ties to the shadow banking system and through their own direct exposure to AI-linked debt.

Commercial banks' exposure to the shadow banking system has grown significantly since the 2008 financial crisis along with the shadow banking system itself.[246] A Federal Reserve report released in May 2026 noted that banks' exposure to shadow debt was increasing quickly as of the end of 2025:

> *Bank credit commitments to other financial entities grew appreciably in the fourth quarter of 2025 to $2.6 trillion, reflecting the growth in market-based finance and other forms of private nonbank lending. Private equity, BDCs [business development companies], and other private credit vehicles constituted the largest portion of bank lending to other financial entities. . . . Yearly growth of commitments has been notably robust for the special purpose entities, collateralized loan obligations (CLOs), and asset-backed securities category, followed by the other financial vehicles category and the private equity, BDCs, and private credit category.*[247]

In other words, banks have rapidly expanding exposure to the shadow banking sector, and particularly to the types of opaque, complex, and risky shadow-system debt obligations that underpinned the last financial crisis — and that are increasingly prominent features of chip and data center financing arrangements.[248]

Commercial banks also have considerable direct exposure to AI-linked debt. As the Abilene financing stack illustrates, banks often sit at the base of data center financing structures. Although banks usually end up offloading most such syndicated loans to institutional investors, it can take several weeks or months for a bank to do so, particularly if demand for the loan ends up being less than anticipated. Moreover, banks typically keep some part of the debt on their balance sheets regardless.[249] Banks also had $450 billion in open commitments to AI-linked borrowers (primarily lines of credit) as of the end of 2025 of which $150 billion was outstanding.[250] The SEC's loosening of rules on the securitization of data center debt means that AI-linked debt could become even more widely dispersed through the financial system.[251]

None of these transmission routes — shadow banking, securitized debt, or banks' direct lending to AI-linked companies — would necessarily be large enough, on its own, for an AI crash to seriously threaten the stability of the banking system. But together, they certainly could pose such a threat. Banks' full exposure to both AI financing and the shadow banking sector may, moreover, be greater than is generally known.

The systemic danger lies in how these risks interact. An AI downturn could reduce the value of loans held by private credit funds and insurers, leave banks stuck with loans they expected to sell, and trigger demands for additional bank funding. Funds and insurers under pressure could then sell similarly hard-to-trade assets, driving prices lower and causing further losses across the financial system. When credit markets deteriorate in this manner, banks typically respond by pulling back on lending, which can spark further defaults and drive cascading effects across the broader economy. Because these connections are often hidden in opaque private markets and off-balance-sheet arrangements, financial institutions may not be able to dependably assess their counterparties' creditworthiness until funding dries up and credit markets begin to freeze. That is what happened in the 2007-2008 financial crisis: the extent to which the commercial and shadow banking systems were intertwined and exposed to the risky subprime market did not become apparent until credit markets froze and the entire financial system was in danger.[252]

Moreover, as discussed further in Part IV, financial regulators have weakened many of the rules designed to protect banks from economic shocks. That leaves banks more vulnerable even as the risk of a crisis increases.

C. DAMAGE TO THE REAL ECONOMY: NEGATIVE WEALTH EFFECTS AND IMPACTS ON WORKING FAMILIES

The other forces that can cause asset crashes to spiral into economic crises play out over longer timescales than financial panics, but they can be just as devastating. Major asset crashes typically lead to recessions, as the bursting of the dot-com bubble did. Even recessions that never result in systemic financial crises have devastating effects on workers' and consumers' economic security, particularly workers who are laid off and older workers and retirees whose pension plans collapse in value. And just as financial crises often trigger recessions, severe recessions can eventually lead to financial crises as the effects of falling wages and asset prices spread through the economy.

The *negative wealth effect* represents one key mechanism through which damage from falling asset prices propagates. As its name implies, the negative wealth effect is the inverse of the *wealth effect*, which takes hold when people see the value of their assets increase. This makes them feel wealthier, which spurs them to spend more money. Some of the additional spending goes towards purchasing additional or more valuable financial assets, such as stocks or real estate. The additional demand for those assets pushes their value even higher, which increases people's wealth still further. At the same time, the additional wealth means people have more money to spend on consumer goods, whether by selling some of their assets or by using those assets as collateral to obtain credit from banks. The resulting increased consumption of goods boosts corporate profits, which makes stocks appear even more attractive. The wealth effect thus acts as a force multiplier in good times, creating virtuous cycles that accelerate the economy's upward trajectory.[253]

But the same forces that propel the economy up in boom times can just as easily drag it down. When people see the value of their houses, stocks, or other assets fall, they start to feel *less* wealthy, causing them to pull back on spending. In a deep enough downturn, people may be forced to sell assets just to cover their bills, especially if they took on too much debt during the boom times. People find it harder to obtain loans, which further cuts consumption. These forces cause asset prices to fall even more, which lowers people's wealth even further in a self-reinforcing negative feedback loop — the negative wealth effect.

Similar forces can take hold even if the amount of wealth destroyed in an asset crash is relatively small. When falling asset prices create uncertainty about economic conditions, consumers may cut back on spending even if their net worth remains relatively unchanged. This is one reason why the Great Crash of 1929 led to a broad and prolonged drop in consumer spending even though relatively few Americans owned stock at the time — the crash shook confidence in the economy, which led even consumers who did not hold stock to cut back on spending.[254]

The negative wealth effects of a stock market crash today could be severe because such a crash would destroy a previously unthinkable amount of wealth at a time when consumers already have a negative view of the economy.

With $76 trillion in publicly traded equities representing nearly 240% of GDP as of September 2026, the stock market is much bigger today, both in absolute terms and relative to the economy as a whole, than it was in 1929 or, indeed, at the time of any prior crash.[255] Consequently, as the Bank of International Settlements' 2026 Annual Economic Report warns, "[a] major equity market correction could have larger macroeconomic consequences today than in the past," with severe consequences for global financial stability.[256]

Because of Big Tech's dominance of those equity markets, even a 25% drop in the value of the Magnificent Seven — just enough to take them back to roughly where they were in May 2025 — would wipe out over $5 trillion in paper wealth, more than the GDP of the United Kingdom. If U.S. stock markets were to fall by 45%, taking them back to the levels they were shortly before the release of ChatGPT, it would evaporate $35 trillion — more than the entire U.S. economy produces in a year.

And that is not even the worst-case scenario. Recall that the stock market is historically overvalued, with the S&P 500 having a CAPE ratio of 42, roughly two and a half times its long-run average of 17. If stock prices fell just to that historical average, $45 trillion in paper wealth would vanish. Needless to say, if prices were to drop *below* that historical average — as often happens during economic crises[257] — the wealth destruction would be worse still.

The negative wealth effects of an AI crash would likely be amplified still further by the historically high level of income inequality. As Galbraith noted in *The Great Crash*, a "bad distribution of income" was a key reason the economy was unable to regain its footing after 1929:

> *Th[e] highly unequal income distribution meant that the economy was dependent on a high level of investment or a high level of luxury consumer spending or both. The rich cannot buy great quantities of bread. If they are to*

dispose of what they receive, it must be on luxuries or by way of investment in new plants and new projects. . . . This high-bracket spending and investment was especially susceptible, one may assume, to the crushing news from the stock market in October of 1929.[258]

Income inequality today is similarly extreme,[259] and consumer spending is disproportionately driven by the highest earners, who are also the ones who would lose the most if the stock market plummets.[260] The wealth effect from rising stock prices drove an additional $250 billion in increased consumer spending in the United States between the summers of 2024 and 2025.[261] The flip side of that coin is that consumer spending could fall dramatically in a serious market downturn. The K-shaped economy of recent years thus serves as an additional source of potential systemic risk.

But it is not only the wealthy who would suffer. The stock ownership rate is far higher today than it was in 1929, and a record number of working-class Americans own stock, primarily through retirement accounts and pension funds.[262] As major holders of risky unsecured data center debt, pension funds would be among the first hit if a significant amount of data center debt became toxic, according to a recent analysis by Stefan Hepp of the University of Chicago's Booth School of Business.[263] These losses would hit pension funds hard, particularly since AI-linked assets dominate stock and corporate bond markets as well.[264] Pension funds are also becoming ever-more exposed to risky private credit debt even as that sector comes under strain.[265]

Big Tech's dominance of stock markets also means that workers' retirement accounts would be hit hard in an AI crash, particularly after SpaceX pressured executives of the world's largest stock index providers to change their inclusion rules to get itself fast-tracked into Nasdaq, FTSE Russell, and CRSP.[266] In pushing for the rule changes, SpaceX engineered a stock market in which retirement savers invested in passive funds tracking those indices would be forced to buy the highly volatile stock whether they wanted to or not. The Trump administration's move to open retirement accounts to private capital markets could further transfer AI risk to workers' retirement accounts.[267]

The increasing risks to pension funds and retirement accounts mean that older workers and retirees would be especially hard-hit by a stock market crash. Other working families would be affected as well. Workers experiencing unemployment or pay cuts after a crash could be forced to liquidate their retirement accounts to pay living expenses. The rising amount of risky consumer debt creates a further risk that consumer spending could fall quickly in an economic downturn. All these forces would further intensify the negative wealth effect.

It may not take much for a negative wealth effect to take hold. Ordinary Americans already have a historically negative view of the economy, with consumer sentiment at an all-time low despite the rising stock market.[268] A falling stock market would likely send consumer confidence plummeting still further, reducing spending and amplifying downward pressures on the real economy.

D. FALLING INVESTMENT AND STRANDED ASSETS COULD WEIGH DOWN THE ECONOMY

The outlook for the American economy in the wake of an AI-driven crash could be especially bleak due to the effects of falling investment and stranded assets. Falling asset prices cause investment to fall along with spending, thus starving the economy of a key fuel that drives growth. As with the negative wealth effect, this can create a negative feedback loop. Falling stock prices cause investment to decline; declining investment hurts productivity and economic growth, which pushes corporate earnings down further, which causes stock prices to fall further, and so on. The massive physical footprint of the AI data center buildout and the amount of debt tied up in it means that the bursting of the AI bubble could make investment fall especially quickly.

This factor would come into play with particular force if an AI crash results from (or results in) a stagnation or decline in generative AI sales, whether due to a dropoff in overall demand or users simply declining to pay for more expensive models. This would not be a major problem if AI chips and data centers could simply be used for non-AI workloads. That may not be economical, however, because AI chips have significantly higher power and cooling requirements — and thus are more expensive to operate — than the chips used for traditional cloud computing.[269] Moreover, the power and cooling needs for AI training are more intense than those used for AI inference.[270] Repurposing AI data centers thus could be economically challenging.[271]

If expected AI demand fails to materialize and the cost of powering and cooling highly specialized AI chips and data centers turns out to be greater than whatever economic value companies can extract from those assets, the economically rational course would be to abandon them. Such *stranded assets* destroy economic value, particularly if

they have debt attached to them; a company may save on operational costs by letting a data center go dark, but any obligations associated with the data center would remain.

As Advait Arun wrote in *Bubble or Nothing,* a report by the Center for Public Enterprise, the bursting of the AI bubble could leave behind a range of stranded assets: "Not only does a prospective market correction create potential stranded assets of data centers, which will lose value as their lease revenue disappears, but it threatens to strand all the energy projects and efficiency innovations that data center demand might have called forth."[272] In such a case, abandoned data centers and connected infrastructure could be white elephants to the communities where they are located — a particularly bitter outcome since many state and local governments gave tax incentives to the data center developers to attract them.[273]

The comparatively short lifespan of AI chips also means that even the assets that retain their value initially probably would not have a long tail of productive use. Even ignoring the likelihood of technological obsolescence, AI chips' useful life appears to be well under ten years. The hyperscalers' balance sheets claim their chips last five to six years, and one analysis found that a cohort of AI GPUs with an expected life of 5.5 years was trending towards an actual life of just 3.7 years based on real world use.[274] Top data center GPUs may last just 1-3 years with typical utilization.[275] The lifespan of AI chips thus appears to be at least an order of magnitude less than fiber-optic cable, the main capex focus during the dot-com boom, which has a lifespan of several decades or more; some of the earliest fiber lines laid in the 1980s remain in active use today.[276] Railroads likewise have a lifespan of many decades.[277]

The high operating costs and short lifespans of AI assets mean that, in the wake of an AI downturn, there is a high risk that stranded assets would act as a further drag on economic growth. This would create a risk of a balance-sheet recession similar to the one that led to Japan's "Lost Decade" in the 1990s, when economic growth ground to a halt as businesses, financial institutions, and investors spent years clearing bad loans and underwater assets from their balance sheets.[278]

E. SURVEYING THE MINEFIELD: WHY NAVIGATING THE FALLOUT FROM AN AI CRASH WOULD BE DIFFICULT

The rising danger of an economic crisis comes not from any one factor. Rather, it comes from the fact that the economy may well have to navigate *all* of these sources of instability (including those that this report has barely touched on, such as the rapid rise in risky consumer debt, pressure from rising interest rates, and the volatile multi-trillion-dollar cryptocurrency market) in the aftermath of an AI crash. Navigating the fallout from an AI crash would be akin to maneuvering through a dense minefield, knowing that one wrong step could not only cause serious damage on its own, but potentially set off a chain reaction.

The delicate task of navigating these accumulating risks would be extremely difficult even for the most vigilant and competent regulators and policymakers under the best of circumstances. In past crises, the Federal Reserve has served as a "lender of last resort" to stop economic crises from spiraling out of control while the Treasury Department and other federal agencies and officials played an essential role in calming stormy markets. But the tools in the Fed's crisis management toolkit may be less effective in the face of an AI crash, and the Trump Administration has hardly instilled confidence that it would be a source of calm and stability in a resulting crisis.

Historically, investors have flocked to purchase U.S. treasuries and scoop up dollars as safe havens in times of instability. Strong demand for dollars and treasuries makes it cheaper for the federal government to borrow money (essential for economic stimulus) and easier for the Fed to print new dollars to inject liquidity into shaky markets.

But when markets destabilized in the wake of the Trump administration's "Liberation Day" tariff announcement, treasury yields rose and the dollar fell — a stunning reversal of the market's usual response to crises.[279] Markets stabilized after the Trump administration backtracked, but the incident suggested that investors may no longer rush to buy up American assets if the U.S. economy sustains self-inflicted wounds. Sure enough, during the Iran War, there were signs that a growing number of investors viewed Chinese bonds as the safer bet.[280] As of September 2026, long-dated U.S. Treasury bond yields are at their highest levels since the height of the mid-2000s housing bubble (when benchmark interest rates were significantly higher), indicating that, despite the booming stock market and high levels of investment, investors are already nervous about the federal government's ability to cover its debts.[281] When Secretary Bessent announced an expansion of treasury bond buybacks in August in an attempt to bring rates down, yields fell only briefly before rebounding to elevated levels.[282]

In a crisis arising from the core of the U.S. economy, and particularly one where the U.S. economy looks likely to be weighed down by stranded assets, investors may prove distinctly less eager to buy U.S. treasuries or hold their reserves in U.S. dollars.

Other countries' monetary and fiscal policy chiefs may also be wary of coordinating with the Trump Administration, which has disdained cooperation through multilateral institutions. Central bankers and finance ministers know that the current crop of U.S. treasury officials is beholden to the whims of a volatile president who has shown a marked tendency to renege on economic agreements. Summits of the G7 and G20, which played a key role in coordinating the responses to the financial crises of 1997 and 2008, seem much less likely to bear fruit if a crisis arises in the next two-plus years.

A dangerous AI crash is not inevitable, nor are the economy-wrecking consequences that could follow. But attention and policy action are urgently required to contain the risks and prevent any potential crisis from devastating millions of people's lives and livelihoods. The necessary policy steps are the subject of Part IV.

PART FOUR

What can be done?

Part IV: What Can Be Done?

The AI bubble presents a serious and still-growing danger to the health of the financial system and the broader economy. As AI executives further inflate the bubble with unprecedented levels of both hype and debt-fueled capital expenditures, that threat becomes ever graver, presenting an array of urgent policy challenges. We are focused here on articulating a set of policy proposals to mitigate emerging threats the AI bubble poses to financial stability, economic security, and democratic governance while laying the groundwork for a people-first response to a bursting bubble.

Section A lays out a set of steps that regulators, policymakers, and law enforcement officials at the federal, state, and local levels should take to strengthen the guardrails around our financial system and shine a light on the true state of the AI industry's finances. That includes reversing recent deregulatory actions that are increasing the odds that the bubble will cause serious economic harm when it bursts. It also means taking proactive steps to deter further bubble inflation and protect the economy. Preventing AI companies and their financial backers from externalizing the costs of development and abusing legal loopholes and enforcement gaps would both address specific financial risks and help slow the AI bubble's further expansion.

If an AI crash does trigger acute financial stress, Section B describes principles and priorities for policymakers to protect ordinary people from the fallout and prevent the crash from spiraling into a crisis. Now is the time to establish that there will be no bailout for distressed AI companies or AI industry financiers. Firmly establishing that principle would help ensure that the costs of a bursting bubble would be borne by those who recklessly inflated it. It would also act as a brake on speculative investment activity by forcing firms to consider whether they can truly absorb the losses if their big bets go bad.

A fulsome crisis response demands both immediate actions to limit harm and deeper reforms targeting the structures and practices that created it. Section C briefly describes a set of principles that are critical for building a more secure and resilient financial system — one structured to support the movement of capital towards productive ends and create economic security and opportunity for all rather than extreme concentration of wealth and power at the top.

A. PULLING BACK FROM THE BRINK

To reduce the severity of the threat from the bubble and limit damage to the broader economy and the well-being of households across the country, policymakers must reverse policies that are exacerbating the risk of a serious crisis (Subsection 1). In addition, policymakers at every level of government must take proactive steps to deter the further expansion of the bubble and protect the banking system and real economy from the effects of an AI crash (Subsection 2).

1. Reverse course on dangerous deregulation

Across the Trump administration, federal regulators tasked with overseeing Wall Street are reducing the resiliency of banks to stress, externalizing costs to working people, decreasing transparency and accountability, and undermining regulators' ability to monitor, assess, and mitigate excessive risk.

By removing critical tools and guardrails, these actions are allowing an unknown degree of additional risks to accumulate across the financial system, preventing regulators from spotting or addressing those risks, and imperiling everyday people's economic security. The whole of these many deregulatory measures is even more dangerous than the considerable sum of their parts.

Weakening protections for retirement savers and everyday investors

Trump administration regulators are amplifying the risk that a bursting AI stock bubble will expose everyday investors to severe financial losses. Under Chair Paul Atkins, the Securities and Exchange Commission (SEC) has made it easier for private investment firms to sell their risky, expensive, illiquid, and opaque investments directly to mom-and-pop retail investors without taking any steps to protect them from fraud, informational asymmetries, and other harms.[283] The Department of Labor is moving to allow private equity and private credit funds to access the $14 trillion in working people's 401(k) retirement plans, providing a lifeline to private equity and credit while further exposing workers to risk and losses in private markets.[284]

The SEC is also making investing in public markets riskier for everyday and passive investors. It is trying to exempt about 81% percent of public firms from the full suite of reporting requirements[285] and allow companies to shift from quarterly to biannual financial filings, reducing the frequency of critical financial disclosures even as the

propagation of financial risk accelerates. Other efforts would allow public companies to game their offering and communications timing to preempt state securities laws and enable market manipulation.[286]

The SEC has also undermined the ability of regular investors to hold corporate insiders accountable, including by explicitly allowing companies to impose forced arbitration clauses on shareholders.[287] What's more, the SEC is working to get rid of its shareholder proposals rule altogether,[288] undermining a tool that regular shareholders have used for decades to push companies on important issues related to workers' rights, climate risk, political spending, and more. The SEC has also moved to reduce regulatory scrutiny of AI data center financing by declaring that certain data center-backed securities are not classified as asset-backed securities,[289] which have been subject to stricter regulatory requirements since the 2008 financial crisis.[290] These measures both expose everyday investors to a greater degree of AI-related risk and make it less likely that they will know the extent of the risky AI assets in their portfolios. Should the bubble burst, retail investors will face greater losses with fewer means of seeking accountability for corporate wrongdoing.

Meanwhile, the Public Company Accounting Oversight Board (PCAOB) is weakening auditing standards just as AI accounting gimmickry and gamesmanship proliferate. The PCAOB was created in the wake of the fraud-induced Enron and WorldCom collapses to "protect investors and further the public interest in the preparation of informative, accurate, and independent audit reports."[291] Despite its stated mission, the PCAOB has recently eliminated its requirement that large firms receive independent, external feedback on the efficacy of their quality control systems.[292] The PCAOB's decision to weaken quality control standards comes amid mounting worry regarding the trillions of dollars in debt that large public AI companies are hiding off their balance sheets.

Undermining critical banking industry guardrails and oversight

The Federal Reserve (Fed), the Federal Deposit Insurance Corporation (FDIC), and the Office of the Comptroller of the Currency (OCC) have slashed bank examination staff,[293] reduced supervision,[294] weakened stress testing,[295] and dismantled critical bulwarks that guard against fragility and disorderly bank failures.

These banking regulators are moving swiftly to weaken the capital requirements that require banks to invest more of their own money and reduce their ability to fund risky bets with borrowed money.[296] By gutting the enhanced supplementary leverage ratio, a cushion designed to enable banks to absorb losses without facing insolvency and triggering systemic instability,[297] regulators are making the nation's largest banks more susceptible to failure in the face of heightened stress. Banks often lobby for weaker capital requirements, which can enable them to spend more of that capital on buybacks and dividends, which, in turn, can enrich wealthy shareholders and senior executives and can boost a bank's stock price.[298] The weakening of capital requirements is of particular concern today as distress mounts in the private credit and private equity markets and threatens to leak into the traditional banking system.

At the same time, the Fed has severely weakened the efficacy of the Large Financial Institution (LFI) framework — a rating system used to evaluate banks' financial strength and resilience.[299] The new LFI framework lowers standards so drastically that the failed Silicon Valley Bank could have been rated as "well managed" — and thus not subject to increased oversight or orders to take corrective action — until the day it collapsed.[300] As AI-related risks accumulate, the fact that the Fed itself may be unaware of banks' true ability to manage those risks should trouble policymakers.

Moreover, the *first* Trump administration weakened a post-2008 rule (the Volcker Rule) intended to protect customer deposits from undue risk, opening the door for banks to sponsor and invest in venture capital and credit funds.[301] The rollback has meant that many large banks today are doubly exposed to AI-related financial risk — both as lenders to risky funds financing the AI build-out and as investors in and/or sponsors of those funds.[302] This increase in the interconnections (and potential conflicts of interest) between banks and private funds heightens the risk of AI-related losses rippling through the traditional banking sector.

The Financial Stability Oversight Council (FSOC) was created following the 2008 financial crisis to close regulatory and supervisory gaps that allowed systemic risk to accumulate outside of the banking system.[303] Now, however, FSOC is moving to eviscerate its own ability to actively monitor and mitigate threats from the shadow banking system's risky activities, including private credit loans and private equity AI investments.[304] Rather than using its authority to supervise and regulate systemically important non-bank financial institutions (NBFIs) that are facing mounting stress, the Trump administration — at the behest of the financial industry — is weakening this tool for protecting financial stability.

The Trump administration has compounded the dangers of weakening protective guardrails and transparency mechanisms across the financial system by greatly reducing the capacity of financial regulators. Hundreds of examiners, supervisors, and regulators across the financial regulatory agencies have been forced out of their jobs.[305] That includes two-thirds of the staff of the Office of Financial Research,[306] hamstringing its ability to collect data from banks and other financial firms on their AI-related risk exposure. FDIC staff cuts prompted that agency's Inspector General to raise concerns about the FDIC's ability to identify and remediate the same kinds of risks that ultimately led to the failure of First Republic Bank.[307] What's more, many remaining staff have been directed to be deferential to the institutions they are supposed to supervise.[308]

These deregulatory actions are notable for how they target and erode safeguards designed to accurately monitor, assess, and mitigate excessive risk-taking in the financial sector — including and especially AI-related risks. These policy changes shift more power into the hands of corporate insiders — including those leading AI-related companies — and away from everyday investors, workers, and community stakeholders. They also amplify the growing threat to the financial system, making it more likely that acute stress in one segment of the market spreads outward and triggers an economy-wide downturn.

It is never advisable to weaken these kinds of crucial safeguards or the agencies tasked with maintaining them. In the years preceding the 2008 financial crisis, regulators weakened banking rules designed to manage financial risk, which allowed Wall Street risk-taking to reach excessive levels and ultimately balloon into a systemic problem. The United States had been spared such systemic crises for decades after the Great Depression thanks to the New Deal's securities and banking reforms. But, as Joseph Stiglitz explained in the aftermath of the 2008 financial crisis, "once deregulation had taken hold, it was only a matter of time before these horrors of the past would return. The so-called financial innovations had just enabled the [housing] bubble to become bigger before it burst, and had made it more difficult to untangle the messes after it burst."[309]

Today, as we face the high and growing risk from another potentially devastating bubble, it is hard to imagine a worse time to reduce market transparency, weaken banking stability standards, and tie the hands of short-staffed prudential regulators. Federal financial regulators should swiftly reverse course. Finalized deregulatory rules should be rescinded and proposed rules should be abandoned. If financial regulators do not walk back these dangerous measures, Congress should direct them to do so.

2. Proactive steps to reduce the AI bubble's economic risks

Reversing the dangerous deregulatory actions outlined above is necessary but insufficient to safeguard the financial system and protect everyday investors. The recommendations below are not an exhaustive list, but they are measures that policymakers could take right now that would support these goals. Policymakers should implement needed rule changes, publish the results of all inquiries and investigations to the maximum extent permitted by law, and bring enforcement actions when they discover evidence of unlawful activity.

a. Strengthen the banking system's resilience

Policymakers should take steps to fortify the financial system against shocks from a potential AI crash. In addition to conducting a supervisory review of banks' AI-related debt exposures, the Fed, FDIC, and OCC should conduct effective stress tests to assess financial institutions' ability to safely absorb losses. The Fed should then set strong minimum-capital-buffer thresholds based on the results of those tests. The Fed should require institutions under the minimum thresholds to halt stock dividends and buybacks and divest from dangerously risky financial vehicles until they are in compliance. Additionally, the Fed should strengthen the LFI framework to better assess whether large, complex financial institutions are operating in a safe and sound manner and effectively identifying and managing risks.

b. Shine a light on the AI industry's shadowy financial ecosystem

Improving transparency across the financial system would both provide the public and regulators with a clearer picture of the AI industry's true financial health and potentially aid in slowing the rapid growth of the AI bubble. Federal, state, and local officials have an array of powers that they can use to require public financial disclosures for AI-related companies and/or projects. This includes closing regulatory loopholes and amending laws to provide the public with financial information on large privately held companies and shadow banking institutions that maintain close relationships with publicly traded companies, as well as using existing congressional and regulatory powers to investigate and publish information on AI-related risks.

Large privately held companies

Private behemoths like Anthropic and OpenAI — which have many beneficial owners, deep relationships with numerous publicly traded companies, and valuations greater than all but a handful of such companies — should be subject to the same registration and disclosure requirements as publicly traded companies. Federal regulators should close loopholes that allow them to avoid those requirements. For example, current SEC rules treat vehicles like investment funds as a single investor, thus permitting huge venture-capital- and private-equity-backed companies to report a lower number of investors and avoid registration. The SEC should instead adopt a "look-through" approach for such investment vehicles and count underlying beneficial owners individually as holders of record. Congress should codify the look-through approach and re-establish the 500 "investors of record" threshold to prevent further abuse. Congress should also direct the SEC to create additional triggers for public registration based on company valuation, capital raised, revenues, number of employees, and other metrics to ensure large private companies register their securities.

Shadow banking system

Similarly, large shadow banking institutions — like private equity and private credit firms — should be subject to supervision and disclosure requirements comparable to those of commercial banks. As a step in that direction, OFR and FSOC should collect and publish data on AI-related risk exposure across the shadow banking system. FSOC should use its authority to subject large private investment funds, hedge funds, and other non-bank financial intermediaries to Fed supervision and enhanced regulatory guardrails. The Fed, in turn, should urgently design and implement an adequate supervisory framework for large shadow banking institutions. Congress should also pass legislation making such supervision and guardrails mandatory for large and/or complex shadow banks going forward. It is unfair and destabilizing for private capital giants and huge investment funds to have less supervision and financial transparency than even small community banks.

Additionally, policymakers have several tools for collecting and publishing valuable financial data related to AI infrastructure development — both within and outside the context of enforcement action. It is urgent that federal regulators and the public understand the banking system's exposure to NBFIs in general and AI-exposed NBFIs in particular. The Fed, the OCC, and the FDIC should use their authority to examine the vulnerability of the banking system as a whole and of individual banks that hold substantial quantities of risky shadow bank exposures.

The Federal Insurance Office (FIO) should likewise examine and closely monitor insurers' exposures to risky asset classes — particularly as they relate to private credit and AI bubble risks — and share findings with Congress, the public, and the Fed (which could then subject them to enhanced supervision, as discussed above). State insurance regulators can also conduct inquiries of their own and disclose information to the public regarding the credit ratings of insurers' debt investments. Such disclosures would help provide greater transparency in insurance and private credit markets alike and strengthen public accountability mechanisms for both industries.

Data centers and AI infrastructure projects

The AI industry's ability to alter and evade rules and protections governing infrastructure development — including the very disclosure of such projects to communities — has aided in the expansion of the bubble. Greater disclosure regarding data center development projects would provide much-needed information both about the economic underpinnings of the AI boom and about the potential impacts of data center projects on local communities. Already, several states, counties, and cities require certified audited financial statements or financial assurance of some kind (e.g., bonds, letters of credit, trusts) for certain high-risk land use projects.[310] For projects as high-risk for communities as data centers, policymakers across the country should go further and mandate detailed, audited, public financial disclosures from both data center developers and related parties at the outset of any proposed construction project. They should also require prospective and operating data center developers and their backers to publish full audited financial statements every quarter.

Such measures will enable policymakers and the public to independently assess developers' financial health, the soundness of their financial assumptions (e.g., the depreciation schedules they apply to GPUs), and their risk profiles. Without access to that information, policymakers and constituents have no way of knowing whether they are inviting soon-to-be unfinished husks of industrial projects into their communities. Requiring granular, segment-level detail on related-party transactions, GPU depreciation schedules and similar assumptions, data center capital expenditures, and utilization rates would also provide valuable information to markets determining risk premiums for AI-related corporate bonds. Such transparency would help ensure that developers with weaker financials face higher borrowing costs, likely slowing the inflation of the bubble.

c. Close loopholes and enforcement gaps that enable the AI industry's deceptive financial practices

As discussed in Part I.A.3, AI companies often engage in financial practices — such as deceptive financial reporting, circular financing arrangements, and the use of shell companies and other financial engineering techniques to hide debt off their balance sheets — that allow them to present artificially high AI-related revenues and artificially low operating costs. Federal regulators, Congress, state officials, and private standard-setting bodies each have a role to play in cracking down on these activities, which can mislead investors and have repeatedly characterized speculative bubbles in recent decades.

The SEC should proactively investigate credible investor allegations of deceptive revenue reporting practices, failure to disclose certain existing or planned debt arrangements or issuances, knowingly issuing unreliably high revenue projections, and other similarly deceptive, fraudulent, and/or unfair activities. The PCAOB, which is overseen by the SEC, should likewise scrutinize the techniques AI companies are using to keep multi-billion-dollar financial commitments off their balance sheets and direct inspectors to conduct detailed compliance reviews across large auditing firms with a focus on those firms' data center- and AI-related clients. Those found to be out of compliance should face enforcement action.

The Financial Accounting Standards Board (FASB), a private standard-setting body, should publish data it is currently collecting on data infrastructure projects and private credit-sponsored vehicles. At the same time, FASB should issue guidance clarifying what can be considered a "reasonable and supportable" useful life estimate for GPUs. It should also move swiftly to formally strengthen standards for determining when a variable interest entity (*VIE*, a category inclusive of SPVs) must be included on companies' balance sheets.

The repeated and escalating use of deceptive tactics to mislead investors and pensioners suggests that statutory changes are needed. As Vanderbilt Policy Accelerator's Asad Ramzanali has argued,[311] Congress should prohibit large-scale circular equity financing deals, large-scale debt financing deals whose ultimate capital sources are undisclosed, and the use of SPVs and similar vehicles to avoid disclosing debt-like obligations in companies' public financial reports.

State regulators and law enforcement officials should use their authorities under anti-fraud and accountancy laws[312] to investigate and, where appropriate, prosecute companies and executives where they have used or approved fraudulent financial practices. There are several past examples of regulators and attorneys general using these corporate accountability tools as firms were falling apart under the weight of their mismanagement, including in the aftermath of the dot-com crash. The successful state enforcement action against Arthur Andersen in the aftermath of the Enron scandal serves as a particularly strong model in this regard (see inset).

> *The Texas State Board of Public Accountancy (TSBPA) successfully prosecuted onetime auditing giant Arthur Andersen, then one of the largest accounting firms in the world, for its role in the Enron scandal. The TSBPA ultimately found that Andersen had "failed to follow generally accepted auditing standards and generally accepted accounting principles in attest work it performed for Enron between 1997 and 2002," and that the firm "lacked objectivity, integrity, and independence" in its role as Enron's external auditor. In particular, the TSBPA underscored that, during those years, Enron's financial statements were "materially misstated, in part because the company used certain 'special purpose entities' to record debt that should have been booked to Enron's financial statements." In August 2002, the TSBPA revoked Andersen's CPA licensing, and the firm ceased operations.*[313]

State law enforcement officials also brought enforcement actions against financial institutions that recommended that investors buy dot-com stocks and debt issued by their corporate clients, even as they privately described those offerings as junk. Observers have identified similarities between that episode and today's IPO frenzy.[314]

This time policymakers should not wait until after the crisis arrives to act. They should move proactively to investigate dubious practices and, where firms or individuals are breaking the law, bring enforcement actions. State securities regulators can use their authorities to protect investors by investigating and referring to the relevant bodies credible fraud claims alleged by investors under their jurisdiction.

Already, state securities regulators are pursuing investigations into and enforcement actions against fraudsters who "imply that artificial intelligence is being used to improve the success of the investment."[315] Such actions correctly signal that slapping the term "artificial intelligence" on an offering is not an incantation that shields securities issuers from the law. These so-called AI-washing cases have largely focused on companies accused of misrepresenting their use of AI technologies as a means of boosting their

share price and attracting investor interest. However, AI firms that mislead the public and/or investors regarding the development, capabilities, and challenges of their models, the nature of their financial position, or other material matters (as investors recently accused Google of doing in its communications regarding the rollout of Gemini 3.5)[316] may also be violating securities laws. If so, federal and state securities regulators should hold firms accountable.

d. Halt AI-related risk transfers to working people and stop subsidizing the bubble with public funds

The inflation of the AI bubble is being fed by private sector actions and policy decisions that make it easier to offload the risks of AI development onto working people and that subsidize AI activity, whether directly through tax breaks or through exemptions and exceptions that give special favors to AI companies. Policymakers should stop these giveaways and limit the damage.

Powerful index providers like Nasdaq have aided in this risk transfer by accelerating the addition of new stocks — already those issued by SpaceX, and perhaps those of Anthropic and OpenAI next — to their indices. Fast-tracked index inclusion means that retail investors and retirement savers' portfolios are being saddled with these AI-related shares, whether they want them or not, at inflated post-IPO prices. And, just as everyday investors are forced into these AI investments, wealthy insiders are able to sell their shares for the first time in a market with built-in demand. Policymakers in Congress and elsewhere can and should investigate how and why NASDAQ and other exchanges made the decision to accelerate index inclusion for these large, newly public companies. Moreover, because fast-tracked inclusions, financial opacity, and circular funding permeate the AI industry, policymakers and courts should make it clear that fiduciaries' obligations require them to actively consider whether these new stocks belong in index funds and whether investments in index funds that do include them can be made in a manner consistent with fiduciary duties.[317]

Massive sales of risky AI investments to pension funds represent another pathway through which working families are being exposed to the dangers of the AI bubble. Pension fund decisionmakers have fiduciary obligations to act prudently, including by asking tough questions about what they are being sold and avoiding conflicts of interest.[318] Policymakers must support those decisionmakers by requiring transparency, engaging in oversight, and preventing fraudulent and deceptive practices. A recent letter from the AFT to Treasury Secretary Bessent provides a useful guide to needed steps.[319]

AI companies are also effectively offloading risk onto life insurance policyholders by tapping their premiums as a funding source. Policymakers must stop them from doing so. State insurance regulators should heighten their supervision and oversight of life insurers that are taking on risky private investments in AI (see Part III.B.2), strengthen their safety and soundness, and limit excessive risk-taking. Congress should establish similar requirements at the federal level.

Outside of the public and private credit markets, the AI industry is draining communities of public resources and

FIGURE 17: The five biggest hyperscalers received nearly $27 billion in depreciation tax breaks in 2025

Dollar amounts in miillions

Company	US income	Current federal tax	Effective tax rate	Total tax breaks	Depreciation tax breaks
Alphabet	$144,359	$11,345	7.9%	$18,970	$3,324
Amazon	$89,041	$1,220	1.4%	$17,479	$6,549
Meta	$79,399	$2,820	3.6%	$13,854	$4,942
Microsoft	$100,934	$2,461	2.4%	$18,735	$11,976
Oracle	$8,638	$1,072	12.4%	$742	N/A
These 5 companies	**$422,370**	**$18,918**	**4.5%**	**$69,780**	**$26,791**

Source: Institute on Taxation and Economic Policy, September 2026

saddling them with substantial AI-related risks by obtaining tax subsidies and generous federal contracts for AI infrastructure projects. In 2025, the federal government handed Amazon, Alphabet, Meta, Microsoft, and Oracle almost $27 billion in tax breaks for their explosive data center spending (see Figure 17).[320] Halting the flow of public money into AI industry coffers will help to slow the risk transfer — and the feeding of the bubble itself.

Grassroots data center opponents have successfully pushed for state-wide restrictions on such tax giveaways in Washington, Oregon, Arizona, Nebraska, Maine, New Jersey, Delaware, and Alabama. Building on these measures can help decelerate the dangerous degree of capex growth driving the AI infrastructure build-out and stop this transfer of wealth.

The massive amount of investment, tax breaks, and other forms of capital flooding into the AI infrastructure build-out transfer wealth to wealthy Silicon Valley and Wall Street speculators and away from communities. Those capital flows also impose an opportunity cost on communities by limiting the amount of capital available for other much-needed investments. Indeed, spending on data centers and other related infrastructure now surpasses residential housing spending.[321] Amid an ongoing housing crisis, billions of dollars in private investments, public funds, and retirement savings are being directed to build data centers instead of homes. But it is more than just housing. As international economic policy expert Jennifer Harris has argued, "A.I. is vacuuming up so much of our land, talent, semiconductor chips, building materials and, above all, so much of our money that it is beginning to crowd out the rest of the economy."[322] It is not possible to quantify what we've lost as a result. But policymakers can and should act to protect their constituents from paying the high price of massive AI investment twice: once as the bubble inflates and again when it pops.

B. PRINCIPLES FOR FACING THE ACUTE PHASE OF AN AI CRASH

If faced with an AI-induced financial crisis and severe economic downturn, policymakers must depart from the unjust and moral-hazard-inducing playbooks of the past. Policymakers must reject bailouts for failing AI companies, financial institutions, and/or the billionaires who own and run them (Subsection 1). Instead, crisis response should be focused on stabilization and recovery efforts that prioritize working people and families rather than imposing austerity measures that force workers and consumers to bear the brunt of the resulting economic pain (Subsection 2). Corporations and executives that engaged in fraudulent, deceptive, or other unlawful acts must be held accountable (Subsection 3).

1. No billionaire bailouts

AI companies and the financial companies serving them have inflated the valuations of their businesses, made big bets based on billionaires' wild projections, and loaded the financial system with trillions of dollars in speculative debt, generating enormous wealth for themselves while creating serious dangers for everyone else. They know what they are doing is risky; in apparent anticipation of the company's possible need for a bailout, OpenAI CFO Sarah Friar floated the idea of a government "backstop" for the company back in November of 2025.[323]

In the face of acute AI industry stress, Congress and executive branch officials must steadfastly oppose bailouts to prop up embattled industry actors or protect them from facing the financial or legal consequences of their actions. Federal policymakers must reject any proposal to rescue AI firms or their executives or financiers with public funds, including through stimulus funds, lines of credit, grants, tax abatements, rescue funding, golden shares, purchases of distressed assets, and/or the unconditional or lightly conditioned use of Fed emergency facilities. In addition to being the right thing to do, committing to a no-bailouts policy now would deter further reckless lending and speculative investment, thus reducing both the likelihood and potential severity of an AI crash.

No Big Tech bailouts

If they face collapse, neither AI-related firms nor their leadership should be shielded from the financial or legal consequences of their mismanagement. Under no circumstances should failing AI-related firms receive government support to remain going concerns.

Instead, failed AI firms should be moved through legal proceedings for liquidating and/or dissolving firms in an orderly manner. As discussed in *No Bailouts for Big Tech Billionaires*, AI companies themselves are not systemically important in the same way that megabanks are:

> *None of the Magnificent Seven, the neoclouds, or AI startups hold the money that consumers use to pay bills, lend money to small businesses, or hold billions of dollars of each other's liquid assets. There simply is no reason a tech company, even a historically large one, cannot go through the usual bankruptcy process.*[324]

While imperfect, the U.S. bankruptcy process is designed to safely wind up failing companies while securing as much value as possible for small businesses, consumers, and other harmed creditors. That said, too often, wealthy corporate insiders have abused the bankruptcy process to divert dying firms' resources to themselves. Moreover, several of the hyperscalers have access to vast troves of personal data that should not simply be sold off to the highest bidder. Consequently, any Big Tech bankruptcy process must be administered in a manner that removes corporate executives and insiders from their positions and holds them accountable, provides for robust clawbacks of pre-bankruptcy compensation and shareholder distributions, and provides strong protections for consumers, workers, and communities. While available to bankruptcy judges and trustees, such provisions should be standard practice in large Chapter 7 and 11 bankruptcies. Congress can and should pass legislation to set that standard.

If government intervention is required to ensure essential cloud, digital, and/or other infrastructure continues functioning, the federal government should acquire that infrastructure at no more than market prices — which, in a deep enough crash, may well be close to zero. To facilitate the continued operation of critical infrastructure, the federal government should take relevant corporate entities into a receivership structure under which corporate executives are removed, crucial staff are retained, and functions critical to the economy are carried out, similar to the FDIC's framework for operating a "bridge bank" after certain commercial banks fail.[325] Ultimately, critical digital infrastructure should be subject to a regulatory regime that guarantees its operation benefits the public, as discussed in the Open Markets Institute's 2025 report, *Engineering the Cloud Commons*.[326]

No bailouts for Wall Street

Likewise, there should be no bailouts for failing financial firms or federal backstops that shield big banks, private investment funds, wealthy insider investors, and other bubble financiers from losses.

Instead, insolvent banks should be moved into the FDIC's orderly resolution process, which was designed after the last financial crisis to "protect insured depositors, preserve value, promote financial stability, and prevent taxpayer bailouts."[327] If a rapid and orderly resolution under ordinary insolvency regimes is not possible — a scenario quite likely to unfold if a systemically important bank fails — the FDIC can act through its statutory authority under Title II of the Dodd-Frank Act. Title II provides the FDIC with tools to "mitigate risks to financial stability by providing for the appointment of the FDIC as receiver of a failed financial company and for an Orderly Liquidation Fund (OLF) to serve as a temporary backstop source of liquidity."[328] Neither of these resolution frameworks require or even contemplate the use of publicly funded bailouts.

Our focus here on existing bank resolution frameworks is not to suggest that we believe these frameworks are perfect — they aren't. But regulators must make use of the tools they have. Otherwise, history demonstrates that *ad hoc* bailouts repeatedly benefit wealthy insiders at the expense of everyone else. Such bailouts undermine faith in democratic institutions and encourage the sort of excessive risk-taking that sows the seeds for future crises, particularly when they benefit people whose poor lending, borrowing, investment, or management decisions helped create the crisis in the first place.

When Citigroup faced significant stress in 2008, for example, the FDIC used a systemic risk exception to guarantee $306 billion in assets held by the bank. Citigroup was, of course, facing such significant stress in part because it had engaged in corporate accounting fraud and predatory lending practices in the years preceding the crash, harming everyday investors and consumers in the process.[329] During the same period, the FDIC used the exception to offer a $118 billion asset guarantee to Bank of America in *"anticipation of market pressure"* on the bank.[330] Bank of America, too, had violated securities laws and engaged in predatory lending practices in the two years leading up to the 2008 crash.[331] But households and communities – many of which were directly harmed by these and other banks' deceptive and fraudulent actions – did not receive federal aid granted in "anticipation of market pressure." Over the course of the following decade, working people would face mass unemployment and sweeping housing foreclosures. Entire cities would lose most of their tax bases, with systemic disinvestment taking a devastating toll on working families.

Financial regulators followed a similar playbook in 2023 during the failures of the crypto-linked banks discussed in Part I.B.2. When Silicon Valley Bank (SVB) and Signature Bank collapsed, the FDIC invoked the systemic risk exception and used its Deposit Insurance Fund (DIF) to cover tens of billions in uninsured deposits held by wealthy clients, venture capital firms, and tech companies. That left the FDIC on the hook for $20 billion in losses, which are borne in part by consumers in the form of bank fees. Meanwhile, SVB's former CEO was flying first class to Hawai'i and hanging on to the nearly $10 million he'd been paid the previous year while mismanaging the bank.

The federal response to the next financial crisis must avoid the unjust and unjustified bailouts of the past.

2. Stabilizing the economy by supporting Main Street

No corporate bailouts does not mean no action. To minimize the severity and breadth of a crisis, policymakers should focus their efforts on supporting the workers, consumers, retirees, and communities whose economic security would be at stake in a crisis. Such efforts will both reduce the immediate harms and make for a swifter and more equitable recovery.

The federal response to an AI bubble-induced crisis should prioritize preserving basic economic security and providing people with access to housing, healthcare, nutrition assistance, elder- and childcare. For those who suffer job losses, the federal government should move quickly to make enhanced unemployment insurance available and lower the likelihood of a sustained drop in household consumption. Steps like these will both limit the economic pain experienced by families and reduce the potential impact of the negative wealth effects discussed in Part III.C.

In a crisis triggered by a bursting AI bubble — and given the multiple channels through which Wall Street is exposing working people to AI-related financial risks — the federal government must also address the needs of modest investors reliant on their retirement accounts for economic security in the immediate term as well as working people and retirees whose pensions face major AI-related losses.

In the event of a crisis, state and local governments are also likely to be squeezed by economic contraction. They may also face an additional set of challenges unique to the AI bubble, as abandoned data center projects and tax subsidies provided to their developers could further constrain economic recovery. It will be crucial that the federal government provide state and local governments with the financial support necessary to continue delivering core services, in addition to the funding those governments already receive for health care, housing, nutrition, and other needs.

3. Hold wrongdoers accountable

Where firms or individuals are found to have broken the law, they must be held accountable. The failure to pursue wrongdoers was one of the most noteworthy failures of the response to the subprime mortgage bubble and the crash that followed. Despite well-documented fraud ranging from mortgage lenders systemically altering loan paperwork to bankers knowingly ripping off their own clients to get out from bad bets,[332] no executive of any of the largest financial institutions involved was held criminally liable for their misconduct. Civil and administrative enforcement actions were little stronger, with Wall Street banks receiving far more in bailouts than in fines. That lack of accountability played a significant role in damaging the public's faith in democratic institutions.

As described earlier in this report, deceptive practices are playing an essential role in inflating and maintaining the AI bubble. Where law enforcement officials and/or regulators identify unlawful practices that have harmed the public, investors, or consumers, the executives and high-level managers who directed and executed the unlawful conduct should be held accountable. Fiduciaries who failed to fulfill their obligations to pension plan participants or fund investors should also be held accountable.

C. BUILDING A MORE RESILIENT FINANCIAL SYSTEM FOR THE MANY

This report has focused on exposing the dangers of an AI crash and financial crisis and describing steps that policymakers can and should take to mitigate potential harms. Much broader structural reforms are required to better tame the cycle of speculative bubbles that enrich insiders, harm millions of people when they burst, and concentrate economic and political power at the top.

A fulsome exploration of those reforms is beyond this report's scope, but the need for such broader reforms is one of its central lessons. Our analysis here points to some key principles for the needed changes in finance, which we very briefly outline here:

- Policymakers must adopt tough financial transparency, accounting, and auditing standards that prevent dangerous financial engineering, and hold all parties accountable when they fail to comply with their legal obligations.
- Policymakers must establish a robust regulatory floor for the shadow banking sector that subjects such firms to strong supervisory, consumer protection, and disclosure regimes and therefore disincentivizes regulatory arbitrage.
- Policymakers must provide investors, workers, and consumers with tools that grant them power over corporate decision-making processes and enable them to hold corporate insiders accountable.

- Policymakers must update the framework for bank regulation and hold the financial system and individual financial institutions to far higher standards for resilience. The severe consequences of bank failures are a product of the critical role banks play in the economy; the danger of an AI crash becoming a systemic financial crisis is increased by banks' growing entanglement with non-bank financial companies. Banks — especially large ones — receive high levels of government support in the operation of their businesses. Consistent with that government support, and given their critical role, new and much higher standards that require banks to focus on serving the public interest are needed.[333]

Lasting reform will, of course, require much more than simply addressing the most obvious features of the current bubble and its most recent predecessors. It will require shifting the rules of the financial system so that it better supports the movement of capital towards productive and sustainable ends, is significantly less prone to dangerous boom and bust cycles, and guarantees economic security for all while providing communities the opportunity to flourish. Achieving those goals will require reforms to expand the power of workers, consumers, and communities while limiting the economic and political power of corporations.

It will also require restructuring the financial system so that it serves the needs of the real economy rather than the other way around. The ability of working people to retire in comfort must be secured through robust protections for retirement savers and income support for all aging people. Security in retirement must be less dependent on the short-term whims of the market. Workers' savings should not be treated as a pool of capital for Wall Street to use to its maximum advantage.

Last but certainly not least, true reform will also mean ensuring that billionaires and large corporations cannot accumulate the economic and political power that enables them to create economy-threatening bubbles in the first place.

Conclusion

Conclusion

Toward the end of *The Great Crash*, Galbraith called policymakers' response to the 1929 crash a "triumph of dogma over thought." In the summer of 1929, the Federal Reserve had meekly asked the banks to stop fueling the speculative frenzy but, having largely been captured in personnel and entirely captured in thought by Wall Street, refused to go any further. After the crash came, policymakers continued to blunder, stubbornly hewing to conventional laissez-faire wisdom by cutting spending when demand was plummeting and obsessing over preventing inflation even as the air was seeping out of the economy. They persisted in this approach even though logic and a mounting pile of evidence suggested that they were worried about all the wrong things, exemplifying the "poor state of economic intelligence" that Galbraith highlighted as a key factor contributing to the economy's eventual spiral into the Great Depression.

Nearly a century later, another major crisis is brewing. With a yawning and still-widening gap between revenues and spending, the AI industry's financial position is becoming increasingly precarious. It may soon become untenable, if it has not already.

But a disastrously severe crash is not, or at least not yet, an inevitable outcome. If they act swiftly and decisively, policymakers can reduce the AI bubble's threat to working people, communities, and the broader economy by slowing the bubble's inflation, shining a light on the true health of the AI industry's finances, and halting the transfer of AI-related financial risk to working people and everyday investors. They must also use and bolster the regulatory guardrails that make the financial institutions on which the real economy depends more resilient in the face of stress.

These steps would lessen the danger of an AI crash cascading into an unmanageable economic crisis. Unfortunately, financial regulators appear too captured both by Wall Street and Silicon Valley's market power and by AI hype to recognize, much less contend with, the fast-mounting risks. By moving to lower capital requirements, expose 401(k)s to private markets, and reduce financial transparency, the Trump administration and the Federal Reserve are making risk *more* attractive and debt *more* easily accessible even as speculation runs rampant. In so doing, they are leaving workers and consumers more exposed to a crash rather than less.

Time for decisive action is running short. If dogma triumphs over thought again, future historians may need to ask for clarification when someone mentions the Great Crash.

Endnotes

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of 123, more than eight times its historical average of 15. This spike occurred because, even though share prices fell quickly in late 2008, profits fell much faster, particularly in the financial sector. The current PE ratio of the S&P 500 is 32.23, well above its long-term average and (again) comparable to the peak of the dot-com bubble, but notably below that 2008 outlier peak.

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> In addition to the lease liabilities included in our condensed consolidated balance sheets, we have operating and finance leases that have not yet commenced as of June 30, 2026. These lease obligations were approximately **$278.99 billion**, consisting of data centers, colocations, and certain network infrastructure, which will commence during the remainder of 2026 through 2036 with lease terms ranging from greater than one year to 30 years. In July 2026, we entered into additional data center leases with lease obligations of approximately $68 billion, which are expected to commence in 2027 and 2028, with lease terms of 18 to 20 years.
>
> As of June 30, 2026, we had **$349.31 billion** of non-cancelable contractual commitments, comprising both short-term and long-term arrangements. These commitments mostly relate to third-party cloud capacity arrangements and investments in servers and network infrastructure, data centers, and consumer hardware products in Reality Labs, with approximately $53.52 billion and $81.65 billion due in 2026 and 2027, respectively.

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199 Cassidy, *supra* note 116. For more detailed and academic explanations of the risks described in this section, *see* chapters 12 (discussing credit busts and other dynamics of financial crises) and 26 (discussing wealth effects and Tobin's Q theory, a key mechanism linking asset prices with businesses' investment decisions) of Frederic S. Mishkin's *The Economics of Money, Banking and Financial Markets*. 13th ed., Pearson, 2021.

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Glossary of Terms

AI Chip	Specialized computer processing chips that perform the intensive computation required to train and run generative AI models. Includes Nvidia graphics processing units (GPUs) and Google/ Broadcom tensor processing units (TPUs).
Artificial intelligence (AI)	A computational system trained on data to recognize patterns, make predictions, or generate outputs such as text, images, audio, and video. Because nearly all of the debt and spending in the AI bubble is on generative AI infrastructure, references to "AI" should be assumed to refer to generative AI unless otherwise specified.
Commoditization	The process where intense competition, low barriers to entry, or other factors create a low-margin market consisting of several companies offering interchangeable goods or services.
Depreciation	A common but easily abused accounting method where the cost of an asset is spread over the asset's useful life rather than booked all at once.
Generative AI	AI systems that generate text, images, or other output in response to an inquiry or prompt.
Graphics processing unit (GPU)	The specialized class of computer processing chips most commonly used to train and often to run generative AI models. Used interchangeably with "AI chips" in this report.
Hyperscaler	The corporations, all based in the U.S., that are spending the most money on building AI infrastructure. Most commonly refers to Alphabet, Amazon, Meta, Microsoft, and Oracle, and sometimes CoreWeave and SpaceX as well.
Index fund	An investment vehicle where investors purchase shares in a fund that tracks the value of a specific index, such as the S&P 500.
Inference	The stage where a trained AI model generates outputs (such as text, answers, or predictions) in response to user inputs.
Large language model (LLM)	The subtype of generative AI that powers ChatGPT, Claude, Gemini, and other text-based generative AI chatbots and related products.
Leverage	Generic financial term referring to the use of borrowed money to invest in or purchase assets.
Leveraged fund	Exchange-traded or mutual funds that use debt and derivatives to deliver multiples of the daily changes in the value of a stock, index fund, or other security.
Margin call	A demand by a lender that the borrower provide additional collateral, typically because the value of the borrower's existing collateral has deteriorated. Margin calls frequently happen for margin debt accounts during sharp stock market downturns.
Margin debt / margin loan	Money that a broker has loaned to an investor for the purchase of stock, bonds, or other securities.
Model developer	A corporation or other organization that develops LLMs or other generative AI models and offers related products and services to the public.

Model training	The process through which a generative AI system identifies patterns from data and uses those patterns to produce new outputs.
Negative wealth effect	Negative feedback loop where falling wealth leads people to cut spending, which hurts economic growth. Inverse of the wealth effect.
Neocloud	Companies (e.g., CoreWeave and Nebius) that focus on developing data centers and leasing access to AI chips to generative AI model developers.
Private investment firm	Non-bank financial institutions that manage private credit or private equity funds.
Private credit	Loans and other forms of debt provided outside traditional bank lending and bond markets. Most often, they are issued by non-bank financial institutions and not traded on public credit markets.
Private equity	Shares and equity in privately held companies that are not traded on public stock markets, or the firms that specialize in managing investment funds that generate profits from the purchase of such equity.
Round-tripping	Deceptive financial arrangement where two companies exchange the same money, goods, or other assets back and forth to create the false appearance of real revenue even though no real economic value is created.
Securitization	The process of pooling loans or other debt obligations into a tradeable bond or similar security, the cash flows from which (e.g., interest payments on the underlying loans) are effectively sold to investors.
Shadow banking system	The system of non-bank financial institutions such as private investment firms, hedge funds, insurers, mutual funds, that manage assets, lend money, and engage in other bank-like functions but that operate outside the regulatory system that governs banks and similar depository institutions like credit unions.
Special-purpose vehicle (SPV)	A shell company set up by a sponsor corporation that holds specific assets or liabilities, often in order to keep those assets and liabilities off the sponsoring corporation's books.
Stranded asset	An asset that loses its economic value before the end of its functional or operational life. Can occur if the asset becomes obsolete or costs more to operate than it can generate in revenue.
Token	The fragments of text that LLMs process and generate. Billing for generative AI products/services is increasingly done on a per-token basis.
Understating depreciation	Dubious accounting tactic where a company effectively claims that an asset has a longer useful life than it actually does, thus allowing the company to spread the cost of the asset over a longer period of time on its balance sheet and make its current expenses appear artificially low.
Wealth effect	Positive feedback loop where wealthier people spend more and stimulate economic growth. Inverse of the negative wealth effect.