EXECUTIVE SUMMARY

brace for impact

PROTECTING PEOPLE AND THE ECONOMY WHEN THE AI BUBBLE BURSTS



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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:
  - More overvalued by most traditional metrics than it has been since at least the peak of the dot-com bubble (see Figure ES-1).
  - More concentrated in its largest companies (see Figure ES-2) than it has been since the 1960s.
  - More concentrated in a single sector (see Figure ES-3) than it has been since the 1890s.
  - 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

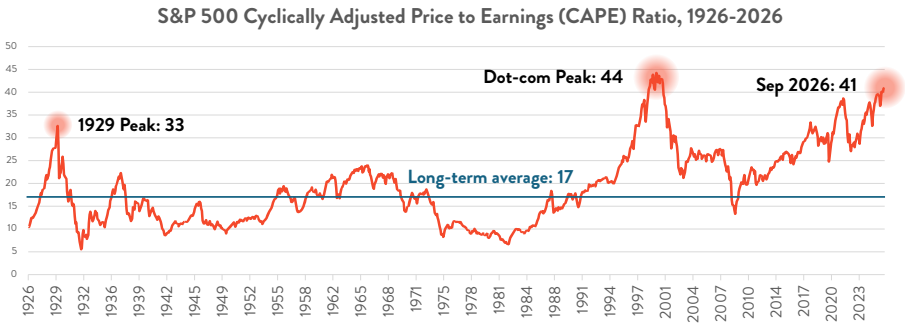


Figure ES-2: The stock market is highly concentrated in its largest companies

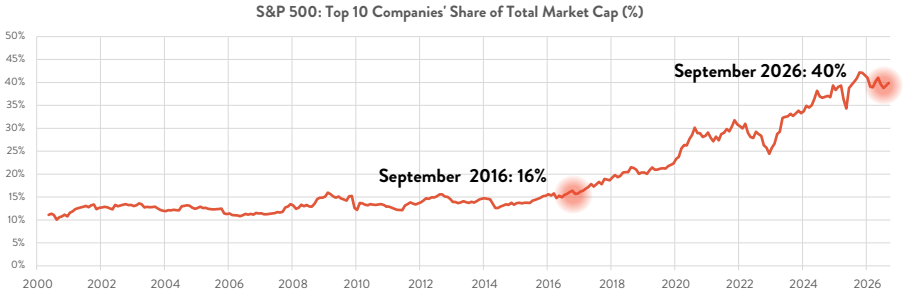


Figure ES-3: Unlike the last era of blue-chip dominance, the biggest companies are all from the same sector



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

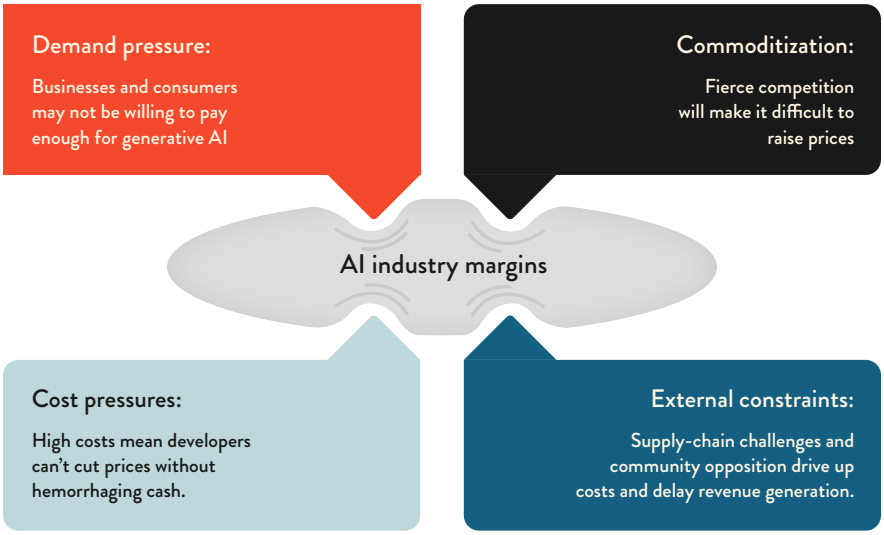
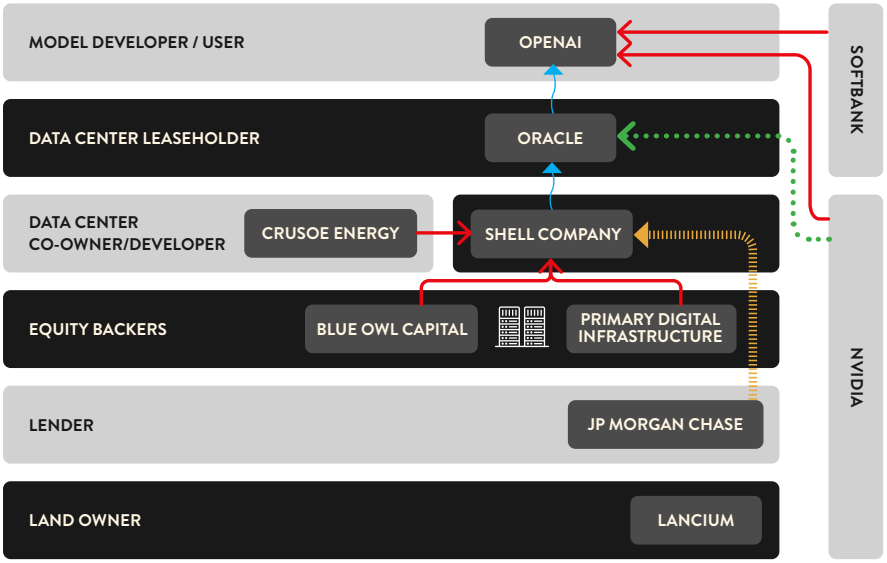


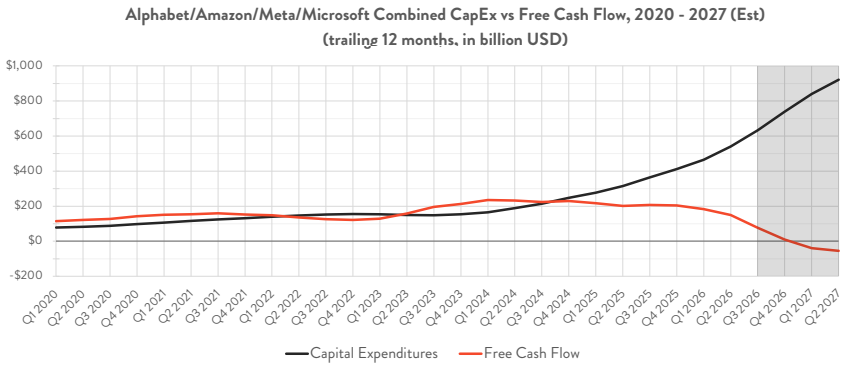
Figure ES-6: The Abilene, Texas data center's corporate layer cake



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.

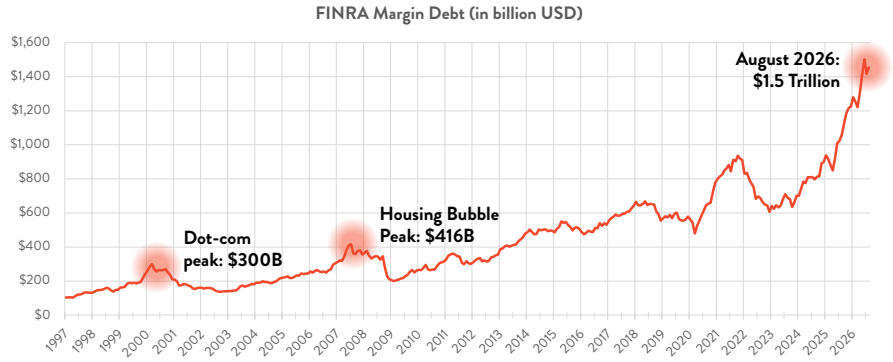


Figure ES-9: Just nine hyperscalers and chipmakers have a combined $3.1 trillion in off-balance-sheet debt

Sources: Wall Street Journal, Company Filings

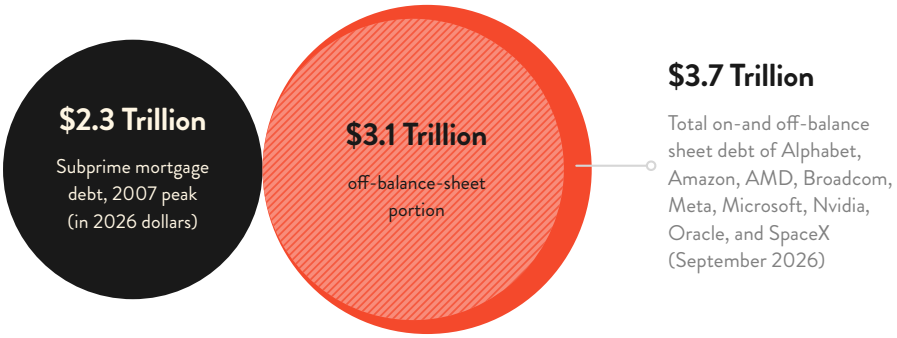
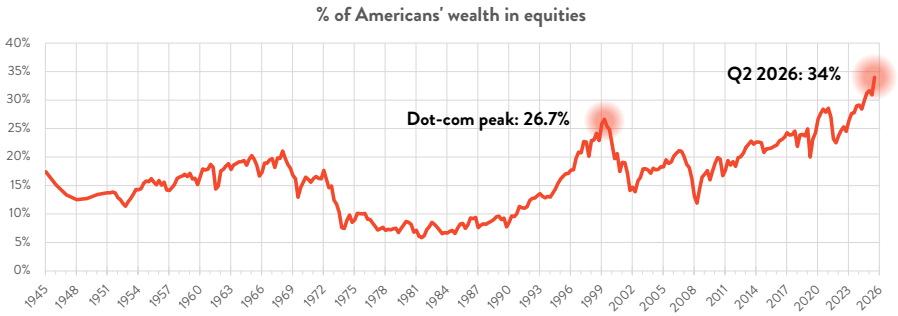


Figure ES-10: More American wealth is tied up in stocks than at any time since at least World War II *Source: Federal Reserve Bank of St. Louis*



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