

Original article

Impact of the collapse of the Lehman Brothers bank and the 2008 financial crisis on global economic security

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INFORMATIONS

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ABSTRACT

The study presents the analysis of the economic phenomena that occurred at the turn of 2007/2008. The financial meltdown and stagnation – a slowdown in the growth of world economies, which led to a chain of bankruptcies and debts, took place in those years. Due to the domino effect, the Lehman Brothers activity had an impact on the global economy. The bank declared bankruptcy on September 15, 2008, which caused panic on the US stock exchange and a greater conviction about the crisis of high-risk mortgage loans. The result was multifaceted activities implementing proper corporate governance and deliberalization of financial law in the United States. The collapse of the colossus achieving record profits was, therefore, a kind of breakthrough that triggered a financial crisis that spread throughout the world.

The State Treasury and the US Federal Reserve System joined the rescue of the company; nevertheless, negotiations with potential investors ended in a fiasco.

KEYWORDS

security of the global economy, global economy, Lehman Brothers, crisis, financial system

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Introduction

The collapse of the Lehman Brothers investment bank that took place on September 15, 2008, was in a way an effect of the cumulative financial crisis that had been going on since mid-2007. It should be noted that at that time banking systems (both European and American ones) were at risk, and a significant part of countries suffered a recession as the follow-up to the bank's bankruptcy. The study aims to present critical phenomena that took place immediately after the bankruptcy of Lehman Brothers and remedies that were made by the state. It should be noted that the primary solution was adequate funding, implementation of legal regulations, and the establishment of

supervisory institutions. The article mainly uses a comparative method which is based on comparing phenomena, which is evidenced by the tables presented in the article.

1. The situation of the real world economies after the outbreak of the crisis in 2008

The collapse of the Lehman Brothers bank was a great surprise for the main actors of the real economy. In part, it has been confirmed that Keynesian economics does not protect the world economy, as was demonstrated by the crisis of the 1970s¹. It also turned out that the global imbalance existing before the crisis of 2008 had not been sufficiently analyzed by economists, which could neutralize its possible collapse².

The macroeconomic situation of the United States resulting from the bank's negative performance was not satisfactory as evidenced by the data from Table 1.

Table 1. Table of main macroeconomic indicators of the US economy

Specification	2007	2008
GDP (global value)	USD 13,807.5 billion	USD 14,441.4 billion
GDP (value per capita)	USD 45.8 thousand	USD 47.5 thousand
GDP growth rate	2.1%	0.4%
Relation of the public finance deficit to GDP	1.2%	3.2%
Total public debt to GDP ratio	66.8%	74.1%
Inflation rate (consumer price index CPI)	2.8%	3.8%
Unemployment rate	4.6%	5.8%
Value of foreign trade turnover	USD 3,166.4 billion	USD 3,393.3 billion
Value of the exports of goods	USD 1,162.7 billion	USD 1,266.9 billion
Value of the exports of goods	USD 1,953.7 billion	USD 2,166.4 billion
The value of the annual inflow of foreign direct investment	USD 237.5 billion	USD 316.1 billion
The value of the annual outflow of foreign direct investment	USD 313.8 billion	USD 311.8 billion
Cumulative value of foreign direct investment in the US (inward)	USD 2,033.0 billion	USD 2,278.9 billion
Cumulative value of US foreign direct investment abroad (outward)	USD 2,791.3 billion	USD 3,122.0 billion

Source: [1].

¹ Keynesian economics – Keynes' theory, regarded as a theoretical revolution, encouraging the construction of mathematical models and their empirical verification; it became the starting point for the new theory and macroeconomic policy in the 1960s.

² The description of global imbalance can be found in the publication: K. Rybinski, *Globalizacja w trzech odsłonach. Offshoring – globalne nierównowagi – polityka pieniężna*. Warszawa: Difin; 2007.

The analysis of macroeconomic data indicates that the USA lost its position of the economic giant in 2008. The general value of GDP decreased by 0.96% in 2008 in relation to the profits achieved by the US economy in 2007. A similar situation related to the amount of gross domestic product per capita, the GDP growth rate decreased in 2008 by 1.7%. The ratio of the public finance deficit to the gross domestic product turned out to be equally unfavorable, as it was 2% more than in 2007. The relation of the current account deficit to GDP decreased by 0.2% as compared to 2007. The Consumer Price Index, which relates to the growth of the prices of consumer goods and services and is the most commonly used measure of inflation in the USA, increased by 1% in 2008, while the unemployment rate was by 1.2% higher in the year of the beginning of the currency crisis than a year earlier. Thus, the decline in product dynamics deepened in Europe. In Germany, France, and the United Kingdom, and these countries recorded a negative GDP growth rate. In 2009, global GDP fell by 2.9%; in highly developed countries it decreased by 4.1%, while in developing countries it increased by 2.2%. In 2010, the situation improved, global GDP grew by 3.8%, but in 2011 the global growth rate dropped again, and GDP amounted to 2.4%. The main reason for the decline in GDP was the slump in world trade. The slowdown in the economic growth in the European Union countries had a negative impact on the financial situation of the countries of Central and Eastern Europe, including Poland. The weakening of the economic situation in the fourth quarter of 2008 was easily noticeable in small countries, where economies were relatively largely open and the share of exports in GDP was significant, for example the Czech Republic and Hungary also recorded a drop in GDP on a yearly basis. The decrease in turnover had the global reach and fast pace. Between September 2008 and February 2009, world trade in goods decreased by almost 17%. At the beginning of 2009, the decline in the value of exports by more than 5% in quarterly terms occurred in more than 90% of countries, and for almost 15% of countries it was a decrease by over 20%. In 2009, according to the data of the World Bank, the value of global exports decreased by almost 11%.

The financial crisis in the United States occurred in parallel with several incidents that took place in autumn 2008. According to Michael Lewis, they included:

- the collapse of Lehman Brothers,
- government assistance for AIG,
- negotiations at the Congress on TARP – a 700-billion rescue package for Wall Street,
- drop in the Dow Jones index [See: 2].

2. The most important interventions of the American government on the financial market in 2008

The actions undertaken by the George W. Bush administration aimed at improvement of the situation caused by the crisis were the first step in the regaining of the position lost by the United States. In 2008, the Federal Reserve Board and the Department of the Treasury carried out the operation. In the fourth quarter of 2008, the US govern-

ment allocated USD 600 billion to financial market by granting loans and guarantees to institutions and implementing restructuring programs for the country's economy. The Federal Reserve Board and the Department of the Treasury did not grant assistance to some American banks. The Lehman Brothers Holdings Inc., which declared bankruptcy on September 15, 2008, received a refusal. Table 2 depicts resources involved by the American Government to support financial institutions.

Table 2. The most important interventions of the American government in the financial market in 2008

Date of intervention	Supported financial institution	The role of the US Government	The cost of assistance provided
March 13, 2008	Bear Stearns Bank	Takeover by JP Morgan Chase supported by the Federal Reserve Board and the Department of the Treasury (FED). The FED agreed to buy up the problematic liabilities of the Bear Stearns Bank USD 30 billion.	USD 30 billion
July 14	Fannie Mae – construction consortium	Takeover of control over Fannie Mae by the Federal Building Financing Agency (FHFA).	USD 100 billion
July 14	Freddie Mac – construction consortium	Takeover of control over Fannie Mac by the Federal Building Financing Agency (FHFA).	USD 100 billion
September 17	AIG	Granting a loan in exchange for 79.9% of shares in the company.	USD 85 billion
November 23	Citigroup	Guarantee of repayment of debts.	USD 306 billion

Source: [3, p. 109].

The crisis aggravated despite the assistance provided by the government administration. Many prosperous financial enterprises found themselves on the edge of bankruptcy, which became a requirement for the American Government to develop a comprehensive plan to save the economic situation of the country.

On 3 October 2008, the US House of Representatives adopted the Paulson Plan, whose main point was the purchase of some of the riskiest debts of financial institutions for USD 700 billion. According to the economists, the plan, although it was necessary, did not solve the source problem, namely the fall in house prices in the USA and the difficulties of the growing group of borrowers unable to pay their debts. Despite the adopted plan, the signs of the crisis were visible in the real economy. In September 2008, there were 159 thousand unemployed people in the USA, which was the most substantial increase in unemployment since 2003 and was an undeniable sign of an economic slowdown. The founder of the plan, economist Henry Paulson, claimed that "The money from the plan will be largely recovered in the future because the government will become the owner of the indebted real estate that can be later sold on the market" [4].

3. Influence on the global economy

The economic crisis in the USA has confirmed in a very unfavorable way for the global and European economy the thesis about the global character of modern economics. The stock exchanges began to record the decreases in the value of currencies and shares of enterprises, as exemplified by the data from 2008:

- on October 15, 2008, the American Dow Jones Industrial Average group reported a 7.8% decline in its value (this is the largest one-off reduction in value since 1987),
- on October 15, 2008, the value of shares in the Japanese concern Nikkei decreased by 11.4%,
- the value of shares of South Korean and Russian companies fell by 9.4% and 9.2% respectively,
- European stock exchanges recorded decreases on average by 5-10%.

In Europe, the banking sector saw extremely serious problems, which is why particular not only European Union countries were forced to intervene in their financial markets (Table 3).

Table 3. The most important activities of European governments aimed to save banking systems in 2008

Country	Measure	Cost of financial intervention granted
Germany	<ul style="list-style-type: none"> – Bank Hypo Real Estate – government guarantees – Special guarantees for interbank loans – Direct injection cash into the banking system 	<ul style="list-style-type: none"> – EUR 35 million – EUR 400 million – EUR 80 million
France	<ul style="list-style-type: none"> – Creating a special guarantee fund for interbank loans – Capital supply for Delia Bank 	<ul style="list-style-type: none"> – EUR 360 million – EUR 4 billion
Great Britain	– Takeover of controlling shares in three banks: Royal Bank of Scotland, Lloyds TSB, HBOS	– GBP 37 billion
Sweden	– Guarantee fund for banks, with the possibility of granting loans in case liquidity problems	– EUR 152 billion
Switzerland	– UBS Bank – recapitalization	– USD 5.3 billion
the Netherlands, Belgium, Luxembourg	<ul style="list-style-type: none"> – Acquisition of 49% of shares in Fortis Bank in individual countries – Capital supply for Dexia Bank (Luxembourg and Belgium) – Capital supply for ING (the Netherlands) 	<ul style="list-style-type: none"> – EUR 12.1 billion – EUR 4.7 billion – EUR 10 million
Portugal	– Bank guarantees	– EUR 20 million

Source: [5, p. B3].

According to the data of the US Department of Commerce, mutual trade between the USA and the EU in 2008 was at the level of USD 640 billion. The US exports to the EU

amounted to USD 271.8 billion (thus representing 21% of total US exports in 2008), while imports – to USD 367.6 billion (18% of total US imports in 2008) [1].

Although in 2008 the United States recorded a deficit in trade in goods with the European Union in the amount of USD 95.8 billion, the situation was slowly beginning to change. As recently as in the first half of 2009, exports to European Union countries amounted to USD 110.6 billion and were lower by 21.3% than exports realized in the same period of the previous year. On the other hand, imports from the EU Member States reached USD 134.5 billion and were lower by 28.7% than imports from the corresponding period of 2008.

The transatlantic trade flows were dominated first of all by highly processed goods. In 2008, the EU exported to the USA mainly passenger cars, machinery, chemical products, and petroleum products. The US sent machines and devices, including computers, planes and medicaments, to the EU. Among the EU Member States, Germany, the United Kingdom, France, the Netherlands and Italy were the most important trading partners of the USA.

4. Legal aspects – liberalization of the principles for granting loans for purchase of real estate

After recovering from the effects of the crisis of the thirties of the twentieth century in the United States of America, loan banks supporting construction were established. As the literature on the subject states:

“Gradual liberalization of control led to a situation in which they began to grant non-secured mortgage loans. At the same time, loan funds have become an attractive investment field first for hedge funds and then for banks” [3, p. 105].

The indicated hedge funds are a type of financial institution very popular in the USA, which manages the entrusted capital in return for the commission. Their characteristic feature is risky investing in order to achieve maximum profit (stock exchange transactions). It is them, among others, that generated the financial crisis, since in practice they are not subject to restrictive legal regulations, as in the case of other investment funds.

Simultaneously, home prices constantly increased. This situation meant that credit institutions counting on a profit that would be disproportionate to the financial contribution more and more often granted loans even to people without a fixed income. It was considered then that a house is a sufficient collateral for the mortgage. Meanwhile, artificially high prices of real estate began to decline. One of the main reasons was that the fact that the Federal Reserve Board had raised the basic interest rates from 1% in 2003 to 5.25% in November 2006. The increased costs of credits led to a reduction in demand for real estate and led more and more Americans to problems with paying their mortgage payments on time [3, p. 105]. This state of affairs caused a further decline in property prices, because the houses taken over by banks and sold on the market were of increasingly lower value. Already in 2007, the profit realized on the sale of

real estate did not cover losses, in the consequence of which more and more banks began to reveal huge deficits caused by unpaid mortgage loans.

“In this way, the ‘mortgage bubble’, i.e., the unjustified artificial increase in property prices in the USA, finally burst” [3, p. 106].

A year before the outbreak of the crisis (2007), only 1% of all properties in the USA were taken over and the size of this phenomenon deepened in August 2008 alone. At that time, the procedure of acquisition covered 303 thousand real estate properties.

The so-called subprime loans brought the US economy to huge financial losses. These types of loans are, or rather were, very popular in the United States. Their idea was to grant loans to people with insufficient financial capacity or those who have a “bad credit history”. These credits were granted at a higher percentage. Another example of the unreasonable lending policy was the so-called Ninja Loan (a credit for the repayment of other loans), addressed to people without income, without work and without assets (no income, no jobs, no assets) [3, p. 107].³ This form of crediting was especially popular at the top of the so-called ‘mortgage bubble’ in the years 2000-2004.

That state of affairs is diagnosed in the literature of the subject in the following way:

“The global economy today consists of two economies: virtual, i.e., financial markets on which capital is traded, and material, i.e., factories, trade and services. On September 15 (2008), the atomic bomb exploded in this first economy. Wall Street, the world’s largest financial market, disappeared from two of the five investment banks holding all the cards in global finance. The 158-year-old Lehman Brothers Bank declared bankruptcy, and Merrill Lynch was absorbed by the retail Bank of America. The third one, Bear Stearns, was taken over by competition already in March. There were only two players left: Goldman Sachs and Morgan Stanley, both voluntarily subjected themselves under the supervision of the Federal Reserve, which practically puts an end to independent investment banking on Wall Street” [6, p. 12].

Conclusion

The article presents the causes and effects of the global financial crisis that broke out in 2008 and caused huge financial stagnation in the world. The collapse of the Lehman Brothers Bank left a global mark, and the bankruptcy directly influenced thousands of financial market participants. Moreover, there were numerous upheavals all over the world, which stemmed from many linkages between cross-border and cross-sectoral interdependent entities. Due to the globalized legal structure, Lehman Brother’s collapse gave rise to more than 75 separate and differing bankruptcy proceeding. New legal norms and preventive systems that are to protect the world from further such crises have been created. The collapse of Lehman Brothers and the bankruptcy risk of subsequent US banks and banks located in Europe caused a crisis in the form of distrust in the banking market. Above all, the banks ceased to borrow money.

³ The name Ninja Loan comes from the financial product of HCL Finance.

It can be stated that politicians and regulators have learned the lessons from this crisis. One of the most important was the statement that its reason was the unregulated financial services market (including the lack of supervision) and, consequently, new regulations were introduced. On July 21, 2010, the USA adopted the Act on the Wall Street Financial Reform and consumer protection (a legal act known as the Dodd-Frank Act). It primarily aimed to regulate the trading of repositories, shortly – new institutions were established to deal with risk measurement and assessment of the level of banking capitals. The key objective of the Act was to reduce the level of risk for the financial sector in the context of transactions on the repositories market, develop rules for the correct valuation of derivatives before and after their performance, and supervise the main market participants [7, p. 56]. The European Parliament and Council Regulation on the capital market infrastructure (European Market Infrastructure Regulation – EMIR), which entered into force a bit later, on August 16, 2012, was a specific counterpart to the Dodd-Frank Act [7, p. 56]. Furthermore, the provisions of the Regulation on prudential requirements for credit institutions and investment companies (CRR) and the Directive on the approval requirements for credit institutions for operations and supervision (CRD) have been in force since January 1, 2014, in the European Union countries. The CRD IV/CRR legislative package introduced primarily new capital requirements and financial liquidity standards for banking institutions [8, p. 145]. In addition, as early as on September 12, 2012, the European Commission issued a draft resolution that gave the European Central Bank (ECB) powers to supervise banks in the euro-area countries. Thereby a single supervisory mechanism has been established [9, p. 29-31].

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Conflict of interests

The author declared no conflict of interests.


Author contributions

The author contributed to the interpretation of results and writing of the paper. The author read and approved the final manuscript.

Ethical statement

The research complies with all national and international ethical requirements.

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Biographical note

Radosław Mieszala – M.A., currently a PhD student in the 4th year of studies at the Faculty of Management, Computer Science and Finance at the Wrocław University of Economics. A graduate of the Military Academy of Land Forces in Wrocław. His scientific interests primarily include management, national security as well as economics and law.

Wpływ upadku banku Lehman Brothers oraz kryzysu finansowego w 2008 roku na bezpieczeństwo gospodarki światowej

STRESZCZENIE

Niniejsza praca jest analizą działań zjawisk gospodarczych, jakie miały miejsce na przełomie lat 2007/2008. W latach tych miał miejsce krach finansowy oraz stagnacja – spowolnienie wzrostu gospodarek świata, które pociągnęły za sobą łańcuch bankructw i zadłużeń. Przez wywołany efekt domina, działalność Lehman Brothers miała wpływ na gospodarkę globalną. Bank ogłosił upadłość dnia 15 września 2008 roku, co spowodowało panikę na giełdzie w USA i większe przekonanie o kryzysie kredytów hipotecznych wysokiego ryzyka. Następstwem były wieloaspektowe działania implementujące odpowiedni nadzór korporacyjny oraz deliberalizacja prawa finansowego w Stanach Zjednoczonych. Upadek kolosa osiągającego rekordowe zyski stanowił więc swojego rodzaju przełom, zapoczątkował kryzys finansowy, który rozprzestrzenił się na cały świat.

Mimo włączenia się w ratowanie firmy skarbu państwa i systemu rezerwy federalnej, negocjacje z potencjalnymi inwestorami zakończyły się fiaskiem.

SŁOWA KLUCZOWE

bezpieczeństwo gospodarki światowej, gospodarka światowa, Lehman Brothers, kryzys, system finansowy

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