

Extra Feature Story

Big Banks Fail, Signaling More Economic Troubles Ahead

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The collapse of one of America's oldest and largest investment banks, and the weakened state of other important Wall Street companies shook stock markets worldwide as the financial crisis tied to falling home prices continues to shake the economy.

Lehman Brothers, a 158-year-old investment bank, filed for bankruptcy on September 15 after an intense weekend of negotiations with the federal government and other financial institutions to save the company.

The government decided not to bail out Lehman, leading to its collapse. Merrill Lynch, an independent investment services company, was also in serious trouble and ended up selling itself to Bank of America. On top of that, the government approved an \$85 million taxpayer bail out of the nation's largest insurance company, American International Group.

The combined news led to a 500-point drop Monday in the Dow Jones industrial average, a measure of the 30 largest public companies in the United States. It was the biggest drop since the stock market reopened after the September 11, 2001 terrorist attacks. According to the Washington Post, about \$700 billion in value evaporated from the stock market during one day.

Nouriel Roubini, chairman of consulting firm RGE Monitor, said the crisis is very serious.

"Unfortunately, this is the worst financial crisis we've experienced in the United States since the Great Depression. Even (former Federal Reserve Chairman) Alan Greenspan says this is once-in-a-century phenomenon. So things are getting worse," he told the NewsHour.

No government bailout

One of the central players in the crisis, Treasury Department head Henry Paulson, decided not to use taxpayer money to help Lehman Brothers, even though just weeks earlier, the government helped the two largest mortgage companies, Fannie Mae and Freddie Mac.

Many experts agreed the decision was the right one.

"I suspect at some point you'll see the federal government back. But it was good to set a baseline, to say, 'You know, we're just not going to bail out everyone in America,'" said Kenneth Rogoff of Harvard University.

Subprime poison

The ongoing financial crisis is tied directly to the recent popularity of risky home loans.

As the prices of homes in the United States continued to rise, doubling from 2000 to 2006, banks and mortgage companies took bigger risks by giving big home loans to people without proof of their financial situation or asking for little or no down payment.

These “subprime” loans were then bundled together and then sold to big investment banks like Lehman Brothers. When home prices started plummeting in 2006, many borrowers could not pay their loans or sell their house and were forced to walk away, leaving banks with worthless mortgages and valueless properties.

Effect on the election

Both major party candidates for president, Republican Senator John McCain and Democratic Senator Barack Obama, have jumped to frame themselves as the best candidate to deal with the economy. Both candidates favor tougher regulation of the financial system.

Obama immediately released an advertisement in battleground states criticizing McCain's comment that “the fundamentals of the economy are strong,” a phrase McCain has used repeatedly, according to NBC News. The ad questions how McCain can fix the economy if he doesn't understand that it's broken.

McCain released his own advertisement, claiming that only he and his running mate, Alaska Governor Sarah Palin, are capable of dealing with the financial crisis and reforming the financial system. The ad promises tax cuts to create jobs, offshore drilling, and better regulation of the financial system.

Both candidates will argue for more regulation, but neither will be in a position to enact reforms until the new president takes office in January.

-- Compiled by Quinn Bowman for NewsHour Extra

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