

Extra Feature Story

Plans Change Dramatically for U.S. Financial Bailout

November 14, 2008

The U.S. government is shifting the focus of the \$700 billion financial rescue plan away from buying up bad mortgage assets, instead trying to help consumers get credit by investing in banks and other financial institutions.

Treasury Secretary Henry Paulson acknowledged the significant change of plans on Wednesday.

"Over these past weeks, we have continued to examine the relative benefits of purchasing illiquid mortgage-related assets," Paulson said. "Our assessment at this time is that this is not the most effective way to use [government bailout] funds."

The original plan was to buy up "troubled assets" from banks and financial institutions holding debt from bad mortgages.

When people can't make the monthly mortgage payment on their homes, they "default" on their loans. Lenders then take ownership of, or "foreclose" on, the house. Banks and lenders have lost money this way and been stuck with lots of debt and devalued homes since the housing crisis began.

Injecting capital

Instead of buying those devalued homes, the U.S. Treasury is buying shares in the banks instead -- giving the government partial ownership. By injecting money, or "capital," into these institutions, the Treasury hopes they will make more loans, helping to relieve tight credit conditions.

The lack of credit available to consumers has contributed to a slowdown of the economy. Credit feeds the economy by enabling people and companies to borrow money to make purchases or payments until they have the cash to pay it back. Governments also borrow money, and banks borrow money from each other.

When banks are unable or unwilling to lend money, the normal flow of business slows down.

The scramble for money

Of the \$700 billion originally approved by Congress in early October, Paulson was allowed to use \$350 billion immediately. About \$290 billion has already been committed as capital for banks and other financial institutions, leaving \$60 billion more to spend. Nov. 14 is the Treasury's deadline for companies to apply for investments.

Banks and companies struggling in the harsh economic climate are lobbying the government heavily for money. Lobbyists are people who are paid to promote a company or interest group, such as the oil industry, to lawmakers and the government. They try to influence decisions in a way that is favorable for their employers.

Banks were the original target for the rescue plan money, but other types of companies are lobbying to receive aid as well, which has some smaller banks concerned.

"By the time they get to the community banks, there may not be enough money left," Edward L. Yingling, the president of the American Bankers Association, told the New York Times.

American Express, the credit card company, is even changing itself into a bank holding company to make itself eligible for rescue funds. Other companies are also trying to be reclassified so they can apply for funds.

The auto-industry dilemma

The U.S. auto-making industry has been pushing for rescue money, too, even though they do not fall under the original intent of the rescue money. Ford Motor Co. and Chrysler LLC are both in danger of bankruptcy. General Motors could go bankrupt before the end of the year without assistance. President-elect Barack Obama asked Congress Thursday to approve as much as \$50 billion to rescue the auto industry.

"The auto industry is too big to fail," Nariman Behravesh, chief economist at IHS Global Insight Inc. told Bloomberg News. "While the Obama administration can wait until Jan. 20 to address other matters, on this one they need to move quickly."

A GM bankruptcy could send the U.S. jobless rate as high as 9.5 percent, up from a 14-year high of 6.5 percent in October, reported Bloomberg.

It has not been determined if the any money for auto companies would be pulled from the \$700 billion rescue plan, but Paulson argued Wednesday that the money was intended to help the financial industry and is not for the auto industry, despite its economic importance.

China's plan

Economic powerhouse China revealed its own plan to stimulate its economy on Sunday, taking a different direction than the United States. China's \$586 billion package includes specific plans for tax cuts and a program of spending on infrastructure for the country and on social programs like education and health care.

The money will help finance the development of low-income housing, technological innovation and rebuilding areas damaged by natural disasters.

The hope is that government spending will keep money flowing to workers and consumers to help grow the country's economy.

In the United States, Mr. Obama is supporting a similar proposal. He is pushing for an additional \$50 billion stimulus package for infrastructure projects such as roads and bridges to help create jobs.

-- Compiled by Talea Miller for NewsHour Extra

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