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### Bailout Deal Finalized, Ready for Vote; Long-Term Cost, Effectiveness Hard to Predict



On Sunday Washington lawmakers announced for the second time that a deal in principle to bail out the nation's ailing banking industry had been reached – a move intended to keep lines of credit flowing to businesses and individuals around the country and prevent a possible financial disaster.

The announcement is likely to be welcome news to Wall Street. But the long-term impact of the deal, assuming it is passed into law, is a big a gamble. The ultimate cost of the plan and its long-term effectiveness are anybody's guess.

Economists and others say the national economy could be devastated if lawmakers in Washington do not pass a plan to fix the nation's credit crisis. Thanks in part to public outrage and political posturing, a framework agreement announced Thursday turned out to be less solid than was hoped. By that evening, a revolt by House Republicans caused the consensus – if there ever was one – to unravel. On Friday, the wrangling in Washington continued.

By Sunday, however, Congressional leaders announced once again that a framework was in place and that a deal involving an outlay of hundreds of billions of dollars was in the process of being finalized.

By early Monday morning, [the bill was written](#).

"We've still got more to do to finalize it, but I think we're there," said Treasury Secretary **Henry Paulson**, who participated in the talks at the Capitol.

The measure would create a program that lets the government spend unprecedented sums of public money to prop up tottering financial institutions by buying their sagging mortgage-based investments and other devalued assets.

A breakthrough came when Democrats agreed to incorporate a GOP demand of letting the government insure some bad home loans rather than buy them designed to limit the amount of federal money used in the rescue.

#### Details Will Matter a Lot

**Amiyatosh Purnanandam**, a finance professor at the **University of Michigan**, said Sunday that lawmakers in Washington seemed to be "moving in the right direction" toward reaching a deal that would help the nation avoid a severe credit crunch. But, as with all things, he said, the details will matter a lot.

"It is important that we don't reward people for their bad decisions of the past," Purnanandam said. So, he said, it's important for any final deal to include adequate safeguards and oversight to avoid a repeat of the same scenario down the road. He said it also is important that the deal not be rushed.

"The financial system won't just melt down," Purnanandam said. So long as it is clear that a workable package is likely to be passed soon, he said, investors will be patient enough to allow the legislative process run its course.

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What would happen if no deal was reached at all? Purnanandam said that could cause banks to lose confidence and severely slow down lending – to each other and to their customers. That could cause banks to fail as access to inter-bank borrowing dried up and for businesses to suffer from tighter credit terms. For example, businesses that rely on bank lines of credit for short-term liquidity could see those lines cut off or restricted. And consumers could find it much hard to get loans for homes, cars or other purchases.

Purnanandam said the bailout plan being worked out addresses the root cause of the problem: a sea of mortgage-backed securities that can't be converted into cash by the banks holding them – an approach he thinks is better than just bailing out individual institutions one by one. He said the plan also appears to give taxpayers the chance to recoup some of their money if the purchased assets can be sold at a profit and that adequate oversight and regulation will be built in.

### Could Bailout Make Things Worse?

Whether or not the bailout plan averts financial catastrophe for now, it won't be a quick fix for the economy. And some experts fear that, in the long term, the bailout plan could have a negative impact on the economy.

"This is going to take years to work out and it will be incredibly complicated," **Bert Ely**, a banking consultant who has extensively studied the U.S. government's 1989 bailout of the savings-and-loan industry, [told the Associated Press](#).

In research a paper released Thursday, **Weiss Research Inc.**, based in Jupiter, Fla., called the proposed bailout "too little, too late" to end the debt crisis and "too much, too soon" for the bond market. In the paper, the economic research firm asserts that the bailout proposed by the Bush administration not only won't work, but could actually make things worse by driving up interest rates.

Weiss says the problem of troubled banks is far greater than the Federal Deposit Insurance Corp. (FDIC) currently indicates. While the FDIC's list of troubled banks consists of 117 institutions with \$78 billion in assets, Weiss thinks 1,479 FDIC member banks are at risk of failure with total assets of \$2.4 trillion. In addition, the firm says, 158 savings and loans with \$756 billion in assets also are at risk.

The report also says that the credit crisis goes far beyond home mortgages and affects a range of U.S. interest-bearing debts, including \$51 trillion and \$180 trillion of derivatives held by U.S. banks. For example, the report cites the debt problems of state and local governments as a serious concern, as are commercial mortgages. Given all that, the report says, a \$700 billion bailout "could very well be just a drop in the bucket."

Furthermore, Weiss says: "There should also be no illusion that the market for U.S. government securities can absorb the additional burden of funding massive government bailouts without traumatic consequences" such as a steep rise in interest rates.

Given all that, the Weiss recommends limiting and reducing the bailout as much as possible, while bolstering existing safety nets for consumers. For a copy of the full report (24 pages, PDF format), [click here](#).

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