U.S. Adjusts Bailout Plan After Backlash

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Paulson has given Congress dire warnings of the consequences of inaction, and has no other plan that the Treasury thinks can address the magnitude of the problems. Congress, for its part, wants to reassert control over an increasingly expensive financial-system bailout in which, until now, it has played little part.

Investors, spooked by the lack of detail in the plan and the wrangling in Congress, sent stocks down 3.27%, or 372.75 points, erasing half the gains of late last week as the proposal was emerging.

The plan's reception—from academics, politicians and commentators of varied stripes—has been largely hostile, weakening the administration's negotiating position on the remaining issues. On executive pay, Republican presidential candidate Sen. John McCain has called for limits.

Sen. Richard C. Shelby, an Alabama Republican and the ranking Republican on the Senate Banking Committee, reiterated his distaste for the plan, calling it "neither workable nor comprehensive, despite its enormous price tag." Sen. Shelby, whose influential position makes his opposition a potential stumbling block, called for Congress to look for alternative solutions.

Even some business groups concede pay curbs might be unavoidable. "If we're talking huge infusions of your money and my money, there's going to be some limitations" on compensation, said Bruce Josten, executive vice president of government affairs at the U.S. Chamber of Commerce.

Mr. Paulson has argued that pay limits shouldn't be part of this plan because they could discourage firms from participating. Some lawmakers are looking to call his bluff, thinking that many institutions would find the choice between limits on executive pay and bankruptcy an easy one.

The Treasury is looking for a compromise, a structure that satisfies Congress yet doesn't punish firms that want to participate, said a person familiar with the matter.

Under the plan, details of which are still being worked out, the Treasury would buy from financial firms up to $700 billion of the souring mortgages and mortgage securities that lie at the heart of the financial crisis.

House Financial Services Chairman Barney Frank (D., Mass.), who is leading negotiations in Congress, said Democratic leaders don't intend to stand in the way of the package. "We do agree you should move quickly," he said. "We understand that bad market choices have put us in a situation where something has to happen." Democratic leaders are aiming for votes in the House and Senate late this week.

Economists and commentators from both ends of the political spectrum, including former House Speaker Newt Gingrich, have heaped criticism on the plan. "Is there anyone who isn't a backlasher?" asked Jared Bernstein, senior economist at the Economic Policy Institute, a left-of-center think tank. "I haven't seen people saying, 'Good plan—like it.' "

Mr. Bernstein noted that the government is in a bind: Paying rock-bottom prices for shaky mortgage-backed securities might hurt the firms the bailout is supposed to rescue, but if the government pays a higher price, taxpayers might end up with securities it can't resell except at a big loss.

"I think it's awful," said Allen Meltzer, a former Reagan economic adviser now teaching at Carnegie Mellon University. "It puts private interests ahead of the public interest." Mr. Meltzer pointed to past occasions when, he said, doomsayers warned of financial panic, the government resisted the urge to bail out the markets, and nothing terrible ensued. Among those he cited was President Richard Nixon's decision not to rescue the commercial-paper market in the aftermath of the collapse of the Penn Central railroad.

Former St. Louis Federal Reserve Bank president William Poole, a senior fellow at the free-market Cato Institute, said, "The Treasury will be stuck with the least-attractive paper, and that means taxpayer losses will be large."

C. Fred Bergsten, director of the Peterson Institute for International Economics, called the package essential, given the unusual circumstances. In addition, he predicted taxpayers would ultimately be on the hook for about $100 billion, once the government resells the securities it plans to take off financial firms' hands.

Discontent continued to simmer among rank-and-file Republicans and Democrats. In Republican ranks, especially among conservatives, there are concerns over the cost and over the scope of powers that would be concentrated with Secretary Paulson.

"Congress needs to slow down, take a breath," said Rep. Mike Pence, an Indiana Republican. He acknowledges the country faces a crisis but still intends to vote against the Treasury plan. House Minority Leader Boehner, while he has pushed for some action, is not yet committed to voting for the legislation.

In some ways, Mr. Paulson isn't the ideal pitchman. A Wall Street titan, he spent 32 years at Goldman Sachs Group Inc. and has a personal fortune estimated at $500 million. A former deal maker, he is comfortable in the language of Wall Street, talking with ease about commercial paper, debt spreads and Treasury yields.

But Congress wants the plan to benefit Main Street, not Wall Street, and Mr. Paulson has tried to shift his language to emphasize how the plan will help ordinary citizens. At a news conference to announce the plan, he talked at length about the threats to the financial markets, ending with a passage about how it would affect ordinary Americans. U.S. purchases of distressed assets would help people, Mr. Paulson says, by enabling lenders to resume making loans for homes, cars and small business and by keeping the economy from sliding into a deep decline that would cost jobs.

Mr. Paulson is scheduled to testify Tuesday and Wednesday before House and Senate committees, giving him a chance to speak to lawmakers' concerns.

One broad area of agreement involves congressional oversight. Rep. Frank said the Treasury agreed to an independent board to monitor the bailout and report on its progress to Congress and the public. The board wouldn't have authority to veto Treasury investment decisions, and the bailout's launch wouldn't be delayed while a board was being put in place.

While details are still being worked out, both sides have also agreed to a measure that would allow—but not require—the Treasury to take an equity stake in a financial institution that sells assets to the government. Whether it did so might be dependent on the size of the capital injection the government makes when it buys the assets, according to a person familiar with the matter.

There are precedents for the government taking stakes in private companies, dating back to the bailout of Chrysler Corp. in 1979, when the government got warrants to buy Chrysler shares. Most recently, the Federal Reserve took warrants in American International Group Inc. representing a majority equity interest in the giant insurer.

There has also been discussion among some Democratic leaders of breaking apart the package, with swift initial action on about a third of the borrowing authority, a senior congressional official said. Approval of the balance of the funding would come later this year or early next, giving lawmakers a chance to assess the success of the bailout and consider additional long-term reforms.

The plan would include help for distressed homeowners. Officials at the Federal Deposit Insurance Corp., the Federal Housing Administration and Fannie Mae and Freddie Mac would all be deployed to help adjust the loans of borrowers who were behind on payments but deemed creditworthy. The bill also includes tenant protections, to ensure that renters in homes headed for foreclosure aren't evicted.