Bond Case Briefs

Municipal Finance Law Since 1971

Democrats Push for Fed to Decide Who Gets Municipal Rescue.

- **Legislation calls for help to state and local debt markets**
- **Opposition party wants to cut Treasury Department out of loop**

Congressional Democrats are pushing to have the Federal Reserve take over the rescue of state and local debt markets — cutting the Treasury Department out of the decision-making.

The central bank is expected to announce a new emergency facility to support municipal debt, part of the $2 trillion stimulus approved last week. It had the backing of progressive Democrats and conservative Republicans alike, including Senators Elizabeth Warren and Mike Crapo. They're urging the Fed and Treasury to move quickly.

The coronavirus pandemic has crimped sources of tax revenue for states and localities at a time when resources, including paramedics and hospitals, are being committed to combat the threat to public health.

In the next round of legislation, House Speaker Nancy Pelosi and some congressional Democrats want to push further. They favor taking decisions about where to use the money out of the political realm and giving them solely to the independent Fed.

The notion has been circulating for months among progressives in Congress. If the law is changed, it would give the Fed another congressionally mandated goal — beyond stable prices and maximum employment — by designating the Federal Open Market Committee to be the buyer of last resort of the debt of troubled states and municipalities.

"If you want money to go somewhere quickly, everybody's idea right now is to get the Fed involved," said Ian Katz, an analyst at Capital Alpha Partners in Washington. "That doesn't take into account that the Fed has to build these facilities and structures to do something they've never done before."

Permanent Change

Legislation introduced by Democratic Senator Robert Menendez would create a permanent change to the Federal Reserve Act to allow the central bank to purchase municipal debt "under unusual and exigent circumstances" through direct purchases via open market operations.

Currently, the Fed and Treasury are operating under Section 13.3 of the Federal Reserve Act. It allows the Fed, with Treasury permission, to open a broad-based facility to support troubled areas of the financial markets in an emergency.

Municipal bonds have rallied in anticipation of the intervention. Last week was the best for state and local debt since 1982, according to Bloomberg Barclays indexes. A handful of debt issuers have been able to price deals in the last few days after billions in transactions were scuttled earlier this month, a signal that the market is starting to regain its footing.

The virus threatens the finances of U.S. states, cities and counties, which rely on taxes on income, sales and stock-market gains. With the much of the country on lockdown, that revenue has slowed to a trickle. New York, home of the most U.S. cases of Covid-19, is projected to lose between $10 billion and $15 billion of revenue in the fiscal year that starts April 1. Ohio state agencies are looking to cut spending by 20%, and Cincinnati is furloughing 1,700 city workers.

Eric Kim, head of state-government ratings at Fitch Ratings Inc., said the $150 billion set aside in the stimulus bill for state and local governments is limited to reimbursement and may not be spent.

Pandemic Hotspots

"Outside of pandemic hotspots like New York, new spending is not the problem for most states, but rather lost revenue brought on by severely reduced economic activity," he said March 27.

Fed Chairman Jerome Powell recently expanded the central bank's lending authority to include support for corporations and medium-sized businesses. Democrats have had a long-standing interest, however, in the Fed using its power to operate in open markets to do something directly for troubled localities.

Congresswoman Rashida Tlaib, a Michigan Democrat, had a sharp exchange with Powell in February over his authority to support municipal debt.

Fed's Job

"Do you not believe that the governments of Detroit and Puerto Rico also play a vital role that should be preserved, even if a financial crisis makes it hard for them to borrow money?" Tlaib asked Powell.

"That's not a job for the Fed," Powell said. "Lending to state and local governments and supporting them when they're in bankruptcy is not — that's not part of our mandate."

Tlaib finished by saying: "We are going to strongly disagree."

Pelosi has also taken an interest in Powell's ability to directly support states and localities.

"I hope that in this next bill that we will be able to address the concerns of our state and local governments," Pelosi told MSNBC on Tuesday. "We need to do more by way of our appropriations, by way of our tax code and by way of policy and also by way of the Fed."

Bloomberg Markets

By Daniel Flatley, Craig Torres, and Amanda Albright

March 31, 2020, 1:09 PM PDT Updated on April 1, 2020, 6:47 AM PDT

— With assistance by Erik Wasson