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Federal Reserve's Emergency Loan Programs at Center of Political Fight.

Democrats are eyeing the programs as a backup option if they can't strike a deal to aid states and localities, and believe they may be needed to backstop markets. Republicans want them off the table.

WASHINGTON — A political fight is brewing over whether to extend critical programs that the Federal Reserve rolled out to help keep credit flowing to companies and municipalities amid the pandemic-induced recession.

The dispute has the potential to roil financial markets, which have calmed significantly since the Fed announced in March and April that it would set up backstops in response to market turmoil spurred by the coronavirus pandemic.

Those programs expire on Dec. 31, and it is unclear whether the Trump administration will agree to extend them. The Federal Reserve chair, Jerome H. Powell, and Treasury secretary, Steven Mnuchin, must together decide whether they will continue the programs — including one that buys state and local bonds, another purchasing corporate debt and another that makes loans to small and medium-size businesses. The officials will probably make that decision by early to mid-December, according to a senior Treasury Department official.

The Fed might be inclined to keep the efforts going, but Mr. Mnuchin, whose Treasury Department provides the funding backing up the programs, has signaled that he would favor ending the one that buys municipal bonds. And he is under growing pressure from Republicans to allow all five of the Treasury-backed programs to sunset.

Senator Patrick J. Toomey, a Pennsylvania Republican who could soon lead the Senate Banking Committee, is arguing that the Fed and Treasury do not have the legal authority to extend new loans or buy new securities beyond this year without congressional approval, according to a person familiar with the matter. While that view is disputed by legal experts, Mr. Toomey also believes it was Congress's intent for the relief programs to end on Dec. 31.

The programs's expiration could come at exactly the wrong moment, as the U.S. faces an expected surge in coronavirus cases this winter and as fiscal stimulus measures that Congress passed in the spring fade. While lawmakers have toyed with passing a new relief bill before next year during the lame-duck session of Congress, President Trump's election loss makes the outcome highly uncertain.

"Cliffing the programs at year-end would be ill advised, opening markets up to a year-end disruption," said Scott Minerd, the global chief investment officer at Guggenheim Partners, who expects the programs to be extended.

Mr. Mnuchin has made clear in responses to congressional questioning that he does not favor extending the municipal bond program. While Mr. Mnuchin's comment was specific to that effort, a senior Treasury official laid out reasons for allowing the others to end, mainly centered on a belief that the worst of the economic crisis has passed and the programs should not be a replacement for support from Congress.

But the programs are mostly designed as backup options: The financial terms for buying state and local debt, for instance, are not generous enough to compete in a market functioning well, and the corporate bond program is now making only small-scale purchases. Their main purpose has been to reassure investors that the central bank is there as a last-ditch option if conditions worsen.

Economists and analysts say there is logic in keeping that option open until a vaccine is widespread and the crisis is clearly over — and there is plenty of capacity left in the Fed's programs to buy more debt and make more loans. But the central bank cannot make material changes to the programs' terms to keep them running into 2021 without the Treasury's signoff.

Some Democrats had begun eyeing the municipal program as a backup option in the event that state and local government relief proved hard to pass through Congress. While the program's terms are unattractive now, they could in theory be sweetened under a Biden administration Treasury Department. Taking that program off the table would leave Democrats with fewer options — and give Republicans another bargaining chip in stimulus negotiations.

Mr. Toomey has talked about limiting the backstop programs for months, on the basis that they are no longer needed and might discourage private investment. Politico reported last week that he would favor letting all the programs end.

Lawyers generally agree that the Fed and Treasury can extend the programs without Congress — the way they are structured means that the Treasury has already made loans to the Fed, which then uses that money to insure against risk as it buys bonds and makes loans. The law that provided the funding allows such "existing" loans made from the government appropriation to remain outstanding.

Democrats also disagree with Mr. Toomey's take.

"It's clear that the Fed and the Treasury have the authority to extend the facilities, and they should," said Bharat Ramamurti, a Democratic member of the Congressional Oversight Commission, which oversees the programs. "There is continuing need for municipalities and smaller businesses, and there is a significant chance of market disruption if these facilities are not extended."

Senators Sherrod Brown of Ohio, Elizabeth Warren of Massachusetts, Mark Warner of Virginia and Chuck Schumer of New York — all powerful Democrats — sent Mr. Powell and Mr. Mnuchin a letter last week saying that the law "is clear that these facilities can be extended" on the Treasury and Fed's authority and that "failing to signal the agencies intent now creates undue uncertainty and threatens the programs ability to promote economic recovery."

If a coronavirus vaccine is rolled out in the coming weeks, the Treasury Department may be less inclined to extend the programs. Mr. Trump could also block a reauthorization by pressuring Mr. Mnuchin, leaving Mr. Biden with fewer economic stimulus tools at his disposal.

There are some signs that the programs could expire without causing a catastrophe. Markets are functioning normally now, having calmed after the Fed signaled that it would set up the backstops. It might be that investors have overcome the panic of the spring and no longer need a backup option from the Treasury and Fed.

But it is also possible that the comfort and security provided by a Fed backstop is still needed.

Millions of people remain out of work, the service sector continues to be hard hit, and state and local governments are facing budget shortfalls, albeit smaller ones than some had initially projected. Further shutdowns, even localized ones, amid rising coronavirus cases could cause a reversal in risk taking that roils markets once more.

“Some market participants have asserted that the expiration” of the municipal program “may be a nonevent since its existence is not essential for market functioning any more,” market analysts at Citigroup wrote in a recent research note. “These assertions are wrong, in our view.”

Analysts interviewed by The New York Times were divided on what ending the programs could mean for markets. Some believed they could function on their own, with the economy recovering nicely. Others pointed to risks looming ahead and suggested that removing the backstop now would be a bad idea.

“You need to see those facilities extended, particularly if you’re not going to see stimulus,” Matthew Luzzetti, the chief U.S. economist at Deutsche Bank, said in an interview last week. “Just having that backstop has been a really important signal to the market that the Fed is there.”

Asked at a news conference last week whether the programs would be extended, the Fed chair demurred.

“We are just now turning to that question,” Mr. Powell said. “We’ve had a lot of things to work our way through.”

After the news conference, Michael Feroli, an economist at JPMorgan Chase & Company, wrote in a research note that for the programs to be extended, “not only will the Fed Board have to decide that it is needed, but Treasury will also have to be convinced that it is both needed and legal.”

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By Jeanna Smialek and Alan Rappeport

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