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FEDERAL RESERVE BANK OF KANSAS CITY

Fall 2009

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Time to expand the Fed's role in retail payments

The migration of consumers from paper checks to credit and debit card networks has been only a part of the story in the area of retail payments. Over the past decade we have also seen a significant change in the competitive environment among payments service providers with consolidation across the industry. While new entrants are providing services on the front or back end of the payments clearing process, the market for clearing payments transactions between senders and receivers is increasingly concentrated, dominated by a few very large providers.

The march toward consolidation has been going on for some time. In 1995, the largest three networks combined controlled approximately 50 percent of the PIN debit volume. That figure rose to roughly 80 percent in a little more than a decade. Perhaps more striking is that over the same period, the number of networks dropped from around 30 to 14.

This evolution is not surprising given the economics—high costs associated with providing a network service that is sufficiently secure, highly available and resilient, and able to connect thousands of banks and credit unions across the United States. This level of market concentration, however, raises serious issues in the areas of pricing, access and security/resiliency. For the benefit of all market participants, from the consumers through the financial institutions, I believe it is crucial that the Federal Reserve consider expanding its role in this area.

In card payments, the Federal Reserve has historically been confined to consumer protection issues. The card networks, which developed privately as tools for accessing bank lines of credit, have long since expanded far beyond their initial role, with electronic payments now

exceeding two-thirds of all noncash payments in the United States. Looking more broadly at the overall payments system, this rise in card transactions means a growing share of payments are clearing via an increasingly concentrated market of networks focused on maximizing shareholder profits and not necessarily on ensuring broad access and sufficient levels of security and resiliency.

Among other concerns, this concentration provides significant pricing leverage that works in favor of the networks and has little benefit to consumers or other system participants. Beyond the competition issues, there are also important system resiliency questions. Card market service buyers are not afforded the same safety net as check and Automated Clearing House (ACH) customers, who can rely on the Federal Reserve as an operator in times of crisis. This issue is increasingly important as we see complex systems controlled by fewer operators—a combination that raises the vulnerability of the entire system to “single points of failure.”

To some, the idea of the Federal Reserve taking an active role in electronic payments networks might seem to reverse the usual path of marketplace evolution. Generally, competition between the public and private sector has been in areas where there was a government monopoly and where it was clear competition would bring benefits—parcel shipping is perhaps the most visible example. A move by the Federal Reserve to compete with the card payment networks would bring another participant into a business where exceedingly



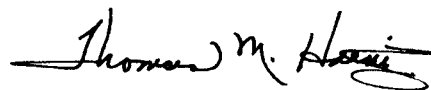
high entry costs block the emergence of new competitors, but it would also have numerous additional benefits.

Historically, the Federal Reserve's active participation in the payments system has been focused on checks and ACH payments. The Federal Reserve does not seek to maximize its profits, rather it is required by law to recover all related operating costs as well as interest, taxes and return on equity comparable to private sector participants. In addition, the Federal Reserve focuses on improving payments system efficiency and providing financial institutions and their customers broad access to payments products at a competitive price, and in doing so, it provides benefits beyond acting as simply another competitor. For example, the Fed was instrumental in lowering the cost of the payments system by being first to the market with services that enabled financial institutions large and small to take advantage of electronic checks. Also, in times of crisis, the Fed stands ready to make its services available to any financial institution as a reliable alternative to their current service provider.

Finally, of course, there are the benefits of the insights the Federal Reserve obtains by being a provider versus solely a regulator in this important component of our economic infrastructure. In many countries, the central bank carries out its payments system policy mandate by regulating rather than competing in the retail payments market. By participating in the market as a provider, not only does the Fed influence pricing that otherwise might tend toward monopolistic, but also it can gain and share hands on knowledge and insights into the impact of proposed regulations and policies on businesses, consumers and banks that would not be possible with solely a regulatory oversight role. This ability to

understand and influence industry standards that promote efficiency in payments processing and ultimately benefit the public, has a long history going back to the introduction of MICR line standards in the early automation of check processing in the 1950s and 1960s. Most recently, we have worked with financial institutions, software vendors and payments processors to improve electronic check clearing processes and standards.

Because the Federal Reserve is charged with promoting the efficiency, integrity and accessibility of the payments system, subject to the constraints of full cost recovery as required by law, we are well-positioned to remain an active provider of retail payment clearing services. Such a role is important in ensuring that we preserve the value that has been derived by our past involvement in such areas as access, efficiency and resiliency. Additionally, there are the important benefits of acting as a safety net, actively participating in setting standards and gaining important market insight. Given the inherent risk in payments, the consolidation of service providers and the increasing reliance on electronic payments, the Federal Reserve's role as an operator has become even more critical. It is time to expand our role in this market.



THOMAS M. HOENIG, PRESIDENT
FEDERAL RESERVE BANK OF KANSAS CITY
president@kc.frb.org

This column originally appeared in the trade publication "E-Finance & Payments Law & Policy."

George named first vice president, COO of the Kansas City Fed

Energy, integrity, leadership, intelligence—and dedication to the Federal Reserve—are just a few attributes of Esther George.

George was promoted to first vice president and chief operating officer of the Federal Reserve Bank of Kansas City this summer, making her second in command to President Tom Hoenig. She is the eighth to hold this position since 1914; she succeeds Richard Rasdall Jr., who retired after 37 years.

“The leadership Esther has exhibited throughout her career, as well as her experience and insight, make her the ideal choice to fill this important position,” Hoenig says.

In her new role, George is responsible for the Kansas City Reserve Bank’s operations, and budget, as well as its IT, Treasury, Financial Services, Administrative Services and Legal areas. She continues to serve on the management committee, which guides the organization.

Her duties as first vice president also include participating in the Federal Reserve’s Federal Open Market Committee (FOMC) meetings in Hoenig’s absence. The FOMC implements the nation’s monetary policy and sets key interest rates. It is made up of the members of the Fed’s Board of Governors and the presidents of the 12 regional Reserve Banks.

“I am humbled and honored to continue to serve the Federal Reserve in this capacity,” George says. “Looking back on my 27 years here, I can’t think of a more fulfilling workplace.”

George is the Kansas City Fed’s former executive vice president of the Supervision and Risk Management Division.

The Federal Reserve has supervisory and regulatory authority over banks and bank holding companies. It works with other supervisory authorities to ensure the safety

and soundness of financial institutions, stability in the financial markets, and fair and equitable treatment of consumers’ financial transactions. As head of that division, George served as the top bank regulator in the region, overseeing about 175 state member banks and nearly 1,000 financial holding companies.

George joined the Fed in 1982 as an assistant examiner and was named assistant vice president in charge of Statistical Services in 1995. She was named vice president over Public Affairs and Statistical Services in 1997 and vice president of Human Resources in 1999.

In August, the Federal Reserve Board of Governors asked George to serve as the acting director of the Board’s Banking and Regulation Division in Washington, D.C., while a permanent director was selected after Roger Cole announced his retirement.

“Her service helped maintain continuity for the Fed’s supervisory function during the current financial crisis,” Hoenig says. “It’s also a testament to the respect in the Federal Reserve System that Esther has earned.”

George has a B.S.B.A from Missouri Western State University in St. Joseph, Mo., and an M.B.A. from the University of Missouri – Kansas City. She is a native of Faucett, Mo., and is married and has two children.

To read First Vice President Esther George’s bio, as well as those of other senior leaders at the Federal Reserve Bank of Kansas City, visit KansasCityFed.org/TEN.



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BY BRYE STEEVES, SENIOR WRITER

Foreclosures in focus

Foreclosure

**Crisis
spreads to
higher-income
neighborhoods**

Bank owned

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During the last 30 years, David Jewell developed a successful one-man marketing company in Kansas City, Mo., and worked as an adjunct professor at local colleges and universities.

But the recession had a direct and sudden impact on Jewell's firm last year. Along with many in the media and advertising industries, Jewell began receiving fewer and fewer contracts. By the fall of 2008, long-time clients he had come to depend on cut their marketing budgets, and Jewell's business suffered.

"I was doing very well until September," Jewell says. "Suddenly, I went from being incredibly busy to having zero business."

With his income drastically cut, Jewell missed a mortgage payment, and despite his best efforts, he was never able to catch up with the growing late fees and penalties assessed by his bank. Earlier this year his lender started foreclosure proceedings, and Jewell lost his house in Brookside—a trendy, urban

neighborhood highly desirable for its parks, tidy shops and well-kept homes.

"I know the same thing is happening to a lot of people," says Jewell, who held a traditional, fixed-rate mortgage. "It's becoming more and more common for people who work hard for their living to find themselves in a foreclosure."

As the country's foreclosure crisis continues to grow, many homeowners are in a similar position. Rising unemployment rates and declining property values are combining to put additional pressure on household budgets. As a result, foreclosures are becoming more common in higher-income neighborhoods that were previously immune from the crisis, says Kelly Edmiston, a senior economist in the Kansas City Fed's Community Affairs Department.

Edmiston, who recently studied the causes of foreclosures and the effects on neighborhoods in the Tenth District, has found a number of factors help explain foreclosure

trends, including income levels, housing market conditions and economic issues such as unemployment and self-employment rates. The District includes western Missouri, Kansas, Colorado, Oklahoma, Nebraska, Wyoming and northern New Mexico—a region that has seen its share of foreclosures, but not at the level found in other areas.

“Foreclosure rates have been higher in low-income neighborhoods for some time, but only to the degree that subprime mortgages took hold in those areas,” Edmiston says. “What we are seeing now is that foreclosures are heading into higher-income areas, and that’s due to weaker economic conditions and a declining housing market.”

Recent trends

During the last few years, foreclosure rates across the country have skyrocketed, but some

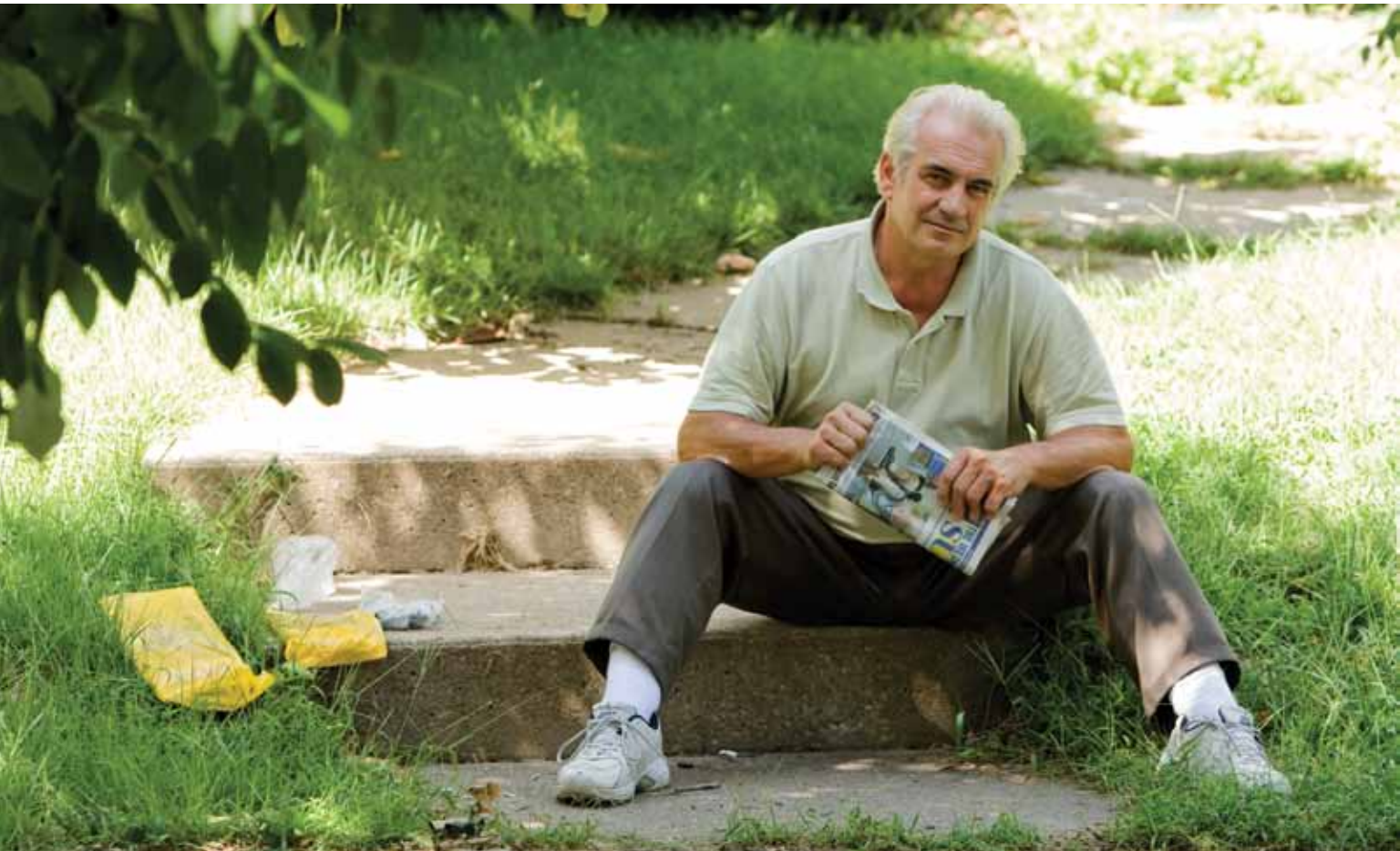
areas have been hurt more than others. The areas that have been hit the hardest—including Nevada, Arizona and Florida—are many of the same places where prices soared the highest during the real estate boom.

In the Tenth District, foreclosures are also increasing rapidly, but have done so at a less-dramatic pace than in the Sunbelt or on the coasts, Edmiston says. In the second quarter of 2009, foreclosure rates ranged from a low of 1.2 percent of all outstanding mortgages in Wyoming to 2.7 percent in Colorado, according to the Mortgage Bankers Association. The national rate was 4.3 percent.

“In general, the more an area grew in terms of price, the more it fell,” Edmiston says. “The Midwest didn’t see as large of a run-up in prices, and the economy in the Tenth District was in better shape than in other places.”

But when comparing neighborhoods

DAVID JEWELL SITS IN FRONT OF HIS RECENTLY FORECLOSED HOUSE in Kansas City, Mo. Jewell, who had a traditional mortgage, lost his home as the economy worsened and his business suffered. Research shows foreclosures are becoming more common in higher-income neighborhoods like Jewell’s as unemployment rises and home values decline.



within the Tenth District, foreclosure rates vary widely. According to data Edmiston reviewed, neighborhood foreclosure rates ranged from 0 percent to as high as 17 percent across the seven-state region.

Income is one factor that helps explain the differences among neighborhoods, Edmiston says. In Tenth District neighborhoods where less than 5 percent of residents are classified as low-income, the average foreclosure rate is minimal. The rate rises to 13 percent on average in neighborhoods where more than half the residents are low-income.

“The neighborhood foreclosure rate in the Tenth District rises consistently with the share of the population that is low-income,” Edmiston says. “But, the data show that the increase in foreclosures in these neighborhoods depends on how deeply subprime lending penetrated the area.”

Although most subprime loans were made to those with low credit scores, Edmiston says many low-income residents were targeted by subprime lenders when they might have actually qualified for better terms under a traditional mortgage. These borrowers did not likely have much experience as homeowners, did not have adequate information and did not completely understand the loan they were receiving.

“That’s why homebuyer education is so important,” he says.

Housing market conditions

Along with income levels, housing market and economic conditions have played a role in the growth of foreclosures.

If homeowners fall behind on their mortgage in a declining market, they often have difficulty refinancing their loan or selling their home at a price that’s high enough to cover their outstanding balance, Edmiston says. Foreclosure becomes the only option.

Several studies have found that when home prices fall, foreclosures tend to rise, and

Edmiston’s analysis confirmed that dynamic is at work in the Tenth District.

“The most important factor in explaining neighborhood foreclosure rates is the change in home values,” Edmiston says. “If someone had 10 to 20 percent equity, they would want to sell their home rather than face foreclosure. A foreclosure often comes about due to a lack of equity.”

Other housing market conditions, such as vacancy rates and owner-occupancy rates, also play a role, Edmiston found. As expected, higher vacancy rates led to higher neighborhood foreclosure rates, but surprisingly, Edmiston discovered that neighborhoods with higher owner-occupancy rates also had higher foreclosure rates. The finding seems to go against the idea that homeowners who live in their homes would be less likely to undergo a foreclosure because they have a personal stake in the home. The results indicate that those who buy homes as an investment rather than as a primary residence are able to more easily cope with losses in the housing market because they have a more-diversified and larger pool of assets, Edmiston says.

Economic conditions

At Neighborhood Housing Services of Kansas City, there is no shortage of homeowners who are looking for ways to save their homes from foreclosure. Along with homebuyer education courses, the nonprofit offers foreclosure intervention and mortgage default counseling.

“There has definitely been an increase in the demand for our services,” says Mark Stalworth, the agency’s president and CEO. “There are people who have already had a





COMMUNITY AFFAIRS

The Community Affairs Department of the Federal Reserve Bank of Kansas City supports the Federal Reserve System's economic growth objectives by promoting community development, financial education, and fair and impartial access to credit.

The department offers resources, events and research related to issues affecting economic prospects in low- and moderate-income communities. Staff often partners with community groups to explore prospective solutions.

- Free tools include the Foreclosure Resource Center, which is an online collection of regional trends, information on local foreclosure rates, links to consumer and community organizations involved in mitigation efforts, and more. Also online are resources for consumers, lenders and community groups.
- Recent events include "Financial Education in Oklahoma: From Policy to Action" and "Creating and Streamlining the Mortgage Approval Process" in New Mexico.
- Recent research papers include "Financial Education at the Workplace," "The Role of Small Business and Large Business in Economic Development" and "Booms and Busts: The Case of Subprime Mortgages."

For more information on Community Affairs and to access its materials, visit KansasCityFed.org/TEN.

modification on their mortgage, but they maybe weren't very sophisticated in what they signed up for. In some cases, their payments went up instead of going down."

Other homeowners "have fought it off as long as they could," Stalsworth adds. "Now they've reached the point where they don't know what to do. With high unemployment and lower home values, it's the absolute worst of everything now."

Stalsworth also has noticed a rising number of foreclosures in areas and neighborhoods that had generally avoided the crisis until recently.

"The target area for where foreclosures have hit has been a constantly expanding area," Stalsworth says. "The assumption was, 'I could always sell my house.' But now it's a buyer's market, and it can be extremely tough to sell a house."

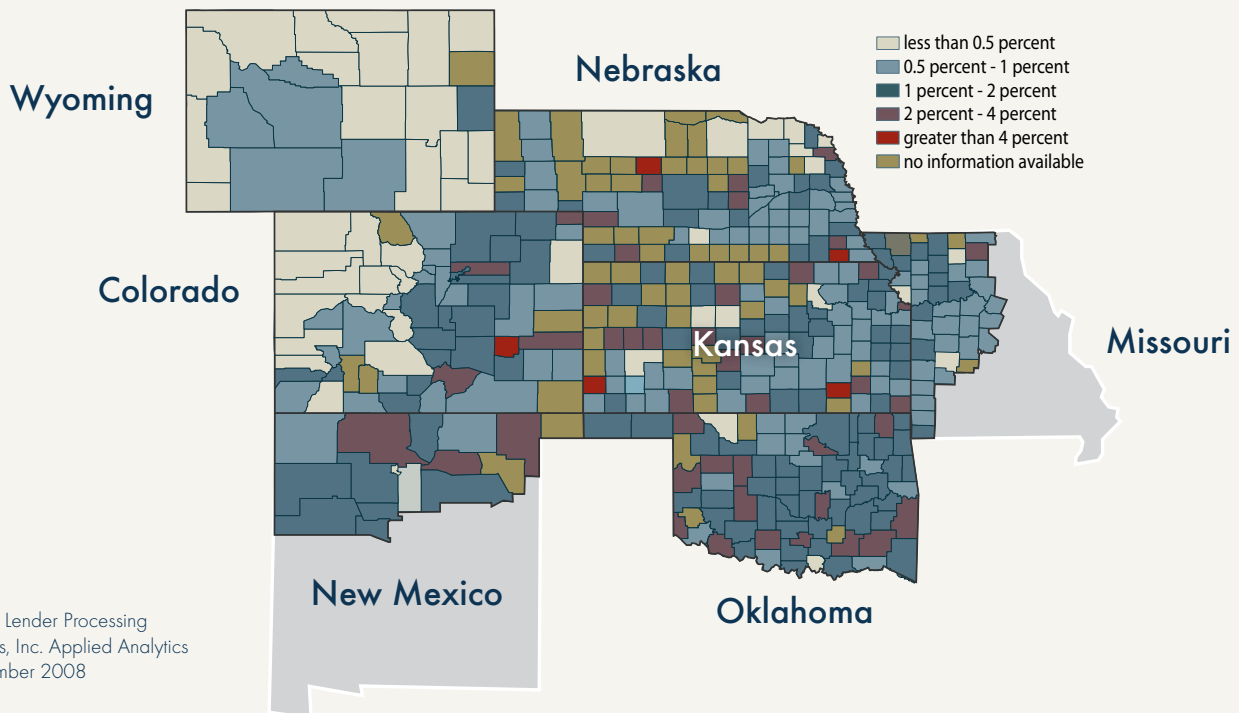
There are several high-profile cases of foreclosures striking in middle-class and even wealthy neighborhoods in Kansas City. In July, a 16-room, five-bath home located on Ward Parkway—a boulevard surrounded by large and historic mansions—was sold on the courthouse steps when its owners defaulted on the mortgage. The home had remained empty for some time after the latest owners gave up on a renovation project.

Just across the state line in affluent Johnson County, Kan., several suburbs are also starting to take notice of the problem. Last spring, the cities of Olathe and Overland Park divided a \$4.5 million federal grant from the Neighborhood Stabilization Program to purchase foreclosed and abandoned homes in an attempt to limit the impact on surrounding neighborhoods. The homes will be renovated and put back on the market as affordable housing.

As the reach of job losses expanded to more neighborhoods during the recession, foreclosures haven't been far behind. In fact, the loss of a job or income is one of the most common triggers for a mortgage default, Edmiston says. According to his analysis of the

Foreclosure Rates By County

in the Tenth Federal Reserve District *



Source: Lender Processing Services, Inc. Applied Analytics
*December 2008

Tenth District, rising unemployment rates had a significant effect on neighborhood foreclosure rates.

A similar increase in the foreclosure rate can also be traced to the level of self-employment in a neighborhood. A high number of self-employed residents in a neighborhood can result in a higher foreclosure rate, Edmiston says.

“Self-employed workers’ incomes are more volatile than salaried workers’,” Edmiston says. “With the downturn in the economy, someone who is self-employed is more likely to have trouble making a house payment than someone who works for a wage or salary.”

That was the position David Jewell found himself in earlier this year.

“When you own a business, you don’t get paid unless you work,” he says. “If there’s no work, there’s no money.”

Following his foreclosure, Jewell has been living with his grown sons. But, he has seen

some reasons in recent months to be optimistic. By re-focusing his business on small firms, his company has started picking up new clients.

“I’m busy again,” he says, “and I’m finally coming out of it.”



BY BILL MEDLEY, SENIOR WRITER

FURTHER RESOURCES

“CHARACTERISTICS OF HIGH-FORECLOSURE NEIGHBORHOODS”

By Kelly Edmiston
KansasCityFed.org/TEN

COMMENTS/QUESTIONS are welcome and should be sent to teneditors@kc.frb.org.



12 District headquarters
of the Federal Reserve System

History shows regional patterns, offers insight for recovery

Although the United States as a whole feels the pain of this most recent recession, the sting varies from region to region.

“There are some exceptions, but the same regions typically suffer longer and deeper recessions,” says economist Chad Wilkerson. “Other regions not only fare better during recessions, but often have stronger recoveries from the downturn.”

Wilkerson, who is the Branch executive of the Oklahoma City office of the Federal Reserve Bank of Kansas City, recently researched the economic performance of the 12 Districts of the Federal Reserve System during the most recent recession, as well as the previous eight recessions. The Districts divide the country by geographic region; each has its own Federal Reserve headquarters, such as the Kansas City

Reserve Bank in the Midwest, as shown above.

“These historical patterns,” he says, “may offer insight to the shape of this recession, and, ultimately, the nation’s recovery.”

Wilkerson’s research shows the recession so far, while deep, has been fairly typical for many parts of the country, especially the Northeast and Midwest. For other regions, such as the Southeast and West, the downturn is clearly the worst in the past 50 years. Many of the differences among regions can be explained by the different industries within these areas, he says.

“These regional variations during recessions can largely be explained by industrial structure or by other special factors, such as overextended real estate sectors.”

Here’s a look at how the regions compare today and historically.

Kansas City Fed creates Financial Stress Index

Timing of entrance

Wilkerson analyzed quarterly employment data to identify regional business cycle peaks and downturns. This shows the U.S. economy entering into recession at the beginning of 2008. Regionally, though, some Districts began their descent earlier in 2007, while others stayed strong well into the second half of 2008.

By early 2009, all 12 Federal Reserve regions had entered the most recent recession. The Atlanta District was the first, followed by the Cleveland and Chicago Districts. The Kansas City and Dallas Districts entered last.

During the previous eight recessions, most Districts entered downturns at a different time than the nation. So it is not surprising that some Districts have performed much differently than others or the nation as a whole, Wilkerson says.

Particularly early or late entrances into the most recent recession can be linked to Districts' key industries, Wilkerson says. For example, the housing crisis began earlier and was deeper in Atlanta's District than any of the other 11 Districts, significantly reducing construction jobs there. The Cleveland and Chicago Districts have been hit hard by declines in manufacturing, which is heavily concentrated in those regions. However, sizable farm and energy sectors—and their high commodity prices—in the Kansas City and Dallas Districts benefited those economies during a good portion of the national downturn.

The U.S. economy is under significant financial stress.

"This stress has contributed to the downturn in the economy by boosting the cost of credit and making businesses, households, and financial institutions highly cautious," says Craig Hakkio, senior vice president and special economic advisor at the Federal Reserve Bank of Kansas City.

Hakkio and Bill Keeton, assistant vice president and economist, recently researched financial stress, including what it is, how it can be measured and why it matters. Their research also includes a new index of financial stress, the Kansas City Financial Stress Index.

"As financial conditions begin to improve, the various measures of financial stress that the Federal Reserve monitors may give mixed signals, and policymakers would benefit from a comprehensive index of financial stress," Keeton says. "This could also prove valuable down the road if the Federal Reserve needs to decide whether financial stress warranted special action."

Read Hakkio and Keeton's research "Financial stress: What is it, how can it be measured and why does it matter?" at KansasCityFed.org/TEN.



PHOTO BY GARY BARBER

Regional Comparison

12 Federal Reserve Districts (listed by headquarters city)	Timing of entry into most recent recession compared to U.S.	Historical job growth during recoveries and expansions	Some defining industries of the District	Entry for past 8 recessions compared to U.S.	Exit from past 8 recessions compared to U.S.
Boston	same quarter	similar to the nation	educational services; finance and insurance; health care and social assistance	2 early in 1 late in	3 late out 1 early out
New York	later	weaker than the nation	educational services; entertainment; wholesale trade	3 early in 0 late in	3 late out 0 early out
Philadelphia	later	weaker than the nation	educational services; utilities; manufacturing	7 early in 1 late in	4 late out 0 early out
Cleveland	earlier	weaker than the nation	manufacturing; management; health care and social assistance	6 early in 0 late in	3 late out 1 early out
Richmond	same quarter	stronger than the nation	federal government (civilian); military; construction	3 early in 0 late in	0 late out 1 early out
Atlanta	earlier	stronger than the nation	administrative and waste services; forestry and fishing; entertainment	0 early in 1 late in	0 late out 4 early out
Chicago	earlier	weaker than the nation	manufacturing; farming	6 early in 0 late in	1 late out 1 early out
St. Louis	same quarter	similar to the nation	farming; transportation; forestry and fishing	5 early in 1 late in	1 late out 2 early out
Minneapolis	later	similar to the nation	farming; utilities; health care and social assistance	2 early in 3 late in	2 late out 1 early out
Kansas City	later	similar to the nation	mining; farming; military	0 early in 6 late in	1 late out 5 early out
Dallas	later	stronger than the nation	mining; farming; construction	0 early in 5 late in	2 late out 3 early out
San Francisco	same quarter	stronger than the nation	forestry and fishing; real estate; accommodation and food services	0 early in 2 late in	1 late out 2 early out

Historically, mining has fared better than other industries in the early stages of a recession when energy prices often are temporarily high—much like when gas prices peaked at more than \$4 per gallon in the summer of '08. Manufacturing has typically entered recessions earlier than other industries, while the education and health care industries have fared better.

Depth

Nationwide, more than two-thirds of the jobs created since the 2001 recession have been lost. By summer, the national unemployment rate reached 9.5 percent with many analysts predicting it hitting double digits before long.

The Atlanta, San Francisco, Cleveland and Chicago Districts have seen the steepest declines in employment. In contrast, employment in the Kansas City and Dallas Districts in early 2009 still was higher than a few years ago.

The same Districts tend to underperform (Cleveland and Chicago) and outperform (Kansas City and Dallas) the nation in recessions. This suggests similar factors, such as a District's industries, may contribute to the timing and depth of recessions, Wilkerson says.

"These defining industries are what make a region's economy most different from that of the nation as a whole," Wilkerson says. "Additionally, industries that are heavily concentrated in a particular District, whether it is oil in the Southwest or manufacturing in the upper Midwest, play a significant role in employment variation."

A few Districts have experienced recessions when the nation hasn't, which is usually related to declines in their defining industries, such as the agricultural or automobile sectors.

Recovery

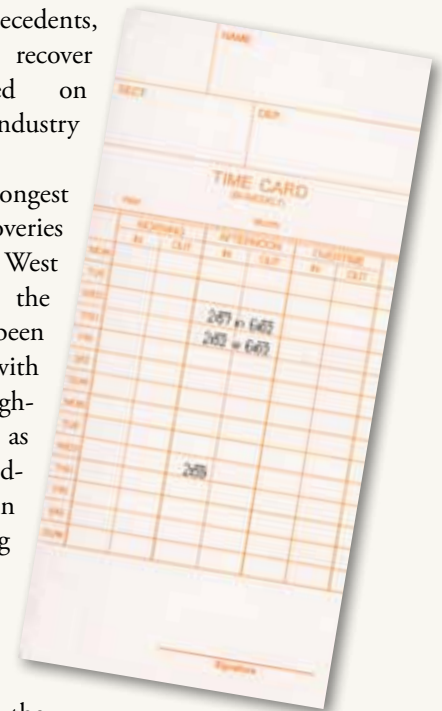
"Regions tend to recover more uniformly from deep recessions than from milder ones, so we may see somewhat of a simultaneous recovery nationwide," Wilkerson says. "Still,

based on historical precedents, some regions might recover more quickly, based on migration patterns or industry concentration."

Historically, the strongest growth during recoveries has occurred in the West and South, where the U.S. population has been migrating. Regions with concentrations of high-skilled workers, such as in the Northwest, Mid-Atlantic and Mountain West, also have promising prospects for recovery.

However, some regional differences in this recession, such as housing markets in the Atlanta and San Francisco Districts, could affect the timing of recovery.

"The country's most recent recession, although painful, has been fairly typical for some regions," Wilkerson says. "This might mean these regions' recoveries will resemble those from past deep recessions, although the reported permanency of many recent layoffs could continue to dampen job growth in the near term."



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BY BRYE STEEVES, SENIOR WRITER

FURTHER RESOURCES

"RECESSION AND RECOVERY ACROSS THE NATION: LESSONS FROM HISTORY"

By Chad R. Wilkerson
KansasCityFed.org/TEN

COMMENTS/QUESTIONS are welcome and should be sent to teneditors@kc.frb.org.

A man with short brown hair, wearing a bright yellow short-sleeved button-down shirt and dark pants, stands in a field of golden wheat. He is holding a stalk of wheat in his hands. The background shows a cloudy sky and a farm building with a silo in the distance.

Range *of* options



Community banks, Farm Credit System vie for same customers

John Gross sees both sides. As president and CEO of his family-owned Farmers State Bank in Pine Bluffs, Wyo., Gross goes head-to-head with the Farm Credit System when it comes to making agricultural loans. The Farm Credit System, which is one of the country's largest farm lenders, often wins, he says, and he can see why. When the other family business, Gross Wilkinson Ranch, needed a multimillion-dollar line of credit, Gross's family became a customer of their bank's biggest competitor.

"We had to," Gross says, explaining a community bank like his was too small to make such a large loan to the ranch and a larger bank couldn't beat the Farm Credit System's rate.

"As a banker, I'm discouraged," he says. "As a rancher, I like the interest rates."

His dichotomy with the Farm Credit System sums up the frustration of many community bankers and the appeal to a lot of loan customers. In the past, rural community banks' stiffest loan competitors were other community banks. But more recently, the

Farm Credit System and its associations are being viewed as significant loan competition—more so than any other source, say regional community bankers.

The Farm Credit System is a federally regulated, federally chartered network of five banks and 90 borrower-owned associations. It differs from banks in that it doesn't offer traditional banking services, such as checking accounts or other deposit services, but rather ag-related loans. This brings it into direct competition with many rural community banks that specialize in ag lending (defined as banks with agricultural production loans plus real estate loans secured by farmland in excess of 25 percent of total loans and leases).

In the 2008 Survey of Community Banks conducted by the Federal Reserve Bank of Kansas City, 63 percent of respondents said they expect intense loan competition from Farm Credit associations in the next five years. Seventy-six percent of the respondent banks are in rural areas with less than 10,000 residents.

Eric Robbins, a policy economist at the Kansas City Fed who co-authored the survey,

has since researched further the issue of rural lending competition. He says community bankers' concerns with Farm Credit generally fall into three areas:

- **Competitive advantage:** Many community bankers say the Farm Credit System is able to offer better loan rates because of its tax-free status and therefore has a competitive advantage. One banker wrote in the survey, "If we didn't have to pay federal and state income taxes, our loan rates could be lower (more competitive with Farm Credit) and our deposit rates could be higher (more competitive with credit unions)."

- **Growth:** The overall loan portfolio of the Farm Credit System has nearly doubled since 2001—significantly more growth than community banks have seen. A banker survey respondent wrote that Farm Credit's "momentum is growing. And because their rates are lower, they pay no taxes, and no filing fees, we will not be able to compete."

- **Expanded mission:** Other community bankers say the Farm Credit System has moved beyond its original intent of farm lending and is entering new lines of business, including offering loans not related to agriculture. A banker survey respondent wrote: "Farm Credit has continued to be a big competitor for loans that aren't truly farm loans."

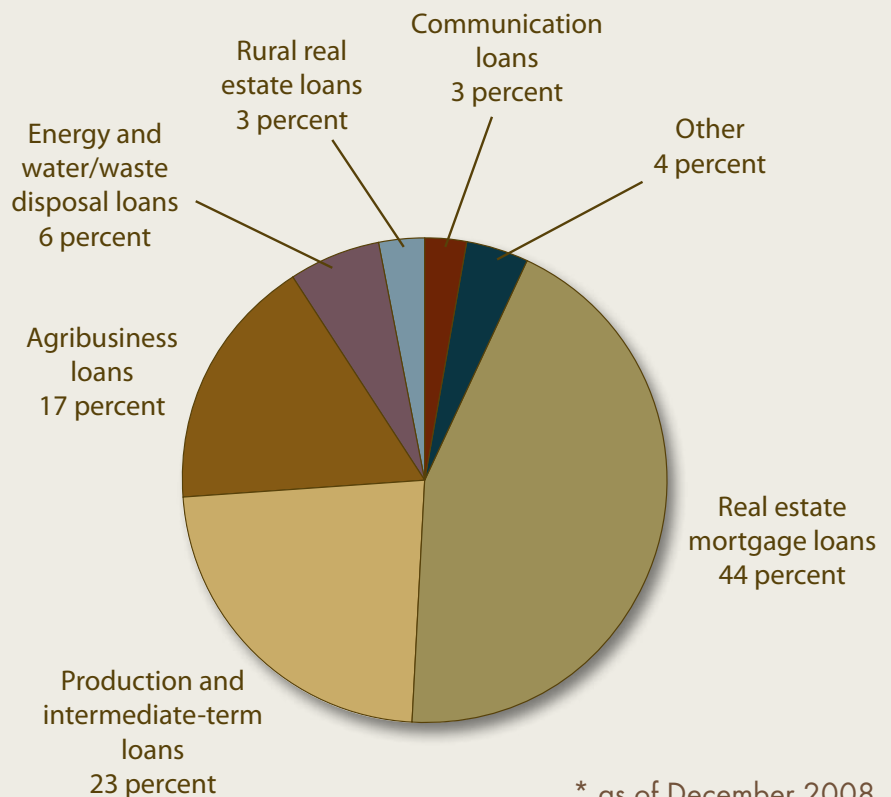
Ken Auer, president and CEO of the Farm Credit Council, a trade association that represents the Farm Credit System, says, "The simple answer (to these three areas of concern) is no, no and no."

Auer says community banks' negative perception about the Farm Credit System stems from the loan competition between the two entities.

"I've never heard anyone say fewer competitors are better for farmers," Auer says. "Community banks serve as a competitor for us, and we serve as a competitor for them. It works out better for the rural economy."

Farm Credit System Loan Portfolio*

The overall growth of the Farm Credit System loan portfolio has been rapid in recent years. Since the 2001 recession, the loan portfolio has almost doubled, increasing from \$82.6 billion to \$161.4 billion. The Farm Credit System's portfolio remains dominated by farm real estate and agricultural production and intermediate-term loans.



* as of December 2008

From the beginning

The Farm Credit System was established by Congress in 1916 as a government-sponsored enterprise in response to complaints about a lack of affordable ag financing. The Farm Credit System banks lend to Farm Credit associations in respective geographic territories. Each association then provides loans to agricultural producers, commercial fisherman and businesses that offer related services. They also provide mortgages to rural homebuyers as long as the total of all rural housing loans isn't more than 15 percent of total bank loans. Additionally, the Farm Credit Act states borrowers can't be charged an interest rate less than the competitive market rate for similar loans made by private lenders to equivalent borrowers.

"However, there have been amendments to the Act that increase the Farm Credit System's lending authority as well as new initiatives that would broaden its focus to include a larger customer base," Robbins says. "So, the Farm Credit System is potentially coming into more direct competition with rural community bankers, as many mentioned in our survey last year."

Auer says the Farm Credit System doesn't want to expand its mission beyond agriculture, but rather is working to further support that mission as established by Congress. The Farm Credit System is a "competitive force to ensure agriculture has the credit it needs," he says.

Financial performance

"Comparing their financial performance suggests that maybe banks' concerns about unfair lending competition from the Farm Credit System could be overstated," Robbins says. "However, looking at the data does show that Farm Credit System associations are lending at slightly more competitive rates than ag banks and that ag banks aren't growing like Farm Credit organizations are."

A comparison of total ag lending (real estate, operational, equipment loans and the



PHOTO BY JOSHUA LAWTON

COMMUNITY BANKERS SAY LOAN COMPETITION in rural America, like in the small town of Pine Bluffs, Wyo., is increasing, especially from the Farm Credit System. The Farm Credit System says more options benefit customers, but bankers say the System has an unfair advantage.

like) shows commercial banks have the greatest share of farm debt at 45.5 percent while the Farm Credit System's share of farm debt is 36.7 percent, and growing.

The Farm Credit System's portfolio is predominately made up of farm real estate, agricultural production (funding for operating costs and farm machinery) and intermediate-term loans. Meanwhile, growth of the overall loan portfolio has been significant during the last few years—almost doubling since the 2001 recession to \$161.4 billion today.

"Community banks may see this rapid loan growth as an indication of the potential for even greater future competition from



PHOTO BY BOB GREENSPAN

RURAL AMERICA WAS NOT LEFT UNSCATHED by the most recent global recession, and as a result, margins have been reduced for the entire financial sector. Meanwhile, loan competition may grow for community banks, which face the Farm Credit System, banks of all sizes, credit unions and others. “Small banks will probably continue to voice concerns,” says policy economist Eric Robbins.

the Farm Credit System for lending in rural markets,” Robbins says.

Robbins’ research shows a comparison of the financial performance of the Farm Credit System in comparison to ag banks, including yield on earning assets, average interest rate earned on farm real estate and non-real estate farm loans, funding costs as percent of earning assets, net interest margin, return on average assets, operating expense to average earning assets, and capital to total assets.

In comparing ag banks’ balance sheets with Farm Credit System lenders’, the latter dominates in farm real estate lending while banks’ share has declined. In 2008, ag banks’ level of farm real estate loans increased by 74 percent to \$21.4 billion, and Farm Credit System farm real estate loans increased by 91 percent to \$71.9 billion. (Farm real estate lending has increased significantly across all lenders as farm land prices have soared.) Ag banks’ share of non-real estate farm loans also

has declined compared to the Farm Credit System’s and other commercial banks’.

Auer says a comparison of community banks’ and the Farm Credit System’s performance data shows “it doesn’t appear that they (ag banks) are being harmed at all by the Farm Credit System being there.”

Competitive advantage

Though the ag lending environment has been positive the past couple of years, an “economic tsunami” struck last summer as the global recession hit rural America, says Daryl Oldvader, president and CEO of FCS Financial, a member of the Farm Credit System. This means margins have been greatly reduced for the entire sector. Still, FCS Financial hasn’t seen any major changes in competition—community banks have the majority of the market share in Missouri, where he operates, and continue to be its most significant competition, he says.

FCS Financial's average real estate and operating loans are about \$100,000 and \$45,000, respectively, and its typical customer is a part-time producer with a small amount of acreage.

"They (ag banks) are vying for that same type of customer," Oldvader says, but he sees this as positive. "We've been a good checks and balances for each other.

"Competition is good for the customer. It provides an opportunity to meet the needs of the customer, and it's a good opportunity for me as a lender to be better," Oldvader says.

Ag banks say the Farm Credit System has competitive advantages in terms of its structure, access to funding and lower operating costs.

Community banks' operating structures, diverse lending and retail banking services mean costs will remain higher than government-sponsored entities, Robbins says. While lower operating costs likely are giving the Farm Credit System a competitive advantage that enables faster growth, its greater advantage is more likely its structure, especially its access to funding and scale, Robbins says.

Smaller banks have access to inexpensive consumer and business deposits, but these deposits have a slow rate of growth. Banks also are able to borrow from other funding sources, such as the Federal Home Loan Banks, but these funds can be more expensive and require collateral. The Farm Credit System, however, can issue bonds to investors, which are guaranteed by its insurance fund. This likely contributed to the Farm Credit System's rapid asset growth, which has been three times faster than ag banks' asset growth, Robbins says.

Another factor contributing to the difference in operating costs is their respective size and scale. By the end of 2008, there were 1,559 ag banks and 95 Farm Credit System entities. Because the Farm Credit System is more concentrated, it can spread costs over a larger asset base, while ag banks' smaller individual size limits their ability to provide large loans to large- and medium-sized agricultural businesses, like Gross Wilkinson Ranch in Wyoming.

"We have no advantages over them except as a depository," Gross says of his family's bank, adding that banks have "far more regulations," which is the biggest disadvantage compared to the Farm Credit System.

As a member of the Farm Credit System, Oldvader says he thinks one of the System's biggest advantages is its niche—staff has an ag background and experience in ag cycles, which appeals to customers.

"We're a mirror of our marketplace," Oldvader says.

Future

"Looking ahead, the agricultural finance market probably will be very competitive," Robbins says. "Community banks face many challenges."

Other competitors include other banks both small and large, credit unions, and others. But the competitive environment for ag lending in particular will be intense as they compete with the Farm Credit System lenders, he says.

"As the Farm Credit System pursues new avenues of lending to non-agriculturally related businesses and infrastructure projects," Robbins says, "small banks will probably continue to voice concerns."

Ultimately, though, rural America will benefit, Oldvader says.

"We all have the interests of our customers in mind."



BY BRYE STEEVES, SENIOR WRITER

FURTHER RESOURCES

"RURAL LENDING COMPETITION OF COMMUNITY BANKS AND THE FARM CREDIT SYSTEM"

By Eric Robbins
KansasCityFed.org/TEN

COMMENTS/QUESTIONS are welcome and should be sent to teneditors@kc.frb.org.



A local perspective

KANSAS CITY FED OFFICIALS, including, from left, Denver Board Director John Pearson, Denver Branch Executive Mark Snead, Kansas City Fed President Tom Hoenic and Denver Board Chairman Kristy Schloss talk with an employee at King's Ropes in Sheridan, Wyo. The tour was part of a recent off-site Board meeting.

Federal Reserve Bank of Kansas City officials, including the boards from two of the Bank's three Branches, learned about key components of the Tenth Federal Reserve District's economy firsthand during meetings earlier this year.

Directors of the Bank's Oklahoma City Branch held their April meeting in Tulsa. As a part of the meeting, the directors also had the opportunity to tour the nearby Port of Catoosa.

More than 2 million tons of cargo—comprising products that are themselves massive or are shipped in massive quantities—move through the port annually. It is the nation's most inland seaport, linking Oklahoma to both the nation's inland waterway system as well as international ports via New Orleans and the Gulf of Mexico.

"Most people come out here ... and say 'My goodness, I had no idea,'" says Bob Portiss, port director.

Nearly 4,000 workers are employed by 65 different heavy industrial firms that work with grain, lumber, steel and iron on an almost unimaginably large scale at the port.

"The real big benefit is being able to move objects you can't move by truck or rail," says Portiss. He notes that a crane used at the port is stout enough to lift an entire locomotive—including the three train engines on the port's 15-mile shortline system.

For directors of the Bank's Oklahoma City Branch and Bank officials, the port is another barometer measuring activity in the District's economy. At the time of the tour, Portiss said that while iron and steel activity had declined,

For a list of current and former directors of the Kansas City Fed and its three Branches, visit KansasCityFed.org/TEN.

agricultural activity had remained strong. As with the region's economy, agriculture is also crucial to the port's bottom line—about 60 percent of its annual tonnage is related to agriculture, much of it coming through one of the two massive elevators flanking the port channel. In addition to the elevators, the port also features a general dry cargo dock, a roll-on-roll-off low-water wharf, a dry bulk terminal and a bulk liquids terminal. Bank officials saw those facilities and learned firsthand the impact of such a port.

Board meetings, such as the one in Tulsa, take the Bank and Branch Boards of Directors to a meeting location other than their Branch offices, which are in Denver, Oklahoma City and Omaha. The meetings provide directors with an opportunity to use their contacts and expertise to give Bank officials, including President Tom Hoening and Branch economists, an opportunity to gain firsthand insight into the diverse economy of the District. Although the Federal Reserve has access to a wide range of economic reports and data, the Bank relies heavily on the local input of its directors in assessing economic conditions. While data are, by nature, backward looking, the directors, who come from a wide range of business backgrounds, offer real-time insight about what they see in their area of expertise.

For the Bank, events such as the tour at the Port of Catoosa offer an opportunity to see directly how the various components of the economy work together for its economists and directors, who reside in all seven states of the District.

"I've lived in Oklahoma most of my life and have never taken the opportunity to see (the Port of Catoosa)," says Bill Anoatubby, Chickasaw Nation governor and director of the Oklahoma City Branch of the Federal Reserve Bank of Kansas City.

Anoatubby, who is relatively new in his position on a Branch Board, says the experience has given him a new perspective on the economy.

"I had a general idea, but it makes a lot of difference being where things actually happen and to see how it actually works," he says.

The tour was arranged by Director Jim Dunn, a Tulsa native and businessman who keeps the Federal Reserve apprised of local economic activities.

After the board meeting, Bank officials participated in a luncheon with Tulsa-area

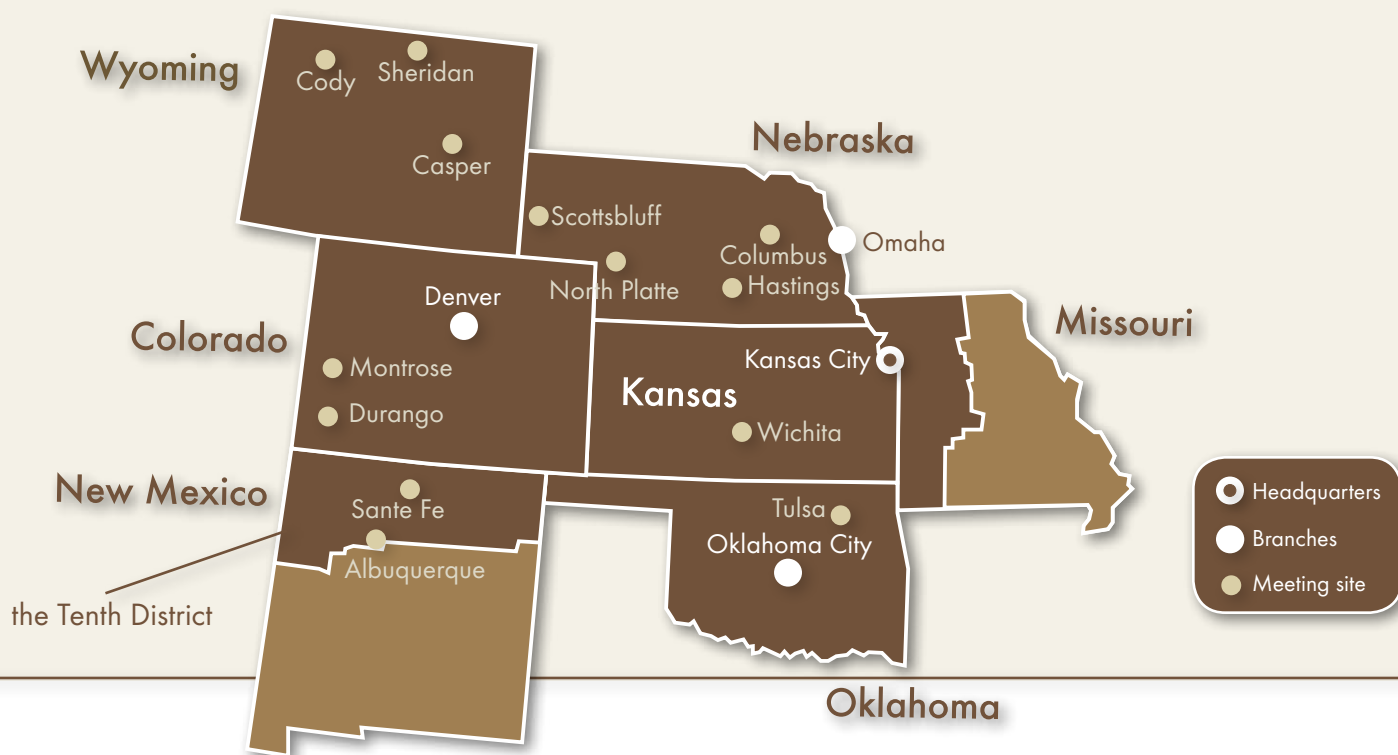


PHOTO BY BRANDI SIMONS

AT A RECENT OFF-SITE MEETING, the Oklahoma City Branch Board members and Kansas City Fed staff toured the Port of Catoosa near Tulsa.

Boards of Directors off-site meetings

In recent years, the Federal Reserve Bank of Kansas City's head office and Branch Boards of Directors have held off-site meetings in several Tenth District communities, including:



business leaders that included a speech by Hoenig. Speeches by the Bank president are often scheduled in conjunction with the remote meetings, bringing the national financial press that follows the Bank president to the District's Main Streets. In June, another example of that occurred after a Denver Branch Board of Directors meeting in Sheridan, Wyo., was followed by a speech from Hoenig.

The evening before the luncheon, Denver Branch directors and Bank officials had a lengthy roundtable discussion with leaders of the local energy industry about the outlook for energy markets. Conversation during the meeting covered a wide range of topics from the price of petroleum and natural gas to Wyoming's energy resources and environmental

issues, including the use and trade of carbon credits.

The group also briefly visited a truly local institution in Sheridan: King's Saddlery and King Ropes, founded by Don King after World War II. Here, some of the same Bank officials who saw cargo barges in Oklahoma had an opportunity to watch leather carver Jim Jackson ply a trade so unique that even the tools he uses are hand-crafted.

Both literally and figuratively, Jackson is far removed from the Port of Catoosa and the business done there. But for the Federal Reserve Bank of Kansas City, it all contributes to the picture of the District economy.



BY TIM TODD, EDITOR

Ask an Economist...

Do state corporate taxes reduce workers' wages?

During times of falling revenues and budget shortfalls, state policymakers juggle spending cuts with attempts to increase revenue and develop policies that attract or keep businesses and jobs.

Policymakers may consider raising corporate tax rates with the intent of not taxing workers who are already suffering from the most recent recession. However, much of the tax burden still falls on workers—higher corporate taxes often mean lower wages, says Alison Felix, an economist at the Federal Reserve Bank of Kansas City, who recently researched state corporate income taxes.

How much do states rely on corporate taxes?

Felix: On average, corporate tax revenues make up about 7 percent of total state tax revenues, but reliance on corporate tax revenue varies widely across states. Three states, Nevada, Washington and Wyoming, do not tax corporate income, while New Hampshire collects 27 percent of its tax revenue from this source.

Has the burden of the state corporate income tax changed over time?

Felix: In the 1990s and early 2000s, wages began falling more in response to higher corporate tax rates than in the late '70s and '80s. This jump may be due in part to increasing global competition, the growing competition among states to attract businesses or both.

Who could bear the burden of corporate taxes?

Felix: If corporations are unable to shift the burden of the tax onto other factors, then shareholders will bear the burden of the corporate tax as after-tax profits decline. Consumers may also bear some of the burden of state corporate taxes in the form of higher prices for products and services. However, recent economic research suggests that it is workers who bear the majority of the corporate tax burden in the form of lower wages.

How much do state corporate taxes lower wages?

Felix: Data from 1977 to 2005 show wages fell between 0.14 and 0.36 percent in response to a one percentage point increase in the state corporate tax rate. Although this number may look small, it implies that increasing the state corporate tax rate by one percentage point leads to a decline in U.S. wages that is larger than the additional amount of tax revenue collected.

Are all workers affected similarly?

Felix: State corporate taxes reduce the wages of highly educated workers by a larger percentage than less-educated workers. Many believe that capital increases the productivity of high-skilled workers more than low-skilled workers. When capital leaves a state in response to higher corporate taxes, this lowers the productivity of high-skilled workers more than that of low-skilled workers.

What can we conclude in general from your research?

Felix: When designing a tax policy, it is important for policymakers to understand the full impact of each tax. The burden of a tax does not always fall on the individual responsible for paying the tax. Also, taxes often encourage individuals and businesses to change their behavior, which creates distortions in the economy.

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BY BRYE STEEVES, SENIOR WRITER

FURTHER RESOURCES

"DO STATE CORPORATE TAXES REDUCE WAGES?"

By R. Alison Felix
KansasCityFed.org/TEN



'Tis the season for smart spending

Michele Wulff is a former public school educator of 30 years and a 2007 recipient of the peer award "Excellence in Teaching Economics." As an economic education coordinator with the Kansas City Fed, she works to heighten financial literacy throughout the seven states of the Tenth District.

When I was in the classroom, one of my students' favorite personal finance activities was comparison shopping. I discovered that a meaningful way to teach savvy spending, especially this time of year, was through real shopping scenarios, like purchasing Halloween costumes, Thanksgiving dinner items and holiday gifts. After I supplied the kids with ads from local stores, we would shop from our desks, looking for the best buys on treats and costume accessories, dinner necessities, or presents. Students were often amazed at the difference in price for the same item at various stores. They would make their shopping lists based on the bargains they found and vow to visit the stores with the best buys. You can do this same fun and practical lesson at home to encourage smart spending.

Point out to young consumers that in comparing the price of similar items, we can make more informed choices and save money on purchases. This practice will help them budget and avoid impulse buys, developing these skills for adulthood.

It's important to be prepared before the shopping trip begins. Share and discuss the "Be a Savvy Shopper" tips on Page 26 to prepare kids in advance, then head to the store together. Allowing your children to actively participate in the purchasing process makes the lesson more memorable.

This fall before hunting with your child for the perfect Halloween costume, be ready to set a non-negotiable price limit. Collect ads from several local stores and look through them together. Once your shopper is in the costume aisle, ask him to consider the costume design, size, quality and cost of several of his favorites before making a decision. If you'd like to add an economic concept to the mix, you can explain that when he makes his final choice, he will have an "opportunity cost," or secondary choice that he gave up for his primary selection.

As November rolls around, plan to take your child for a few Thanksgiving meal shopping trips. Ask your child to use the "Be Aware and Compare Chart," also on Page 26, to list all food items, filling in the amount needed, size or weight, brand, and price at Stores A and B. He should pay attention to sales and purchase limits. Ask your child to be your personal shopper, using the chart to recommend the best buys at the stores you visit.

When the gift-giving season approaches, have your child make a shopping list of his or her family members and friends. Because sales abound this time of year, you may want to play "The Better Birthday Buy" game on Page 27

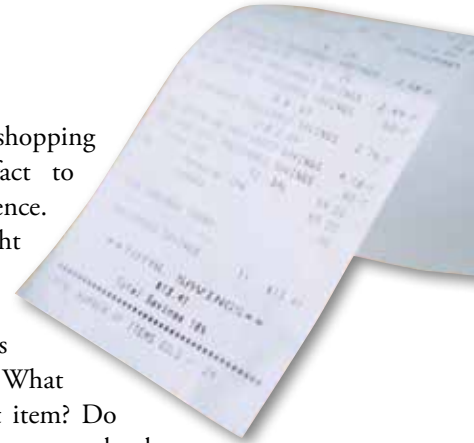


to sharpen math skills before heading out to shop. Children often have trouble figuring the percentage discount, so use the game cards and store ads to give them practice. Discuss the fact that sometimes sales aren't as good as they sound, such as "buy one, get one at half off," which is only a 25 percent reduction off each item.

Once your child is comfortable with percents and has followed the "Savvy Shopper" tips, allow him or her to make reasonable choices and purchases. Older children can do their comparison shopping and price checking online. By visiting the virtual stores, children can narrow their gift ideas and easily compare items to get the best overall buys. This preparation should help them stay within their holiday gift budget and avoid impulse purchases.

Discuss your child's shopping adventures after the fact to evaluate the experience. Some questions you might ask: Were the purchases you decided upon better buys? What was your best bargain item? What was an opportunity cost item? Do you feel confident that you made the best choices?

Regardless of the occasion, these comparison shopping experiences will develop kids' financial awareness and consumer expertise for many shopping trips to come.



Financial Education Resources

The Kansas City Fed is committed to promoting economic and financial literacy and greater knowledge of the Federal Reserve's role by providing resources for teachers, students and the public.

Online at KansasCityFed.org/TEN:

"Kids and Money—Teaching Children to Manage Their Finances" A booklet of family activities to teach school-age kids about savings goals, budgeting and shopping.

"You Are Here" A website with a virtual mall where kids ages 10-14 learn consumer concepts as they visit local businesses.

"Smart Shopping" A website that gives tips to teenagers on ways to stretch their dollar while shopping for clothes, entertainment, electronics and sporting goods.

Books:

Bunny Money by Rosemary Wells
Characters go shopping for their grandmother's birthday present; spending choices lead to a lesson about the value of money. For ages 5-8.

Pigs Will Be Pigs by Amy Axelrod
A pig family's quest to collect money to go out to dinner; readers look at the dinner menu to decide what the pigs can afford. For ages 5-8.

Be a Savvy Shopper:

Do your homework! Follow these tips for a more successful shopping experience. 

- Check the store ads for the items you want to buy before you begin to shop. Note the stores with the better buys.
- Plan a shopping trip to the store(s) with the best sales.
- Narrow your possible choices of desired items to simplify your shopping.
- Estimate how much you can afford to spend and stay in that price range.



Be Aware and Compare:


Item to Buy	Quantity	Size or Weight	Brand or Type	Store A Price	Store B Price

"The Better Birthday Buy" game cards

Sometimes a sale isn't always the best deal. Calculate which item is less expensive.

Easier Game

Harder Game

A  Which is the Better Birthday Buy?

B-Day Card 1	B-Day Card 2
\$1	\$1.50 with 50% off

E Which is the Better Birthday Buy?

B-Day Card 1	B-Day Card 2
\$3	\$5 with 20% off



B Which is the Better Birthday Buy?


Ice Cream Cone 1	Ice Cream Cone 2
\$2.50	\$3 with 10% off

F Which is the Better Birthday Buy?

Ice Cream Cone 1	Ice Cream Cone 2
\$3.75	\$4 with 25% off

C Which is the Better Birthday Buy?

Birthday Cake 1	Birthday Cake 2
\$5	\$6 with 20% off

G  Which is the Better Birthday Buy?

Birthday Cake 1	Birthday Cake 2
\$7	\$12 with 40% off

D Which is the Better Birthday Buy?

Gift 1	Gift 2
\$6.50	\$8 with 25% off



H Which is the Better Birthday Buy?

Gift 1	Gift 2
\$9	\$15 with 33% off

Answers:

A) \$1.50 with 50% off, or 75 cents; B) \$2.50; C) \$6 with 20% off, or \$4.80; D) \$8 with 25% off, or \$6; E) \$3.00; F) \$4 with 25% off, or \$3; G) \$7; H) \$15 with 33% off, or \$10.

Moore leads Supervision and Risk Management Division

Kevin Moore has been named senior vice president of the Federal Reserve Bank of Kansas City's Supervision and Risk Management Division.



As part of its mission, the Federal Reserve supervises and regulates financial institutions' activity to ensure the safety and soundness, market stability, and fair and equitable treatment for consumers. In his new role, Moore oversees this realm for the Tenth Federal Reserve District.

This includes financial institutions in western Missouri, Nebraska, Kansas, Oklahoma, Wyoming, Colorado and northern New Mexico, as well as Fed staff at the Kansas City headquarters and its Branches in Denver, Oklahoma City and Omaha.

In addition to its oversight role, the Supervision and Risk Management Division tracks banking conditions in the District; publishes related research; offers bank directors a variety of training courses and resources; manages District institutions' access to the Federal Reserve Discount Window; and more.

"Kevin has managed a variety of departments within our Reserve Bank and also has held various national roles related to supervision, statistics and the Discount Window," says Tom Hoenig, president of the Kansas City Fed. "His experience, knowledge and leadership are a great asset to our organization and its mission."

Moore replaces Esther George, who was promoted to first vice president, also in August. He joined the Kansas City Fed as an examiner in 1982 and was promoted to assistant vice president in 2000 and vice president in 2003.

Moore has a B.S. in business management from Northwest Missouri State University in Maryville, Mo., and an M.B.A. from Rockhurst University in Kansas City, Mo. He is a graduate of the Stonier Graduate School of Banking.



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To browse our selection and then order or subscribe, visit KansasCityFed.org/TEN.



Fed chairman taped PBS special at Kansas City Reserve Bank

PBS Television recently hosted a special town hall meeting featuring Federal Reserve Chairman Ben Bernanke. The taping took place in July at the Federal Reserve Bank of Kansas City.

Kansas City-metro residents made up the audience; PBS NewsHour host Jim Lehrer served as the moderator. During the one-hour event, Bernanke answered questions from both the audience and Lehrer about the economy and the Federal Reserve's role in the financial crisis.

"Kansas City was chosen for the town hall meeting because of its location in the country's heartland," says Krissy Young, assistant vice president of Public Affairs at the Kansas City Fed. "Additionally, our recently built headquarters provided an ideal venue. We were happy to host Chairman Bernanke and PBS." The taping was edited into three segments that aired on NewsHour during the last week of July. It is available on NewsHour's website.

Kansas City bank examiner nationally recognized

Marsha Reese, a bank examiner at the Federal Reserve Bank of Kansas City, recently was awarded the 2009 William Taylor Award for excellence in leadership and bank supervision.

The award, which is the highest of its kind, honors those in the Federal Reserve System who have demonstrated extraordinary achievement in the financial regulation sector. The award was established in 1993, a year after Taylor's death. He dedicated his career to financial regulation, including his work as director of the System's Division of Bank Supervision and Regulation and later as FDIC chairman.

During Reese's 22 years with the Federal Reserve Bank of Kansas City, she has participated in large-scale examinations throughout the country. Contributing to her award were two examination teams she led that uncovered weak management covering up problem loans in one bank and rapid deterioration in asset quality in both.

She was honored by her colleagues in a ceremony at the Kansas City Fed. President Tom Hoenig spoke of Taylor's prestigious legacy and how Reese exemplifies those standards.

"This is a well-deserved honor and a tremendous privilege for me to present this award," Hoenig said at the event.

Reese is the seventh Kansas City Fed employee to receive the award. Past recipients are Marge Wagner, Dave Anderson, Ron Sisneros, Ed Hughes, Forest Myers and Alinda Murphy.



Discount Window helps with contingency preparedness

Depository institutions have a safety net that provides funding and liquidity, even if they never need it.

The Federal Reserve's Discount Window is a source of temporary funding available to depository institutions regardless of whether they have a Federal Reserve account or are a member.

The Discount Window is most often used by institutions to prevent an overdraft or a deficiency in meeting reserve requirements, but it may also be accessed for a number of other reasons, including the recent financial market disruptions, says Susan Zubradt, vice president of Credit and Risk Management at the Federal Reserve Bank of Kansas City.

There are three permanent Discount Window lending programs: primary (short-term funds for sound institutions); secondary (a more restrictive program available to institutions not eligible for primary credit); and seasonal (for smaller institutions with cyclical funding needs, usually tied to agriculture or tourism).

Additionally, a term auction facility (TAF) has been made temporarily available to institutions qualifying for primary credit. The TAF is to assist in reducing current pressures in the term funding markets.

"We suggest every bank incorporate the Discount Window into its contingency liquidity plans," Zubradt says. "For those that have, we encourage periodic testing or confirmation of their access."



Borrowing from the Discount Window is electronic. To ensure access to the Discount Window, interested institutions should contact the Reserve Bank in their region to obtain the necessary borrowing documents and pledge collateral.

For more information on the Discount Window, visit KansasCityFed.org/TEN.

New economic resources for students are online, free

Additional lessons and activities that teach children about the economy and promote financial literacy are available from the Federal Reserve Bank of Kansas City.

Three new classroom lessons are:

- The “There’s No Business Like Bank Business” role play that introduces students in grades 3–5 to the benefits of saving money in a bank.

- The “Payment Parliament” role play that shares with students in grades 5–8 the different methods of payment consumers can use to buy goods and services.

- The “Brain Drain” lesson, which teaches students in grades 9–12 about the loss of skilled labor from one area to another as a result of labor movement to a more favorable economic environment.

Two new resources for educators and youth organizations are:

- The Fifty Nifty Econ Cards that teach elementary and middle school students the meanings of economic and personal finance words. A teacher’s resource guide with activities and games accompanies the cards.

- A Traveling Trunk, which includes Fed artifacts, lesson plans and activities to teach economic and personal finance concepts



in the classroom. Its contents help develop an understanding of the Federal Reserve, money and banking. It is free and available to educators.

Materials were written by Michele Wulff, an economic education coordinator at the Kansas City Fed’s Omaha Branch and a former public school teacher.

“These lessons offer educators fun, age-appropriate activities for their students to learn about banking, money and economics,” she says. “Financial literacy lessons taught at a young age will benefit children into adulthood.”

Part of the Federal Reserve’s public outreach efforts includes economic education for all ages. Staff offers curriculum and lesson plans for all grades, in-service classroom training, and educational publications. All resources are free.

To access or order new materials, and other economic and financial education tools, visit KansasCityFed.org/TEN.



Annual economic policy symposium

More than 100 central bankers, policymakers, academics and economists recently convened for the Federal Reserve Bank of Kansas City's 33rd annual economic policy symposium "Financial Stability and Macroeconomic Policy."

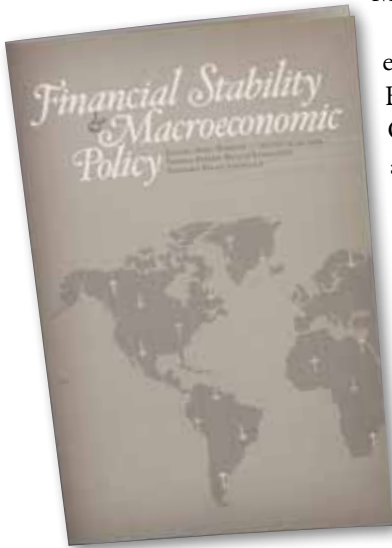
Speakers included Federal Reserve Chairman Ben Bernanke, Bank of Japan Governor Masaaki Shirakawa and president of the European Central Bank Jean-Claude Trichet, as well as central bank governors and academics from around the world. Participants discussed economic issues, implications and policy options related to this year's topic.

"Lessons learned from the current global economic crisis will influence the response to future financial crises," says Tom Hoenig, president of the Kansas City Fed. "This year's symposium explored these important policy issues in light of recent events."

The symposium was Aug. 20-22 in Jackson Hole, Wyo., which sits in the northwest corner of the Kansas City Fed's seven-state region. Since 1978, the Federal Reserve Bank of Kansas City has sponsored a symposium on an important economic issue.

"Each year we are honored to host a distinguished group of individuals who engage in discussion of a crucial matter on a global scale," Hoenig says. "This exchange of ideas is invaluable."

To read the proceedings, including papers, commentary and discussion, for this year and the previous events, visit KansasCityFed.org/TEN.



Bank Anniversaries

The following banks in the Tenth Federal Reserve District are celebrating one, five, 10, 20 or more years as Federal Reserve members in October, November and December.

Bank of Versailles	Versailles	Mo.	90
First State Bank of Newcastle	Newcastle	Wyo.	79
Grant County Bank	Medford	Okla.	69
Stock Exchange Bank	Caldwell	Kan.	69
Fidelity State B&TC	Dodge City	Kan.	66
First State Bank	Fairfax	Okla.	64
Farmers State Bank	Pine Bluffs	Wyo.	43
Bankers' Bank of the West	Denver	Colo.	29
Citizens State B&TC	Ellsworth	Kan.	29
Bank of Elgin	Elgin	Neb.	10
First American State Bank	Greenwood Village	Colo.	10
First State Bank	Lincoln	Neb.	5
Guaranty B&TC	Denver	Colo.	5



Compiled By TEN Staff

COMMENTS/QUESTIONS are welcome and should be sent to teneditors@kc.frb.org.



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The Federal Reserve System

Congress created the Federal Reserve in 1913 to bring financial stability after a number of banking panics. It is the nation's third central bank. The first, established in 1791, and the second, created in 1816, were each operational for 20 years. In both cases, its charter failed to be renewed and the banks closed.

With the Federal Reserve Act, Congress sought to create a central bank the public would be more likely to support by making it "decentralized" with more local control. This new structure was designed to overcome one of the primary weaknesses of the previous central banks: public distrust of an institution that many felt could potentially be under the control of either government or special interests. The new central bank is a network of 12 regional Federal Reserve Banks, located throughout the country and under the leadership of local boards of directors, with oversight from the Board of Governors in Washington, D.C., a government agency.

The Federal Reserve is considered to be independent within government and broadly insulated from political pressures. While members of the Board of Governors are nominated by the president of the United States and confirmed by the Senate, the Federal Reserve's regional structure, including local boards of directors and advisory councils, ensures that views from a broad spectrum of the public nationwide contribute to the central bank's deliberations.

President Woodrow Wilson signed the Federal Reserve Act on Dec. 23, 1913, and the 12 regional Federal Reserve Banks opened on Nov. 16, 1914.

The Federal Reserve Bank of Kansas City

The Federal Reserve Bank of Kansas City and its Branches in Denver, Oklahoma City and Omaha serve the Tenth Federal Reserve District, which encompasses western Missouri, Nebraska, Kansas, Oklahoma, Wyoming, Colorado and northern New Mexico. As a part of the Federal Reserve System, the Bank participates in setting national monetary policy, supervising and regulating numerous commercial banks and bank holding companies, and providing check processing and other services to depository institutions.



SENIOR VICE PRESIDENT & PUBLIC INFORMATION OFFICER:
Diane Raley

ASSISTANT VICE PRESIDENT & PRODUCTION ADVISOR: Lowell Jones

EDITOR: Timothy Todd

SENIOR WRITERS: Brye Butler Steeves, Bill Medley

ART DIRECTOR: Angela Anderson Miles

MAGAZINE DESIGNER: Gary Barber

COPY EDITORS: Sara Brunsvold, Sarah Kemp

CONTRIBUTORS: Kelly Edmiston, Alison Felix, Craig Hakkio, Bill Keeton, Eric Robbins, Chad Wilkerson

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The views and opinions expressed in **TEN** are not necessarily those of the Federal Reserve Bank of Kansas City, the Federal Reserve System, its governors, officers or representatives.

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Federal Reserve Bank of Kansas City
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