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FEDERAL RESERVE BANK OF KANSAS CITY

Fall 2014

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**Healthcare reform's role
in the labor market**

Kansas City Fed's first president

**BUILDING NEW
FOUNDATIONS**

Credit conditions limit the housing recovery



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A central role in payments

When lawmakers designed the Federal Reserve System a century ago, they envisioned a central bank that would serve as a source of financial stability, provide a safety net in times of crisis and support the growth of the U.S. economy. To fulfill these roles, the Federal Reserve necessarily played a central role in the U.S. payments system.

While the Federal Reserve was initially concerned with clearing checks, technology has evolved over the past 100 years to offer consumers and businesses better ways to pay. During these years of change, Congress has continued to turn to the Federal Reserve to ensure payments improvements are universally available and that the entire system remains safe and secure.

A look back at the historical issues the Fed has faced throughout its evolution as a payments system operator, regulator and leader provides important context for the current discussions over the central bank's future role and responsibilities in this critical mission area. Many of these issues are highlighted in a new book from the Federal Reserve Bank of Kansas City: *Highways of Commerce: Central Banking and the U.S. Payments System*.

Interestingly, several of the core questions about the payments system today—including “Who bears the costs of operating the system,” and “What is the proper role of a central bank”—are remarkably similar to the issues banks, consumers, businesses and policymakers faced even before the Federal Reserve was established.

Moving checks

In the late 19th century, retail payments in the United States largely relied on the

movement of checks. The process of clearing and settling these pieces of paper was a risky and expensive endeavor for the banks, consumers and businesses involved in everyday commerce across the country.

To help cover this risk and expense, many banks assessed fees on the checks that passed through their institutions, and as a result, consumers and businesses often did not receive the full face value, or “par” value, of a check they deposited. In an attempt to avoid these so-called exchange fees, banks often sent checks through a complicated network of correspondent institutions that agreed to honor checks at par value. This practice resulted in lengthy delays between when a check was credited to a bank account and its final settlement as a check could travel through dozens of different banks located hundreds of miles apart.

This delay, known as check float, constituted a “serious danger to banking liquidity or solvency,” noted Rep. Carter Glass of Virginia, one of the Federal Reserve Act's authors. Glass and others decried the “fictitious balances” that float created throughout the banking system. The Act's Senate sponsor, Robert L. Owen of Oklahoma, also felt this issue should be addressed by equipping the new central bank with the ability to clear payments on behalf of disconnected banks. Such an institution would provide a “much





higher velocity to the great credit system of the United States,” and improve financial stability.

In its final form, the Federal Reserve Act called for a number of regional Reserve Banks to be located across the country that would decentralize power as well as serve as regional clearinghouses for member banks. The Federal Reserve’s founders felt the Reserve Banks, by working together to clear checks at par, would establish the first truly national clearinghouse in the United States and would help lower costs and remove obstacles throughout the payments system. As Glass said in a speech a day before the Act was signed into law, the Federal Reserve’s new payments responsibilities would “tear down these tollgates upon the highways of commerce.”

An ongoing challenge

While Glass, Owen and others had high hopes for the Federal Reserve’s ability to improve the speed and efficiency of the payments system, those within the central bank faced a daunting challenge, and the Federal Reserve Act provided little guidance for how the Reserve Banks should carry out their payments mandate. It was, as the Board of Governors noted in its first annual report in 1914, a problem “of great novelty” that “calls for the application of a high degree of technical skill.”

The Board of Governors was determined to eliminate exchange fees on checks throughout the entire banking system, and during its first few years, the Reserve Banks spent an incredible amount of resources working to convince banks to honor checks at their full face value.

However, this initial effort led to controversy. The Federal Reserve’s experience in the early 1920s in Nebraska and elsewhere provides a colorful example of the public backlash that resulted.

Armed agents from the Kansas City Fed’s Omaha Branch, and elsewhere, visited non-member banks in rural Nebraska towns in an effort to persuade these institutions to stop charging exchange fees. When a bank refused, the agents would collect a large number of checks written on that institution and then present them all at once at the bank’s counter for immediate cash payment. This practice effectively drained a bank of its cash reserves, and in some cases, threatened a bank’s survival if it did not have enough cash on hand.

Soon, bankers who were targeted by the Federal Reserve’s heavy-handed tactics complained to their elected officials, who held hearings and passed resolutions demanding the Federal Reserve account for its actions. The Federal Reserve Banks soon found themselves mired in state and federal lawsuits. After several court cases and heated rhetoric from bankers and businesses on both sides of the controversy, the issue was resolved with a 1923 Supreme Court decision that upheld state-chartered banks’ right to charge exchange fees. The Federal Reserve ended its aggressive methods, and small banks in some rural areas continued to charge exchange fees until 1980.

A collaborative approach

The Federal Reserve’s experience during this era was proof that change in the payments system would require the cooperation of



other participants. As a result, the Federal Reserve began to pursue a more collaborative approach with the banking industry, businesses and consumers. This led to significant improvements in the payments system in the mid-20th century, such as the use of magnetic ink (MICR) on checks, greater standardization across the banking industry and other technology improvements, such as automated sorters, that vastly improved efficiency.

By the late 1970s, it became clear that the Federal Reserve's leadership was needed once again. Hundreds of member banks were leaving the Federal Reserve System in an attempt to escape the Fed's reserve requirements and other regulations on savings and checking accounts. This was affecting the Fed's ability to conduct monetary policy, and Chairman Paul Volcker and others pushed for a solution that would level the regulatory playing field while also significantly changing the payments landscape.

Under the Monetary Control Act of 1980, all financial institutions would be required to meet the Federal Reserve's reserve requirements. At the same time, the Federal Reserve would be required to price its payments services and make them available to all institutions rather than providing them for free to member banks only. The passage of the Act meant the Federal Reserve would now compete with other institutions for check-clearing and other services, resulting in efficiency gains for the entire system.

As the payments system continued to evolve over the next several years, the Board of Governors in 1996 established a commission, led by Vice Chair Alice Rivlin, to develop a plan

for the Federal Reserve's future role. Working together with bankers, consumers, merchants and others, the commission found there was overall support for the Fed to continue its role as a payments system operator and regulator. But, the commission also identified areas where the Federal Reserve needed to improve, particularly when it came to preparing for a more electronic payments system.

Soon after the Rivlin Commission's final report, it became clear that the payments system was transitioning from paper to electronics. In 2003, the Federal Reserve led the way by pushing for the passage of Check 21. This legislation modernized the way checks were cleared and settled by making an image of a check equivalent to the original paper version. The result was reduced transportation costs, a faster settlement process and improved efficiency overall.

More recently, the issue of interchange, or the fees that banks charge merchants on each payment card transaction, became the focus of a heated debate in Congress. As with other issues in the payments arena, Congress turned to the Federal Reserve by mandating the central bank set a "swipe fee" limit for debit card transactions. This issue remains controversial today, but Congress' directive that the Federal Reserve regulate this fee reflects the public's expectation that the Fed continue to play a role in the payments system.

A strategic plan for the future

Last year, the Federal Reserve took a next step to foster coordination, and where appropriate, drive payments system



improvements. A paper issued in September 2013 sought comments from consumers, financial institutions, merchants, trade groups, payment networks and processors, software vendors and many others, with the goal of developing a plan for making the payments system faster and more responsive for end users.

Throughout this process, the Federal Reserve has identified a number of desired outcomes, including a ubiquitous, faster electronic solution for business and personal payments, improvements in cross-border payments to and from the United States, and enhanced payments safety and security so that the public's confidence in the system remains high. I encourage you to visit www.fedpaymentsimprovement.org for information on these initiatives.

Since the Federal Reserve's founding, Congress has looked to the central bank to take steps to facilitate cooperation to address network or coordination challenges that otherwise impede innovation, efficiency and other public benefits.

Industry collaboration and engagement is essential to any enduring strategic improvements to the U.S. payments system. This is an exciting time as the Federal Reserve prepares for the next steps in the payments

system's evolution. I am looking forward to seeing what the future holds for the central bank and a next generation payments system.

**ESTHER L. GEORGE, PRESIDENT
FEDERAL RESERVE BANK OF KANSAS CITY**

President George is a member of the Federal Reserve's Financial Services Policy Committee, which oversees the strategies and operations of the Reserve Bank's product offices and the provision of Federal Reserve financial services to depository institutions and the U.S. Treasury. An electronic version of the book *Highways of Commerce: Central Banking and the U.S. Payments System* is available from the Kansas City Fed's website, www.KansasCityFed.org.



Tenth District Data



27%

In 2011, the percent of workers employed by establishments 0-5 years old in Colorado

4.9%

The July 2014 unemployment rate in Kansas

51%

The percent of jobs in New Mexico that are middle-skill jobs



5.5%

increase in Missouri farmland values from last year

9.07 million



The number of tourists who visited Wyoming in 2013

1,020,632

The number of people in Nebraska's labor force at the beginning of 2014

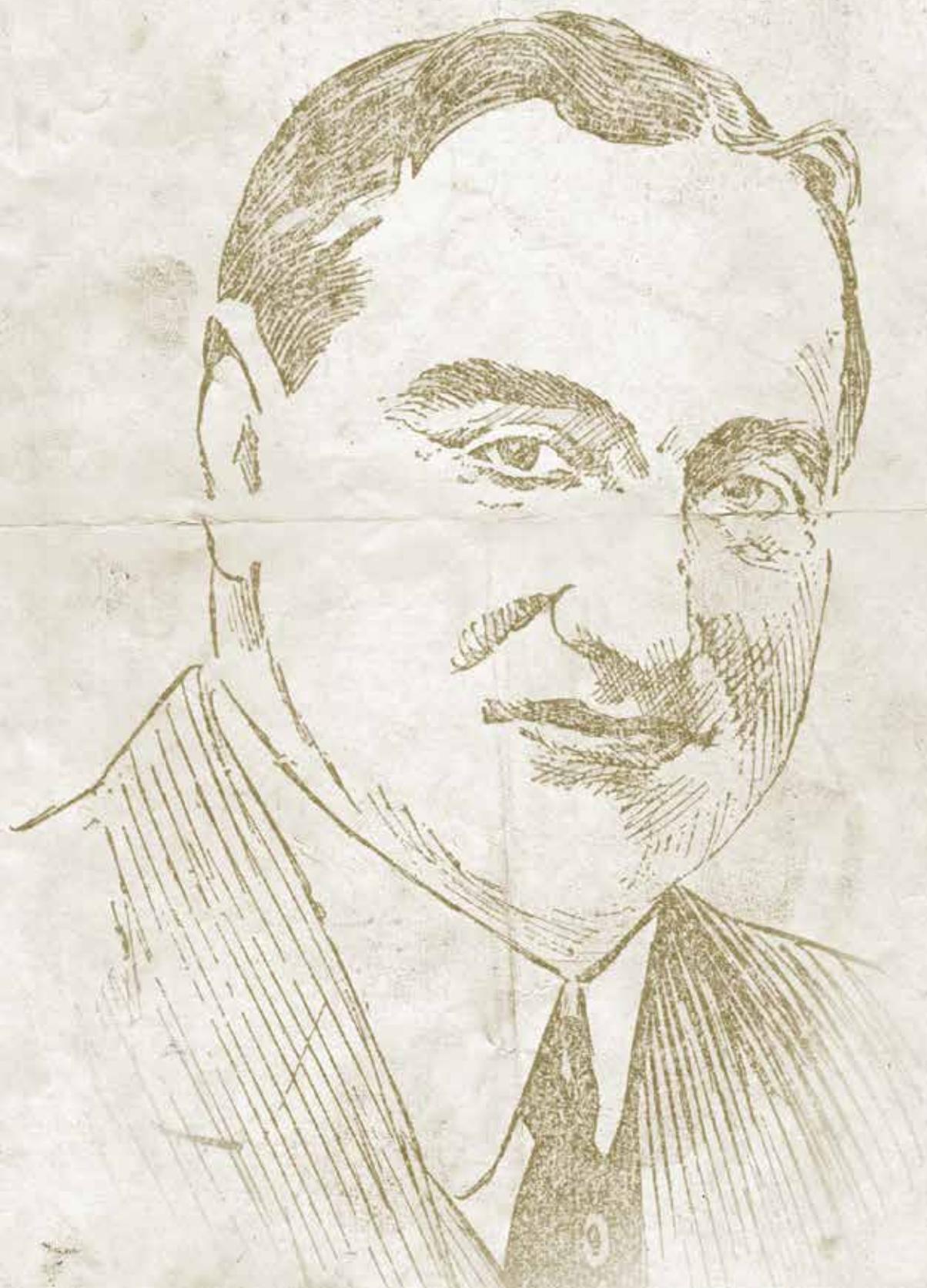
485 miles

The length of pipeline that connects Oklahoma's Cushing oil hub with refineries along the Gulf Coast



SAWYER'S SWAY

THE INFLUENCE OF KANSAS CITY'S FIRST PRESIDENT





As the Federal Reserve Bank of Kansas City and the Federal Reserve System commemorate 100 years, many stories and people come to mind when contemplating the Fed's rich history. Some events changed the nation, while other occasions were small but important to shaping the Bank, like an artist slowly chiseling away a stone. People's contributions were the same way. Some were small and not so noteworthy, while others defined history and sometimes created popular myth.

For example, many consider Jo Zach Miller, Jr., to be the first president of the Kansas City Fed; however, Charles Manville Sawyer was the first person to serve as president when the Bank opened for business Nov. 16, 1914.

Technically, Sawyer was the first governor of the Bank—the title of president wasn't used at Federal Reserve banks until Congress passed legislation in 1935 to address concerns about the nation's banking system, which also changed the title and election process of governors.

Sawyer, an Illinois native, was one of eight children and the only child not to attend

college. He moved to Norton, Kan., in 1887, when he was 21. He soon became a cashier at First National Bank.

William E. Connelley wrote in his 1918 book "A Standard History of Kansas and Kansans" that the position gave Sawyer the opportunity to meet early settlers to the state and know the people of the northwest region.

His contact with Kansans broadened when he became a national bank examiner, and more importantly, Connelley noted, Sawyer's increased interaction with bankers in the state would shape his career.

In 1897, Sawyer returned to the Norton bank as president. He later became president of the Kansas Bankers Association in 1898 and a member of the executive council of the American Bankers Association.

In 1913, Kansas Gov. George H. Hodges appointed Sawyer the state's bank commissioner due to Sawyer's influence and connections with bankers throughout the state.

His influence would play a key role in his election as governor to the Kansas City Fed a year later. But Sawyer wasn't the Kansas City Board of Directors' first choice.

According to a partial transcript of the Bank's first board meeting on Oct. 16, 1914, Director Willis J. Bailey, along with many local bankers, favored Peter W. Goebel for the job.

Goebel, who would later become president of the American Bankers Association, was president of the Kansas City Clearing House Association. Goebel, however, wouldn't take the governor's position for less than \$10,000 a year. This caused a problem. Miller, as chairman, made an annual salary of \$7,500.

Because the governor would report to Miller, the Kansas City board thought it inappropriate to offer a higher salary to the governor.

R.H. Malone, a Bank director from Denver, told his fellow board members that he had discussed the issue of governor salary with Federal Reserve officials during

an earlier meeting. The officials thought a governor should work for less. They want someone to "work for patriotism and honor and good of the government rather than for financial compensation," Malone said. "The impression left on me was honor rather than compensation."

The Board voted to limit the governor's salary to \$7,500 annually, which eliminated Goebel from consideration. That's when Miller raised Sawyer's name for discussion.

Miller's choice was based more out of necessity than Sawyer's qualifications as an executive. The Kansas City bank needed to induce state banks to become members, and half the business the Bank expected to receive would come from Kansas banks. Sawyer's influence in this area was invaluable.

The board quickly voted to hire Sawyer.

BECOMING A MEMBER BANK

Commercial banks chartered by the federal government and state banks that choose the designation are known as Federal Reserve member banks. The designation has several implications for a commercial bank, including the determination of a regulatory agency.

To become a member, the commercial bank must purchase stock in the regional Federal Reserve Bank in an amount equal to 6 percent of its capital and surplus, half of which must be paid while the other half is subject to call by the Board of Governors of the Federal Reserve System.

The stock lacks the control and financial interest of common stock in publicly held companies, and the stock may not be sold or pledged as collateral for loans. Member banks receive a 6 percent dividend on the stock and the right to vote in specific director elections.

The First National Bank of Jasper, Mo., sent the Federal Reserve Bank of Kansas City \$350 in gold as its first payment for membership. The payment was 1 percent of the commercial bank's capital and surplus of \$35,000. The bank had

jumped the gun in 1914, because the Kansas City Fed hadn't opened for business yet. The early payment, however, unofficially made the Jasper Bank the Kansas City Fed's first member bank.



Sawyer may have been a jovial person or a nose-to-the-grindstone leader; it's difficult to say because history is quiet, almost a whisper regarding Sawyer's tenure as governor. One thing is certain: directors soon discovered that Miller and Sawyer were better suited for each other's jobs.

Less than two years later, at a Jan. 4, 1916 meeting, the Kansas City Board appointed Miller as governor, and a short time later, the Federal Reserve Board approved the Kansas City Board's recommendation to appoint Sawyer as chairman.

Sawyer's time as chairman was uneventful, and he left the Fed when his term expired in December 1917.

Little is known about Sawyer's life after the Kansas City Fed and it appears he may have left Kansas City for good.

He retired to Hollywood, Calif., and was featured in the March 21, 1928 edition of *The Los Angeles Times* among other prominent Kansans who had attended a luncheon. The luncheon included Bailey, who was governor of the Kansas City Fed at the time, and former Kansas Gov. Hodges.

Sawyer's obituary, which published in the Sept. 28, 1950 edition of *The Los Angeles Times*, referred to him as the "retired first president of the Federal Reserve Bank, Kansas City." He was 84.

KEVIN WRIGHT, EDITOR



FURTHER RESOURCES

For more history and insight to the Federal Reserve Bank of Kansas City, read "**Confidence Restored: The History of the Tenth District's Federal Reserve Bank**" by Tim Todd at <http://www.kansascityfed.org/publicat/confidencorestored/confidencorestored.pdf>.

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

HOW THE FED BEGAN

Photos courtesy of the
Library of Congress



Robert L. Owen



Carter Glass

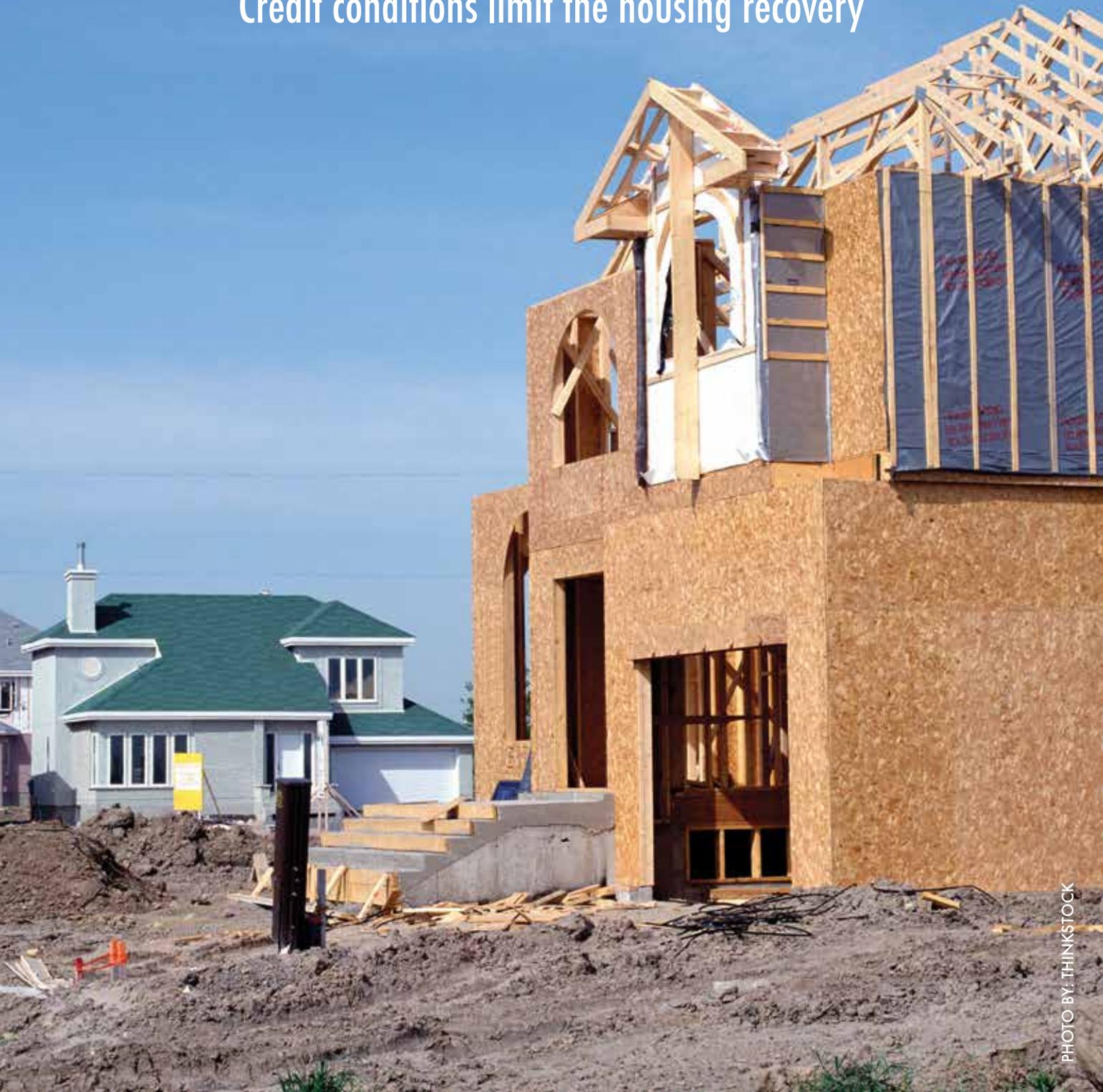
Oklahoma Sen. Robert L. Owen and Virginia Rep. Carter Glass sponsored the Federal Reserve Act in the U.S. Congress, which President Woodrow Wilson signed into law Dec. 23, 1913. The bill authorized the creation of the Federal Reserve System, the United States' first central bank in more than 75 years, including both a government agency in Washington, D.C., and 12 semi-independent regional Reserve Banks around the country.

The structure of the System favored Owen's design, which proposed a unique public-private structure. The Board of Governors in Washington, D.C., which has broad oversight responsibilities for the entire Federal Reserve System, is a governmental agency. The regional Banks are private corporations, each with a board of directors.

The directors are a distinctive mix—six of the nine directors are elected by commercial banks that are members of the Federal Reserve System in each District, while the remaining three positions are appointees of the Board of Governors.

BUILDING NEW FOUNDATIONS

Credit conditions limit the housing recovery





Homes sales fluctuate with the economy. Prices increase, decline, then increase again. Credit thresholds for mortgages tighten and loosen. Inventory expands and contracts.

Economic crises have greater impacts on these fluctuations; but home sales, in the past, have recovered fairly quickly following recessions. The most recent financial crisis—and the aftermath of regulatory reform—however, have made the recent housing recovery somewhat more difficult.

Making a sale

Existing home sales continued to improve for the fourth month in a row in July. Single-family existing home sales rose 2.7 percent to a seasonally-adjusted annualized rate of 4.6 million units, the highest pace since September 2013. The consecutive increases show the housing market continues an upward trajectory and is consistent with the improving labor market.

Despite these good numbers, however, the housing market remains sluggish.

Char MacCallum, owner and broker of Char MacCallum Realty in Kansas City said people are still buying homes, but the

market could be better.

“We are having a hard time getting people approved for loans,” she said.

And available homes are in short supply, she added.

The months of supply remained at 5.5 at the current sales pace in July, as total housing inventory increased at about the same pace as sales. Existing homes sales have had a minor effect on GDP growth, which remained unchanged at 2.5 percent.

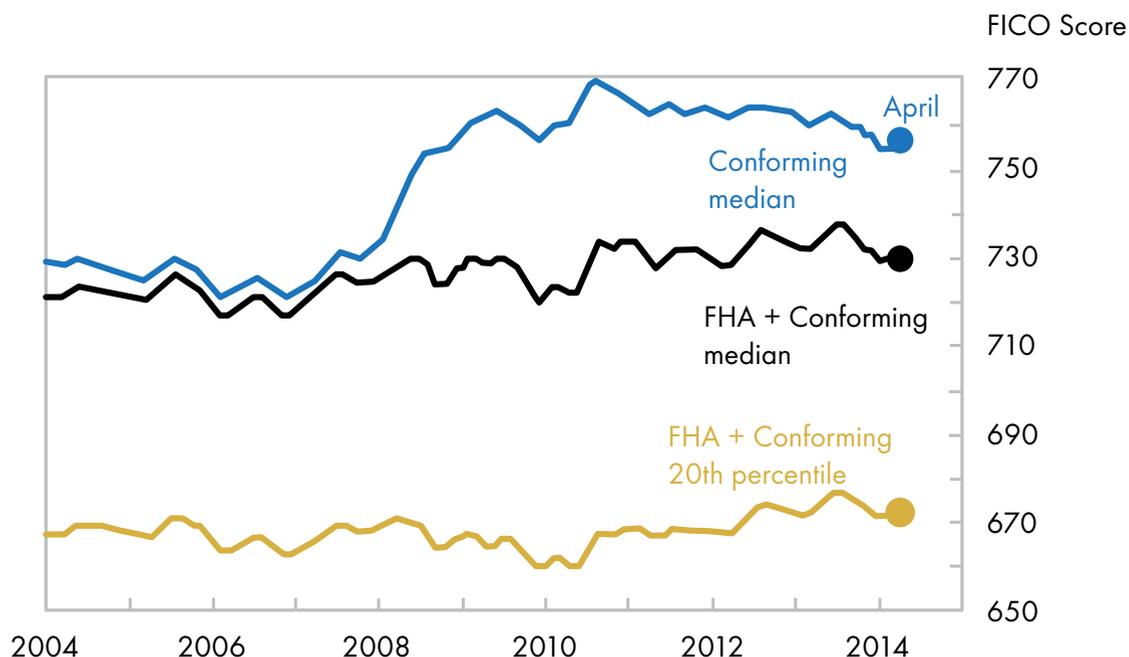
Home prices continue to remain below pre-crisis levels, which is good for buyers, but prices are increasing. Closing a sale, however, is not the same as it was before the financial crisis, MacCallum said.

Closing the sale

Senior Economist Jordan Rappaport with the Federal Reserve Bank of Kansas City and Paul Willen, a senior economist at the Federal Reserve Bank of Boston, found that originations of mortgages to purchase a home fell in the first quarter this year—the lowest level since early 2011.

“Credit conditions have been a key factor constraining the recovery,” the economists explained. “With the onset of the housing

CREDIT SCORE BY LOAN SEGMENT



Note: Percentiles are for purchase loans with FICO \geq 620
 Source: Black Knight Financial

crisis, banks and other lenders significantly tightened their criteria for making mortgage loans. Most visibly, they stopped making ‘subprime’ loans to households with especially poor credit histories.”

Households with FICO credit scores below 620—a score that might be triggered by being 90 days late on a loan payment—essentially lost any access to mortgage borrowing. Lenders no longer allowed borrowers to take out a “piggy back” second mortgage to make a down payment.

Rather than exclude or cut off poor-credit households outright, the economists said, lenders have been applying strict underwriting conditions on all borrowers.

Federal Housing Administration (FHA)

lending has allowed many buyers with imperfect credit or the inability to make a large down payment—the average requirement is 20 to 25 percent—maintain access to mortgage borrowing. FHA-guaranteed purchase loans typically require a down payment of 3.5 percent.

MacCallum says this leaves potential buyers even more dependent on government-guaranteed loans, and the increase in guaranteed-government loan applicants has caused a lending log jam, especially when agencies, such as the United States Department of Agriculture (USDA), make cutbacks.

“It used to take six weeks to close, now it takes 10 weeks,” she said.

Buyers who receive approval from

traditional mortgage lenders, such as banks, can watch sales fall through because of strict underwriting, a conservative appraisal process and strict documentation requirements, including questions over title.

Rappaport and Willen say that to an extent, these conditions constitute sound lending practices and they are a positive development in lending. But the level of vigilance suggests that regulatory uncertainty may also play a role.

“Regulations and standards have made it more difficult to buy a home,” MacCallum said. “It’s keeping many people who might otherwise qualify from getting a loan.”

Mortgage tightening

The tightening of mortgage credit is reflected in the Senior Loan Officer Opinion Survey. Each quarter the Federal Reserve asks a large number of banks whether they have tightened, loosened or left unchanged their standards for mortgage lending. The percentage of banks reporting they had tightened standards minus the percentage reporting they had loosened standards remained high, quarter by quarter, from early 2007 through early 2010. Since then, there has been almost no offsetting loosening.

According to Rappaport and Willen, beginning in 2007, FHA lending grew rapidly. It accelerated in 2009 after Congress authorized the FHA to more explicitly target a broader set of households. To do so, the FHA increased the maximum loan it would guarantee to \$730,000. Single-family purchase mortgages guaranteed by the FHA grew from 300,000 in 2006 to 1.1 million in 2010. Over these years, originations of all other types of purchase mortgages plunged. Correspondingly, the FHA share of single-family purchase originations jumped from 5 percent to 44 percent.

The success of FHA lending in maintaining access to credit is borne out by credit scores on newly originated purchase mortgages. From early 2007 to mid-2010, the median FICO score on a conforming mortgage increased

by almost 50 points. But the median FICO score for the combination of conforming and FHA-guaranteed mortgages increased only 10 points. Over this same interval, the 20th percentile FICO score for combined purchase originations—a better measure of access to mortgage borrowing—was unchanged.

The increase in median FICO scores was primarily due to a switch in the composition of borrowers. Borrowers with lower credit scores, who had taken out conforming loans in the past, switched to taking out FHA mortgages. The switch increased the median FICO score among conforming and FHA borrowers.

FHA lending has traditionally focused on helping low- and moderate-income households purchase a first house. Hence, it allows for some credit impairments and requires only a modest down payment.

For the combination of conforming and FHA purchase mortgages, the share of households making a down payment of 5 percent or less—net of any secondary liens—has remained comparable to what prevailed during the housing boom and higher than what prevailed previous to it. Consistent with this, the share of lending in the combined segments to purchase a house in a low- or moderate-income community is actually higher today than during the housing boom.

Buying a home

Despite the new regulatory conditions, people are still able to buy a home.

Kimberly Teen purchased a home in the Kansas City area in December 2013. She worked with a mortgage adviser and real estate agent to secure a mortgage and buy a home that was within her means.

She began the process two years ago and had originally approached her bank about obtaining a mortgage.

“They told me that my credit needed to be clean,” she said. “It wasn’t bad; I had a lot of things on my credit report that were inaccurate.”

A mortgage adviser—a type of financial adviser who helps people secure home mortgages—helped her work on her credit rating, and within two months, she qualified for a home loan. Teen saved enough money for a down payment, but also enough money in reserve—in case she lost her job—to make mortgage payments.

“If anything were to happen, if I lost my job, I wanted to make sure that along with unemployment I had enough to make the monthly payments,” she said.

She also didn’t want to get in a situation where the purchase of a home had unforeseen, out-of-pocket expenses.

“I’m a single mother so that was huge for me,” she said.

Teen said working with the right people,

such as a good real estate agent and financial adviser, made the process seamless. She had heard a lot of horror stories and she wanted to make sure the people she worked with helped her make the right decisions when purchasing her first home.

She purchased a home built in 2011 that was below original market value and in a good neighborhood. Teen secured a mortgage at a 4 percent interest rate, the seller paid the closing costs and she closed on the home within two weeks. Her monthly payment was the same amount she paid in rent before purchasing the home.

“It was definitely worth going through,” she said.

And although it’s a buyer’s market right now, Teen said, people need to be prepared

KIMBERLY TEEN PURCHASED HER FIRST HOME IN DECEMBER 2013 after a two year search. She worked with a mortgage adviser and real estate agent to make sure she found a home that met her needs and fit within her budget.



for the process, such as meeting credit requirements, finding the right home that fits within their means and working with the right people.

Staying put

Homes are more affordable today than pre-financial-crisis markets, but people are not moving like they were before. The number of Americans moving to new cities and buying homes has decreased dramatically. There are a number of reasons besides tight credit standards, including a sluggish economy, weak income growth, student debt and the lack of new homes. But much of it has to do with similarity of job options from city to city.

When people do move, according to studies, they move for family, climate and employment.

Among people who have moved long distances, the number of those who cite housing as their primary motivation for doing so has more than doubled since 2007. And the Tenth District states appear to have some of the most affordable housing and lowest cost of living in the United States. For example, Oklahoma City has outpaced most other cities in growth since 2011, becoming the 12th-fastest-growing city last year. It also has won over a coveted demographic, young adults age 25 to 34, going from a net loss of millennials to a net gain.

But of those who moved more than 500 miles, the share who said they were chiefly motivated by housing has risen from 8 percent in 2007 to 18 percent in 2014, the earliest year such data is available, according to the Census Bureau. The desire for a new, better or cheaper home and the opportunity to buy instead of rent were among the housing-related reasons people cited.

The story was different from 2000 to 2006, when cities with high-cost housing grew more quickly than those with affordable housing, according to an analysis of metro areas by Redfin, a national real estate brokerage firm. From 2006 to 2012—years that encompass

the housing bust, recession and recovery—that pattern reversed itself, with most low-cost cities growing 2.5 percentage points more than high-cost cities. The analysis excluded cities with poor job growth.

Improving the market

Since the housing crisis, Rappaport and Willen say the FHA, the Federal Housing Finance Agency, the Consumer Financial Protection Bureau, and other government and private organizations have been continually developing a new regulatory framework. Lenders fear that departures from the evolving standards will result in considerable costs, including the forced buyback of loans sold to Fannie and Freddie and the rescinding of FHA mortgage guarantees.

This has created uncertainty among lenders, causing them to enact restrictions based on possible future standards. It's these type of conditions that have been a key factor constraining the recovery, they said.

The economists suggest that clarifying what constitutes approved lending may help relax credit conditions with minimal increase in risk.



KEVIN WRIGHT, EDITOR

FURTHER RESOURCES

"Tight Credit Conditions Continue to Constrain Housing Recovery"

By Jordan Rappaport and Paul Willen
www.KansasCityFed.org/publicat/research/macrobulletins/mb14Rappaport-Willen0707.pdf

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

HEALTHCARE REFORM'S ROLE IN THE LABOR MARKET



PHOTO BY: THINKSTOCK



Given that most Americans obtain health insurance coverage from their employers, health insurance plays an important role in people's employment decisions. Some economists argue the relationship between health insurance and paid-employment has hampered entrepreneurship in the United States, as obtaining health insurance may be more costly and difficult for self-employed individuals in comparison to employees.

The Patient Protection and Affordable Care Act, commonly referred to as the Affordable Care Act, implements changes to the U.S. healthcare system in an effort to decrease the number of uninsured people in America. Some economists say the reform could increase the self-employment rate in the United States because it breaks the link between paid-employment and health insurance by making the latter more accessible.

Didem Tüzemen, an economist, and Thealexa Becker, a research associate, both with the Federal Reserve Bank of Kansas City,

addressed the relationship between health care reform and self-employment by analyzing the effects of the Massachusetts Health Care Reform Act, which the Patient Protection and Affordable Care Act is loosely based upon. What they found is that the uninsured rate for the self-employed decreased and the share of self-employment in total employment has stayed flat after Massachusetts adopted the reform. This is in contrast to the national self-employment rate, which has declined steadily.

Health insurance and self-employment

Self-employment in the United States has decreased over the past 30 years. Taxes and regulations could explain the decline—it's more burdensome for a small business to address taxes and legal issues than a big corporation. Also, paid-employment could be more attractive than self-employment due to the affordability and accessibility of health insurance.

In 2012, 64 percent of the self-employed had either private or public insurance coverage; however, 85 percent of private-sector employees worked for employers who offered health insurance.

Previous research has shown that employees with access to employer-provided health insurance are 25 percent less likely to leave their jobs than those without, largely due to the fear of losing insurance coverage. Another study finds that, during the 1983-89 period, among the 25-54 year old males, 89 percent of those employed had some form of private insurance coverage, while only 49 percent of those who left their jobs remained insured with a private insurance plan.

Also, people may be reluctant to start their own businesses when they have no alternative insurance options or if they have pre-existing medical conditions, which makes obtaining health insurance difficult.

The effects of healthcare reform

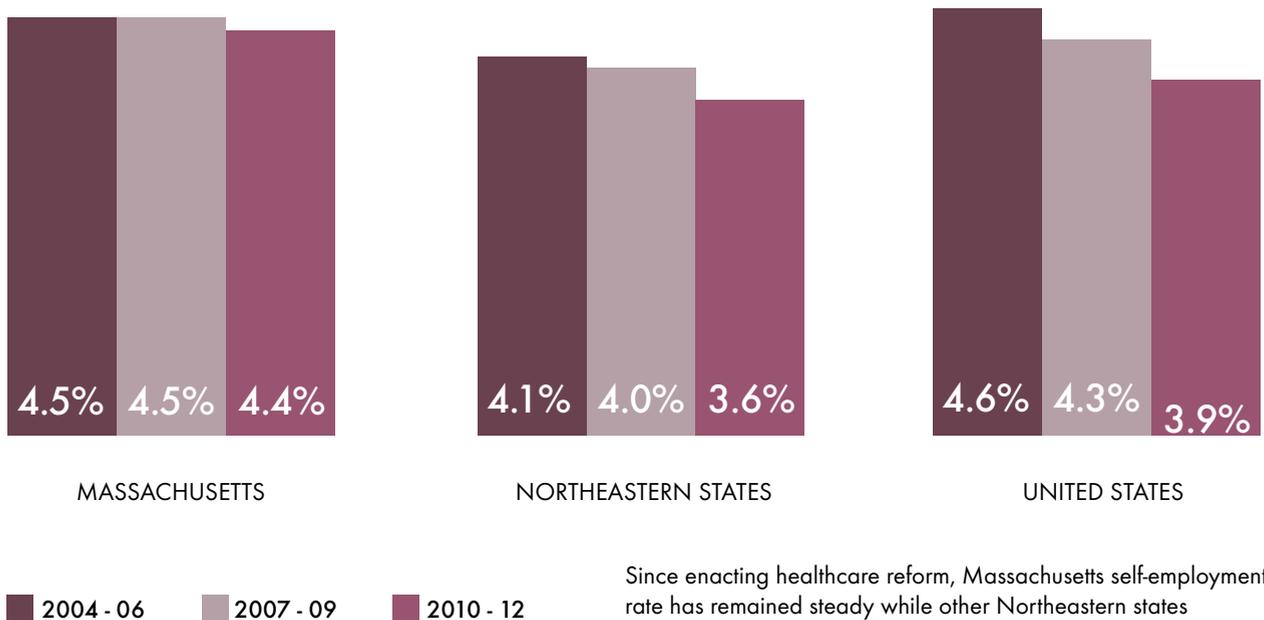
Massachusetts Health Care Reform took effect in 2007. The key components of the reform were forming a state health insurance marketplace, enforcing new coverage requirements for employers and individuals, expanding public health coverage and establishing new rules for insurers.

Due to the reform, enrollment in private health insurance increased as the pool of firms that sponsored health insurance expanded and the state provided individuals with subsidized insurance options. Similarly, Medicaid expansion led to increased enrollment in public insurance in the state.

Using data from the Current Population Survey's Annual Social and Economic Supplement, Tüzemen and Becker show that the percentage of working-age Massachusetts residents without insurance dropped significantly from 14 percent in 2006 to

SELF-EMPLOYMENT RATE

SHARE OF THE SELF-EMPLOYED IN TOTAL WORKING AGE POPULATION



Since enacting healthcare reform, Massachusetts self-employment rate has remained steady while other Northeastern states and the nation have experienced a decline.

Source: Current Population Survey's Annual Social and Economic Supplement

5 percent in 2012. Over the same period, the average uninsured rate in the rest of the Northeastern states, none of which adopted the same health care reform, moved from 16 percent in 2006 to 15 percent in 2012. Similarly, the uninsured rate in the nation increased, rising from 20 percent of the population in 2006 to 21 percent in 2012.

The reform also led to increased enrollment for the self-employed. Pre-reform, the average uninsured rate for the self-employed was 20 percent. During the first two years of the reform, 2006-07, the uninsured rate fell to 18 percent. It dropped to 10 percent by 2008-12—a net decrease of 10 percentage points. Notably, the decrease occurred during the financial crisis and recovery. During this time, however, the national uninsured rate among the self-employed increased from 31 percent to 36 percent.

Reform supports self-employment

In the past decade, self-employment in the United States has declined. In the 2004-06 period, the average share of the self-employed in the total working-age population was 4.6 percent nationwide, excluding Massachusetts. This average share declined to 3.9 percent in the 2010-12 period. The Northeastern states, excluding Massachusetts, followed a similar pattern, as the average share of the self-employed in the total working-age population declined from 4.1 percent in the 2004-06 period to 3.6 percent in the 2010-12 period.

Massachusetts' experience differed from other Northeastern states and the nation as a whole. The share of the self-employed in the total working-age population did not change appreciably in the post-reform period, remaining around 4.5 percent.

Because the share of self-employment did not decline significantly in Massachusetts, Tüzemen and Becker's analysis concluded that there has not been a definitive shift from self-employment to paid-employment.

Therefore, the reform does not appear to have any detrimental effects on self-employment in Massachusetts.

Instead, the results suggest that easier access to both private and public health insurance might have been an underlying support to self-employment in Massachusetts.

The effects of national reform

Given the similarities between the health care reform in Massachusetts and the ongoing national reform, Massachusetts' experience can be a case study for the possible effects of the Affordable Care Act on the nation's uninsured rate and self-employment. Based on Tüzemen and Becker's analysis, the Affordable Care Act can be expected to decrease the uninsured rate among the working-age population and among the self-employed in the nation.

Additionally, Massachusetts' experience does not suggest any negative effects of the reform on the self-employment rate. Therefore, the Affordable Care Act may also support self-employment as it removes a barrier to self-employment by expanding health insurance options for the self-employed.



KEVIN WRIGHT, EDITOR

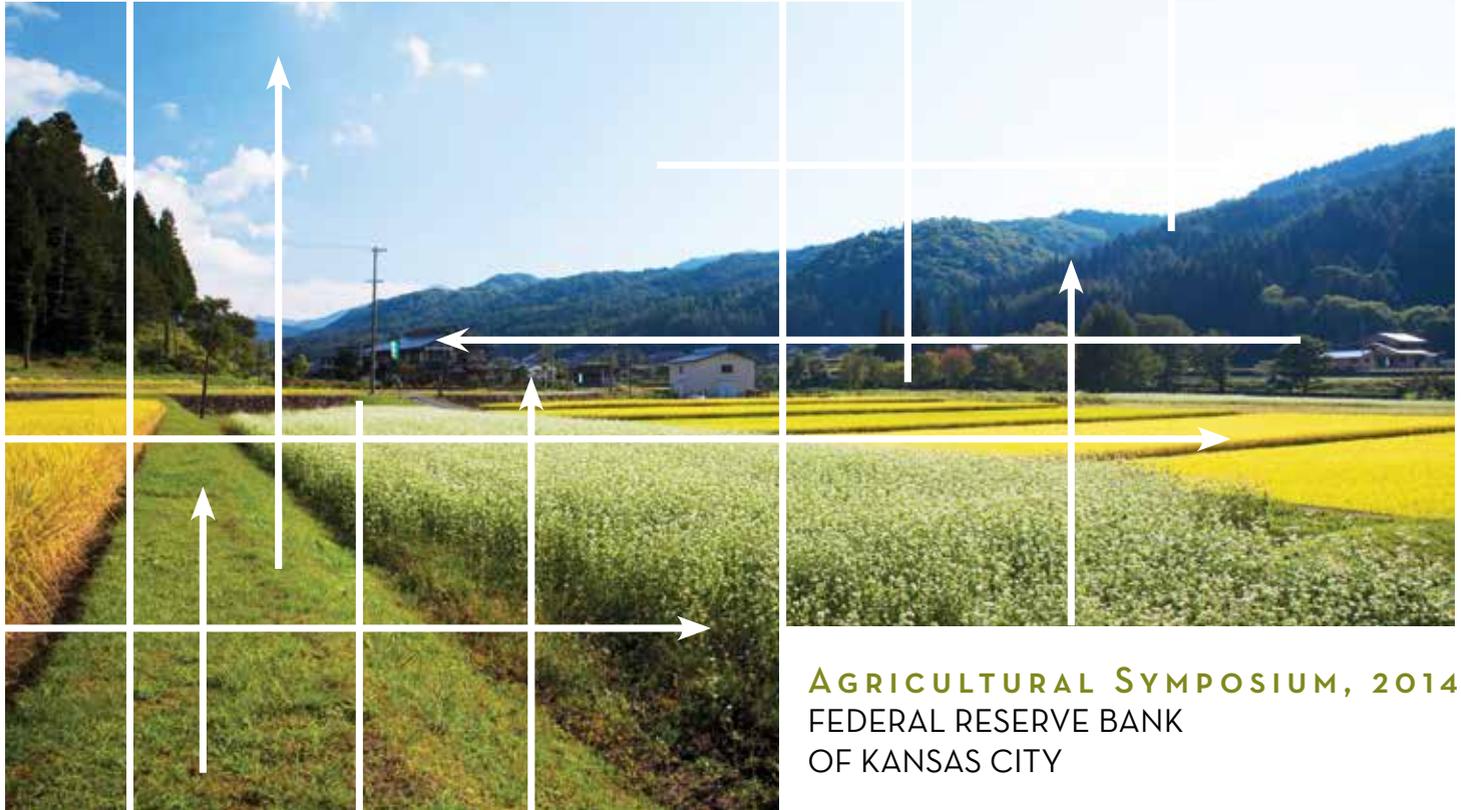
FURTHER RESOURCES

"Does Health Care Reform Support Self-Employment?"

By Didem Tüzemen and Thealexa Becker
Visit the Kansas City Fed's website at KansasCityFed.org/publications/research/er/index.cfm

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

STRUCTURAL *TRANSITIONS* IN GLOBAL AGRICULTURE



AGRICULTURAL SYMPOSIUM, 2014
FEDERAL RESERVE BANK
OF KANSAS CITY

Periods of economic prosperity or hardship often give rise to structural changes and industry realignments. Agriculture has experienced a multiyear boom as elevated crop prices have underpinned near-record income and a surge in investment.

Extraordinary profitability has transformed the global crop sector and farm economy, from the expansion of agribusinesses to the consolidation of farming operations and strategies of agricultural finance institutions.

Soaring crop prices and severe drought, however, have squeezed profit margins for livestock producers, leading to industry contraction in some regions.

Yet, history has shown booms eventually fade and busts ultimately end. Following a strong rebound in global crop production in 2013 and a brighter near-term livestock outlook, sharply lower crop prices highlight the possibility of tighter profit margins in crop production.

At the 2014 Agricultural Symposium, which took place July 15-16 at the Federal Reserve Bank of Kansas City, keynote speakers and discussion panels explored how, after years of exceptional profitability, global agricultural economies, institutions and industries might realign alongside sharp changes in agricultural commodity prices and lower farm incomes.

KEYNOTE SPEAKERS

Esther L. George, president and chief executive officer, Federal Reserve Bank of Kansas City

Jean-Philippe Gervais, chief agricultural economist, Farm Credit Canada

Chad Hart, associate professor of economics, Iowa State University

Don Macke, director of entrepreneurial communities, Center for Rural Entrepreneurship

Mark Partridge, professor, Swank Chair in rural-urban policy, The Ohio State University

Derrell Peel, Charles Breedlove professor of agribusiness, Agricultural Economics Department, Oklahoma State University

Mary Shelman, director, agribusiness program, Harvard Business School

PANEL PARTICIPANTS

Todd Becker, president and chief executive officer, Green Plains Inc.

Carl Casale, president and chief executive officer, CHS Inc.

Elizabeth Hund, senior vice president and division head, U.S. Bank Food Industries

Brian Newcomer, executive vice president of business development, Rabo AgriFinance

Doug Stark, president and chief executive officer, Farm Credit Services of America

Charles Studer, director of industry relations, Deere & Company

Max Wake, president, Jones National Bank & Trust Company

Joe Swedberg, vice president of legislative affairs, Hormel Foods Corporation

Dhamu Thamodaran, executive vice president and chief commodity hedging officer, Smithfield Foods Inc.

Complete details, presentations and papers from the conference are available at the Federal Reserve Bank of Kansas City's website at www.KansasCityFed.org.

A Leader in Agricultural Research



With the heavy concentration of agriculture across the Great Plains, research on agricultural enterprises and rural economic issues has been a long-standing area of expertise for the Kansas City Fed. Economists publish a wide variety of research and analysis on agricultural and rural issues in various publications, including:

The Main Street Economist

Tenth District Survey of Agricultural Credit Conditions

Agricultural Finance Databook

Economic Review

TEN Magazine

To receive notification of new research and publications on agricultural and rural issues, please visit www.KansasCityFed.org and sign up for email updates.

The Kansas City Fed's agricultural and rural research is based out of its branch office in Omaha, Neb. Economists are available to speak on a variety of issues affecting farms and rural areas with organizations and the news media. For speaking inquiries, please visit <http://kansascityfed.org/research/speeches/speakerrequestform.cfm>.



It's Free, But at What Cost?

Michele Wulff is a former public school educator of 30 years and a recipient of the national 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.

How do you react when you are offered something for free? Do your eyes light up? Do you become excited? Do you take the freebie, even if it's an item you normally wouldn't buy or use? When many of us come upon something given away for free, we happily take advantage of the situation. But is it truly free or are strings attached?



You've probably heard the classic phrase "There is no such thing as a free lunch," which is often shortened to the acronym TINSTAFL. This phrase dates back to the time when local bars offered a "free lunch" if drinks were purchased. Its meaning emphasizes that it's

impossible to get something for nothing. The cost may be hidden or distributed among other items, such as charging more for drinks, but it's there somewhere.

In today's world, the word "free" is a marketer's best friend. Retailers offer "buy one, get one free (or BOGO)." They may advertise an item "free with purchase." Clubs and websites give "free trial periods" for their services.

Most discerning adults see through these ploys of "free" goods and services and understand there's some type of cost under the surface. But kids often think something offered for free is hidden treasure. They can hardly believe their luck—it's free! Because kids can't see through the illusion of these offers, it's up to parents and other adults to help them look more deeply at these situations.

So how do you explain that free does not always mean free? Try using terms and examples that kids understand. When they receive their kid meal with a "free-with purchase" toy, discuss how fast food restaurants often increase the price of the meal or other items on the menu to cover the cost of the toy. If you dine out with your family at a "kids eat free" establishment, each child generally gets their meal free with a paid adult entrée. Since the family may not have chosen the restaurant otherwise, tell them that the establishment is selling adult-sized meals in return for free smaller-sized kid portions. And the restaurant is hoping you'll be back for additional meals in the future. So the increase in business is worth the cost.

Now give kids insight on what "buy one, get one free" really means. Tell them that BOGO is actually a reduction of 50 percent off the listed price of each item (which may

have been increased before the offer.) So the second pair of shoes is not free, since you must purchase two pairs. Whether the child really needs two is worth considering. The next “free” topic of discussion is “free trial periods.” These can be tricky for kids to comprehend. If they are dying to join a LEGO club for a trial period, make sure they know when the free ride stops. They should mark it on a calendar or write it down so they are able to cancel before a membership fee may be charged.

If your child is old enough to think critically, further explain that everything kids buy has a hidden cost. Economists call this an opportunity cost. Tell them that opportunity cost is the next best choice that you give up when you made a final choice. So if a child buys a video game with his savings, he gives up buying the other video game he was considering, or another item with those same dollars. The concept also works without money in the picture. A child can have an opportunity cost when she chooses to play tennis instead of softball. She is giving up softball time for tennis time. One more example that kids understand is making a meal choice. Choosing chicken

nuggets over a hamburger puts the burger in the opportunity cost category. Try working through the opportunity cost examples on page 23 to sharpen kids’ skills.

A newer free phenomenon is the offer of a free college education. Some states are considering a law that makes their community colleges tuition-free, regardless of family income. College students may enjoy the benefits of free education, but their parents and other taxpayers will bear the cost. Annual community college tuition averages about \$3,300 nationally, with books and fees adding to the cost. A state offering this freebie will need millions of additional dollars to make this a feasible option.

So the message to kids is to be wary of goods or services offered for free. Tell them to consider whether they would buy the item if it wasn’t a freebie. If not, they probably don’t really need or want it, even if getting it feels like a treat. Understanding that most free items have a related cost should help them become more informed consumers.



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. Visit our website at KansasCityFed.org for more information. The resources below are a few of many available on this subject.

Federal Reserve Resources

Once Upon a Decision online course for consumers (http://www.stlouisfed.org/education_resources/once-upon-a-decision-c/) A young girl makes decisions and considers her opportunity costs. Ages 7-10.

The Art of Decision-Making online course for consumers (http://www.stlouisfed.org/education_resources/the-art-of-decisionmaking-c/) Discusses how to make informed decisions successfully. Ages 14-17.

Opportunity Cost online course for consumers (http://www.stlouisfed.org/education_resources/opportunity-cost-online-course-c/) A 12-minute course that explains that every choice we make has a cost. For Adults.

Fiction Books

Glo Goes Shopping by Cheryl Willis Hudson (http://www.stlouisfed.org/education_resources/assets/lesson_plans/GloGoesShopping.pdf) Glo uses decision-making skills to make the best choices. Ages 5-8.

Non Fiction Books

It’s Your Decision For Teens: A Commonsense Guide to Making Better Choices by Al Foderaro. This book gives teens a commonsense approach to making initial social and financial decisions. Ages 14-17.

Smart Choices: A Practical Guide to Making Better Decisions by John S. Hammond. This book suggests skills to help adults become more consistent and confident in their decisions. For Adults.

An Opportunity Cost is an Opportunity Lost

Here's your chance to become an economist. Read each story below and give your choice and your opportunity cost, or the choice that was given up.

- It's 4 o'clock and school's out for the day. You have two hours of free time before dinner. You can spend your time in one of two ways: Play at the park with a friend or ride bikes in the neighborhood. Which one would you choose, and what would be your opportunity cost?

I would choose to _____; my opportunity cost would be _____.

- Your cousin is visiting and you have two ways to spend Saturday afternoon together: Go to the zoo or the newest Disney movie. Which one would you choose, and what would be your opportunity cost?

I would choose to _____; my opportunity cost would be _____.

- Your birthday money is burning a hole in your pocket. You have narrowed down your possible choices to two items: A lazer tag set or remote control plane. Which one would you choose, and what would be your opportunity cost?

I would buy _____; my opportunity cost would be _____.

- Your class has earned a party. Class members need to vote on the food for the event: Pizza or hot wings. Which one gets your vote?

I would vote for _____; my opportunity cost would be _____.

Time to create your own opportunity cost story. Think of a situation that would have two possible choices for the outcome. Write the story and choices below, then complete by making your choice and telling your opportunity cost.





Money Museums receive 2014 TripAdvisor Certificate of Excellence

The Federal Reserve Bank of Kansas City's Money Museums in Kansas City and Denver have received TripAdvisor's Certificate of Excellence, which is given to businesses that continually have exceptional reviews on TripAdvisor, a website that compiles user ratings for hotels, restaurants and other travel destinations. The average TripAdvisor reviewer posted a review rating of four stars out of five after visiting either of the Bank's Money Museums. The Money Museums are an important component of the Bank's educational outreach. The museum is free to the public and walk-in visitors are welcome from 8:30 a.m. to 4:30 p.m. Monday through Friday. Tour groups are welcome with advanced reservation. In 2013, there were more than 84,000 visitors total to the two museums.

Learn more at KansasCityFed.org/moneymuseum/.

Summer @ The Fed program completes third year

A Kansas City Fed program, Summer @ the Fed, which aims to increase elementary school students' understanding of the Federal Reserve, budgeting and saving, recently completed its third year. The sessions are lead by recent high school graduates from Kansas City, Mo., and Kansas City, Kan., who participated in the Student Board of Directors program.

The Kansas City Fed worked with community partners, including Boys and Girls Club, the Gregg/Klice Community Center and the Upper Room, to conduct the sessions. This year, Summer @ The Fed reached more than 600 students.

Visit KansasCityFed.org/education/foreducators/ to learn more about the Kansas City Fed's educational resources.





Ramirez appointed assistant vice president, Community Affairs officer

The Federal Reserve Bank of Kansas City has promoted Erika Ramirez to assistant vice president and Community Affairs officer with responsibility for the Bank's community and economic development functions. In this role, she will lead the Community Affairs Department, which includes a portfolio of initiatives focused on community development investments, financial stability for the underserved, workforce development, healthy neighborhoods, and small business development and sustainability.

Ramirez, a native of Colorado, started at the Bank in 2007. In 2008, she transferred to the Community Affairs Department, where she led several initiatives, including nonprofit sustainability and consumer financial stability for the Tenth District. In 2010, she rotated to Human Resources as manager and diversity and inclusion coordinator with responsibility for the Kansas City Fed's diversity and inclusion recruiting, programming and reporting. She has a bachelor's degree in Business Administration from Colorado State University and an MBA from Rockhurst University.

Regional databooks offer easier access to Tenth District data

The Federal Reserve Bank of Kansas City has introduced monthly databooks, which offer Tenth District state and regional overviews and provide visual summaries of state, regional and national economic indicators.

Each databook tracks current economic indicators using charts, tables and maps that can be used to monitor state and regional trends in gross domestic product; inflation; employment; employment by industry; county and state unemployment; personal income; home prices; housing indicators; manufacturing; oil, gas and coal production; agriculture; and exports. The economic databooks are released monthly to coincide with state employment data releases from the Bureau of Labor Statistics.

"The databooks are designed to be usable and readable by a broad audience," said Alison Felix, Kansas City Fed Denver Branch executive. "Our goal is to help businesses and consumers and state and local officials better understand their economies."

Read the latest databooks on KansasCityFed.org/research/regionaleconomy/





PLAN. PREPARE. PREVAIL.

A Disaster Financial Readiness & Recovery Blueprint

Be Prepared: How to organize your finances for an emergency

Oklahoma City Branch moving to new location

The Federal Reserve Bank of Kansas City has signed a lease to relocate its Oklahoma City Branch to Leadership Square, 211 N. Robinson Ave., one block south of the current location in downtown Oklahoma City. The move is scheduled for mid-October.

“We are excited about our new location and look forward to continuing to serve the state of Oklahoma in research, bank examination and public programs,” said Chad Wilkerson, Oklahoma City Branch executive.

In 2006, the Kansas City Fed sold its building at 226 Dean A. McGee Ave., and then leased third-floor space in the building.

Oklahoma City Branch employees have served Oklahoma for the past 94 years—first in the Continental Building, then at Dean A. McGee and soon in Leadership Square—and will continue their service to Oklahoma in the new location.

The Federal Reserve Bank of Kansas City has developed an array of materials to help consumers and small business owners be prepared before and after a disaster.

The resource called Plan. Prepare. Prevail. makes it convenient for individuals, families and small business owners to learn about the financial documents and records they need to have available in case of an emergency. The resource includes a website (www.KansasCityFed.org/planprepareprevail) that contains disaster-preparedness information, along with personal and small business financial inventory forms; quick checklists to identify and organize key financial records; and links to other valuable resources and materials.

“The Kansas City Fed has seen disasters occur in its district,” said Ariel Cisneros, senior Community Affairs advisor, who leads the Plan. Prepare. Prevail. initiative. “Through discussions with our stakeholders, we found that there is a gap in financial preparedness. Some people did not have their financial information in order when they needed it the most.”

Visit KansasCityFed.org/PlanPreparePrevail to learn more and to begin preparing.

Research evaluates current labor market conditions

Labor market conditions play an important role in monetary policy. In its most recent monetary policy statement, the Federal Open Market Committee stated it will take into account a wide range of information, including labor market conditions, in determining the appropriate stance of monetary policy.

The Federal Reserve Bank of Kansas City's Labor Market Conditions Indicators (LMCI) are two monthly measures of labor market conditions based on 24 labor market variables. One indicator measures the level of activity in labor markets and the other indicator measures momentum in labor markets.

LMCI findings are the Kansas City Fed's newest research product and can be found at www.KansasCityFed.org/research/indicatorsdata/lmci/index.cfm



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 or December.

Bank of Versailles	Versailles, Mo.	95
First State Bank of Newcastle	Newcastle, Wyo.	84
Grant City Bank	Medford, Okla.	74
Stock Exchange Bank	Caldwell, Kan.	74
Fidelity State Bank & Trust Co.	Dodge City, Kan.	71
Farmers State Bank	Pine Bluffs, Wyo.	48
Citizens State Bank & Trust Co.	Ellsworth, Kan.	34
Bankers' Bank of the West	Denver, Colo.	34
Citizens Bank & Trust Co.	Ardmore, Okla.	23
First Bank of Chandler	Chandler, Okla.	21
Morris State Bank	Morris, Okla.	21
Oregon Trail Bank	Guernsey, Wyo.	20
Guaranty Bank & Trust Co.	Denver, Colo.	10
Kaw Valley State Bank & Trust Co.	Wamego, Kan.	10
First State Bank of Nebraska	Lincoln, Neb.	10
Citizens State Bank	Wisner, Neb.	5
Farmers & Merchants Bank of Ashland	Ashland, Neb.	5
Stanton State Bank	Stanton, Neb.	5
High Country Bank	Salida, Colo.	5
Enterprise Bank	Omaha, Neb.	1
Steele State Bank & Trust	Denver, Colo.	1
FirstBank of Nebraska	Wahoo, Neb.	1



Fall 2014

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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 Colorado, Kansas, western Missouri, Nebraska, northern New Mexico, Oklahoma and Wyoming. 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 other services to depository institutions.



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TEN magazine is a quarterly publication of the Federal Reserve Bank of Kansas City focused on the connection between the Bank’s research and the Tenth Federal Reserve District. **TEN** also features articles on the Federal Reserve’s history, structure and operations.

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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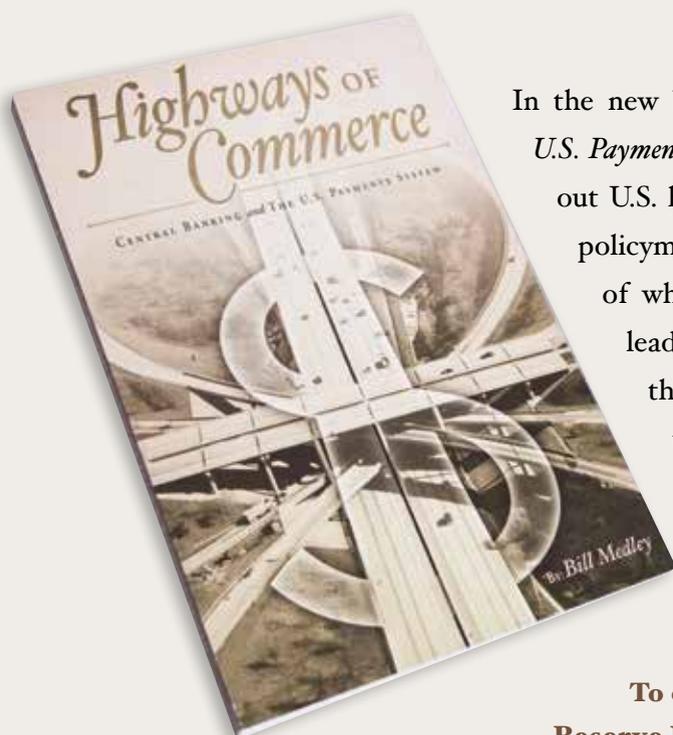


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Since its formation, the Federal Reserve has played an important role as both an overseer and participant in the U.S. payments system. But the origin of central bank involvement goes back even further.



In the new book *Highways of Commerce: Central Banking and the U.S. Payments System*, author Bill Medley explores how throughout U.S. history, consumers, merchants, financial institutions, policymakers and others have grappled with the question of who is ultimately responsible for what congressional leaders in 1913 called the “highways of commerce.” From the chaos of the early 19th century to today’s digital transactions, there has been a spirited—and often contentious—debate over the central bank’s roles and responsibilities.

To order a copy or to read it online, visit the Federal Reserve Bank of Kansas City at www.KansasCityFed.org.