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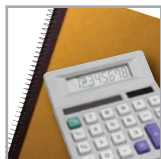
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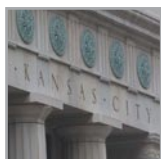
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### The Federal Open Market Committee

**A**s the central bank, the Federal Reserve has a unique set of responsibilities focused on providing a firm foundation for the nation's financial system. We are a regulator and supervisor of banks, helping to ensure consumers are able to conduct business with sound and secure financial institutions. We provide financial services to depository institutions, including the processing of cash and checks, and play a major role in operating the nation's payments system.

Our operations in these areas are crucial components of the Federal Reserve's ability to fulfill its mission. Congress created the central bank in 1913 after a series of panics caused consumers to lose trust in the nation's financial system. Well-regulated banks and a secure payments system that functions smoothly even in times of national crisis or tragedy, provide consumers and businesses with the confidence that is a necessary cornerstone for a strong economy.

Another component in providing conditions for economic stability is the most publicly watched of all the Federal Reserve's operations: the Federal Open Market Committee. The FOMC is responsible for the Federal Reserve's open market operations, which are the most often used of the Federal Reserve's monetary policy tools. The FOMC's decisions about its target for the federal funds rate, which is the interest rate depository institutions lend balances at the

Federal Reserve to other depository institutions overnight, are closely followed by the markets and financial media. In recent years, changes in the fed funds rate target have received increasing attention from the mainstream media and the public.

The FOMC consists of 19 participants, 12 of whom vote on policy action. The seven members of the Board of Governors of the Federal Reserve System and the presidents of the 12 regional Reserve Banks comprise the full committee. The seven governors and the president of the Federal Reserve Bank of New York, which conducts the open market operations on behalf of the entire Federal Reserve System, are permanent voting members of the committee.

The four remaining voting seats rotate annually among the other 11 presidents of the regional Federal Reserve Banks, which are divided into four groups. In my position as the president of the Federal Reserve Bank of Kansas City, I rotate FOMC voting status with the presidents of the Federal Reserve Banks of Minneapolis and San Francisco.

The FOMC's design is reflective of the Federal Reserve's unique structure that blends aspects of government and the private sector. The seven members of the Board



# Monetary

of Governors, including Chairman Ben S. Bernanke, are presidential appointees who have been confirmed by the U. S. Senate. The presidents of the regional Reserve Banks, meanwhile, are selected by the Boards of Directors of their respective Banks, subject to review by the Board of Governors.

This year, for the sixth time since I became president of the Federal Reserve Bank of Kansas City in 1991, I am a voting member of the FOMC. Occasionally, media coverage of the Federal Reserve will note the voting status of a particular Reserve Bank

president as either a “voter” or “non-voter.” In terms of the FOMC’s policy deliberations, however, the distinction between the two is less significant than you might assume, because all members are included in all discussion until the vote is actually taken.

Perhaps most significantly, the Federal Reserve Bank presidents provide the committee with information about business activity within their Federal Reserve Districts. During the first of two go-arounds that are the key elements of each FOMC meeting, the presidents each provide the full

## FOMC 2007

### Voting members:

**Ben S. Bernanke**, *Chairman, Board of Governors*

**Timothy F. Geithner**, *Vice Chairman, Federal Reserve Bank of New York*

**Thomas M. Hoenig**, *President, Federal Reserve Bank of Kansas City*

**Donald L. Kohn**, *Board of Governors*

**Randall S. Kroszner**, *Board of Governors*

**Cathy E. Minehan**, *President, Federal Reserve Bank of Boston*

**Frederic S. Mishkin**, *Board of Governors*

**Michael H. Moskow**, *President, Federal Reserve Bank of Chicago*

**William Poole**, *President, Federal Reserve Bank of St. Louis*

**Kevin M. Warsh**, *Board of Governors*

### Non-voting members:

**Richard W. Fisher**, *President, Federal Reserve Bank of Dallas*

**Jeffrey M. Lacker**, *President, Federal Reserve Bank of Richmond*

**Dennis P. Lockhart**, *President, Federal Reserve Bank of Atlanta*

**Sandra Pianalto**, *President, Federal Reserve Bank of Cleveland*

**Charles I. Plosser**, *President, Federal Reserve Bank of Philadelphia*

**Gary H. Stern**, *President, Federal Reserve Bank of Minneapolis*

**Janet L. Yellen**, *President, Federal Reserve Bank of San Francisco*

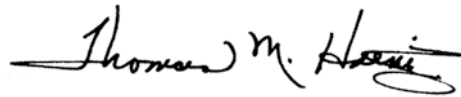
*Two seats held by the Board of Governors are vacant.*

# Policy

committee with a brief but important report on regional economic conditions. These reports are based on firsthand accounts that the regional Reserve Banks receive from business and banking contacts within their Districts. When woven together, the comments provide the FOMC with an insightful picture of the total U.S. economy that is often more timely and complete than what can be determined from surveys and other reports. Because of the delays involved with gathering and processing data, the information gained through these firsthand accounts may offer the first suggestion of changing economic conditions, for example.

The regional Bank presidents, of course, offer much more to the monetary policy process than reports about their own Districts. All members, again, regardless of voting status, analyze national trends and offer comments on the national outlook. They ask questions of other Reserve Bank presidents and governors, or the Board's staff. And during a second go-around, each president discusses possible policy action and has ample opportunity to offer their insights and opinions to the full committee prior to the vote.

The deliberations of the entire committee are an exceptionally important part of the monetary policy process. Although the markets and some members of the financial press may give increased significance to comments from the FOMC's voting members, the Federal Reserve's monetary policy actions are the product of deliberations by the entire committee. Each member, regardless of voting status, is a crucial part of that process.



THOMAS M. HOENIG, PRESIDENT  
FEDERAL RESERVE BANK OF KANSAS CITY

To see how the committee members work together and transcripts of all FOMC meetings posted after a five-year lag, visit [www.FederalReserve.gov/fomc/transcripts/](http://www.FederalReserve.gov/fomc/transcripts/).

To learn more about the Federal Reserve's role in setting and implementing national monetary policy, visit [www.FederalReserve.gov/policy.htm](http://www.FederalReserve.gov/policy.htm) and [www.FederalReserveEducation.org/fed101/policy/](http://www.FederalReserveEducation.org/fed101/policy/).

## FOMC Meeting Dates

Jan. 30-31 | March 20-21 | May 9 | June 27-28 | Aug. 7 | Sept. 18 | Oct. 30-31 | Dec. 11



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## Home lending in low- and moderate-income neighborhoods is on the rise, prompting change

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**A**s little Catalina and Anthony grew, the townhouse the Melgoza family had been renting for the past five years was starting to feel cramped. And space would be even more precious when baby Diego arrived.

So after living all their adult lives as tenants, Hugo and Sarah Melgoza bought their first house, joining a growing number of recent homebuyers on a newly revitalized block in what had been a deteriorating neighborhood in urban Kansas City, Kan.

“We were tired of wasting money (renting),” Hugo says, “and we wanted a big yard for our kids to play in.”

An area nonprofit helped the Melgozas with financing as part of its efforts to increase homeownership in the low- and moderate-income neighborhoods into which it is breathing new life.

“We love it,” Sarah says of their new lives as homeowners.

The Melgozas aren’t alone in dreaming

of homeownership—or achieving that goal. Neighborhoods, too, are reaping the benefits.

Since the early 1990s, home financing in low- and moderate-income areas within the Kansas City metro has increased notably, say Jim Harvey and Ken Spong, policy economists at the Federal Reserve Bank of Kansas City.

This heightened home financing can be attributed to many different factors, including an overall strong economy, falling interest rates, financing innovations, new regulations and special lending programs.

Harvey and Spong recently researched a variety of demographic, housing and other variables to study possible relationships between increased home lending and changes in neighborhood conditions throughout the metro, which includes 15 counties in both Kansas and Missouri.

“For homebuyers and home lenders, increased lending has several implications,” Harvey says. “This stability in many lower-income neighborhoods encourages more



# A home of our OWN



PHOTO BY SCOTT INDERMAUR

households to become homeowners and will provide more support for those that already are.”

Their research shows there are many facets that may be affected by increased lending, such as new construction and reduced crime, but home financing appeared to be most closely related to homeownership rates and home values.

“The availability of credit,” Spong says, “changes neighborhood conditions.”

## Overview

To measure the effects of home financing from 1990 to 2000, Harvey and Spong first assessed demographic and housing conditions at the beginning of the decade. Their research included income levels, home values, homeownership rates, new construction and vacant properties. Overall, there were a number of areas where low- and moderate-income neighborhoods lagged in 1990.

“These characteristics raised the question of whether such neighborhoods will continue to trail behind others, or will be able to show noticeable improvement,” Harvey says.

In most cases, it was the latter. And results suggest housing finance played a role in supporting improvement.

During this period, home-purchase lending in low- and moderate-income neighborhoods grew at a faster pace than across the rest of the Kansas City metro area. Through the 1990s, there were significant changes in home lending trends, resulting from strong economic conditions, technological innovation, regulatory and legislative changes, and an increased role for special lending programs.

“As a result of these factors coming together,” Harvey says, “home financing became more accessible for low- and moderate-income homebuyers.”

Two economic trends may be particularly important: The longest period of uninterrupted economic growth took place in this country between 1991 and 2001, providing many



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**THE MELGOZA FAMILY** purchased a home with help from City Vision Ministries, a nonprofit in Kansas City, Kan. Overall increased lending in recent years is the result of many factors, including these special finance programs, as well as declining interest rates and technological innovation.

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lower-income households' employment—and optimism—to buy homes. And at this same time, mortgage interest rates declined substantially.

“The level of borrowing became associated with much lower mortgage payments, providing another incentive for homeownership,” Harvey says.

Technological innovation also may have made some of the greatest contributions to lower-income home lending. Improved data collection and processing provided lenders with better information on prospective borrowers





and their neighborhoods, in turn reducing the risk of lending and lowering the cost.

Additionally, there have been a number of programs instituted during the past few years to aid first-time and lower-income buyers.

Alice Brentano, a Kansas City real estate consultant with Keller Williams Realty, has noticed an increase in a certain clientele as homeownership rates in general have grown. She's assisting more young, first-time homebuyers—something she attributes to homeowner-ship education; employment to support owner-ship; buyer assistance programs; and, above all, more financing.

"Increased availability of home lending provides an opportunity for many more people to achieve the American dream of owning their own home," Brentano says.

This, Harvey and Spong say, leads to measurable benefits for families and the neighborhoods where they're buying homes.

## Strengthening communities

Nearly 10 years ago, when Stephanie Jackson was finalizing her divorce, coping with the death of her twin brother and starting a new job, it was comforting to live with her parents in the house where she was raised. But Jackson knew she couldn't stay for long. She wanted more for her young daughter.

Jackson wanted Kiara to have a home of her own.

With help from City Vision Ministries, Jackson purchased a small, two-story home in a Kansas City, Kan., neighborhood nearby. Otherwise, financing the home would not have been possible, she says.

"When I moved in, I said, 'This is a dream come true,'" Jackson, now 44, remembers.

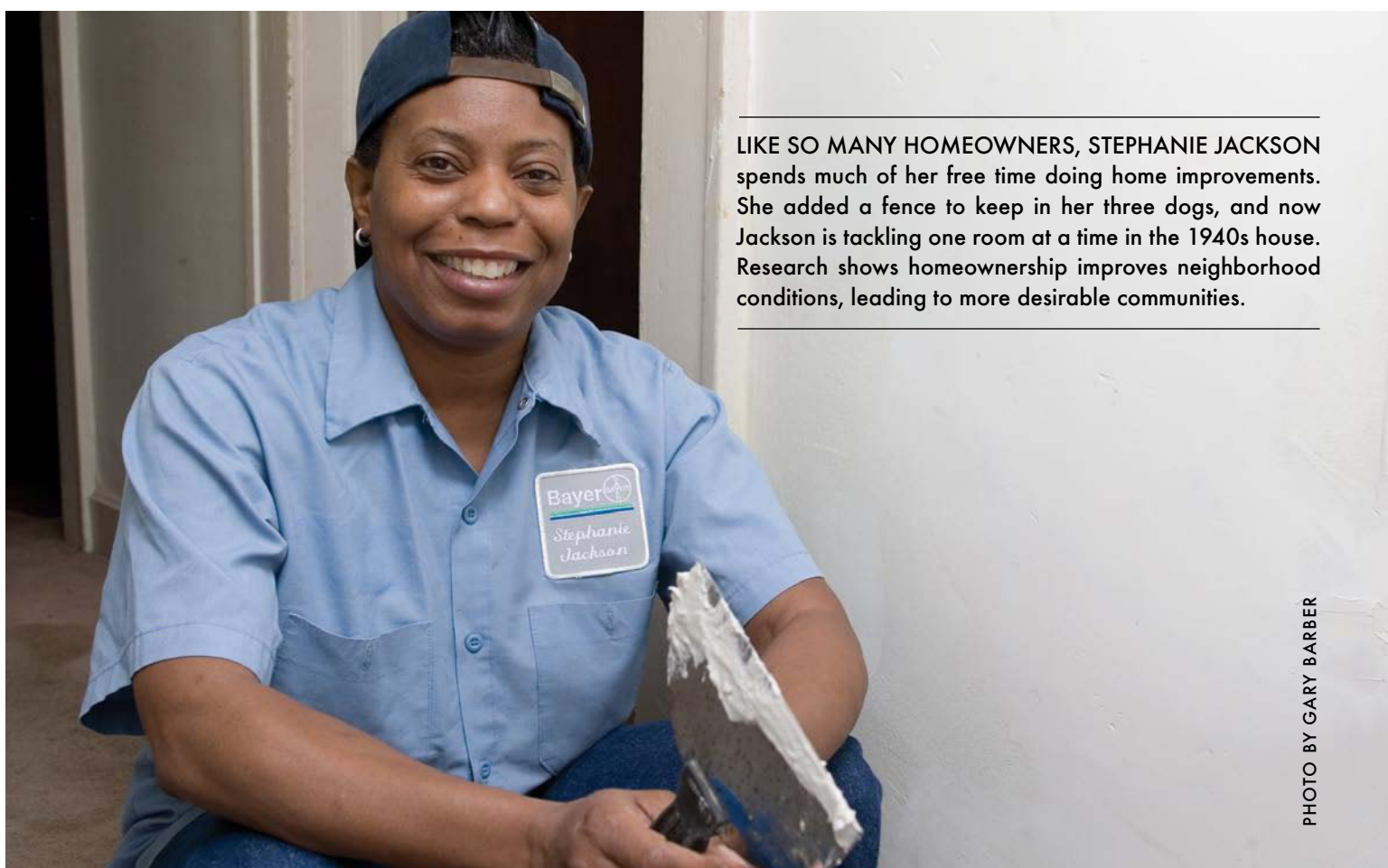
Owning a home is important to Jackson for several reasons, such as family stability and the pride that goes along with being a homeowner. But, more so, Jackson is building a secure future.

"The equity in that home—I see that as an asset," Jackson says, adding that these financial lessons will be passed on to Kiara, 16. "I'm hoping she does the same thing. It will be an asset to her."

Homeownership is highly beneficial, beyond putting a roof over a family's head, says Julie Riddle of The Family Conservancy, a Kansas City, Mo., nonprofit that administers programs to help families build assets. It can lead to increased financial knowledge as well as continued asset building, overlapping into higher education or entrepreneurship.

The positive effects also can be seen in the neighborhoods themselves. Those who own their residences are invested in their communities emotionally (garnering the status of a homeowner and planting family roots) as well as physically (vandalism, litter, theft and petty crimes are often less prevalent, as are property blight and abandonment). This makes for more desirable communities, say both Riddle and Brentano.





LIKE SO MANY HOMEOWNERS, STEPHANIE JACKSON spends much of her free time doing home improvements. She added a fence to keep in her three dogs, and now Jackson is tackling one room at a time in the 1940s house. Research shows homeownership improves neighborhood conditions, leading to more desirable communities.

PHOTO BY GARY BARBER

“Most homeowners take more pride in their homes and their neighborhoods than those who rent,” Brentano says. “Homeownership contributes to people living in their homes longer and being more active in their community.”

This is true for Jackson—and her neighbors. Now they’re invested in their homes beyond the monthly mortgage, and as a result, they live in a desirable community, just as City Vision Ministries foresaw when it began its mortgage assistance program.

Before Jackson realized financing would be available to her, she could only drive hopefully through the neighborhood that encompasses her New Jersey Avenue residence.

“I used to say, ‘I’m gonna get me a house there.’”

Now she simply says, “I love this home.”

### **Measured progress: 1990-2000**

To gauge broad changes in neighborhood conditions, like Jackson’s, Harvey and Spong examined how lending varied from one

census tract to another and whether lending levels may have contributed to observed changes in neighborhood conditions.

Their research shows many areas may be affected by increased lending, but home financing was associated most directly with changing homeownership rates and home values.

Among Kansas City’s low- and moderate-income neighborhoods, the areas with the highest rates of lending also showed the most noticeable improvements during the last decade, suggesting a higher rate of home purchase lending may have helped to improve housing conditions and attract homebuyers.

The low- and moderate-income tracts that received the most lending typically began with more favorable demographics in terms of income levels (fewer people in poverty and more households), and they continued to maintain or extend those advantages. While these results suggest a positive influence from home lending, they also may imply that lenders are more willing to provide financing in the

neighborhoods already in the best condition.

Overall, home lending grew at a faster pace in low- and moderate-income neighborhoods than across the rest of the metro area during the 1990s. This increased lending undoubtedly helped first-time homebuyers, and it may also be a sign that more active and liquid real estate markets are developing in lower-income neighborhoods.

Fannie Mae, a national organization with a mission to expand homeownership, partners with mortgage lenders to serve low- and moderate-income borrowers. Spokesperson Alfred King says recent recognition that this demographic of would-be homebuyers has long been underserved may have helped change lenders' approach to granting credit to low-income households.

"Having lenders willing to come into these areas is definitely important" to neighborhood improvement, King says, adding as lenders have expanded their markets to include low-income home loans, housing needs are being addressed. Meanwhile, lenders now view these neighborhoods as viable investments.

In the rapidly growing real estate market of the 1990s, lower-income neighborhoods in Kansas City more than held their own, and this, say Harvey and Spong, indicates neighborhood progress.

## income

By definition, low- and moderate-income neighborhoods, when compared to other neighborhoods, will be made up of households with less income to meet their housing needs.

This characteristic remained true throughout the 1990s, with median income levels in Kansas City's lower-income neighborhoods staying at about 57 percent of the metrowide medium income level in both 1990 and 2000.

This income stability does indicate that median income levels in low- and moderate-income neighborhoods at least kept up with the general growth in incomes across the metropolitan area. In addition, a moderate decline

occurred in the portion of the population below the poverty level in lower-income neighborhoods during the 1990s, which suggests these neighborhoods did benefit from matching the metrowide income trends.

## home values

"Rising home prices also provide a positive sign that lending in lower-income neighborhoods can be undertaken with the same confidence and collateral protection as in other neighborhoods," Spong says. "It further indicates a positive influence from the lending that has taken place and offers proof that enough lenders are becoming interested in lower-income neighborhoods to support the existing stock of homes there."

Harvey and Spong's research found a significant increase (45.6 percent) in the median value of homes in low- and moderate-income neighborhoods during the 1990-2000 time span. This increase, which was similar to the metrowide average, implies low- and moderate-income neighborhoods may have reversed some previous signs of deterioration.

These increases in values also indicate housing in low- and moderate-income neighborhoods was just as good of an investment during the '90s as in other parts of the metro area—something lenders have recognized as well.

"Increased lending does stabilize and increase home values," says Brentano, the real estate consultant. "If more people are able to get loans, there is more of a demand for homes. An increase in demand most likely would increase the value."

## vacant property and construction

Another indicator of neighborhood attractiveness and housing conditions is vacant property rates.

Although vacant property was more common in low- and moderate-income

neighborhoods than in other Kansas City neighborhoods, the vacancy rate in these lower-income neighborhoods declined from 15.3 percent in 1990 to 13.8 percent in 2000. This suggests a successful effort had begun to clean up neighborhoods and restore or tear down deteriorated properties.

The greatest rate declines generally occurred in neighborhoods with the higher rates of home lending, which implies conditions may be improving the most in those neighborhoods with the best access to credit.

Building permits are a “vote of confidence”—a sign of new and significant investment—and provide a perspective on which neighborhoods the builders, lenders and buyers regard as attractive with favorable prospects, Harvey says.

New-home construction was rare in low- and moderate-income neighborhoods during the early 1990s. However, in later periods Harvey and Spong found a substantial increase in the number of building permits issued. This increase, consequently, implies these neighborhoods are becoming more attractive for housing investment.

City Vision Ministries has developed hundreds of new and rehabilitated homes in its 15 years of undoing absentee ownership and property deterioration that plague urban neighborhoods of Kansas City, Kan.

Capitalizing on available land, the nonprofit’s mission is to improve communities at the neighborhood level while in turn benefiting the families who live there, says executive director John Harvey.

## crime

Crime is another possible indicator of neighborhood conditions, Harvey and Spong say. The rate of crimes against people in low- and moderate-income neighborhoods in Kansas City, Mo., generally followed a metrowide trend, dropping by half from the 1990-1994 period to the 2001-2005 period.

Increased home lending supports neighborhood progress, area nonprofit groups say, and ownership can be linked to improved neighborhood conditions.

“Homeownership is like an inoculation from social problems,” says Riddle of The Family Conservancy.

Brentano adds, “(Home)ownership is one of the best ways to stabilize a neighborhood and keep it from declining.”

All these results suggest higher lending rates in low- and moderate-income neighborhoods are associated with improving neighborhood conditions in the form of rising home prices, stable or increasing homeownership rates, and a jump in new-home constructions, Harvey and Spong say.

It’s difficult to conclude how much of a contribution home lending made to these positive changes in neighborhood conditions, especially when economic trends, neighborhood redevelopment efforts and other factors are considered as well.

However, Harvey and Spong say home lending contributed to or helped enable many of these favorable trends to take place by supporting homeownership and rising housing values.

These effects can be exponential—the success of low- and moderate-income neighborhoods attracts homebuyers, like the Jackson and Melgoza families. Their lives are better because of homeownership, they say.

“People see these areas as a place where they would like to live and raise a family,” Brentano says.

## Home sweet home

Above the chatter of little voices and the clanking of pots in the kitchen, a car pulling into the driveway can be heard.

“Daddy!” 9-year-old Catalina exclaims, running to peer through the window blinds as the car’s headlights illuminate her face.

Hugo Melgoza is home from his job as





PHOTO BY GARY BARBER

During the past decade, home-purchase lending in low- and moderate-income neighborhoods grew at a faster pace than the rest of the Kansas City metro area. This Kansas City neighborhood has benefited thanks to one nonprofit's rehab efforts and lending assistance.

a technician at a local engineering company. His wife, Sarah, is in front of the stove with Diego, 1, balancing on her hip and 6-year-old Anthony looking on.

Sarah works as a secretary at the children's school just minutes from their home. It was the drive from their townhouse to the school that took her past Lloyd Street, which is now their address. The nonprofit that sold the Melgozas the house also awarded them a grant to help purchase it.

Catalina has a bright pink room covered with her artwork and filled with dolls. Even though they no longer share a bedroom like they did in the rental, her little brother, Anthony, disregards the "keep out" signs posted on Catalina's bedroom door to jump on her bed. Still, a room of her own is her favorite thing about the house, Catalina says.

Hugo and Sarah understand. They both grew up in homes their parents owned. They want the same for their children, and someday, their children's children.

In addition to the investment they are building and the contribution to the community they are making, the Melgozas have something to call their own, Sarah says.

"This is home."



BY BRYE STEEVES, SENIOR WRITER

## FURTHER RESOURCES

- **HOME FINANCING IN KANSAS CITY AND ITS CONTRIBUTION TO LOW- AND MODERATE-INCOME NEIGHBORHOOD DEVELOPMENT**
- **LOW- AND MODERATE-INCOME HOME FINANCING: WHAT ARE THE TRENDS IN KANSAS CITY?**

By James Harvey and Kenneth Spong  
[www.KansasCityFed.org/TEN](http://www.KansasCityFed.org/TEN)

**COMMENTS/QUESTIONS** are welcome and should be sent to [teneditors@kc.frb.org](mailto:teneditors@kc.frb.org).

# A taxing way to live



PHOTO BY ROBERT ERVIN



## After 25-year lows, sharp tax increases likely for middle-income households

**L**ike the average American, Greg Paprocki—a husband, father and entrepreneur—gets a few tax breaks.

Paprocki, 34, of Omaha, Neb., considers himself middle-class, although as an illustrator he does earn more than the average household. His marriage to Beth in 2004 allows the couple to file taxes jointly, and the birth of Lydia in late 2006 offers them an additional deduction.

Effective federal tax rates for middle-income households actually are at 25-year lows as a result of changes in the tax laws beginning in the early 1980s and culminating in 2001-2003. Still, Paprocki feels like he “absolutely” pays too much in taxes.

Middle-income Americans may think this way partly because growing household incomes have kept the dollar amount of taxes paid from declining as dramatically as the percentage tax rate, say Troy Davig, senior economist, and C. Alan Garner, assistant vice president and economist, both at the Federal Reserve Bank of Kansas City. Additionally, middle-income households have not experienced comparable declines in state and local tax rates.

It’s no wonder, then, that Paprocki says, “It’s hard to get ahead.”

For him and many other middle-income taxpayers, this situation is unlikely to improve.

Although legislation could change, under current law the effective federal tax rates on middle-income households are projected to rise sharply, say Davig and Garner, who recently researched the trends and prospects of middle-income tax rates. Much of the economic analysis and political debate about these federal tax changes focus on the impact on upper- and lower-income groups, while the

impact on middle-income taxpayers is sometimes forgotten.

“Among middle-income households,” Davig says, “those with children have experienced the greatest decline in effective federal tax rates. However, going forward, these households will face the largest tax increases among middle-income households and all in this bracket will likely see a rise.”

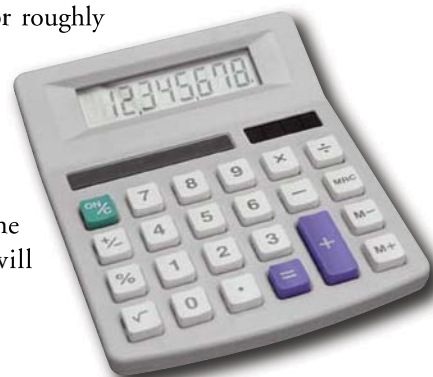
Under current law, the income tax rate for middle-income households with children is projected to double from 2004 to 2013. Elderly and non-elderly households without children face a more gradual increase until 2011, when they experience a jump in tax rates stemming from the expiration of tax provisions.

With the federal government running a substantial deficit, increases in the middle-income taxes are likely as fiscal policy makers attempt to move the budget closer to balance. Unfunded liabilities of Social Security and Medicare, in addition to state and local funding requirements such as education, Medicaid and public employee retirement, imply that middle-income households could face tax increases going forward, Garner says.

These projected changes will impact a wide spectrum of middle-income households.

For families like Fred and Judy Clark, who are nearing retirement, and Stan and Pat Hoig, who have been retired for roughly 20 years and living on a fixed income, an increase in taxes means an impact on their spending.

For families like the Paprockis, not only will





# Taxes 101

Changes in tax liabilities are a result of household circumstances (such as a shift in income or birth of a child), or legislated changes in the federal tax code. As a result, federal taxes for different income groups change constantly.

These tax law changes can be “targeted” when policymakers want to alter tax treatment for a specific group, such as the child tax credit, which only benefits households with children. Tax law changes are “general” when they are broad-based, such as an increase in the amount of personal exemptions.

Since 2000, Congress has lowered individual income tax rates, increased child and dependent care credits, and reduced taxes on dividends and capital gains. Modest revisions in any given year might not be noticed, but in time these revisions could build into a large change in the middle-income tax rate.

Tax trends for middle-income taxpayers can be difficult to determine, say Troy Davig and Alan Garner, economists with the Federal Reserve Bank of Kansas City.

These households are defined as “middle-quintile taxpayers.” The Congressional Budget Office divides the U.S. population into quintiles, or fifths of the income distribution, using a comprehensive income measure.

Income quintiles are not fixed groups; households can move from one group to another. Two households in the same income quintile may differ considerably in their tax liabilities. For example, two married-couple households with the same income might

have different tax liabilities because they have a different number of children.

A household’s taxable income is calculated based on gross income (wages, interest, pensions), less: adjustments (retirement plan contributions, moving expenses, interest on education loans), deductions (standard or itemized) and personal exemptions.

In the Tenth Federal Reserve District, where the Federal Reserve Bank of Kansas City is located, the median income for middle-income households ranges from \$40,000 to \$70,000. The District includes western Missouri, Nebraska, Kansas, Oklahoma, Wyoming, Colorado and northern New Mexico.

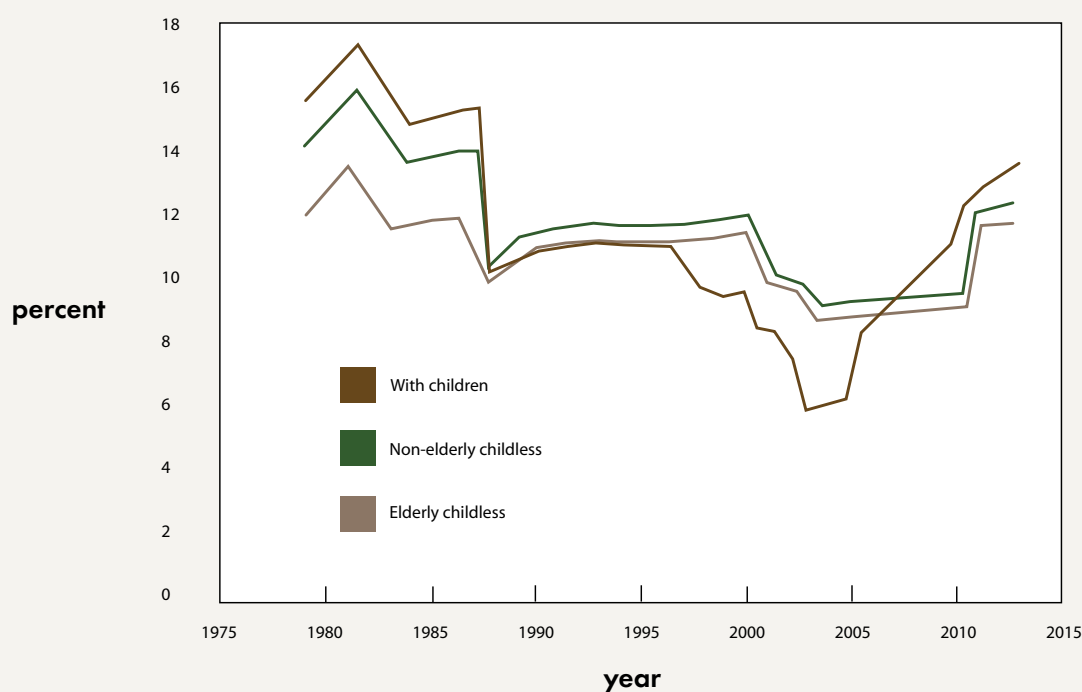
Additionally, taxes are indirectly transferred to households, such as business taxes and social insurance taxes.

Business taxes are ultimately shifted to households through complex adjustments in wages, prices and quantities traded, although the amount shifted can only be estimated. For employer-paid social insurance taxes, an analysis suggests payroll taxes paid by employers are largely reallocated to workers, mostly through lower wages.

Keith Price, a certified public accountant of 35 years in Cheyenne, Wyo., knows that the last thing middle-income households want is a tax increase, but they should be prepared for it. This means cutting back on the day-to-day frivolous expenses rather than savings funds.

“Most people in that (middle-income) group are tight on money,” Price says, “so an increase is not nice.”

## Effective Federal Income Tax Rates for Different Middle-Income Groups



their short-term spending be impacted, but also their long-term saving for their golden years and their daughter's college education. Paying higher taxes while maintaining an adequate nest egg may affect the family's lifestyle, although Paprocki can't imagine where they could cut back.

"We live pretty modestly," Paprocki says, "watching how every dime is spent."

## Going down

The total federal income tax liability has declined dramatically for middle-income households, dropping from 7.5 percent in 1979 to 2.7 percent in 2003.

"Tax policy in the United States has experienced several major changes during the past 25 years," Davig says. "Many of which were explicitly designed to benefit middle-income households."

This downward trend is a result of the ratification of various tax bills. First, in 1981, changes in the law reduced income tax liabilities. Then in 1986, changes led to a stabilization of rates. A third period of sharp declines began in 1997 and gained more momentum after the passage of three tax bills in 2001-2003.

Meanwhile, social insurance tax rates—referred to as "payroll taxes" because they are deducted directly from an employee's paycheck—have been relatively stable. By 2006, each employee paid 7.65 percent of his/her wages in payroll taxes, with an equal amount matched by employers, to finance Social Security benefits and portions of Medicare.

To assess the differences across middle-income households, the Congressional Budget Office reports rates for three groups:

- households with children,
- non-elderly childless households,
- elderly childless households.

Several trends have emerged, Garner says. First, the tax rate for elderly childless households has remained fairly stable, although there



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**MIDDLE-INCOME FAMILIES WITH CHILDREN**—like Greg, Beth and baby Lydia Paprocki—have seen the greatest federal tax rate benefits. But looking ahead, they will face the largest tax rate increases among middle-income households, under current law.

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was a slight upward trend in the 1990s that was reversed by the post-2000 changes in tax law.

Second, the tax rate for both non-elderly households without children and households with children has declined, following the general trend for all middle-income households. And, non-elderly households with children have experienced sharper declines than households without children.

"The difference in the downward trends between non-elderly childless households and households with children is a consequence of changes in tax law, instead of income differences," Garner says.

Prior to 1986, the difference between these groups was modest. However, following these changes, households with children began



Stan and Pat Hoig, here with two of their seven grandchildren, have always been diligent savers but now worry they won't be able to financially help their grandkids as much as they had planned.

PHOTO BY KEITH BALL

facing less stringent tax rates than non-elderly childless households—the tax code changed to benefit those with children.

The 1986 bill increased the personal exemption amount from \$1,080 to \$2,000, impacting all households, but more so those with children. Changes in 1997 established a \$500 child tax credit. The post-2000 tax law changes continued to widen the gap between the two groups due to increases in the child tax credit and dependent care credits.

In contrast to income taxes, federal social insurance tax rates grew, leveling off around 1990 for households with children and non-elderly households without children.

Elderly households without children have seen steady social insurance tax rates. This is a reflection of the small fraction of payroll taxes paid by elderly households who were also eligible for old-age Social Security benefits.

## Rising share of payroll taxes

Over time, a larger fraction of middle-income households' federal tax liability has been devoted to payroll taxes. Because payroll taxes are paid only up to a certain amount of wage income, payroll taxes make up a larger share of the tax liability for low- and middle-income households versus high-income households.

"The falling trend in federal income taxes and the rising, or steady, trend in payroll taxes have a clear implication for middle-income households," Davig says. "A larger fraction of their tax liability is devoted to payroll taxes."

Research shows payroll taxes were higher than federal income taxes for 44 percent of all U.S. households in 1979, and that percentage increased to 67 percent in 1999. Current revenues from payroll and income taxes are nearly equal.

Personal federal income taxes as a share of



federal taxes dropped from 40 percent in 1979 to 24 percent in 2002. At the same time, payroll taxes as a share of federal taxes rose substantially—from 46 percent to 64 percent.

“Generally, one way to view the changing composition of tax liability for middle-income households is that the total ‘pie’ (tax liability) has shrunk,” Garner says, “while the size (share) of the ‘slices’ has clearly changed and shifted toward payroll taxes.”

During the next few years, many features of the post-2000 legislation are set to expire, leading to a gradual rise in effective income tax rates going forward. Expiring factors

hobbies will be lucrative, such as winemaking at the small vineyard he’s planning for his land in southeastern Nebraska, although he’s not counting on turning a large profit. Still, he’ll need a small income to supplement his and his wife Judy’s retirement.

“I’ve resigned myself to the fact that we’re going to have to cut back,” Clark says. “Anyone who lives on a fixed income is going to have to cut back.”

Unfortunately this is also true for retirees Pat and Stan Hoig, of Edmond, Okla.

It’s not the day-to-day spending or even their long-term budget that will be most affect-

## **The decline in income taxes for middle-income households during the past 25 years is likely to be completely reversed during the next 10 years.**

contributing to the rise include the decline in the child credit and the expiration of provisions that diminish marriage penalties. In addition, the alternative minimum tax will affect a larger number of middle-income households in the future.

“The decline in income taxes for middle-income households during the past 25 years is likely to be completely reversed during the next 10 years,” Garner says.

The effective federal income tax rate for households with children is forecast to rise from 5.8 percent in 2004 to 13.4 percent in 2013. Households without children will face similar, but less dramatic increases. These families, however, likely will still feel effects.

### **Effect on retirement**

Fred Clark is at least five years from retirement, but already knows when he leaves his job his days won’t be filled with fishing and golf.

“I need to remain productive from a psychological and spiritual standpoint, but more so financially,” says Clark, 61.

So when he retires from his long-time position as a life and disability claims analyst in Omaha, Neb., Clark will still punch the proverbial time clock. He hopes one of his

ed by increased tax rates in the coming years.

“It’s going to impact us to some extent, but we won’t be deprived,” says Pat, 72. “We just won’t be able to do as much for our grandkids.”

Pat, a former elementary school music teacher, and Stan, a former journalism instructor at the University of Central Oklahoma, adamantly saved throughout their lives, always with retirement—and their grandchildren—in mind. They help two of their seven grandchildren pay for college, but worry about the children’s future financial obligations.

“The burden shouldn’t fall on them,” Hoig says.

BY BRYE STEEVES, SENIOR WRITER

### **FURTHER RESOURCES**

#### **MIDDLE-INCOME TAX RATES: TRENDS AND PROSPECTS**

By Troy A. Davig and C. Alan Garner  
[www.KansasCityFed.org/TEN](http://www.KansasCityFed.org/TEN)

**COMMENTS/QUESTIONS** are welcome and should be sent to [teneditors@kc.frb.org](mailto:teneditors@kc.frb.org).



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**I**t wasn't by chance that Annie Kao's parents moved to the Cherry Creek Colorado school district, where she and her twin sister would be surrounded by intensely academia-driven—and predominately white—peers. “That’s exactly what they were looking for,” Kao says.

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Born in Taiwan and China respectively, Kao's mother and father immigrated to America to study biochemistry at Utah State University, where they met.

“They went where the scholarship money was,” Kao says. “That was their ticket to the United States. That was their way out.”

And as they raised their daughters in south-east Denver, they would always emphasize the importance of education.

“It wasn't whether you were going to college, it was which one of the best colleges were you going to,” Kao remembers. “You were unsuccessful if you didn't go to college. ... It was a very big deal, basically since birth.”

Now 30, Kao is a lawyer. Her sister is a doctor.



# Career Builders

**Education can help growing minority population face workforce challenges**



PHOTO BY JOSHUA LAWTON





PHOTO BY JOSHUA LAWTON

**THE IMPORTANCE OF EDUCATION** was emphasized at home. Kao's mother (right) and father immigrated to the United States to educate themselves and, years later, their daughters.

Higher skill and education levels are vital to career opportunities, but are often advantages minority groups lack. In turn, this may significantly limit the job and earning potential of rapidly growing minority populations in the region, says Chad Wilkerson, an economist and branch executive of the Federal Reserve Bank of Kansas City's Oklahoma City Branch.

Wilkerson and Megan Williams, an associate economist also at the Oklahoma City Branch, recently examined the occupational outlook and its implications for minority groups in the Tenth Federal Reserve District.

In the District, which is made up of western Missouri, Nebraska, Kansas, Oklahoma, Wyoming, Colorado and northern New Mexico, the share of ethnic and racial minorities has almost doubled since 1970, now making up 25 percent of the area's population—and also a rapidly growing part of the labor force.

"The five- to 10-year outlook for jobs held by minorities generally is not as bright as the outlook for jobs held by non-Hispanic whites,"

Wilkerson says. "More education will be needed to boost both long- and short-term job prospects for minorities in the District."

It's a lesson Kao wasn't taught in the classroom, but learned by her parents and passed on to her. She is grateful for that.

"Always their No. 1 priority was education," Kao says. "It has given me so many more options."

## A growing population

In 1940, minorities made up less than 10 percent of the total population of the states in the District. The average annual minority population growth through 1990 was nearly 2.5 percent—three times as fast as population growth among whites due in large part to higher birth rates—with the fastest growth occurring among Asians.

More recently, the minority population share in the District has increased even more rapidly. Meanwhile, growth for whites has eased slightly since 1990.

The District's three largest minority groups are Hispanics, blacks and Native Americans.

By state, minorities make up more than half the population in New Mexico and more than 25 percent in Colorado and Oklahoma. The minority populations in Kansas, Missouri, Nebraska and Wyoming range from 11 percent to 18 percent.

More specifically, the largest concentrations of minorities in the District are found in northern New Mexico, southern Colorado, eastern and southwestern Oklahoma, and southwest Kansas, including metropolitan areas such as Albuquerque, Denver, Oklahoma City, Tulsa and Kansas City.

The largest minority group in the District, like the nation, is Hispanics with 12 percent. The next three minority groups in the District are: blacks (6 percent), Native Americans (2.5 percent) and Asians (1.7 percent).

Although the presence of minority workers is growing, the earning levels continue to lag.

## Making ends meet

After graduating from high school in New Mexico, Dave Melton did what the other young men he grew up with on the Pueblo Laguna reservation did and what their fathers before them did: looked for work.

For nearly 10 years, Melton put in long grueling days with minimal pay, first as a motorcycle mechanic and then mining for uranium.

"I could feel it," Melton remembers. "I knew I didn't want to be doing this (type of work) for the rest of my life."

So at age 27, with a wife and four children, Melton enrolled at the University of New Mexico on a scholarship from his tribe to study economics.

Now, at 53, Melton owns Sacred Power Corporation, a manufacturer of renewable energy equipment, such as solar power panels. He started his Albuquerque-based business six years ago. Much of the company's technologies are used in Indian Country to provide electricity and hot water.

"This is why I'm here," Melton says. "I've been put on this earth to help people."

This includes guiding his children, who are all currently attending college. He didn't want their career choices and, in turn, their lifestyles to be limited by a lack of education as his once were.

Research shows differences in occupational structure result in differences in salary levels. Both are tied to levels of educational attainment.

In the District, the actual median earnings for Hispanics and Native Americans are nearly 25 percent below the District average. Blacks earn about 15 percent less than the average while Asians earn less than non-Hispanic whites.

Job and salary projections for 2014 are positive for all races and ethnic groups. However, growth of high-paying jobs held by Hispanics, blacks and Native Americans isn't projected to outpace the growth of low-paying jobs to the extent it is for whites and Asians, Williams says.

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**DAVE MELTON AND HIS WIFE, ADA, are both entrepreneurs in Albuquerque, N.M. "If I could pin one thing on how I came to be here, it would be education," Melton says.**

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RESEARCH SHOWS MINORITIES are concentrated in lower-paying, non-management jobs. This can be attributed to several factors, including immigrant assimilation, geographic mobility, cultural factors and educational attainment.

PHOTO BY TOBY JORRIN

Management positions account for about 13 percent of all jobs in the District, and as a whole, are the highest-paying major occupational group. In 2000, the share of Hispanics, blacks and Native Americans in management positions in the District was barely half that of whites. The share of Asians was moderately higher than for other minority groups, but still less than whites.

Professional jobs, such as lawyers, teachers and other non-management positions that require post-secondary training, account for nearly a fifth of all jobs in the District. Similar to management positions, these jobs are high-paying but there is a much lower minority concentration compared to whites. By contrast, Asians are highly concentrated in professional jobs.

Other occupational groups account for two-thirds of employment in the District, but pay considerably less than management and professional jobs.

“Minorities are more highly concentrated in these jobs,” Williams says.

## Explaining the gap

Three cultural factors have been found to influence occupational structures and economic outcomes of minorities relative to whites: labor market discrimination, immigrant assimilation and geographic mobility.

Historically, racial discrimination in the labor market accounted for some of the occupational and economic differences for minorities and whites, Wilkerson says. Some studies show this still to be a factor today while others have found little impact. Other studies have found evidence that immigrant assimilation plays an important role—immigrants’ education, experience and skill levels do not transfer perfectly in the U.S. labor market.

Geographic mobility may also contribute to differences in occupational structure and wages. Cultural factors may constrain mobility, which is especially true for Native Americans, who often live on reservations in remote or rural areas where job opportunities are limited.

“Despite these cultural factors, the biggest contributing factor, by a wide margin,



lies in the differences in human capital traits,” Wilkerson says, “which are typically measured by education and skill attainment.”

## Higher education, higher pay

Education varies widely by race and ethnicity in the District. Hispanics tend to have the least education of all minority groups; only 36 percent of Hispanics ages 20 and older have attended some college and only 11 percent have a bachelor’s degree or higher, according to Wilkerson and Williams’ research.

Blacks and Native Americans also have below-average post-secondary education, while in contrast, more than two-thirds of Asians have at least some post-secondary education and those with master’s and doctorate degrees (23 percent) greatly exceed that of all other races and ethnic groups, including whites.

Phil Birdine sees a direct link between minority workers’ overall job and pay concentrations and the low level of minorities’ degree

attainment. For this very reason, Oklahoma State University is committed to minority students’ graduation, says Birdine, OSU assistant vice president for institutional diversity.

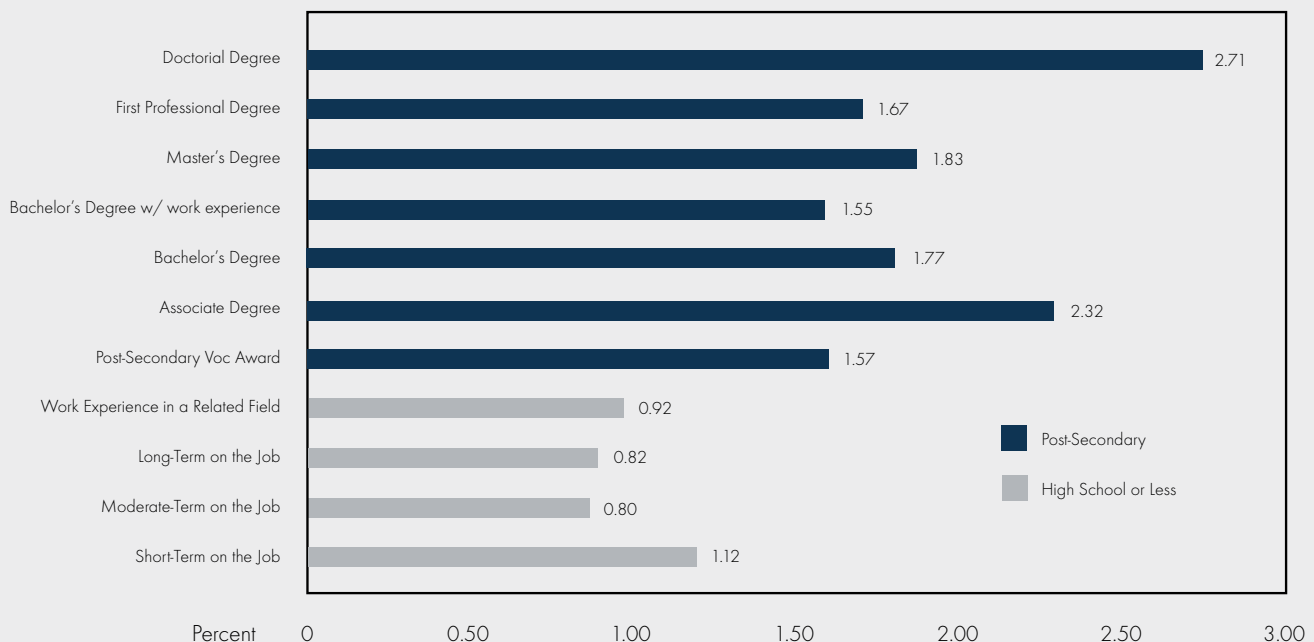
“Education is one of the main answers to closing that gap,” Birdine says. “Our society is so competitive, without an education you’re at a disadvantage. ... The more skilled you are, the more valuable you are to an employer.”

OSU has a higher share of minorities in terms of both enrollment and graduates than most major universities in the region.

However, recruiting minority students is challenging, Birdine says. Often college-age minorities have grown up in families whose members aren’t highly educated and may work in lower-paying jobs.

The university has programs to not only identify and target potential minority students, but also retain them once they are enrolled. The Multicultural Student Center, for which Birdine is the director, was established nearly

## Annual Projected U.S. Job Growth for 2004-2014 by Primamry Education or Training Requirements of Jobs



Source: U.S. Bureau of Labor Statistics

two decades ago to do just this. The Center offers academic, career and social advisement to help ensure the success of minority students at OSU—and beyond.

The workforce demands diversity, and it demands highly skilled workers, Birdine says.

Bill Ray, spokesperson for the Denver Metro Chamber of Commerce, agrees, saying the need for educated workers is rapidly increasing as the aerospace, bioscience, engineering and health-care industries continue to grow.

With this in mind, the Chamber is helping prepare the area's future workforce via school programs to teach children about the importance of education at an early age. These more recent efforts are in line with the Chamber's mission of economic growth.

"It's all about workforce development," Ray says. "The key is developing a talent pool."

## Looking forward

Because minority groups in the region have different occupational mixes than whites, job prospects during at least the next five to 10 years are also likely to differ, Wilkerson says. Projecting the demand for occupations currently filled by minority workers helps indicate workers' prospects.

The fastest growth in the United States during the next decade is anticipated among professional and service occupations, which are generally near the top and bottom of the pay scale, respectively. These fields include health-care, software and personal care services.



## In the classroom

Crystal McClarty's college professors always know whether she's present.

"For most of my classes, I'm the only African-American," says the 23-year-old graduate student at Oklahoma State University.

This means McClarty stands out. Teachers and students remember who she is; when there's a class discussion about race issues, everyone looks to her.

She's never felt out of place on campus, though. College is where she belongs, she says.

McClarty knows she's representing her family as a member of its first generation to go to college, but also her race and ethnic minorities as a whole.

"It makes me want to work harder," McClarty says.

Research shows minority groups' representation at universities is somewhat lacking when compared to population numbers. Economists Chad Wilkerson and Megan Williams, of the Federal Reserve Bank of Kansas City, recently examined 2002-2004 enrollment and graduation data from all Title IV institutions (schools that have federal student financial assistance pro-

grams) in the Tenth Federal Reserve District. This includes western Missouri, Nebraska, Kansas, Oklahoma, Wyoming, Colorado and northern New Mexico.

The 18- to 34-year-old minority population in the region (27 percent of the total population) is somewhat larger than minority enrollment in universities, particularly four-year schools. Minority presence was much higher in two-year and vocational or trade schools.

Wilkerson and Williams also researched graduation rates of minorities at regional universities' and found them to lag enrollment rates in most cases.

The races examined were Hispanic, black, Native American and Asian. Overall, Hispanics had the largest disparity between enrollment and degree shares and total population shares, while Asians had the smallest.

When she receives her master's degree in business administration and finance next spring, McClarty plans to pursue a career in the oil and gas industry—a field she thinks has a promising future, and one she's prepared for.

"I can't do it without an education."

Meanwhile, farming and manufacturing are anticipated to be the slowest areas of job growth in the United States through 2014, actually declining due in large part to advances in technology.

Jobs that were held by Hispanics in the District in 2000 are projected to increase slower than the average across races. The projected annual growth rate (1.08 percent) for these jobs

rapidly, including physicians and computer software engineers.

Projected job growth sheds light on anticipated short-term demand for minorities currently employed, and the likely increase in pay gaps between minorities and whites.

Obtaining the right kind of education is the answer for long-term job viability, quality and pay, Wilkerson and Williams say.

## “ Our society is so competitive, without an education you’re at a disadvantage . ”

is low because of high concentrations in occupations such as cashiers, construction laborers and telemarketers.

The prospects for jobs held by Hispanics are helped by large concentrations in health-care aide and services occupations, which are predicted to grow rapidly, although average salaries are generally low.

Jobs held by blacks in the region should rise at about the same pace (1.17 percent) as whites through 2014.

During this same time, jobs held by Native Americans in the region are projected to grow 1.12 percent annually. The outlook is hurt by high concentrations in occupations expected to experience sluggish growth or losses, such as precious-stone workers, and low concentrations in high-paying professions projected to grow rapidly, such as doctors and lawyers.

Like Hispanics, the outlook for black and Native American workers is helped by high concentrations in a number of health-care aide and services occupations, which are expected to grow rapidly but don’t pay the highest wages.

In contrast, jobs held by Asians in the District are anticipated to grow at 1.31 percent—faster than the average (1.17 percent) across all races—during the next five to 10 years. Like white workers, Asian workers in the region have high concentrations in many high-paying professional occupations predicted to increase

This has been true for Annie Kao, as she strived first through Amherst College, where she graduated magna cum laude, then through George Washington University law school, and then on to the firm Brownstein Hyatt Farber Schreck, P.C., in Denver, where she specializes in commercial litigation, often from inside a courtroom winning multimillion-dollar judgments. It’s a path of success not too different from her mother’s and father’s.

“Education is opportunity,” Kao says. “My parents had the opportunities they did because of schooling.”

And so did she.

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BY BRYE STEEVES, SENIOR WRITER

### FURTHER RESOURCES

• **MINORITY WORKERS IN THE TENTH DISTRICT: RISING PRESENCE, RISING CHALLENGES**

• **MINORITIES IN THE TENTH DISTRICT: ARE THEY READY FOR THE JOBS OF THE FUTURE?**

By Chad R. Wilkerson and Megan D. Williams  
[www.KansasCityFed.org/TEN](http://www.KansasCityFed.org/TEN)

**COMMENTS/QUESTIONS** are welcome and should be sent to [teneditors@kc.frb.org](mailto:teneditors@kc.frb.org).





# Moving mountains *(of funds and securities)*

THE WHOLESALE OPERATIONS SITE SUPPORTS HIGH-VALUE TRANSACTIONS

**F**ever wonder how financial institutions move large amounts of money?

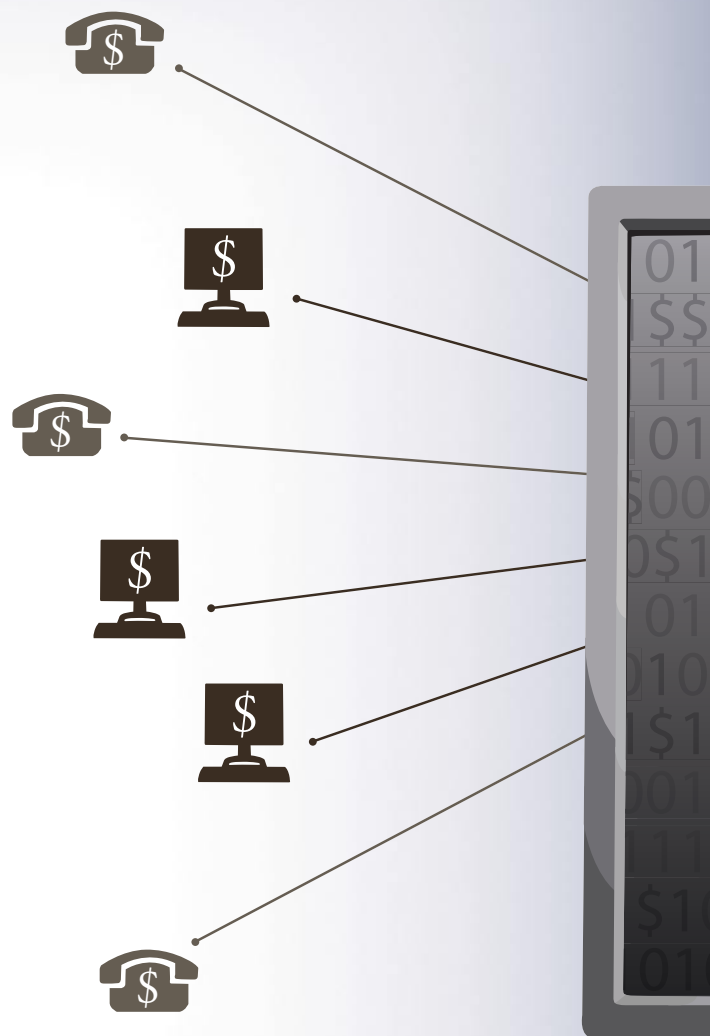
Funds and securities transactions totaling millions—and even billions—of dollars are transferred every day with the help of the Federal Reserve Bank of Kansas City's Wholesale Operations Site (WOS). As one of only two operations sites in the Federal Reserve System, the WOS supports six of the 12 Federal Reserve Districts spanning four time zones.

The WOS primarily helps ensure financial institutions can quickly and safely exchange large-value, time-critical payments. Every month, staff processes roughly 2,500 offline funds and securities transactions, each with an average value of \$1.5 million and \$4 million, respectively.

Operations are split between two functional units with unique duties and responsibilities. The Administrative Unit works with customers to ensure their application profile is representative of their business needs, while the Transfer Unit processes offline transfers and provides customers with transaction and other account information.

In addition to normal operations, staff exercises contingency-readiness procedures throughout the year. These tests ensure effective plans are in place to respond to network disruptions, natural disasters and terrorism. The WOS has withstood all three, including the 9/11 terrorist attacks when staff worked to help maintain liquidity for the nation's largest financial institutions.

The general daily process is outlined to the right.



## RISK MITIGATION

*WOS operations are tightly controlled and monitored.*

- Operations are located in a secured area to prevent unauthorized viewing of sensitive data.
- All phone calls with customers are recorded.
- Unique identifiers are used to establish customer authenticity.
- Offline transactions require a strict four-party callback procedure.
- Only people authorized by the depository institution can conduct business with the WOS.
- Data security reviews are conducted regularly to ensure staff has been granted appropriate access.

TEXT BY BRYE STEEVES, SENIOR WRITER  
ILLUSTRATIONS BY CASEY MCKINLEY,  
SENIOR GRAPHIC DESIGNER

# WHOLESALE OPERATIONS SITE



Funds and securities transactions are domestic and flow through Fedwire, which is the Federal Reserve's highly secure, real-time system. Transactions are immediate, final and irrevocable.

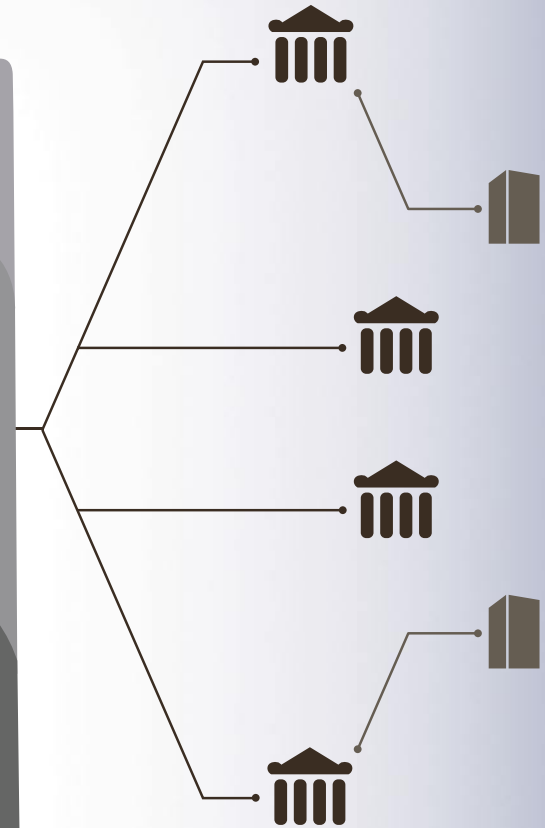
BANK TO BANK



THIRD PARTY



A funds transfer can be a straight bank-to-bank transaction, or it can be destined for a named third party. Securities can be exchanged without payment, but most are "delivery versus payment" where a simultaneous payment is received for the value of the securities.



TRANSACTIONS ARE PROCESSED  
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Online customers use an electronic connection, which is the most cost-effective and efficient method for originating transactions. The majority of Fedwire volume is processed in this manner.



For offline customers (those without an electronic connection to the Federal Reserve), the WOS serves as an intermediary by entering transactions into Fedwire on their behalf. This requires a highly secure authentication and verification process.

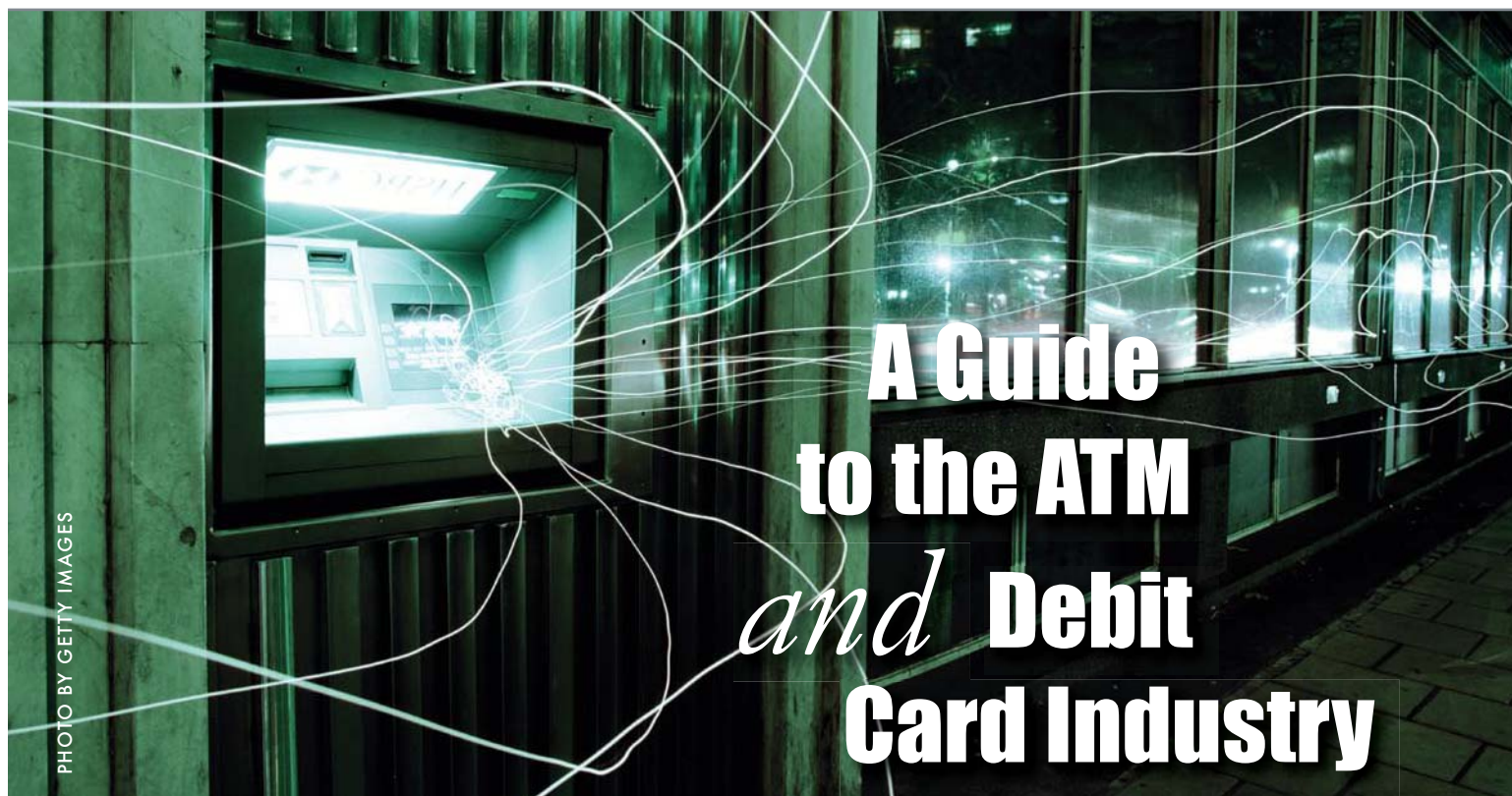


PHOTO BY GETTY IMAGES

## A Guide to the ATM *and* Debit Card Industry

**T**hree years ago, economists from the Federal Reserve Bank of Kansas City published *A Guide to the ATM and Debit Card Industry*. Since then, there have been a number of important developments in what has been a dynamic time for this industry, say Fumiko Hayashi, Rick Sullivan and Stu Weiner, authors of the *Guide* and its follow-up, *2006 Update*.

“The purpose of this new publication is to document these trends and patterns by updating the data we presented in the original book,” Hayashi says. “*Update* also discusses implications for the current and future state of the industry.”

The most important development is the two segments—ATM and debit—in some sense are going in opposite directions. The ATM industry has matured and stagnated.

Major players are vying for market position and adopting different business strategies to adjust to the maturation of the industry. Meanwhile, the debit card industry is expanding rapidly with new players, partnerships, products and markets.

“Here the challenge is how to preserve and enhance market position—and not be left behind,” Hayashi says.

### Important industry changes

There are many reasons for the divergence between the ATM and debit card industries, but they are related. It’s become easier to use payment alternatives, such as debit and credit cards, and as a result, consumers don’t need as much cash.

The total number of ATM transactions peaked around 2000 and generally has been



declining since. The number of ATM networks is also in decline, and the top three firms now process more than 55 percent of ATM transactions.

One interesting, long-run trend in the ownership structure among large regional networks is the emergence of nonbank and single bank forms of ownership at the expense of bank joint ventures. Meanwhile, the largest financial institutions continue to expand their ATM fleets, perhaps in conjunction with building branches. There have been few changes in wholesale pricing and continued increases in some retail ATM fees.

In contrast, debit is the fastest-growing retail payments type in the United States. Signature debit has a 3-to-1 lead in merchant outlets over PIN debit, but both methods have worked to develop their markets, and merchant acceptance has grown steadily.

There is a tremendous amount of network competition in the industry. The original book discussed three competitive battlegrounds within debit card networks: competition among regional PIN debit networks, competition between regional and national PIN debit networks, and competition between PIN and signature debit networks. All three remain and likely will continue, Hayashi says.

The debit card industry faces a challenge from another payment industry, the automated clearing house (ACH) system, which is developing a number of payment options that could substitute for debit.

This shift from paper-based transactions, along with the rising predominance of debit card transactions, raises a number of important policy issues related to safety, efficiency and accessibility.

## **Policy, fraud and data security considerations**

Answers to policy questions are not easy, say the books' authors. The challenge for policymakers and industry participants alike is to stay informed and ready to make solid, sound decisions.

Amid heightened public, industry and government awareness, both data security and fraud concern spans the industries—a compromise of debit card data can enable a fraudster to exploit either the ATM or the debit function.

"Data security and fraud is a cloud that hangs over the ATM and debit industry," Sullivan says.


During 2006, two major debit card PIN breaches resulted in hundreds of thousands of dollars stolen from consumers. The year prior has been identified as the worst for data security breaches. Additionally, fraud was the primary reason for a 2005 surge in chargebacks on several networks.

However, the United States may well be able to fight fraud by improving security systems for magnetic stripe cards.

"This can help foil exploits such as card skimming and clandestine observation of ATM customers," Sullivan says.

While there are concerns that a shift from magnetic stripe to chip cards would be expensive, this is an available solution that could considerably strengthen debit card security.





Consumers are also important because their behavior ultimately determines payment methods used, based on factors such as risk of fraud, consumer protection, price, convenience and incentives.

## What lies ahead

“It seems likely that there will be further shake-out in the ATM industry in light of the saturated and possibly overbuilt market,” Weiner says.

To what extent depends on deployers finding a profitable mix of functionality, pricing and location. Unless significant changes are made, difficult adjustments are likely.

Banks place heavy emphasis on the ATM as a delivery channel for financial services, and because few bank customers use other functions, ATMs are mostly viewed as cash dispensers. However, they cannot be thought of as substitutes for tellers as the demand for cash declines.

and product innovation. The authors envision four scenarios:

- Both PIN and signature continue to grow, shifting slightly into each other’s market share. Customers maintain their preferred method.
- The two methods converge and become indistinguishable to consumers, such as PIN-less and signature-less debit.
- PIN networks use price, convenience and risk advantages to gain on signature debit.
- Networks enhance their signature debit products (via consumer protection and incentives) and market share over PIN debit.

A wild card for PIN and signature debit is whether ACH alternatives for retail payments become increasingly viable. There is a good deal of effort in developing these products.

“ **Debit will likely become an even more important payment method in the future.** ”

“Some banks hope to change consumer perceptions of ATMs by adding new functionality, such as imaging capability for taking deposits,” Weiner says.

Because check use is also declining, ATMs could be used to initiate ACH transactions for person-to-person or bill payments, as is done in other countries. Nonfinancial services dispensed through ATMs, like vending machines, is another option. This could be an opportunity to sell many items, with cash access as one of its features.

“Debit will likely become an even more important payment method in the future,” Weiner says. “The conflict between merchants and card issuers, and also how the PIN and signature debit rivalry resolves, will be key.”

PIN and signature debit will be affected by factors including pricing, costs, profits, security

“Each scenario has some plausibility,” Weiner says, “but which of these scenarios is most likely is hard to predict. It would be best for the market to lead to a payments system with the most desirable set of characteristics in terms of efficiency, safety and accessibility, and combinations of payment alternatives may best serve this goal.”

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BY BRYE STEEVES, SENIOR WRITER

## FURTHER RESOURCES

### A GUIDE TO THE ATM AND DEBIT CARD INDUSTRY: 2006 UPDATE

By Fumiko Hayashi, Richard J. Sullivan and Stuart E. Weiner  
[www.KansasCityFed.org/TEN](http://www.KansasCityFed.org/TEN)

**COMMENTS/QUESTIONS** are welcome and should be sent to [teneditors@kc.frb.org](mailto:teneditors@kc.frb.org).



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## *Economic Education*

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The Federal Reserve Bank of  
Kansas City offers resources for  
students, teachers and the public.

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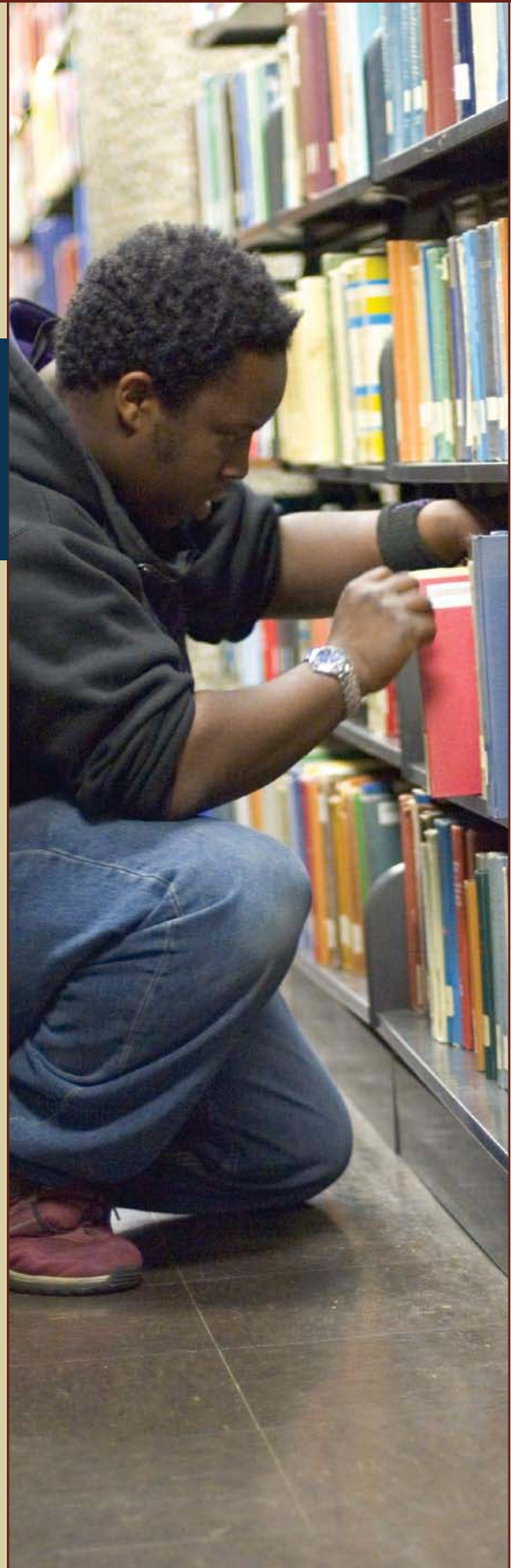
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to learn more about personal finance programs, school-based  
programs and contests for students, such as Fed Challenge and  
the essay contest.

or

**[WWW.FEDERALRESERVEEDUCATION.ORG](http://WWW.FEDERALRESERVEEDUCATION.ORG)**

for free personal financial and economic education resources  
including publications and classroom-ready materials.





# Notes



## Lesson plans coming soon

Newly developed economics and personal finance curriculum will be available online at [www.KansasCityFed.org](http://www.KansasCityFed.org) for use in high school classrooms April 30.

The eight lessons, called “The Money Circle,” include the history of money, its functions and characteristics, budgeting, financial planning, and how the Federal Reserve affects the money supply.

The Money Circle was created by the Federal Reserve Bank of Kansas City, in partnership with the University of Missouri-Kansas City’s Center for Economic Education Operation Outreach, as part of the Federal Reserve System’s commitment to providing educators with classroom-ready resources to help teach economic and financial education concepts.

“The goal is to promote financial literacy at a critical time in children’s lives,” says Gigi Wolf, economic education specialist at the Bank, who co-developed the program. “If they are equipped with this knowledge before reaching adulthood, they are better prepared to lead financially responsible lives.”

The lessons target ninth- through 12th-grade economics, personal finance, family and consumer science, history, and math classes.

For more information about this and other free teacher resources, contact Gigi Wolf at [gigi.wolf@kc.frb.org](mailto:gigi.wolf@kc.frb.org) or 800-333-1010 ext. 2736.

## First annual event unites metro-area organizations for common cause

In an effort to raise financial awareness and benefit area residents, the Federal Reserve Bank of Kansas City is coordinating a week of events this spring for organizations dedicated to financial education.

The MoneyWi\$e Week, April 23-28, includes activities that promote financial education among peers and networks through shared information. The event targets consumers, policymakers, employers, educators and social service organizations.

“The goal of this collaboration is to provide a range of quality financial-education events during National Financial Literacy Month,” says Jan Huckleberry, MoneyWi\$e coordinator at the Federal Reserve Bank of Kansas City.

Part of the Federal Reserve’s mission is to increase understanding of economics and personal finance. Other ongoing programs sponsored by the Bank throughout the year are geared toward educators and school-aged children.

Activities are organized and implemented by partner organizations across the Kansas City metro.

For more information, visit [www.KansasCityFed.org/moneywise](http://www.KansasCityFed.org/moneywise), or contact Jan Huckleberry at [jan.huckleberry@kc.frb.org](mailto:jan.huckleberry@kc.frb.org) or 816-881-4768.



# JYM WEEK

## JUMPSTART YOUR MONEY

An Oklahoma Jump\$tart Coalition Event • April 23 - 28, 2007

### Groups merge for common cause

In an effort to increase financial literacy for all Oklahomans, organizations from around the state are combining efforts for a week of events April 23-28.

Jump\$tart Your Money Week provides an opportunity for schools, universities, local organizations, corporations and others to distribute and receive vital economic and financial education.

The week of events is sponsored by the Oklahoma Jump\$tart Coalition for Personal Financial Literacy. The coalition brings together more than 65 organizations—including the Federal Reserve Bank of Kansas City's branch in Oklahoma City—to strengthen financial knowledge.

"The goal of Jump\$tart Your Money Week is to raise financial education awareness, provide related events across the state and show the range of services available for diverse needs," says Steven Shepelwich, Community Affairs Advisor of the Bank's Oklahoma City Branch and past president of the Oklahoma Jump\$tart Coalition.

For the calendar of events, list of participants, registration information and more, visit [www.KansasCityFed.org/jumpstart/index.htm](http://www.KansasCityFed.org/jumpstart/index.htm).

# Bank

## Anniversaries

The following banks in the Tenth District are celebrating one, five, 10, or 20 or more years as Federal Reserve members this spring.

Sundance State Bank	Sundance	Wyo.	76
First Nebraska Bank	Valley	Neb.	73
First State Bank	Ness City	Kan.	73
Bank of Hartington	Hartington	Neb.	71
Bankwest of Kansas	Goodland	Kan.	68
First State B&TC	Larned	Kan.	65
First State Bank of Hotchkiss	Hotchkiss	Colo.	65
First State Bank in Temple	Temple	Okla.	64
Citizens Farmers Bank Cole Camp	Cole Camp	Mo.	62
Jackson State Bank & Trust	Jackson	Wyo.	59
Bank of Commerce	Rawlins	Wyo.	29
Union Colony Bank	Greeley	Colo.	28
Citizens Bank of Edmond	Edmond	Okla.	26
Bank of Jackson Hole	Jackson	Wyo.	25
Bankers Bank	Oklahoma City	Okla.	21
Castle Rock Bank	Castle Rock	Colo.	21
Heritage Bank	Louisville	Colo.	20
Bank of Commerce	Chelsea	Okla.	10
Citizens Security B&TC	Bixby	Okla.	10
First American Bank	Purcell	Okla.	10
Cowboy State Bank	Ranchester	Wyo.	5
1st Bank	Evanston	Wyo.	1
Citizens Bank of Oklahoma	Pawhuska	Okla.	1
First Bankcentre	Broken Arrow	Okla.	1

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Compiled By TEN Staff

COMMENTS/QUESTIONS are welcome and should be sent to [teneditors@kc.frb.org](mailto:teneditors@kc.frb.org)

# About...



**A**lthough his tenure as the first secretary and cashier of the Federal Reserve Bank of Kansas City was brief, few individuals played a more pivotal role in the Bank's history than Jerome Thralls.

The campaign to win over the Reserve Bank Organizing Committee involved many of the city's business leaders, but it was Thralls who first presented the idea to local bankers. He convinced the community it could win one of the regional banks, and he did much of the work in preparing the city's presentation, including proposing boundaries that the selection committee would nearly replicate when drawing the Tenth Federal Reserve District.

Then, little more than a year after the Bank opened, Thralls left Kansas City, taking a job on the East Coast where he became an authority on international trade with an office in the middle of New York's financial district—a long way from his humble beginnings in rural Missouri.

## Early years

Thralls grew up northeast of Kansas City in the small town of Chillicothe, Mo. The youngest of Henry and Margaret Thralls' nine children, he earned 50 cents a day pitching hay for a neighbor—the first in an eclectic string of early jobs and an early indicator of his work ethic and ambition.



According to a 1926 *Kansas City Star* article, Thralls built chicken coops, then took a job in a rural general merchandise store. He was later involved in small town real estate and banking, and he even earned \$800 for six months as a fur trapper in the Ozarks.

He spent five years with an express company, a job he sought after reading a newspaper article that mentioned the hefty salary paid to the company's president.

"I decided that I should like nothing better than to be president of that great company and I headed at once for the job," Thralls said in the *Star* article.

He did not make it to company president, but the job took him to Kansas City, where he was offered a position with the Kansas City Clearing House Association, an organization involved in routing payments between banks. He soon became the Association's manager and still held the position when President Woodrow Wilson signed the Federal Reserve Act in December 1913. The new legislation prompted the then-32-year-old Thralls, whose job had him well-positioned to understand the relationships between the region's financial institutions, to immediately begin contacting local bankers about the idea of seeking one of the regional reserve banks for Kansas City.

Although the *Kansas City Times* later wrote "Kansas City's campaign for the Federal Reserve Bank was one of the most determined in its history," the effort did not start that way.

"At first most (Kansas City bankers) thought it was a forlorn hope," the *Kansas City Journal* wrote. "Thralls was confident and he believed differently. He insisted that there was a territory belonging to Kansas City which would supply such a bank with all needed capital and surplus."

The *Times* wrote about Thralls' initial meeting with an unidentified "president of one of the biggest banks in the city" who reportedly told Thralls, "I

admire your courage, but I am afraid it would be a useless task."

It would not be the only time Thralls would find resistance to the idea.

"Other bankers were inclined to think he was too ambitious, but he said he was willing to do the work if they would get behind him," the *Times* reported.

Eventually, Thralls was able to convince the bankers to warm to his idea and the community-wide effort began to take shape.

## The best-case scenario

The push eventually resulted in a Kansas City visit by the Reserve Bank Organizing Committee where Thralls presented each panel member with a leather-bound report detailing why Kansas City was an ideal location for one of the regional banks. Although the committee received similar filings from 36 other communities nationwide,





the Kansas City report “was more concise, contained more real meat and was in better shape than any which had been filed with the committee,” the *Journal* wrote in its April 3, 1914 story announcing the city’s selection as a Reserve Bank city.

The man whom the *Star* later described as “modest and unassuming” fit the definition of those terms with the public comments he made during a boisterous gathering of local business

12 years and it’s the greatest of Kansas City’s victories in that time.”

He seems to have been only slightly more emotional than he had been a day earlier when he used the words “highly gratified” to describe his feelings about the decision to a *Journal* reporter.

## The Federal Reserve and beyond

The Federal Reserve Bank of Kansas City’s Board of Directors chose Thralls to serve as the Bank’s first cashier and secretary during its meeting on Oct. 31, 1914, about two weeks before the Bank opened for business.

“I shall support Mr. Thralls for cashier for the reason that nearly every bank in town is supporting him for that position and expects him to have it,” Director and future Bank Governor Willis J. Bailey told the Bank’s other directors during the meeting.

Thralls held the position for only a matter of months, however, resigning on Feb. 10, 1916 to accept a job with the American Bankers Association. According to Bank records, Thralls’ resignation was accepted and “a most complimentary resolution of regret and appreciation” was adopted by the Bank’s Board of Directors.

Thralls’ immense popularity with area bankers and his efforts to win the Reserve Bank

## “ Kansas City’s campaign for the Federal Reserve Bank was one of the most determined in its history. ”

leaders celebrating the community’s selection. At an event featuring at least one vaudeville-style performer and nearly three hours of speeches that elicited laughter and applause, Thralls was almost stoic in his brief remarks.

“We came nearer getting the territory we asked for than any other city,” Thralls said. “That shows we were honest and sincere in presenting our case. We asked only for what rightfully belonged to us. I have been here

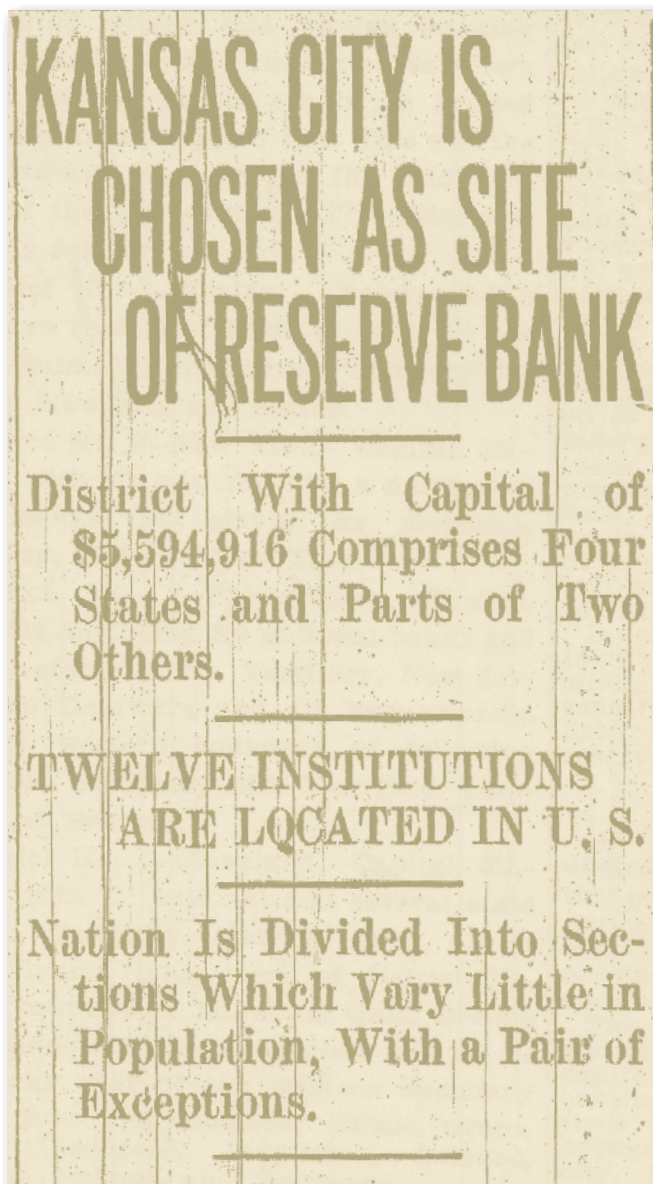
for Kansas City were likely contributing factors to a small controversy that erupted in the weeks prior to his then-rumored departure.

An article in the *Journal* suggested he was being forced out by politicians attempting to politicize the nation’s new central bank. The article suggested the political pressure may have even prevented Thralls from an initial appointment to the Bank’s top position.

“The bankers of Kansas City recognized

the ability of Mr. Thralls and after Kansas City had been selected as the location of one of the Federal Reserve Banks, he had many endorsements to head the institution as Federal Reserve agent and chairman of the Board of Directors," the article says. "His political affiliation is believed to have kept him out of that."

Thralls, who was out of town interviewing for the ABA position at the time the story was published, sent a letter to the newspaper refuting the article's claims and voicing support for both the Bank and the entire Federal Reserve System.



"My connection with the Federal Reserve Bank ... has no relation whatever to politics and when I leave the service of the Federal Reserve Bank of Kansas City, it will be for the purpose of engaging in a line of work which will afford a broader field of activity, and with matters of common interest to the members of the Federal Reserve System," Thralls wrote.

After leaving the Bank, Thralls went on to great success.

At the ABA, he was once again involved with clearinghouses and he served in an advisory capacity to the government's financing program for World War I. He authored a textbook, became a recognized expert on foreign trade and was involved in the formation of the American Trade Acceptance Council. He served as vice president of the Discount Corporation of New York and, later in his career, became president of the Prudence Securities Corporation.

He died on March 19, 1965 at the age of 84 in Brooklyn, N.Y.

In the *Star's* 1926 article, Thralls was asked about the various career opportunities he had pursued, with the reporter suggesting chance is a key component of any life.

"I wouldn't call it chance," Thralls said. "I'd call it opportunity. We are, in a measure, creatures of environment and opportunity. Some see and grasp every opportunity for advancement in life, while others let the opportunity slip by.

"It was opportunity to work in the neighbor's hay field that gave me my first half dollar and the inspiration to earn more."

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BY TIM TODD, EDITOR

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