

# TEN

FEDERAL RESERVE BANK OF KANSAS CITY

Summer 2010

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**Recovering from financial crisis**

**Understanding unbanked consumers**

**Examining rural economies**

**Curbing debit, credit card fraud**

**Giving kids allowance**

## POWER PLAYERS

**Attracting young, educated residents to metros in the region**



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### The high cost of exceptionally low rates

**A**fter Congress passed the Federal Reserve Act nearly a century ago, a special committee was appointed to determine where the nation's 12 regional Federal Reserve Banks would be located and what regions those banks would serve. When that committee met in Kansas City to discuss business relationships in the central United States, Frank Phillips was among those who attended and spoke in favor of locating our Reserve Bank in Kansas City and having it serve Oklahoma. The support from Mr. Phillips and others from Oklahoma was absolutely critical to the eventual decisions that established the Bank in Kansas City and included Oklahoma in the Tenth Federal

President Hoenig delivered these remarks at the Bartlesville, Okla., Federal Reserve Forum on June 3. It was hosted by the Bartlesville Chamber of Commerce.

Reserve District that we serve. A few years after our founding, we opened our Oklahoma City Branch.

This is not the only connection between the Federal Reserve's founding and Oklahoma. The Senate sponsor of the Federal Reserve Act was one of Oklahoma's first senators, Robert Owen. Sen. Owen, like Mr. Phillips, recognized the importance of having the central bank of the United States tied directly to America's Main Streets and not isolated in Washington or on Wall Street. That structure is at least as important today as it was a century

ago. It is my hope that, after much debate, the regulatory reform legislation now under discussion in Washington will affirm in its final version the importance of these regional responsibilities.

It is our job as the regional headquarters of the nation's central bank to serve as the link between our communities and national policy deliberations. Although these policy issues are always important to our nation, today we find ourselves at a unique and difficult point. We are attempting to support an economic recovery, but in doing so, also avoid fostering the next crisis. It is this challenge that I would like to discuss.

#### Economic outlook

At this point, the U.S. economy appears on the path to recovery. Subject to the risks I will discuss a bit later, the general outlook is good. The gross domestic product (GDP) grew at nearly a 4 percent pace in the second half of last year, after bottoming out last summer. I anticipate growth will be slower this year, coming in between 3 and 3½ percent.

What is perhaps most encouraging now is the changing composition of growth that we are seeing. Last fall, a good portion of the GDP growth could be traced to temporary factors related to fiscal stimulus and inventory adjustments by firms that had scaled back



during the worst of the recession. At that time, there was considerable uncertainty about what might happen once these temporary factors subsided. However, more recent data suggest that the recovery is more broad-based and self-sustaining, and perhaps even stronger than anticipated.

Consumer spending, which makes up more than 70 percent of GDP, has been expanding at a solid pace. While consumers have been cautious about big-ticket purchases, we're starting to see some signs that this is changing as consumer confidence improves. Manufacturing activity continues its sharp rebound, and nonmanufacturing activity has been expanding as well. With businesses seeing a recovery in demand, business purchases of equipment and software have been robust.

Jobs, of course, remain a critical issue. Improvements in labor markets boost household income prospects, and enable Americans to take care of themselves and their families and to save for their future. So of course jobs are a crucial component in the transition to self-sustaining growth. We are now seeing clear signs that the process of job creation is taking hold. Payrolls have risen in each of the first four months of this year. In April, payrolls increased by a strong 290,000. The recent uptick in the unemployment rate from 9.7 to 9.9 percent actually reflects an improved outlook, as workers who dropped out of the job market are gaining confidence and beginning to re-enter the workforce. Solid job gains in the months ahead will translate into

a downward trajectory for the unemployment rate later this year and into next year.

Nevertheless, while the economy is improving, recovery in certain sectors will be prolonged. Notably, the construction industry has yet to convincingly turn the corner. The residential housing market received a boost from federal homebuyer tax credits last fall and again this spring, but given the overhang of unsold homes, building activity will remain subdued through most of this year or longer. Nonresidential construction likely will continue to contract this year due to high vacancy rates in that sector. These are important negatives, but by themselves should not derail the recovery.

Looking at the economy more broadly, inflation has drifted lower in recent months, which is typical following a recession. While energy prices have kept consumer price inflation around 2 percent, inflation in non-food and non-energy prices, which is core inflation, has been running at rates of around 1 percent. These inflation rates are likely to continue for the next year or so. However, as the economic recovery continues, or picks up momentum, I expect inflation to drift higher.

As for risks to this outlook, there are several. The fluid situation in Greece and Europe reminds us to be wary. The European debt problems have increased uncertainty and renewed aversion to risks, and are causing investors to flee riskier assets such as stocks and junk bonds for safer assets such as U.S. Treasury debt. These shifts will have a modest

negative net effect on U.S. economic growth in the near term. As an aside, I would note this episode illustrates the longer run danger of running persistent budget deficits—a situation that we must soon address in the United States.

## **Monetary policy**

It is within the context of this outlook and its longer run implications that the Federal Open Market Committee (FOMC) must balance its objectives of supporting short-run economic growth and long-run stable growth and low inflation. It also is within the context of this outlook and these objectives that policy must be normalized, as reflected in the level of real interest rates and the size and composition of the Federal Reserve's combined balance sheet.

Achieving such multiple objectives requires deft handling. But most certainly, the first step toward a more normal policy is to move policy rates off zero, back toward neutral.

In saying this, I have no illusions about the challenges of moving away from zero. But in my judgment, the process should begin sooner to avoid the danger of having to overcompensate later, as so often happens in policy.

I would begin the normalization of policy by outlining for the public a two-step process:

First, the Federal Reserve would continue to unwind its extraordinary policy actions implemented as a response to the financial turmoil that began in the fall of 2008. The market's need for these facilities has eased and we have closed most of them, returning the

discount window to more normal operations. As part of this first step, the FOMC would also eliminate its commitment to maintaining "exceptionally low levels of the federal funds rate for an extended period."

Second, with these steps taken, with the improvements in market conditions and liquidity, and with an improving outlook, the FOMC would be prepared to raise the funds rate target to 1 percent by the end of summer. This would continue the current highly accommodative policy, but would move nominal rates away from zero and real rates to a less negative level.

We would then pause, maintaining the funds rate at 1 percent while we assess the economic outlook and emerging financial conditions. This would provide time to judge whether, and to what degree, further policy adjustments are warranted to assure long-run financial equilibrium and stability.

Based on the current outlook consensus, it seems reasonable that the economy would be well-positioned to accept this modest increase in the funds rate. As a reminder, the funds rate target remained between 1 and 2 percent even after the intensification of the crisis in the fall of 2008. It was reduced to its current target range of zero to ¼ percent in mid-December 2008. Relative to the depths of the crisis, conditions today are much improved from where we were 18 months ago. Financial stress is clearly reduced and a sustainable economic recovery appears under way. It is also important to emphasize that the 1 percent fed funds rate

target, coupled with the Federal Reserve's large balance sheet, provides an extraordinarily accommodative monetary policy environment and one that would ensure the economy's continued progress in the recovery.

Setting out such a plan would be a more orderly move toward unwinding the earlier extraordinary actions and would serve to reduce the likelihood of a buildup of new financial imbalances.

Let me turn now to the subsequent steps that might be taken to more fully restore policy to a long-run equilibrium policy level. Given the relatively modest expected trajectory of growth and inflation, these added moves will involve some quarters to complete. But the direction should be firmly established now with the timing dependent on the performance of a combination of financial, inflation and growth variables. Experience tells me that a clear commitment now to such action would mitigate the likely need to later tighten beyond our estimate of neutral that so often comes with delay. More specifically, these next steps involve raising the funds rate from 1 to above 3 percent reasonably quickly as we gain confidence that GDP and employment are on a steady path. The final steps would take rates to between 3.5 and 4.5 percent as economic growth approaches long-run potential.

If we are to achieve a steady rate environment, it is also important that the Federal Reserve's balance sheet be restored to its pre-crisis size and composition. Obviously this requires the careful process of selling the Federal

Reserve's \$1.3 trillion portfolio of mortgage-backed securities. Various approaches to this can be identified, but most agree that it should be done with the process or time horizon clearly set out for all to see. I also would suggest it begin at least when the fed funds rate rises above 1 percent or sooner if conditions provide the opportunity.

## **Monetary policy, unemployment**

Finally it is important to move the federal funds rate off of zero even though the unemployment rate remains above 9 percent. It has been argued, with some supporting evidence, that the Federal Reserve's commitment to very low interest rates in 2003 and 2004 was too low for too long and contributed to the housing and credit boom and subsequent busts.

Between August 2002 and January 2005—two-and-a-half years—the federal funds rate was below the rate of core inflation. Such low interest rates encourage borrowing and a buildup of debt, sometimes in ways we do not fully appreciate until much later with the benefit of hindsight. In addition, low interest rates—especially with a commitment to keep them low—led banks and investors to feel “safe” in the search for yield, which involves investing in less-liquid and more risky assets. In addition, financial institutions often search for yield by increasing the amount of assets supported by each dollar of net worth—leverage. For example, leverage at securities broker dealers

rose dramatically. After averaging just 13¼ between 1970 and 2000, leverage climbed to a high of 40 in the third quarter of 2007—the start of the financial crisis.

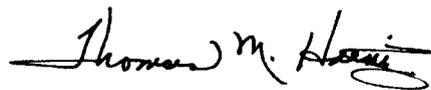
It was after a period of too-low interest rates, too much credit, too much leverage that the collapse of the housing bubble, the rapid deleveraging and the ensuing financial crisis occurred. And it was after these events that unemployment rose to more than 10 percent and the United States lost 8.4 million jobs. In 2010, we have gained back only 573,000 jobs.

In another period, the mid-1970s and early 1980s, low interest rates also triggered an extreme swing in the economic cycle. The real fed funds rate was kept negative for a span of nearly three years, from November 1974 to September 1977. The low interest rate environment led initially to a drop in the unemployment rate. But rising inflation and asset bubbles eventually dictated a restrictive monetary policy implemented by Fed Chairman Paul Volcker and his FOMC colleagues. In the end, the nation paid a high price for the low rates of the 1970s, when unemployment reached 10.8 percent in the recession of the early 1980s.

In the drive to achieve price stability and stable growth, monetary policy is a powerful tool. Certainly lowering interest rates is the appropriate monetary policy response to the onset of an economic recession and rising unemployment. But it is also a blunt instrument that has a wide set of intended but also unintended consequences that can and

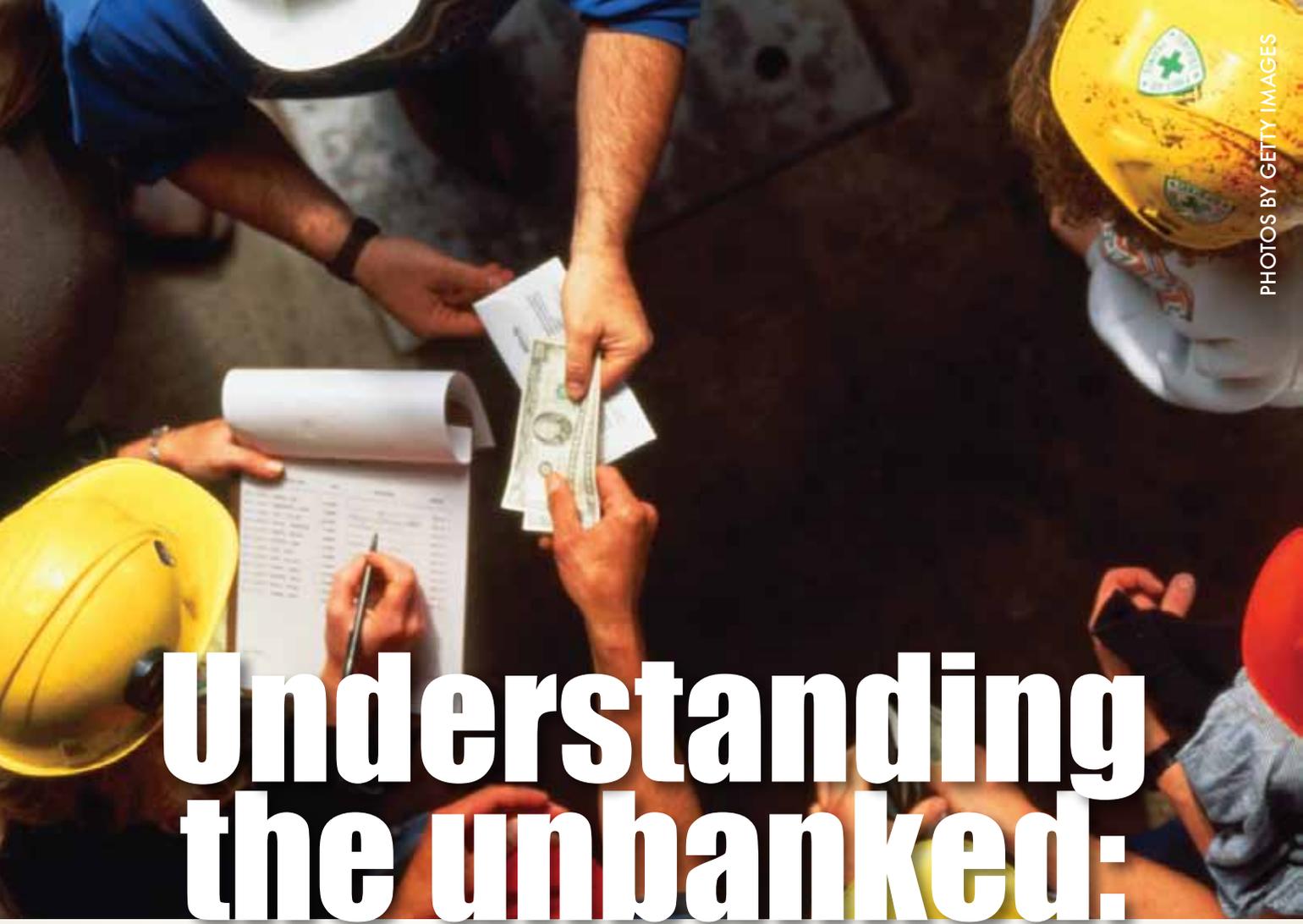
have worsened economic outcomes including misallocation of precious resources, inflation and long-term unemployment. That is why we want to return to a sustainable long-term equilibrium policy rate, starting soon.

The economy is improving and policy should reflect that fact, carefully but confidently. Although we find ourselves in a unique environment, history offers us some important lessons. If we do not learn from past mistakes, we will find ourselves repeating them yet again.



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

Read more recent speeches from  
President Hoenic at [KansasCityFed.org](http://KansasCityFed.org).



# Understanding the unbanked:

## Kansas City Fed listens to consumers through regional focus groups

**B**ecause she lives paycheck-to-paycheck most months, Destany, a 24-year-old resident of Omaha, Neb., considers budgeting for each month's expenses an essential part of tracking her finances.

But, a checking or savings account isn't a part of the newlywed's money management strategy. Instead, she pays for everything with cash or money orders.

"It's not a necessity of ours," Destany says of checking and savings accounts. On payday, she takes her check to a store to be split into money orders and cash, which she then delivers by hand to utility companies or other creditors

"We pretty much just get money orders,

and then we'll just go and pay them," Destany says. "(We) pay cash for the phone, utilities ... and things like that."

Anything left over after the bills are paid, which is often very little, is kept at home rather than in a savings account, she says. Destany's experience outside the traditional banking system is not uncommon, says Steven Shepelwich, a senior Community Affairs advisor at the Federal Reserve Bank of Kansas City's Oklahoma City office. Shepelwich and his colleagues recently conducted a qualitative study to examine the attitudes and strategies of the unbanked, those who do not use banks, and the underbanked, those who use banks minimally.

“Most consumers say they understand a bank account can help them reach goals like owning a home, buying a car or improving their credit,” Shepelwich says. “However, many choose not to use banks and turn to informal ways of handling their money, even if those methods are less secure and, often, more costly.”

Destany is one of several dozen people who shared their experiences in a series of focus groups the Kansas City Fed hosted last winter to better understand the attitudes and strategies of the Tenth Federal Reserve District’s unbanked population. The District includes western Missouri, Kansas, Colorado, Nebraska, Oklahoma, Wyoming and northern New Mexico.

“Unbanked and underbanked consumers are finding checking and savings accounts less relevant to their financial lives, but research shows that access to safe and affordable bank services is a key step in achieving personal financial stability,” said Tom Hoenig, president of the Federal Reserve Bank of Kansas City. “We hope this study will provide an understanding of these challenges and assist financial institutions, policymakers and community organizations in improving the outcomes for all involved.”

As a result of the focus groups, which involved small group interviews with 76 unbanked or underbanked individuals in Kansas City, Omaha, Denver and Oklahoma City, a clearer picture emerged of why some people decide to forgo a relationship with a bank, Shepelwich says.

“Throughout the focus groups, unbanked individuals described financial hopes and worries that are familiar to most people: the importance of saving, establishing a good credit history, managing their debt and sticking to a budget,” he says. “But, often low and unstable incomes and sometimes a lack of financial knowledge or understanding about banking become the largest barriers for the unbanked.”

## Who are the unbanked?

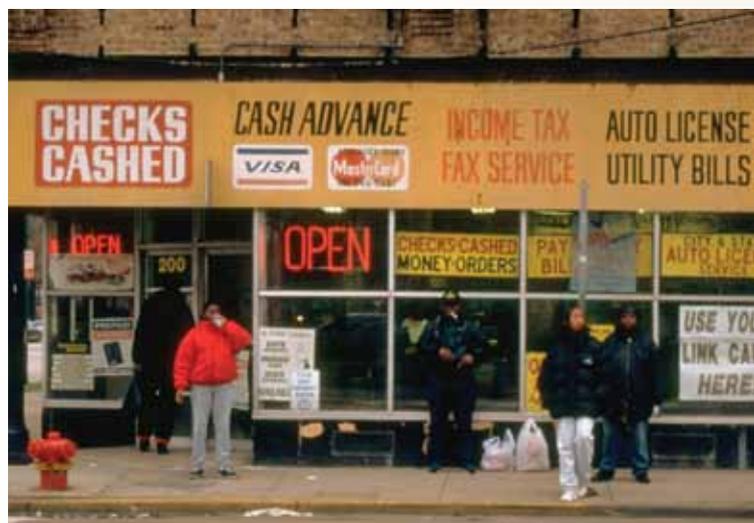
Recent studies estimate that more than 30 million households in the United States—and

more than 2.3 million in the District—are unbanked or underbanked, meaning they rely on nonbank businesses for all or some of their financial service needs, such as check cashing, bill payment, remittances or borrowing.

The focus groups conducted by the Kansas City Fed’s Community and Public Affairs departments sought to uncover the reasons why the unbanked mistrust banks, how that mistrust developed over time and how these consumers manage their finances outside the traditional banking system.

“This information will help us better understand the needs of the unbanked consumer and how financial educators and institutions can better assist them in establishing financial security and stability,” says Tammy Edwards, assistant vice president of Community Affairs at the Kansas City Fed. “This study is just one way we support the Federal Reserve’s objectives of promoting community development and fair and impartial access to credit.”

The focus groups revealed that many unbanked consumers faced financial pressures



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EACH DAY, AN ESTIMATED 2.3 MILLION HOUSEHOLDS across the region—more than one in four—go to payday lenders, check cashing outlets, convenience stores and other nonbank businesses to meet their financial service needs. A new study by the Kansas City Fed provides insight into why some consumers choose to manage their money outside the traditional banking system.

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and other challenges that constrained their ability to use banks. For example, Shepelwich says, many participants lived paycheck-to-paycheck and had limited or unstable incomes.

“Because there was no money leftover at the end of the week, and there was no money to save, they didn’t see any benefit to opening a savings account,” he says. “In addition, limits on the availability of funds and minimum balance requirements also reduced the perceived usefulness of bank accounts.”

Past negative experiences with banks, confusion about bank products and services, and a strong need for physical control of money were also cited as reasons why the focus group participants did not use banks.

A participant from Denver who works part-time and receives disability benefits said a bad experience led him to now “do mainly everything with cash and money orders.”

“In the past, I had lots on credit cards and was in a lot of debt,” the man said. “Now, I pay cash for everything.”

Another participant said he stopped using banks after overdraft fees piled up.

Many of the participants noted the ease and convenience of being able to cash checks, pay bills and get money orders at the same place they shop. The participants said the simple and

transparent fees charged by retailers made them the preferred choice. Retailers are conveniently located and provide services at night and on Sundays.

## The impact of family, culture

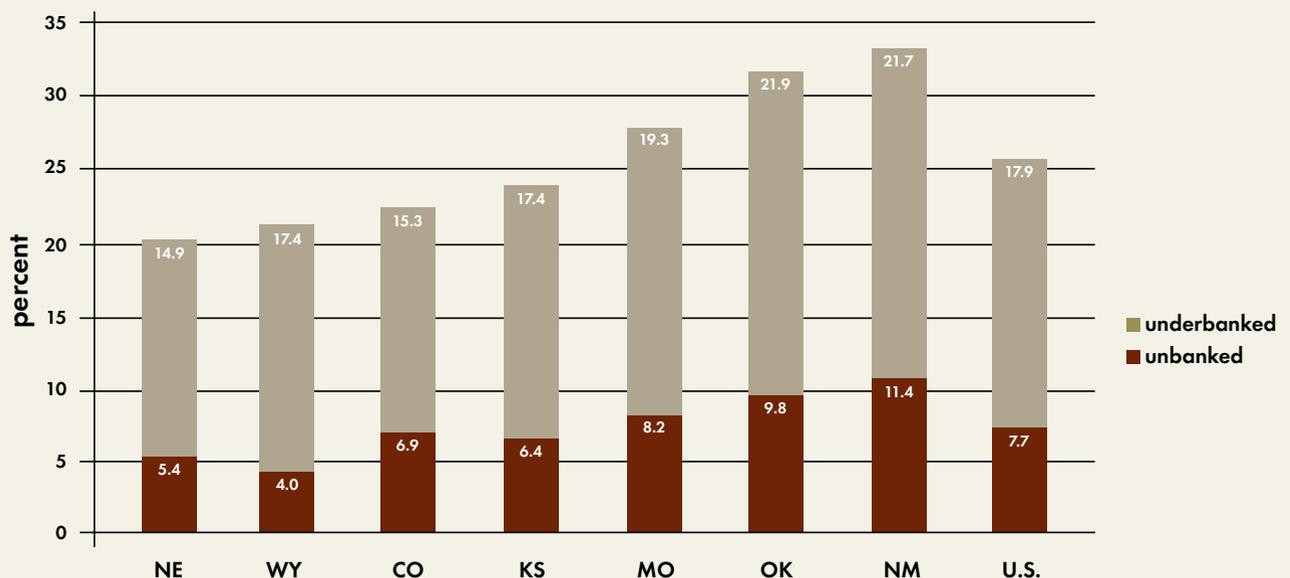
For many of the unbanked and underbanked surveyed by the Kansas City Fed, families and culture were among the strongest factors that led to their decisions to use alternative financial service providers rather than banks, Shepelwich says.

“Many participants in the focus groups said a family member had helped them open a bank account before they were ready to handle the responsibility of managing their money, which led to problems with their account and, eventually, the perception that banks were not necessarily useful for them,” he says.

A young mother who participated in the study said she started with a checking account her parents helped her open. However, she soon realized she was not ready to manage the account, and she could not keep track of her debit card transactions. Soon, her account was closed. The experience damaged her credit and, she says, has kept her out of the banking system.

Other participants noted family members’

## The unbanked and underbanked population in the Tenth District



attitudes about banks played a pivotal role in their own feelings about financial institutions. Several said they remembered their parents keeping money in the house, either in a closet or in a box under a bed.

Cultural factors also played a large role in how some Hispanics perceived banks. Language barriers, identification requirements, and comments from friends and family about high fees and negative banking experiences were considerable obstacles for this segment of the unbanked population, Shepelwich says.

Also notable is the use of culturally derived money pools, known as “tandas,” which some Hispanics use as a way to save for larger purchases, such as a down payment for a car or house. A tanda starts with about a dozen people contributing to a pool of money every week or bi-weekly. The tanda organizer receives the amount of the pool in the first week. The contributors then decide among themselves or hold a raffle to determine the order of who receives the pool for the remaining weeks. The tandas are potentially risky, considering that the organizer or participants could leave after receiving their part of the pool.

## Reaching the unbanked

In Fort Morgan, Colo., an agricultural community with a large migrant worker population, 60 percent of the adult population may be unbanked, according to some estimates.

John Sneed, president and CEO of Fort Morgan State Bank (FMSB), says the area’s immigrant population, made up of workers from Mexico, Puerto Rico, Somalia, Nigeria and other countries, is often distrustful of banks and the services they offer.

“Like many people all over the world, these workers rely on referrals,” Sneed says. “If someone in their family or friend circles likes the bank, then they will come and talk with us. If someone doesn’t like us, the worker won’t even look at you.

“We also have to educate them that banks in the United States are not like the banks in their home countries,” he adds. “Their money is guarded” by regulators.

Several years ago, FMSB began looking

at ways to better serve the area’s growing unbanked population. Soon, one of the area’s largest employers, Cargill, an international food producer, approached the bank seeking a partnership. A majority of the local plant’s employees were immigrants who did not use checking or savings accounts, and Cargill was looking for a way to promote direct deposit services.

In 2007, the bank opened a branch inside the Cargill plant that offered check cashing along with deposit services and a 24-hour ATM. During employee orientation meetings, Cargill explains the bank’s services, which include a free checking account, a complimentary box of checks, direct deposit and interest bonuses for savings accounts.

“Our biggest success has been educating our customers who have become financially independent and confident to open deposit accounts and get loans,” Sneed says. “The challenge has been to remain patient during this process. Because of the banking practices in many of their home countries, their trust in any bank is nonexistent.”

Education is the key to better reaching the unbanked, Shepelwich says.

“Through our focus groups, we learned that many unbanked individuals have a need for simple, affordable and easy-to-understand banking services,” Shepelwich says. “Combating the misperceptions and the knowledge barrier can go a long way in helping this group establish financial security.”



**BY BILL MEDLEY**

TEN CONTRIBUTING WRITER

## FURTHER RESOURCES

The full report on the unbanked, an executive summary, summaries for financial institutions and financial educators, and other resources are available at [unbanked.kcfed.org](http://unbanked.kcfed.org). A link to a recent quantitative study of the unbanked by the FDIC is also available.

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



# Power *players:*

Attracting young, educated residents to metros in the region

**E**d DeBarr heard Denver was a cool place.

So, along with his girlfriend Noelle, he packed up and moved from Ohio to the Mile High City three weeks after graduating from college—without friends in town, a place to live or any job offers.

“It was the city we wanted and then we’d find the jobs,” says DeBarr (pictured above).

They liked the climate, skiing, nightlife, professional sports and lower cost of living, among other amenities that Denver offers.

The couple found an apartment downtown across from Coors Field and quickly made friends with their neighbors, also young adults who were drawn to the city from Florida and Montana for the same reasons. Soon, temp jobs led to permanent ones and nearly four years later, Ed and Noelle, now married with a baby, still love living in Denver.

In retrospect, the move “was very risky,” he says with a laugh.

But it’s a gamble many young, educated childless adults take. And cities are noticing, says Kelly Edmiston, a senior economist at the Federal Reserve Bank of Kansas City.

“A big question metros are asking is whether people follow jobs or jobs follow people,” he says. “Because the latter has increasingly become the norm, state and local governments are focusing on luring young, college-educated residents by creating an attractive environment for them to live. Having a workforce already made up of this demographic is of course appealing to employers, whose presence boosts economic development in these cities.”

As a whole, metros (those with populations above 500,000) in the Tenth Federal Reserve District don’t draw as many young professionals as other cities even though economic factors are favorable, says Edmiston, who recently researched the region’s migration trends for this power group. The District includes western Missouri, Nebraska, Kansas, Oklahoma, Wyoming, Colorado and northern New

Mexico. There are some exceptions, including Denver and Kansas City, but other metros such as Wichita, Oklahoma City and Omaha seem to attract fewer young, educated residents than would be expected given their populations, wages and housing costs.

“The difference between these cities seems to be a quality-of-life issue,” Edmiston says. “A nice paycheck or low mortgage is only part of the package. This power group wants culture and recreation. After work they want to go to happy hour, concerts and hiking.”

Such is true for Ed DeBarr. His career in marketing at Janus, a large investment management company, is important, but so is how he spends his free time.

“I want to enjoy life,” he says.

## Influencing factors

Location is nearly as important as job satisfaction in determining happiness according to the Gallup Organization. Edmiston’s analysis shows many metros in the District lack amenities attractive to the power group, though economic factors are positive.

### **Economic factors associated with migration:**

- **Unemployment:** The District generally has lower unemployment rates than most other metro areas in the country.

- **Wages:** Average weekly wages in most large metros in the District are higher than the national average, sometimes substantially more, such as in Denver (by 38 percent) and Kansas City (by 27 percent).

- **Taxes:** District cities as a whole have significantly lower per capita property tax collections than U.S. metro areas as a whole.

### **Other factors associated with migration:**

- **Arts and culture:** The District’s metros have fewer performing arts companies than other metros.

- **Sports, recreation and dining out:** The number of golf courses, ski facilities, recreation centers and the like, as well as restaurants and bars, is in line with national average.

- **Colleges and universities:** The District’s metros have similar ratios to others, with

exceptions such as Denver and Albuquerque, which are significantly lower, and Oklahoma City and Omaha, which are significantly higher.

- **Crime:** Data from 2008 show rates were lower than the national average in Denver, Colorado Springs and Omaha, but significantly higher in Kansas City, Albuquerque, Oklahoma City and Wichita.

## Wanted: An educated workforce

“An increasing trend today is for firms to seek out locations where the workers they need are located rather than places that offer the lowest direct costs,” Edmiston says. “Companies can move to the kind of place where they know the employees they need will be attracted.”

Mega computer company Dell has business centers with a thousand or more employees in cities around the world, including in the District’s Oklahoma City. The sales and customer service center is near the Oklahoma River and just a few miles west of downtown.

“One of the primary considerations for Dell is the availability of a skilled workforce and the availability of institutions of higher



**CITIES WANT TO ATTRACT YOUNG**, college-educated workers by creating an attractive living environment, including recreation and entertainment. In Kansas City, Mo., during the monthly “First Friday” event, art galleries, shops, and restaurants offer specials to patrons while vendors and performers fill the downtown streets.

education with which we can collaborate to develop training programs to ensure a continuing supply of qualified employees,” says Jess Blackburn, a Dell spokesperson. “Certainly Oklahoma City met that requirement.”

The city’s metro area has a population of roughly 1.2 million and three large universities close by: Oklahoma City University; Oklahoma State University in Stillwater and University of Oklahoma in Norman.

“Since most of our employees were recruited from the immediate area ... the existing pool of potential employees was a big consideration in locating there,” Blackburn says. “Beyond the factors of the workforce, we look for places where the local government is supportive of business development. Again, Oklahoma City has that type of environment.”

In the past, Oklahoma City has had difficulty drawing young residents. Census data from 2000 show just 9.7 percent of the population was between ages 18 and 24. The 45- to 64-year-old group made up the largest segment of the population with 35.3 percent. Some of the city’s amenities, such as the Bricktown entertainment district and ballpark, are recent efforts to bolster its urban appeal. Overall, though, Edmiston’s data show Oklahoma City lures fewer residents than expected given its economic assets.

## **The business of attraction**

From 2007 to 2008, more than half a million residents moved to one of the seven states in the District. The mobility rate of young adults with a college degree is almost twice that of those without a college degree, Edmiston says.

Young professionals not only are more likely to move, but also have become scarcer, making the competition stiff among cities to lure them, Edmiston says. Weaker ties to employers and willingness to job hop means workers are more likely to consider quality of life when deciding where to live, he adds. So it’s no wonder policymakers and businesses want to tout amenities that appeal to the power group.



Both jobs and amenities have to be there for a young professional to be attracted to a city, says Bob Marcusse, and Kansas City does pretty well.

Marcusse is the president and CEO of the Kansas City Area Development Council (KCADC), a nonprofit charged with stimulating economic growth by promoting the region as a business location. More recently, though, KCADC is focusing efforts on recruiting young professionals as well. One of its programs, KC2.0, promotes career and lifestyle, including competitive salaries and entertainment options.

The Kansas City metro area, which spans Kansas and Missouri and has a population of roughly 2 million, is home to Hallmark Cards, Sprint-Nextel and H&R Block, among other large companies’ headquarters. A recently revitalized downtown includes the Power & Light District, which is nine blocks of retail, entertainment, office and residential space, and the nearby Sprint Center, which is a multiuse indoor arena with roughly 19,000 seats that has hosted performers ranging from Elton John to Britney Spears. To the west, the under-construction Kauffman Center for the Performing Arts will house the symphony,



Noelle and Ed DeBarr play with their son, Owen, at an urban park in Denver, Colo. The young couple left Ohio for the city's natural and cultural amenities several years ago. Denver successfully draws young professionals based on these factors as well as economic ones, such as living costs and wages.

ballet and opera.

"We have a long list of organizations that exist to connect and engage young residents in the things they are most interested in," Marcusse says. "...Where K.C. stands out is that our salaries rank above the national average, but our cost of living is 30 percent below the national average. That makes for a pretty competitive package."

Kansas City lacks a strong transit system and diversity, and there are concerns about the quality of its public schools and high crime rate, according to a 2008 KCADC study.

"In recruiting companies, workforce is almost always the number one deciding factor for them as they evaluate locations to expand or relocate," says Marcusse, adding KCADC likes to point out the high percentage of college-educated professionals in the region—32 percent of the Kansas City workforce has a college degree compared to the national average

of 27 percent.

In addition to companies locating where young professionals live, there are other benefits for the city—young professionals tend to be more engaged in a community, Marcusse says, whether it's going to entertainment venues, shopping, dining or philanthropy.

Recruitment efforts can also diversify the local industries. Wichita, Kan., where the driving industry has long been aviation, is suffering from a declining manufacturing base. Efforts by the Wichita Downtown Development Corporation and community groups like ROK ICT! are dedicated to growing the local arts through events and resources, which also gives an economic boost to downtown while bolstering the industry through job creation, tourism and more.

Back in Denver, Ed and Noelle DeBarr are happy they followed their gut instinct "to just try something different" rather than move back to the East Coast, where they both grew up. They have a nice life, DeBarr says, which has become even more important with the addition of baby Owen. The couple likes the idea of raising their son in a city surrounded by mountains, with opportunities for outdoor recreation plus urban living.

"I think we'll stay here long term," DeBarr says.

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BY BRYE STEEVES, EDITOR

## FURTHER RESOURCES

### "ATTRACTING THE POWER COHORT TO THE TENTH DISTRICT"

By Kelly D. Edmiston  
[KansasCityFed.org/TEN](http://KansasCityFed.org/TEN)

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

# Rural America in 2010

## Producers, lenders recover from recession

**A**s the U.S. economy emerges from recession, prospects for a rebound in rural America are also rising.

“2010 looks promising for farmers and agricultural lenders alike,” says Jason Henderson, an economist and branch executive at the Federal Reserve Bank of Kansas City’s Omaha office. “Rural job losses are slowing, farm incomes are rising, access to credit is improving and farm programs are evolving.”

Henderson, along with Maria Akers, an associate economist, recently researched the financial challenges facing farms as well as the year ahead for rural America. Economist Brian Briggeman, also at the Omaha Branch, analyzed two farm programs and Alison Felix, in Kansas City, looked at fiscal challenges.

The Kansas City Fed commits resources specifically to understanding the rural areas of its region during both good and bad economic times, Henderson says. This tradition stems from the makeup of the Tenth Federal Reserve District—western Missouri, Nebraska, Kansas, Oklahoma, Wyoming, Colorado and northern New Mexico—and its large agricultural presence. Efforts include dedicating research staff to rural issues, maintaining a fixed presence around the region, hosting events and producing numerous publications examining rural economies.

“We’re always tracking rural America,” Henderson says. “More recently, there’s reason to be optimistic.”

Here’s a look back and what may be ahead.

### Credit

Some farmers have struggled to obtain financing. In 2009, farm profits dropped and lending risks grew. In response, ag lenders raised their credit standards. Credit conditions remain tight despite the crisis easing, but new profit opportunities and lower loan default rates should improve access to credit for many producers in 2010.

### Lenders

Ag banks had a relatively strong performance during the financial crisis and remain in solid financial condition. However because the recession curbed ag profits and the demand for ag products, the risk on ag loans has risen. Still, interest rates on ag loans remain low and banks report funds are available for borrowers who can meet higher collateral requirements to qualify for financing.



## Recovery

In 2009, the farm boom faded and activity on Main Street took a hit. By year-end, the global economy rebounded and rural economies stabilized, though at low levels. In past recoveries with slow job growth, rural areas recovered more quickly than metro areas. This time, rural economies have kept pace with their metro peers. The rural economy in 2010 may be shaped by the national recovery. Stronger global economies and a weak dollar could offer new export opportunities.

## Fiscal Challenges

Fiscal challenges at state and local governments are a potential threat to economic recovery in rural America. Rural communities depend heavily on intergovernmental transfers from the states to provide local services, and many people rely on state or local governments for their jobs and on Medicaid as part of their income. Although strong rural real estate markets continue to support property tax revenues, rural governments must still find ways to offset declines in intergovernmental transfers. Tough times require tough choices, but there is an opportunity for rural America to spur new innovation in service delivery through consolidation, cooperation and privatization of services.

## Producers

Overall, farm debt levels remain near historical lows, but some ag sectors are more highly leveraged than others. Larger farming operations, livestock producers, and young and beginning farmers typically have higher debt levels and less ability to service debt, especially when demand for ag products is declining and farm incomes fall. Rebounding farm profits, spurred by a global economic recovery, should bolster farm income statements and balance sheets. This could open up the flow of credit and foster additional investments in U.S. agriculture.

## [KansasCityFed.org/TEN:](http://KansasCityFed.org/TEN)

### FURTHER RESOURCES

#### "FINANCIAL CHALLENGES FACING FARM ENTERPRISES"

By Jason Henderson and Maria Akers

#### "WILL THE RURAL ECONOMY REBOUND IN 2010?"

By Jason Henderson

#### "THE NEW ACRE PROGRAM: COSTS AND EFFECTS"

By Brian C. Briggeman and Jody Campiche

#### "RURAL AMERICA'S FISCAL CHALLENGE"

By Alison Felix and Jason Henderson

### RELATED PUBLICATIONS

Main Street Economist

Survey of Agricultural Credit Conditions

The Manufacturing Survey

The Beige Book

## Farm Programs

This year, many farmers will choose to remain in the more familiar 2002 farm program or enroll in the new Average Crop Revenue Election (ACRE) program, which protects against revenue shortfalls from falling prices or low yields, but requires farmers to forgo a portion of their traditional 2002 farm program payments. The decision to enroll in either program will affect farm profits, which, in turn, could reshape farmland values and the overall costs of farm programs.

# Too low *for* too long?

**Kansas City Fed economist looks  
at impact of monetary policy decisions**

COM  
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**BREAKING  
NEWS**

|             |        |        |      |       |               |
|-------------|--------|--------|------|-------|---------------|
| 4W          | 12     | -0.01  | 13   | 12    | 3M            |
| 3M          | 25     | 0.00   | 25   | 25    | 6M            |
| 6M          | 43     | 0.00   | 43   | 42    | 1Y            |
| 1Y          | 87     | 0.03   | 87   | 85    |               |
| S&P 500 FUT | 709.00 | +18.82 |      |       | CCMP          |
| 900 EURS    |        |        |      |       |               |
| DEALER CP   |        |        |      |       |               |
| SK/CHG      |        |        |      |       |               |
| 27          | 99-27+ | -04+   | 150  | 0.420 | MAR           |
| 30+         | 100-01 | -09+   | 300  | 0.870 | JUN           |
| 30+         | 99-21  | -17+   | 600  | 0.960 | SEP           |
| 7-30        | 97-31  | -30    | 900  | 1.340 | DEC           |
| 8-25        | 98-27  | -1.10  | 1200 | 1.500 | MAR           |
|             |        |        | 1800 | 1.700 | JUN           |
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**A**s the nation emerges from the worst economic recession since the Great Depression, one of the key questions facing policymakers will be whether monetary policy may have inadvertently played a role in fostering financial imbalances that eventually led to the crisis.

This question is not unique to this crisis.

While the recent crisis had a substantial economic impact, during the past quarter century the United States faced a number of economic shocks, including the Russian debt default and the bursting of the high-tech bubble. To some extent, each crisis was preceded by a buildup of financial imbalances.

George Kahn, vice president and economist at the Federal Reserve Bank of Kansas City, recently completed a research article looking at the crises of the past 25 years to determine if monetary policy focusing on stable inflation and long-term growth may have left interest rates too low for too long and fostered the turmoil.

Kahn's research is based on what is known in economics circles as the Taylor rule. First proposed in 1993 by economist John Taylor, the Taylor rule suggests how a central bank should adjust monetary policy based on such variables as the inflation rate and the level of gross domestic product (GDP). Although not used explicitly by the Federal Reserve's policy-setting Federal Open Market Committee

(FOMC)—which must also consider other factors including data not encompassed by the comparatively simple formula—the Taylor rule does align closely with policy moves during the late 1980s and early 1990s. As Kahn notes in his research, the rule has become a key guidepost for policymakers.

In his research, Kahn looks at four variations of the Taylor rule to define so-called “off-rule” behavior by Federal Reserve policymakers. His analysis uses data available today, which incorporates revisions that would not have been available to policymakers in real time. His goal was not to identify policy mistakes, but to see what impact the decisions may have had on financial imbalances. Kahn found that the fed funds rate, as targeted by the FOMC, closely followed the Taylor rule for a 10-year span starting in 1987. The fed funds rate is the interest rate depository institutions lend balances to each other overnight.

“From 1998 to 2008, however, the fed funds rate was frequently and persistently below the prescriptions from all versions of the Taylor rule by almost 2 to almost 6 percentage points,” Kahn says.

Two episodes stand out.

The first is from late 1998 through 2000. This period encompassed: the liquidity crisis connected with the Asian financial crisis in 1997, the 1998 Russian default and the later collapse of the hedge fund Long-Term Capital




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THE FEDERAL OPEN MARKET COMMITTEE (FOMC) forms monetary policy to ensure a healthy, growing economy. The FOMC is made up of the seven members of the Federal Reserve Board of Governors and five of the 12 regional Reserve Bank presidents, who vote on a rotating basis with the exception of the New York Fed president, who always votes. Kansas City Fed president Tom Hoenig is a voting member this year.

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Taylor rule prescriptions.

“Policymakers potentially fostered the financing of asset purchases with short-term borrowing, feeding a buildup of financial imbalances,”

Kahn says. “In addition,

they may have contributed to increased leverage, greater risk taking and speculation in commodity markets.”

## Asset bubbles

Monetary policy has been successful in containing inflation essentially since the Paul Volcker-led Federal Reserve took unprecedented action in the early 1980s. Although broadly successful by this measure, has policy contributed to boom and bust cycles in asset prices? And did it foster the most recent crisis?

“Ironically, the success of the Federal Reserve in responding to the 1987 stock market crash and the aftermath of the 1998 Asian financial crisis may have contributed to a view among investors that the stock market represented a one-way bet,” Kahn says.

In both of those cases, the FOMC aggressively lowered rates and put liquidity into the system. This belief, combined with the opinion the Internet would be a boon to business and the search for yield in an environment of low rates, may have led to the stock market’s high-tech bubble, Kahn says.

When it burst, the Federal Reserve once again lowered rates from 6.5 percent in 2000 to 1 percent in 2003.

“Moreover, the FOMC signaled in its statements that rates would remain low, first

Management. Looking back with perfect hindsight, the U.S. economy actually expanded briskly during this period, and while the fed funds rate target was lowered because of the unfolding crises, the Taylor rule actually called for a rate hike. In 1999, the FOMC reversed course and began to tighten policy, albeit at a slower rate than suggested by the Taylor rule.

The second notable episode was 2002 through 2006, which included the response to the 2001 recession. During this period, the FOMC slashed rates to 1 percent and held them there for a year amid concerns about high unemployment and sluggish GDP growth. There was even some discussion about the possibility, although remote, of deflation.

“Clearly, concern that the United States could experience the same kind of deflationary episode experienced in Japan in the previous decade weighed heavily on policymakers’ minds,” Kahn says.

In the United States, as policymakers hoped to avoid a crisis, they not only lowered rates, but also offered guidance on numerous occasions that rates would remain low for “a considerable period.”

“All of these statements (by the FOMC) contributed to a view among investors that a low level of rates relative to fundamentals would likely persist,” Kahn says.

Rates remained persistently well below

indicating that policy accommodation would be maintained for a 'considerable' period and then suggesting that it could be removed at a 'measured' pace," Kahn says. "This period of low rates may have set the stage for the 2008 global financial crisis."

Kahn notes that Taylor himself has argued that easy monetary policy from 2003 to 2006 helped to create the housing bubble.

"Taylor ran simulations that showed that the housing boom would have been less excessive in terms of housing starts had the federal funds rate followed the path prescribed by the Taylor rule instead of its actual path," Kahn says. "He also suggested the subsequent collapse of housing activity would have been less severe."

Not everyone agrees with Taylor, Kahn notes. Fed Chairman Ben Bernanke, most notably, disagrees with Taylor's conclusions and has offered his own case to suggest that the fed funds rate played only a small role in the housing boom.

Kahn also examined leverage activity, which he found accelerated rapidly from 2003 to 2007, and commodity prices, which rose from 2002 to 2007.

## The crisis of 2007-08

So, did easy money in the years before the crisis foster the recession?

That question will be debated for a long time, Kahn says.

A case can be made that low rates encouraged over-leverage, high-risk investments and a spike in home prices. But an argument can also be made that the Federal Reserve's actions were appropriate based on what was known at the time and that other factors were at work in fostering the crisis. One such factor suggested by Bernanke may have been a glut in global savings that sought safe harbor in U.S. assets.

Kahn also notes a real world challenge facing policymakers. William McChesney Martin, the Federal Reserve's longest-serving chairman, famously said that the Federal Reserve's job is "to take away the punch bowl just as the party gets going," but can that always

be accomplished?

"Detecting and leaning against growing financial imbalances may be difficult or impossible in real time," Kahn says.

Regardless, the question remains: Did steps taken to stabilize output and inflation cause other problems?

Kahn concludes that while there appears to be a statistically significant relationship between deviations from the Taylor rule and a number of financial indicators, their economic significance is mixed. With the benefit of 20/20 hindsight, it appears that the Taylor rule deviations helped to predict the housing bubble; it was not as useful in predicting other bubbles. One challenge in finding a robust relationship is that imbalances appeared in different areas at different times.

Policymakers may be able to be on alert for emerging imbalances that may suggest interest rates are too low even when real-time data on inflation and output might suggest low rates are warranted.

"Policymakers should be cautious in deliberately maintaining rates below Taylor rule prescriptions," Kahn says. "Although policymakers may have reasons to deviate from simple rule-like behavior, they should be alert to unintended consequences from maintaining rates too low for too long."

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BY TIM TODD, TEN CONTRIBUTING WRITER

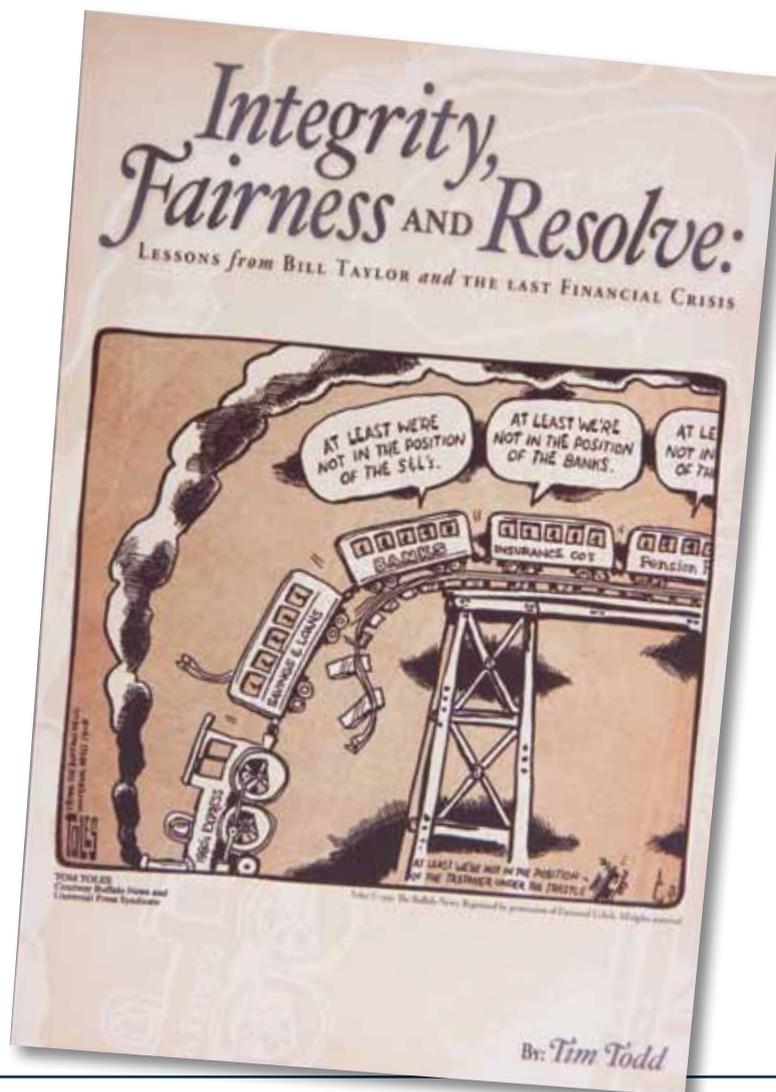
## FURTHER RESOURCES

### "TAYLOR RULE DEVIATIONS AND FINANCIAL IMBALANCES"

By George A. Kahn  
KansasCityFed.org/TEN

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

To learn more about the Federal Reserve System's FOMC, and to read minutes from its meetings, visit [KansasCityFed.org/TEN](http://KansasCityFed.org/TEN).



# LESSONS *of a* FINANCIAL CRISIS

**W**illiam Taylor played a central role in ensuring the nation's stability during the banking and financial crisis of the 1980s. During this time, Taylor was the Federal Reserve's head of banking supervision. Not unlike today, it was a time that presented the nation with challenges. The country saw widespread bank failures, the collapse of the savings and loans, and the introduction of the idea that a firm could be too big to fail.

Due in large part to his exceptional performance in handling these and other crises, Taylor was named head of the Federal Deposit

Insurance Corporation (FDIC) in 1991. His FDIC tenure, however, was cut short when Taylor died less than a year later.

Recently, the Federal Reserve Bank of Kansas City published "Integrity, Fairness and Resolve: Lessons from Bill Taylor and the Last Financial Crisis" to help Federal Reserve bank examiners understand the history and parallels to the recent financial turmoil.

Former FDIC Chairman William Issac said that if Taylor had not died after only 10 months in office, "he would have gone down in history as the best chairman the FDIC has ever had." It was a comment echoed by many

others, who noted that Taylor was also the greatest director of supervision in the Federal Reserve's century-long history.

Of course there is no way to know what Taylor would have thought about today's environment, or how his opinions on banking supervision and regulation would have evolved over time.

"If Bill were here today, he would probably share my disappointment that we learned so little from the crisis of the '80s," says Kansas City Fed President Tom Hoenig. "After that crisis, no 'rules of the road' were introduced that are fundamental to performance. Clear and enforceable rules work to contain excess risk during the booms and mitigate misery during the correction. Now, as we work to overhaul financial regulation in this country, implementation is key."

**regulators:** "I've always answered this question in a very straightforward fashion and the answer is 'no.' There should be one. It should be the Federal Reserve. Many people don't agree with that, but that's my opinion."

**Examiners being "wrong":** "You can't be single minded and say that all loans must have cash flow. But what we are teaching our examiners is this: If they are not going to criticize a loan for a project that does not have a prospect of fairly immediate revenue, they must have an exceptional story. ... I can recall examiners classifying real estate credits that didn't have sufficient cash flow based on existing market economics, and the bank arguing violently with them. Then the building would sell for twice the loan value. Bankers would turn to the examiner and say, 'See, you people were wrong about collateral values,' and

## **"If Bill were here today, he would probably share my disappointment that we learned so little from the crisis of the '80s."**

*Kansas City Fed President Tom Hoenig*

Looking back, Taylor's comments then have a connection to today's crisis and ongoing recovery:

**Complex mortgage products:** "Some (adjustable rate mortgages) are more complicated than a VCR; you have to understand the arithmetic to be sure you are making the right payment. We find cases all the time where banks charge the wrong amount inadvertently. If the errors are in the bank's favor, they have to make restitution. But even though we watch out for you, you must also watch out for yourself."

**Fed's supervision role:** "The key role for the central bank in all this is to see that in the process of change, the stability of the banking system is maintained. As the lender of last resort, it is essential that the Federal Reserve be able to assess the risk of new powers and new geography. Maintaining a strong supervision function is essential in this regard."

**Need for three federal banking**

at the time, it looked that way, but sometimes worse than being wrong is being right too soon."

**Deregulation / the then-proposed repeal of Glass-Steagall:** "Bankers, and rightly so, argue that the reason they need more powers is because everyone else is in their business and yet (they) are kept out of everyone else's. To a degree, this is true. Big corporations no longer go to the banks for their loans. They generally access the public markets directly through the commercial paper mechanism. Every insurance man and broker, every department store, offers a kiosk that says, 'We'll invest your money, we offer a mutual fund, you can write checks, we take care of all of your financial services.' And so we've come to have a psyche of financial services industry. And so it goes. And some people think that these additional powers can lead to greater problems and potential conflicts of interest in the provision of financial services. But you'd have to say the course of the debate,



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AFTER A LONG FED CAREER, BILL TAYLOR was sworn in as FDIC chairman on Oct. 31, 1991. His first and only year at the FDIC helm would be impactful, though it would be brief.

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the tender of the debate, really seems headed for more powers for banks. Now one never knows. It's not over 'til it's over. But there seems to be an awful lot of conversation in this regard and ... (this) old examiner ... has these suspicions lurking in his heart. Suspicions that say the answer to world hunger is not eating someone else's lunch."

**Another potential crisis similar to the savings and loan debacle:** Bank supervision and regulation "...is a business of worrying and today we have to be in that mode when thinking about the real estate situation and the increasing corporate leverage that you see in these leveraged buyout deals. Combine these worries with a strong and growing economy with stable prices and low interest rates and one's sense of well-being appreciates. However, add a more negative scenario on these other factors and life gets tougher. Hopefully, another S&L-type crisis is not looming out there, but the fact that we have had such a crisis ought to make all of us in the business of banking supervision pay very close attention to our business."

**Consolidation, deregulation and internationalization:** "You come down to the end of the road and you say there's stress and

there are all these changes and what is the future of banking? ... It looks like pressure for more deregulation will continue. Banks getting into other businesses, more internationalization of banking markets, you'll be able to cash your check in Paris drawn on your Japanese bank in Chicago. The holding company structure will continue to grow, maybe at the margin, meaning less local control, maybe more services. Banking concentration measured on a national market basis will no doubt increase. Bigger banks will get bigger. There will be more big banks. Not to say that the small banks (will disappear) ... but the country is seemingly headed towards a higher level of concentration. ... The banking structure of the country will change, and has changed I think already. It's just now a matter of playing it out from a state and county type of banking arrangement to a nationwide banking arrangement. It may take a while to sort through, but I think that's where it's going. ... Although I have some hope for moderation, the increased competition brought about by all these changes, and in combination with the fascination of this country for debt and leverage, will continue to create stress that will require very close attention."



BY TIM TODD, TEN CONTRIBUTING WRITER

The Federal Reserve Bank of Kansas City published "**Integrity, Fairness and Resolve: Lessons from Bill Taylor and the Last Financial Crisis**" to help Federal Reserve bank examiners understand the history and parallels to the recent financial turmoil. The book is free and available at [KansasCityFed.org](http://KansasCityFed.org).

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# Ask an Economist...

## What can be done to curb debit and credit card fraud?

While debit and credit card payments are convenient for consumers, widely accepted by merchants, and more efficient than cash or checks, concerns about their safety have increased, especially as consumers become more aware of identity theft.

Rightfully so, says Rick Sullivan, a senior economist at the Federal Reserve Bank of Kansas City. Annual fraud losses totaled more than \$3.7 billion in the United States, according to data from 2006.

Sullivan recently analyzed card payment fraud in the United States, including security vulnerabilities, criminal tactics and deterrence initiatives.

### Why is the Federal Reserve involved with credit and debit cards and what's its role?

**Sullivan:** The Federal Reserve has three mission areas. It formulates monetary policy, regulates and supervises financial institutions, and oversees the payments system. For payments in particular, we work to ensure they are safe, efficient and accessible. The Federal Reserve monitors developments in card payment fraud because it is important that consumers have confidence in the safety of payments.

### How has debit and credit card fraud evolved?

**Sullivan:** Traditional forms of card payment fraud, such as lost or stolen cards, are still prevalent, but newer forms of payment fraud are related to breaches of personal information. The main vulnerability is that fraudulent payments can be made with just a few pieces of information—the same information that the payment card industry uses in its payment approval process. At the same time, criminal efforts to get this information are increasing in organization, scale and level of sophistication, like writing malevolent software or establishing fake websites.

### How does fraud in the United States compare elsewhere?

**Sullivan:** U.S. fraud loss rates on debit and credit card transactions are higher than in Australia,

France, Spain and the United Kingdom. In the United States, significant factors that contribute to relatively high fraud include continued reliance on older technology, the use of signatures more than PINs to identify the cardholders and a highly developed Internet economy.

### What's being done to curtail fraud?

**Sullivan:** In the United States, the major credit card companies are leading efforts to improve security and control fraud. Projects include enhancing data security standards, supplementing approval systems of contactless payment cards, developing methods to encrypt payment data and disguising card numbers. Progress has been slowed by conflicts of interest, inadequate incentives and lack of coordination among participants.

### Can more be done?

**Sullivan:** Policymakers might consider a more active role. To guard against excessive fraud losses and to ensure confidence in card payments, policymakers need to monitor developments in card payment security. Additionally, industrywide statistics are needed on both the sources and level of fraud losses, which would help determine whether the industry continues to tolerate a relatively high rate of fraud. So far, the role of public policy has been to encourage the card payment industry to develop its own standards and procedures that limit fraud. Whether this policy stance is sufficient depends on the effectiveness of the industry's efforts to limit fraud in light of the dramatic shift toward card payments.

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BY BRYE STEEVES, EDITOR

## FURTHER RESOURCES

### "THE CHANGING NATURE OF U.S. CARD PAYMENT FRAUD: INDUSTRY AND PUBLIC POLICY OPTIONS"

By Richard J. Sullivan  
KansasCityFed.org/TEN

# About...

## *the* LMI Survey

Understanding low- and moderate-income  
community conditions

**T**he recent recession has hit this region's most vulnerable communities harder than past recessions.

Low- and moderate-income workers have remained unemployed longer. Higher skilled individuals who have lost better paying jobs have taken many of the jobs formerly held by these workers. These are some of the recent findings of the Low- and Moderate-Income (LMI) Survey published by the Federal Reserve Bank of Kansas City.

The LMI Survey was launched last year to monitor economic conditions affecting the LMI communities in the Tenth Federal Reserve District and the nonprofit organizations that serve them. The District includes western Missouri, Nebraska, Kansas, Oklahoma, Wyoming, Colorado and northern New Mexico.

The quarterly survey findings are posted online at [KansasCityFed.org](http://KansasCityFed.org)

"The purpose of the survey was to develop key indicators that would tell us about the financial health of low- and moderate-income communities," says Kelly Edmiston,

a senior economist in the Kansas City Fed's Community Affairs department and author of the survey. "We wanted to combine indicators, such as affordable housing, access to credit and employment, into one survey instrument that would allow us to track these trends over time."

The survey is sent to between 100 and 130 nonprofits in the District that regularly assist LMI individuals and families in some capacity related to their financial situation. The survey asks specific questions supported by open-ended ones that "help us to understand what is happening behind the numbers," Edmiston says. For example, recent survey results show more people are dependent on food pantries for the first time.

"This insight suggests that many have lost their jobs or have used up their savings," he says.

Among the benefits for nonprofits: They can get a clearer idea of the services that are most needed and compare the conditions they see with those of other assistance organizations.

The survey relies on indexes that range in value from zero, indicating the most deterioration in conditions, to a high of

200, indicating the most improvement in conditions. A value of 100 indicates little or no change.

Recent LMI surveys suggest that the overall financial condition of LMI consumers has continued to deteriorate (remaining below 100), but at a slower rate. But they also show that while demand for assistance has increased, funding for nonprofit organizations that serve LMI communities has remained largely unchanged over the last year and a half, possibly due in part to aid from the American Recovery and Reinvestment Act, Edmiston says.

“The overall trend is that the LMI economic situation seems to be stabilizing,” Edmiston says. “And things have to stabilize before they improve.”

Other Federal Reserve Banks around the country are looking at the Kansas City Fed’s survey as a model to see how it might be replicated or expanded to other regions of the Federal Reserve System.

Barbara Robles, senior research liaison with the Division of Consumer and Community Affairs at the Board of Governors of the Federal Reserve System, says one important benefit of an LMI survey is that it can provide “a better sense of what kind of community resources and

community-capacity support is really needed.”

Additionally, an LMI survey can result in a benchmark that can be used to capture and compare economic information that can act as an early warning system over time.

“This would allow us to strategize and innovate around sustainability issues,” she says, adding the state of LMI communities is often a “bellwether” of where the overall economy is heading.

Edmiston agrees that understanding what is happening in the LMI community can “lead to a better understanding of what is going on in the overall economy.”

Both Robles and Edmiston said this relationship makes the survey relevant to policymakers who want to keep their fingers on the pulse of the economy.

“They can make more informed choices about the policies they implement,” Edmiston says.

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**BY PAUL WENSKE,**  
TEN CONTRIBUTING WRITER

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## Community Connections

Community Affairs professionals at each of the 12 Federal Reserve Banks and the Board of Governors in Washington, D.C., provide financial institutions, nonprofits, city leaders and others with research and assistance on issues related to community and economic development, and access to credit.

At the Kansas City Fed, staff at each regional office take policymakers to the front lines by sponsoring programs, hosting events, conducting research and more. In addition to the Low- and Moderate-Income Survey, their efforts include work on Native American lending, unbanked populations, home foreclosure prevention and more.

Contact us or visit us online.

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## Earn to learn: Allowances teach kids value of money, responsible use

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

**J**ust because school is out doesn't mean learning has to go on vacation, too. Summer break is the perfect time to implement personal finance lessons. Consider using money as your teaching tool. Thinking back to my days in the classroom, nothing got my students talking like the topic of allowances and money management. Like adults, children are fascinated with money, so it's a great way to sneak in some valuable lessons on earning, spending and saving, and maybe even a little math.

Although many parents feel chores are a part of a child's responsibilities as a member

of the family and should not have a monetary reward, an allowance provides earned income and helps kids develop money management skills.

When paying your child an allowance, consider an amount appropriate to his or her age, but also decide whether it will be based on needs and wants, or simply discretionary funds. If parents are including non-discretionary expenses, such as lunch money and school supplies, the allowance amount should be higher and require more money management skills as the child learns to budget between basics and extras. Allowances that include non-discretionary expenses may be more appropriate for children 10 and older. When determining an amount, also consider the chores your child will do; what's feasible for your household income; payment increments; opportunities for "raises"; and the like. Other parents may be a good source, but the ultimate decision should rest on what you feel is reasonable.

Once these allowance decisions have been made, it is important to let each child in the family know the specific chores and weekly responsibilities necessary to earn their dollars. A family meeting may be in order to discuss who does what and to give your children input and buy-in. Our Chore Chart Check-Off on Page 28 may be helpful in listing these jobs, the total allowance and the child's plan for his or her earnings. This visual can help kids keep on track and save parents from nagging them. Our Allowance Agreement on Page 29 is a good format for preteens and older to spell out job and payment responsibilities, as well as assist in budgeting.

Once children begin earning their wages,



the money management lessons begin. Guidelines should be established for how the money can be spent, with non-discretionary items purchased first and the remainder divided between savings (promoted as “pay yourself first”), discretionary items and possible donations. Discuss and set amounts for each of these categories, and help your child stick to his or her budget. If the money for discretionary items runs out before his or her desires do, stress that no cash advances or IOUs will be available. The lesson of delayed gratification is better learned sooner than later. This also

will help lay the foundation for better credit decisions in the years to come. Expect that some spending mistakes will be made along the way as part of the financial learning curve. As your children become more confident in making spending choices, you should see them shift from spending loosely to comparison shopping and analyzing purchases. These newly acquired money skills will help develop consumer expertise and serve them well in the future.



## Financial Education Resources

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

### **Online resources at [KansasCityFed.org/TEN](http://KansasCityFed.org/TEN):**

**“Kids and Money: Teaching Children to Manage Their Finances”** is a booklet of family activities about savings goals, budgeting and shopping. For school-aged children.

**“Piggy Bank Primer”** introduces children to saving, spending and budgeting through a story format. For ages 6-9.

### **Fiction Books:**

#### **“Can I Have Some Money?: Max Gets It!”**

By Candi Sparks

Max wants the latest video game and begins earning an allowance to reach his goal. After wasting his money, he makes a financial plan that includes saving and giving to charity. For ages 7-10.

### **Non-Fiction Books:**

#### **“Allowance Magic: Turn Your Kids into Money Wizards”**

By David McCurrach

This “how to” book has two sections: An overview for parents on how to set up an allowance program and a “Money Wizard Journal” for kids to record job responsibilities and a financial plan. For ages 8 and older and parents.

#### **“Raising Money Smart Kids: What They Need to Know”**

By Janet Bodnar

This book touches on mastering six money skills; setting allowance systems; and helping kids learn the virtues of working for pay. For parents.

### **Online:**

For a calculator that determines how much allowance your child needs based on his or her expenses, go to [www.practicalmoneyskills.com/calculators](http://www.practicalmoneyskills.com/calculators)

For free activities, videos, curriculum and other resources, go to [federalreserveeducation.org](http://federalreserveeducation.org)

# Chore Chart Check-Off

FOR CHILDREN YOUNGER THAN 10

Help your child list his or her chores and track their completion. For children too young to write, help them draw a picture or use stickers to symbolize the task. Chores and allowances should be age appropriate and consider the child's discretionary and non-discretionary expenses.

Child's Name: \_\_\_\_\_

| My Daily Jobs   | S | M | T | W | T | F | S |
|---|---|---|---|---|---|---|---|
| Clean Bedroom  | ✓ |   |   |   |   |   |   |
|   |   |   |   |   |   |   |   |
|   |   |   |   |   |   |   |   |
| My Weekly Jobs  |   |   |   |   |   |   |   |
|   |   |   |   |   |   |   |   |
|   |   |   |   |   |   |   |   |
|   |   |   |   |   |   |   |   |

If I complete all my jobs, my allowance will be \_\_\_\_\_ each week, to be paid on \_\_\_\_\_ (day).

I will save \_\_\_\_\_ each week and donate \_\_\_\_\_ each week.

I will spend wisely.

Child's signature: \_\_\_\_\_

Parent's signature: \_\_\_\_\_



# Allowance Agreement

FOR CHILDREN 10 AND OLDER

It's important to discuss with your child how he or she will earn an allowance and how to manage that income. Writing down the specifics can be an opportunity to teach him or her the value of money and its responsible use, as well as the importance of saving and spending wisely.

## Jobs I agree to do to earn my allowance:



1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_

## Things I will be responsible to pay for with my allowance:

1. \_\_\_\_\_
2. \_\_\_\_\_
3. \_\_\_\_\_

My allowance will be \$ \_\_\_\_\_ per week/month, payable on \_\_\_\_\_ (day of week/time of month)

## When I receive my allowance, I will divide it into these categories:

Saving \$ \_\_\_\_\_

Spending \$ \_\_\_\_\_

Donating \$ \_\_\_\_\_

Child's signature: \_\_\_\_\_

Parent's signature: \_\_\_\_\_

## Kansas City Fed invites economic development leaders to two-day conference this fall

The Federal Reserve Bank of Kansas City invites economic development researchers, practitioners and other related parties to its conference “Economic Development in Underserved Communities: Where Research and Practice Meet” on Sept. 9 and 10 at its headquarters building at One Memorial Drive.

This national conference will be divided into four sessions:

- Attracting and Retaining Talent,
- Entrepreneurship and Small Businesses,
- Local Government Policy, and
- Collaborative Approaches.

Additionally, there will be break-out sessions for rural issues and urban low- and moderate-income issues.

Keynote speakers include Mark Partridge, chair of Rural-Urban Policy at The Ohio State University, and Carol Marinovich, former mayor of the unified government of Wyandotte

County and Kansas City, Kan.

“The conference brings together the latest research and practice in economic development in underserved rural and low- and moderate-income urban communities,” says Kelly Edmiston, Community Affairs senior economist at the Kansas City Fed, who is co-chairing the conference with Molly McGrath, Community Affairs advisor at the Omaha Branch.

The Community Affairs department of the Kansas City Fed supports the Federal Reserve System’s economic growth objectives by promoting community development and fair and impartial access to credit. Staff research related issues as well as bring together community stakeholders to explore solutions at events like this one and others.

For more information and to register for the conference, visit [KansasCityFed.org](http://KansasCityFed.org), or e-mail [kcecondev@kc.frb.org](mailto:kcecondev@kc.frb.org).



## Free assistance for foreclosure prevention

The Federal Reserve Bank of Kansas City's Community Affairs department in May co-hosted a free foreclosure prevention workshop for those struggling with their mortgages in the Kansas City metro area.

About 500 attended the homeowner assistance program. The Kansas City Fed and local housing partners joined with the HOPE NOW Alliance and NeighborWorks America to offer counseling on foreclosure prevention, budgeting, rental housing and jobs. The United Way provided information on other local programs that focus on individual and family needs.

"More often than not, borrowers have a chance to resolve mortgage issues and explore options to avoid foreclosure," says Paul Wenske, senior Community Affairs advisor at the Kansas City Fed. "We want to let them know help is available."

The Kansas City Fed has offered similar events in the past few years as the housing crisis has persisted. Its Community Affairs staff works to promote community development and fair and impartial access to credit. In addition to partnering with community stakeholders, the department also conducts related research, which often focuses on low- and moderate-income communities.

For more information on this event, and Community Affairs, visit [KansasCityFed.org/TEN](http://KansasCityFed.org/TEN).

## Traveling currency exhibit available for banks

The Kansas City Fed is offering its traveling exhibit of historic U.S. currency to banks and depository institutions in the Tenth Federal Reserve District for temporary display.

The exhibit features currency from the Colonial period through today. It focuses on historically significant items, such as State Bank notes, and also includes silver and gold coins, Confederate notes, and Demand notes, which are often called "greenbacks."

There is no charge to host the exhibit, but institutions must have at least \$5,000 in liability insurance and must pay shipping costs to transport the display to its next location. It ships in two cases, each weighing about 130 pounds. The exhibit is circular and needs a space of at least 6- by 6-feet to stand.

To reserve the exhibit, contact the Kansas City Fed at (800) 333-1010 ext. 2554.



COURTESY PHOTO

## 'Money Smart,' 'Teach Children' events promote financial literacy

The Kansas City Fed and partnering organizations hosted the annual Money Smart Week of Greater Kansas City in April, offering financial information through 154 free events.

Money Smart Week of Greater Kansas City is an annual program that brings together area organizations to offer resources to consumers of all ages and backgrounds. It is also an opportunity for financial education providers to showcase their work or services.

"The idea behind Money Smart is to build financial knowledge so consumers can manage their money more effectively and confidently," says Gigi Wolf, economic and financial education specialist at the Kansas City Fed. "It also raises awareness among area employers, government entities, social service organizations and others."

Three contests were sponsored to help students learn more about money management: a poster contest for kindergarten through second grade students, an essay contest for sixth through eighth graders and a video contest for ninth through 12th graders.

One event, Money Smart Day at the Fed, saw about 127 attendees. Partnering organizations included the FDIC, the United Way of Greater Kansas City, Consumer Credit Counseling Service, Central Bank of Kansas City and the Mexican Consulate.

Also in April, local volunteers visited 149 Kansas City area classrooms to introduce basic money management concepts and promote saving in recognition of the nationwide program Teach Children to Save Day.

For the fourth year, staff from the Kansas City Fed and partnering organizations taught nearly 3,200 first-, second- and third-graders at 58 elementary schools. These efforts are part of the Federal Reserve's dedication to promoting financial and economic education. The 45-minute lessons, which include a story and group activities, were developed by the Center for Economic Education and Entrepreneurship at the University of Missouri-St. Louis and the Center for Economic Education at the University of Missouri-Kansas City.

The Kansas City Fed's Branch offices in Denver, Omaha and Oklahoma City also host similar financial education events during the year.

For more information on economic education, including free resources for all ages, visit [federalreserveeducation.org](http://federalreserveeducation.org).



PHOTO BY GARY BARBER

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STUDENTS look at a display at the Kansas City Fed's Money Smart Week with Jay Reardon and Mario Urquilla from Commerce Bank.

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## Bankers talk, Fed listens at Regulatory Update Seminars

In March and April, the Supervision and Risk Management Division of the Kansas City Fed hosted its annual Regulatory Update Seminars.

More than 450 attendees participated, including presidents, chief executive officers, directors, and senior staff of state member banks and bank holding companies.

The goal of these seminars is to share current regulatory and supervisory issues, and for the Kansas City Fed to hear from bankers about the challenges they are facing. Topics covered the economy and current banking conditions, consumer compliance, safety and soundness, and more.

Presenters included Kansas City Fed President Tom Hoenig, Senior Vice President of Supervision and Risk Management Kevin Moore, and economists, including Branch Executives Jason Henderson of Omaha; Chad Wilkerson of Oklahoma City; and Mark Snead of Denver.

This year's seminars were held throughout the Tenth Federal Reserve District in Wichita, Kan.; Denver; Albuquerque; Oklahoma City; Tulsa; Kearney, Neb.; Omaha, Neb.; Montrose, Colo.; Casper, Wyo.; and Kansas City, Mo.

## Educators' workshops available

The Kansas City Fed and its Branches in Denver, Oklahoma City and Omaha offer economic workshops for elementary and secondary educators as well as those at area universities.

"The purpose of these workshops is to provide educators with a better understanding of economics and the Federal Reserve System, as well as to contribute to the economic and personal finance lessons they teach in the classroom," says Trudie Hall, special programs coordinator at the Kansas City Fed.

The sessions often include one or more speakers on the Fed or economic and personal finance topics; an overview of the Federal Reserve's resources that are available to educators; and a tour of the Fed, where available.

To schedule a workshop at the Branch nearest you, visit the Education Resources section of [KansasCityFed.org](http://KansasCityFed.org).

## Regional workshops for Community Reinvestment Act training

The Federal Reserve Bank of Kansas City recently hosted workshops for more than 200 officials from regional financial institutions. Training focused on the Community Reinvestment Act, which, as established by Congress, encourages financial institutions to lend throughout their communities, including low- and moderate-income areas.

Held at the Kansas City, Denver, Oklahoma City and Omaha offices of the Kansas City Fed, the training is a partnership with the Office of the Comptroller of the Currency, Federal



PHOTO BY GARY BARBER

Deposit Insurance Corporation and Office of Thrift Supervision.

The training is designed for new officers and as a refresher for those who are more seasoned. It includes all of the focus areas of preparing for a Community Reinvestment Act exam, including an overview of performance, and assessing lending performance and community development, and more, says Ariel Cisneros, senior Community Affairs advisor at the Denver Branch. Offering these workshops is in response to requests the Kansas City Fed received from financial institutions.

The Community Affairs department of the Kansas City Fed supports the Federal Reserve System's economic growth objectives by promoting community development and fair and impartial access to credit. Staff research issues affecting low- and moderate-income communities and bring together community stakeholders to explore solutions.

For more information on the Kansas City Fed's Community Affairs department, visit [KansasCityFed.org/TEN](http://KansasCityFed.org/TEN).



PHOTO BY GARY BARBER

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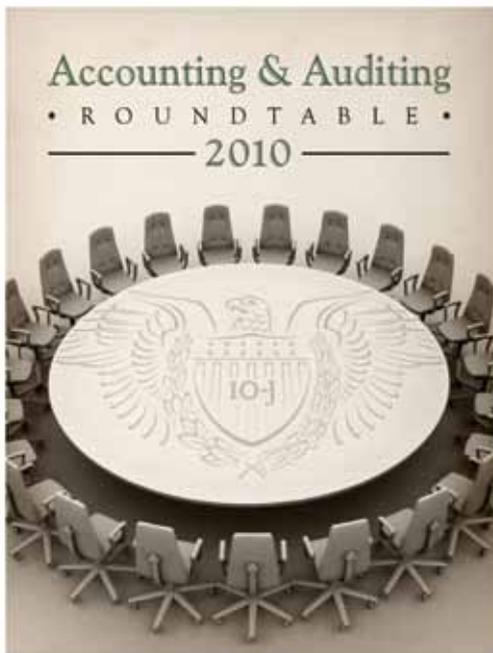
SUSAN HOWARD, western district community affairs officer for the Office of the Comptroller of the Currency in Glendale, Calif., and, above right, Larry Jones, senior compliance examiner with the FDIC's Kansas City region, speak at the Community Reinvestment Act training workshops at the Kansas City Fed headquarters.

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## Register now for roundtables

The Supervision and Risk Management Division of the Federal Reserve Bank of Kansas City is hosting its annual Accounting & Auditing Roundtables the week of Nov. 15 in Kansas City and Denver. Registrations will be accepted until Oct. 8.

The primary goal of the roundtables is to share knowledge about issues arising from accounting pronouncements, banking legislation and examination experiences relative to financial reporting for banking organizations while enhancing communication with the Federal Reserve. About 120 bankers and accounting and auditing professionals are expected to attend. For the roundtable dates and agenda, visit [KansasCityFed.org](http://KansasCityFed.org). For questions or registration information, call Lisa Aquino at (800) 333-1010 ext. 12491 or Anita Feemster at (800) 333-1030 ext. 38603.



# Bank Anniversaries

The following banks in the Tenth Federal Reserve District are celebrating five, 10, 20 or more years as Federal Reserve members in July, August or September.

|                         |               |       |    |
|-------------------------|---------------|-------|----|
| Uinta Bank              | Mountain View | Wyo.  | 90 |
| Wahoo State Bank        | Wahoo         | Neb.  | 78 |
| Gunnison B&TC           | Gunnison      | Colo. | 70 |
| Farmers State Bank      | Stanberry     | Mo.   | 69 |
| Union State Bank        | Clay Center   | Kan.  | 68 |
| Bank of Holyrood        | Holyrood      | Kan.  | 67 |
| Farmers Bank of Lincoln | Lincoln       | Mo.   | 65 |
| Security State Bank     | Basin         | Wyo.  | 62 |
| Premier Bank            | Lenexa        | Kan.  | 31 |
| Bank of Cushing & TC    | Cushing       | Okla. | 30 |
| Montrose Bank           | Montrose      | Colo. | 26 |
| Bank of Locust Grove    | Locust Grove  | Okla. | 10 |
| Community Bank          | Raymore       | Mo.   | 10 |
| First Priority Bank     | Pryor         | Okla. | 10 |
| Lakeside Bank of Salina | Salina        | Okla. | 10 |
| Security Bank           | Tulsa         | Okla. | 10 |
| Rocky Mountain Bank     | Wilson        | Wyo.  | 5  |

## 'Farming, Finance and the Global Marketplace' draws widespread participation, attention

The common thread of agriculture brought together diverse speakers, including an ag banker from York, Neb., and the Brazilian CEO of the world's largest meatpacker, at the Kansas City Fed's first Regional Symposium in June at its headquarters in Kansas City, Mo.

About 180 ag leaders, producers, academics and financiers gathered at "Farming,

Finance and the Global Marketplace" to discuss the industry's changing structure and future profitability.

The Kansas City Fed commits resources specifically to understanding the rural economy because of the makeup of its Federal Reserve region. This area includes western

Missouri, Nebraska, Kansas, Oklahoma, Wyoming, Colorado and northern New Mexico. In addition to hosting events, staff regularly produces research and reports that focus on rural America.

The symposium greatly benefits these efforts, says Jason Henderson, economist and executive officer of the Kansas City Fed's Omaha Branch and the event organizer.

"The symposium fostered a conversation with business leaders on an industry that's so important to our region," Henderson says. "It allowed us to glean perspectives about issues affecting the global economy and the food chain."

Session topics included ag profitability in the 21st century, reshaping global agricultural production, evolving agricultural supply chains and meeting the financial needs of global agriculture.

Speakers included J.B. Penn, the chief economist for John Deere; Wesley Batista, the CEO of JBS Swift and Company, the world's largest meatpacker; James Borel, an executive vice president with DuPont; Michael Swanson, agricultural economist from Wells Fargo, the largest U.S. ag lender; and Michael Boehlje, distinguished professor from Purdue University. Speakers also came from the Central Bank of Argentina and the Bank of New Zealand to share a global perspective.

The symposium drew attention from national media and trade publications—a benefit to consumers and their understanding of how ag issues affect them.

"Right now, we have strong economic growth in emerging countries," Henderson says. "That's raising the demand for agricultural commodities as countries like India and China raise their standard of living and spend more for food. Rising demand affects prices at grocery stores and restaurants and energy prices at the gas pump. Understanding these issues helps us better understand what the future might hold and allows us to make more informed choices."

To read papers, presentations, speaker biographies and remarks from "Farming, Finance and the Global Marketplace," visit [KansasCityFed.org/TEN](http://KansasCityFed.org/TEN).



PHOTO BY GARY BARBER

**MICHAEL BOEHLJE**, distinguished professor from Purdue University



BY TEN STAFF



## The Federal Reserve System

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

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

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

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

## The Federal Reserve Bank of Kansas City

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



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**TEN** also features articles on the Federal Reserve's history, structure and operations.

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The Kansas City Fed is committed to promoting economic and personal financial education by offering free resources to educators, students and the public.

*Visit our newly updated website for:*

- age-specific activities
- publications and videos
- classroom curriculum
- consumer resources