

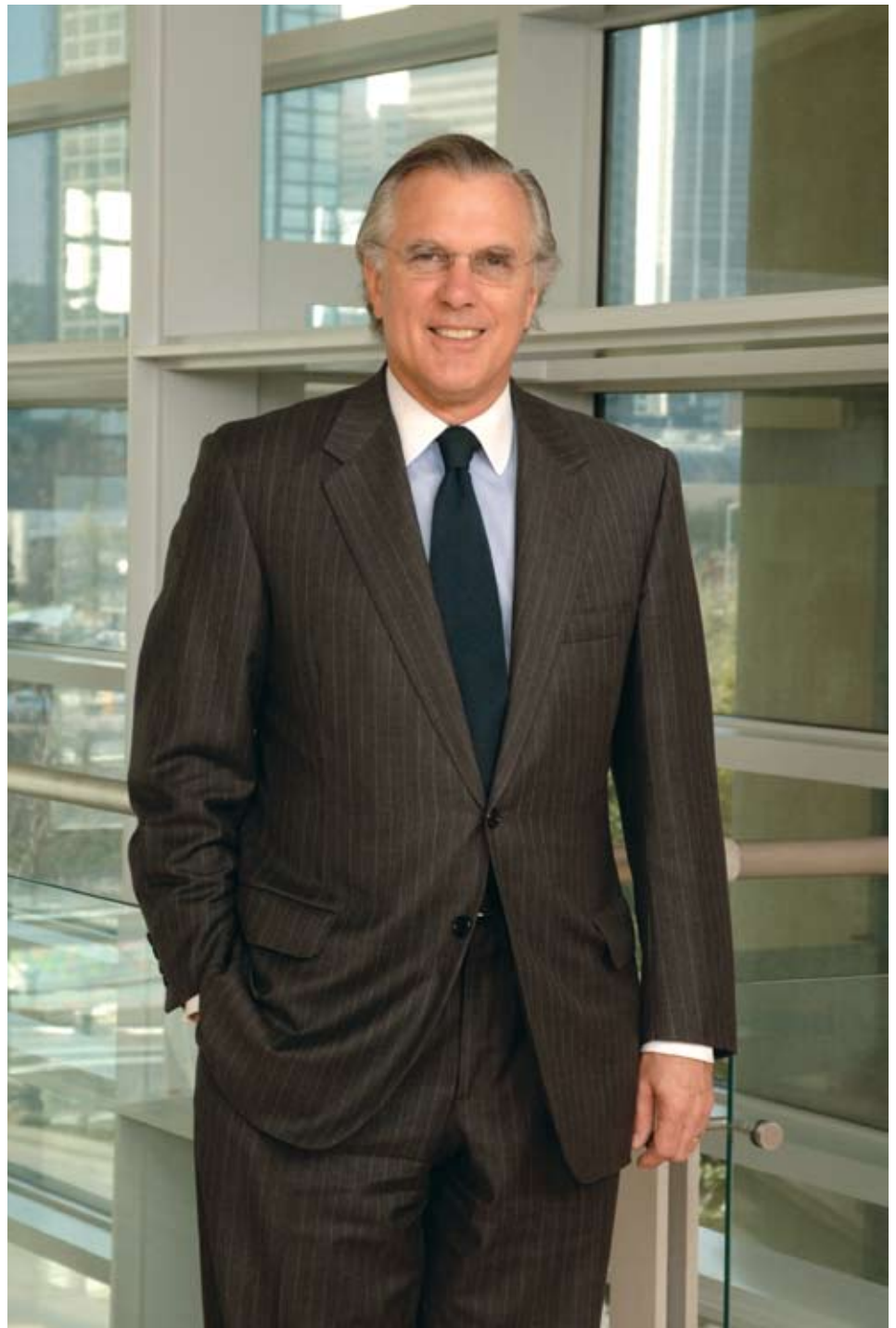
A Letter from the President

All of us can see the footprints of globalization in everyday life. They appear in what we buy, in our jobs, in our evolving culture and in our investment portfolios. While the word *globalization* has been defined in many ways, I believe it remains misunderstood by both the public and policymakers.

I took the reins of the Dallas Fed three years ago with a strong suspicion the economic models used for monetary policy were systematically overlooking globalization as a critical factor in the economy. Essentially, these models treat the economy as if borders are closed and what happens beyond them matters little. In reality, borders become more open every day, and what happens around the world matters more than ever.

No businessmen or women I know would think of sourcing their inputs or selling their products or services solely within a domestic framework. And all U.S.-based businesses look at capital markets from a global perspective today. Yet the imaginations of policymakers often seem confined by our territorial borders.

At the Dallas Fed, we are rethinking this closed-economy view. It was with great pride



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last fall that we launched the Globalization and Monetary Policy Institute to examine the policy implications arising from freer flows of goods, services, capital and labor across national borders.

The Dallas Fed already boasts a top-notch team of economists dedicated to researching and monitoring our dynamic economy, and they will continue to do so. With this new, in-house institute, we are ratcheting up our commitment to producing groundbreaking research on key issues of globalization and monetary policy. We will endeavor to develop better models of trade, capital flows and migration; explore how global demand affects commodity prices; examine the repercussions of the large labor and consumer pools in China and India; estimate the impact of trade on pricing decisions; and execute other ambitious economic research.

Many of the world's most influential monetary policy scholars and practitioners have agreed to be our guides and companions on this fascinating intellectual journey. Chairing our advisory board is John B. Taylor, an eminent Stanford professor and senior fellow at the Hoover Institution and developer of the widely heralded Taylor rule for monetary policymaking.

Also on the board's roster are Charles R. Bean, executive director and chief economist at the Bank of England; Martin Feldstein, Harvard economics professor and president of the National Bureau of Economic Re-

search; R. Glenn Hubbard, dean of Columbia University's Graduate School of Business and former chairman of the Council of Economic Advisers; Otmar Issing, president of Germany's Center for Financial Studies and former member of the European Central Bank executive board; Finn Kydland, professor at the University of California, Santa Barbara, Dallas Fed consultant and winner of the 2004 Nobel Memorial Prize in economics; Guillermo Ortiz, governor of Banco de México; Kenneth S. Rogoff, Harvard professor, Brookings Institution fellow and former research director of the International Monetary Fund; and William White, head of the Monetary and Economic Department at the Bank for International Settlements.

Mark A. Wynne, the institute's director, has assembled a staff of five full-time economists and recruited three highly regarded economists to serve as senior fellows: the University of British Columbia's Michael B. Devereux, the University of Virginia's Francis E. Warnock and Dallas Fed chief economist W. Michael Cox.

The Globalization and Monetary Policy Institute's goal entails developing the tools monetary policymakers need to accomplish their objectives in the 21st century, when it is critical to understand what is happening around the world, not just at home. The institute has a challenging mission, but one that our advisors, staff and fellows believe must be accomplished if monetary policy is to be effective in the future.



John B. Taylor

The Globalization and Monetary Policy Institute



Charles R. Bean



Martin Feldstein



R. Glenn Hubbard



Otmar Issing



Finn Kydland



Guillermo Ortiz



Kenneth S. Rogoff



William White



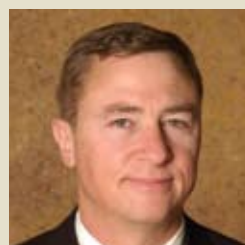
Mark A. Wynne



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Success Abroad

The Dallas Fed's commitment to research on globalization extends to our annual report essays. For 2005, we examined how globalization disciplines public policy and for 2006, how it impacts productivity and costs. In this year's essay—“Opportunity Knocks: Selling Our Services to the World”—Mike Cox and senior economics writer Richard Alm counter the hand-wringing over globalization by looking at a U.S. success story: dominance in the service sector.

We export more services than any other nation—by a long shot. Better still, most of what we sell abroad are highly valued services—industrial engineering, entertainment, health care, and the work of architects, lawyers and other professionals. Our growing services trade supports many well-paying jobs.

We developed our expertise in these services to meet the needs of our own economy, but the prospects for exporting them have never been brighter. Internet Age technologies are shrinking the constraints of time and space, opening global markets to more services. Just as important, global demand will rise rapidly as consumers in China, India and other fast-growing nations shift their spending from goods to services.

One of the essay's valuable insights comes from explaining what economists call “income elasticity of demand,” a powerful concept that can help us better understand globalization. High elasticities suggest rising incomes will lead to rapid growth in global consumption of many of the services we

produce so well.

Scattered throughout the essay are stories that spotlight Texas companies taking advantage of the growing global market for services. Dallas-based Laguarda.Low Architects designed a world-class project on the shores of Tokyo Bay. The seismic crews of Houston's Geokinetics Inc. are doing their part in the oil and gas industry's worldwide search for new reserves. San Antonio's Methodist Healthcare System treats 1,500 foreign patients a year.

Global business is complex, and the Dallas office of FTI Consulting helps companies cope with it. Irving-based Fluor Corp., an engineering and construction firm, is just one of many Texas multinationals doing business on a global scale. But even a small El Paso web designer has found a niche for selling services abroad. Many other Texas companies have done likewise, and I am sure we will see others follow them into the global marketplace.

U.S. companies are ready to meet the world's growing demand for services—but we will face competition. Staying ahead in services trade requires well-educated workers and adroit managers; developing more of them will be key to selling our services to the world. Every chance I get, I stress the importance of education to good jobs and rising incomes in this country—a point this essay underscores.

Closer to Home

While I am on the subject of providing good service, I am tremendously proud of

the Dallas Fed's continued success in operational areas. In 2007, the Federal Reserve System decided that its 22 check-processing sites around the country would be consolidated into just four centers. The Dallas Fed will be responsible for processing checks deposited in the entire western United States, allowing us to play a vital role in the smooth functioning of our nation's payments system. I am confident in the ability of our check-processing staff and management to meet the challenges of this consolidation while continuing the same outstanding service to financial institutions.

2007 marked the first full year our cash operations handled the increased volume from the consolidation of an out-of-state cash-processing center and dramatic growth in international deposits. As a result, the Dallas Fed paid and received a record \$121 billion in currency.

In response to pressures in the short-term funding markets, the Federal Reserve established a term auction facility (TAF) to help promote efficient dissemination of liquidity. As administrative and development site for the automated system the Reserve Banks use for discount window operations, our Dallas team was called on to quickly develop the software capabilities to support the TAF.

The Federal Reserve and the U.S. Treasury's Financial Management Service launched the *Go Direct*® program in 2005, aimed at increasing electronic payments and decreasing paper checks for people who

receive federal benefits. The Dallas Fed assists this program by hosting a *Go Direct* call center and website that handle direct deposit enrollments. Monthly participation expanded throughout the year, and in August, our call center processed its 1 millionth enrollment.

Our public outreach and education programs continued to make their mark on the Eleventh District. Our staff organized community forums in Austin, San Antonio, Laredo, Corpus Christi, Abilene, Las Cruces, McAllen and Amarillo. They also planned conferences and roundtables on homeownership preservation and health care. In 2007, our highly successful Building Wealth program, which teaches sound financial management principles, was launched in CD-ROM format. More than 70,000 *Building Wealth* workbooks, available in English and Spanish, and 50,000 CDs were distributed in 48 states and six countries.

It is an honor to work for and alongside the dedicated women and men of the Federal Reserve Bank of Dallas and its branches in Houston, San Antonio and El Paso. They, and their counterparts at the 11 other Federal Reserve Banks and at the Board of Governors in Washington, are the backbone of the Federal Reserve System. I am grateful for their support and brilliant work.



Richard W. Fisher

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