

# A LETTER FROM THE PRESIDENT

Shortly after becoming president of the Dallas Fed, I stumbled upon an observation from the great British prime minister William Gladstone, and it has become a favorite of mine: *Not even love has made so many fools of men as pondering over the nature of money.*

Gladstone's witticism is a humbling reminder for me and my colleagues in the Federal Reserve System. Our job is to contemplate the nature of money: how to protect its value; how to use monetary policy to promote growth with low inflation; how to manage the payments system to keep our financial infrastructure humming at peak efficiency.

My first year as president of the Federal Reserve Bank of Dallas has been filled with all those contemplations—and many more. I have been truly inspired by the intelligence, integrity, competence and work ethic I have found at the Federal Reserve, not only in Dallas but in Washington and at the other regional Banks around the country. I owe a particular debt to my colleagues at the Dallas Fed. I cannot think of a more interesting job than serving as the leader of this exemplary group of women and men.

## The Forces of Change

The global economy is in the midst of a tectonic transformation. Powerful new players—among them China's 1.3 billion people and India's 1.1 billion—have entered the marketplace in full force. At the same time, technology continues to make enormous advances that spawn new forms of competition and transform how businesses operate worldwide.

Trade and technology accelerate what economist Joseph Schumpeter



called “creative destruction,” a somewhat self-contradictory shorthand for how capitalist systems constantly replace existing ways of doing business with new ones. (For more on Schumpeter, see the excerpts across from this page.) Yesterday's business practices are rapidly replaced by tomorrow's ways of doing business in an economic revolution that reaches into nearly every corner of the world.

We are not sheltered from the forces of change at the Dallas Fed. New technologies are creating challenges and opportunities in the way we process payments, run cash operations, serve as the Treasury's fiscal agent, supervise and

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regulate banks and provide them with liquidity, and keep the public informed.

One of the essays in this annual report, "Critical Mission," summarizes the Dallas Fed's business side and reports some numbers that illustrate the depth and breadth of our operations. Last year, for example, we processed almost 1 billion checks, worth about \$900 billion. We paid out and received a record 5.4 billion in circulating notes worth almost \$92 billion.

This is important work. Money flows are an economy's lifeblood, and the Federal Reserve's great responsibility lies in maintaining the cardiovascular system of American capitalism. The Fed's operations—from payments processing to bank regulation to the New York Desk's trading activities—keep open the arteries, veins and even the capillaries of capitalism.

The sacred duty of the Federal Reserve System is to conduct monetary policy that sustains non-inflationary economic growth. To fulfill our role of helping set monetary policy for the United States, the Dallas Fed must conduct groundbreaking research to better understand how our economy behaves in an intensely interconnected, increasingly globalized world. The new reality creates a need to rework key assumptions about the gearing of the U.S. economy and how it affects the Federal Reserve's ability to do its job.

Immediately upon becoming Bank president last year, I challenged our research team to develop new principles and analytical tools for a globalized world—new ideas that could serve as guides for the Federal Open Market Committee and stimulate the thinking of monetary economists worldwide. "Racing to the Top," the cover essay of this annual report, pre-

sents a view of globalization's impact on the economy and its effect on a wide range of public policies.

The essay notes a striking correlation between increasing globalization and better economic policies. A good example is price stability. In a world where capital moves at light speed, nations that allow inflation to erode the value of their money face stiff penalties in the form of capital flight. Sound money has become imperative, and inflation has been receding in all parts of the world over the past two decades.

The Dallas Fed's work on globalization is only beginning. Over the next few years, we will devote much attention to the benefits and challenges of a world where national borders are becoming less significant as economic barriers. We will keep you informed of our findings.

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My first day at the Dallas Fed, I called a meeting of the entire staff and quoted a passage from Carlos Ruiz Zafón's brilliant novel, *The Shadow of the Wind*: "What destiny does not do is home visits. You have to go for it."

The men and women of the Dallas Federal Reserve are not sitting back, waiting for change to affect us. We have a responsibility to anticipate and effect the change our hypercompetitive world requires. We are wasting no time in going for it.



Richard W. Fisher

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## Old Words, Renewed Meaning

In a February 2006 speech at an Institute of Economic Affairs' conference in London, Dallas Fed President Richard W. Fisher paid homage to economist Joseph Schumpeter and his concept of creative destruction. The following is adapted from that speech.

I like Schumpeter because his writings focus the mind on the process of change and adaptation. They are particularly relevant today. Listen carefully to these quotes from two of his seminal works.

In his book *Capitalism, Socialism, and Democracy*, Schumpeter wrote: “The opening up of new markets, foreign or domestic, and the organizational development from the craft shop and factory . . . illustrate the same process of industrial mutation . . . that incessantly revolutionizes the economic structure *from within*, incessantly destroying the old one, incessantly creating a new one. This process of Creative Destruction is the essential fact about capitalism. It is . . . what every capitalist concern has got to live in.”

And from volume 1 of Schumpeter's *Business Cycles*: “A railroad through new country, *i.e.*, country not yet served by railroads, as soon as it gets into working order upsets all conditions of location, all cost calculations, all production functions within its radius of influence; and hardly any ‘ways of doing things’ which have been optimal before remain so afterward.”

String the key phrases of these citations together and you get the bottom-line plot of capitalism's process of creative destruction: *The opening up of new markets, foreign or domestic, revolutionizes the economic structure, destroying the old one, creating a new one. [It] upsets all conditions of location, all cost calculations, all production functions, and hardly any ways of doing things which have been optimal before remain so afterward.*

Here is where China and India and all the bristling new economic entrants come in. They are today's equivalent of Schumpeter's railroads. They and the phenomenon of globalization are agents of creative destruction writ large. From now on, hardly any way of doing things which used to be optimal will ever be so again.