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President's Foreword

Last year at this time, the Federal Reserve Bank of Cleveland was enjoying some satisfaction over the absence of problems associated with the century date change. The prospect of serious, unforeseen events had spurred our Bank and the Federal Reserve System to work together in pursuit of a common objective. In the aftermath of that project, we found that we had forged some new relationships—and deepened some old ones—among our customers, the institutions we supervise, the public, and even our colleagues inside the Federal Reserve System. Many of our activities in 2000 revolved around strengthening those relationships and refocusing our energies on issues of importance to all of our constituents.

Our Supervision and Regulation Department prepared for a new era of financial supervision introduced by the Gramm-Leach-Bliley Act, popularly referred to as “financial modernization.” This law, long in the making, overhauled the banking and financial services industries by removing the legal barriers that had kept such businesses as banking, securities underwriting, venture capital, insurance, and real estate separate from one another. Depository and nondepository institutions alike are now reorganizing to take advantage of new business areas—and new revenue streams—that were formerly off limits. The supervisory agencies, which have the responsibility of implementing the provisions of the act, are hard at work adapting to their new charge.

The Cleveland Fed responded to the passage of the Gramm-Leach-Bliley Act by fully implementing our program for large, complex banking organizations and by identifying supervisory risks within these organizations. We also conducted a number of training programs across the Fourth District to inform financial institutions of the many provisions of the law.

Another area that is on the verge of profound change within the Federal Reserve System is retail payments. As banking organizations expand their geographic reach and develop more electronic products, retail clearing and settlement systems must evolve as well. Our Bank has leadership responsibilities within the Federal Reserve System for the Check Modernization Project—a multifaceted initiative that will reduce the ongoing cost of Federal Reserve check services, speed the distribution of new products, further automate our check services, and improve overall service quality.



David H. Hoag, chairman; Sandra Pianalto, first vice president; Robert W. Mahoney, deputy chairman; and Jerry L. Jordan, president.

The Federal Reserve's Check Modernization initiative will provide new efficiencies, not only in our paper-based check-processing operation, but also in our electronic check products and services. Under the largest component of the project, a standardized software platform will be established for all 45 of the Federal Reserve System's check-processing sites. This enhancement will serve as a natural launching pad for revamping services such as check imaging, adjustments, and electronic delivery. Major initiatives were completed in virtually every aspect of this project during the year. In addition, the Bank assumed the leadership role in developing a national electronic billing service and in assisting the U.S. Treasury with its e-commerce initiatives. We are excited about the new capabilities we are developing to deliver cost-effective services to our customers.

Internally, the Bank continues to foster a high-quality environment for employees through innovative personnel practices and management information systems. In 2000, we completely overhauled our job evaluation and salary administration policies to reward career development and to remain competitive with other employers in the marketplace. We also enhanced our balanced scorecard measuring tools, which enable employees to see how their individual performance contributes directly to the Bank's corporate goals.

The New Economy is forcing all organizations to challenge themselves in the areas of customer service, cost structure, and performance measurement. Organizations can manage only what they can measure, so they must think carefully about the accuracy and validity of their measuring systems. The same principle holds true for economic policymakers: In an economy characterized by fast-paced change in technology and business practices, policymakers must be confident they are measuring the appropriate aspects of the economy, and that their measurements are accurately gauging the economy's performance.

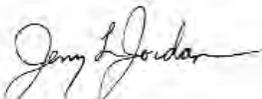
In our *1999 Annual Report*, we examined the historical evolution of the idea that monetary policy should be geared principally to control economic growth and, thereby, inflation. We cautioned that the economic rhetoric commonly used to describe the goals and operating principles of central banks has led people to believe that central banks can deliver more than should be expected of them. We urged readers to reconsider the issue, suggesting the traditional demand-management framework be put to rest and more emphasis be placed on price stability and long-term economic growth.

In the essay that follows, we continue our conversation about economic policy and economic growth: We discuss the measurement system that is used to track U.S. economic activity, and why it is not yet up to the task of effectively measuring aspects of economic activity that contribute the most to long-term economic growth. For historical reasons, our measuring system has concentrated on expenditure and output; going forward, though, it will need to gauge the true economic values of land, labor, and capital more accurately. Contemporary theories about the business cycle and economic growth indicate that conventional methods of measuring these factors fall short of what we really need to understand how our economy is operating.

We could not have accomplished all that we did in 2000 without the guidance provided by the directors of our Cincinnati, Cleveland, and Pittsburgh offices, and the members of our business and community bank advisory councils. We especially want to thank those directors who completed their terms of service on our boards in 2000. For their oversight and valuable contributions we are truly grateful. On our Cleveland Office board of directors, David S. Dahlmann (president and chief executive officer, Southwest Bank) completed his second term as a director in 2000; Mr. Dahlmann had previously served as a director of our Pittsburgh Office. For our Cincinnati Office board of directors, Judith G. Clabes (president and chief executive officer, Scripps Howard Foundation) and Wayne Shumate (chairman and chief executive officer, Kentucky Textiles, Inc.) both completed their second terms of office. And for our Pittsburgh Office board of directors, Thomas J. O'Shane (senior executive vice president, Sky Financial Group) and John T. Ryan (chairman and chief executive officer, Mine Safety Appliances Company) also completed their second terms as directors; Mr. Ryan served as chairman of the board during both terms.

A special debt of gratitude goes to David A. Daberko (chairman, National City Bank), who finished his one-year term as the Fourth District's representative to the Federal Advisory Council.

I wish to express my sincere appreciation to the officers and staff of the Federal Reserve Bank of Cleveland for their extraordinary efforts throughout 2000. Preparing our Bank and our District's depository institutions for the century date change was a challenging task that required countless hours of work and unparalleled dedication. Remarkably, we were able to handle this extraordinary responsibility and still accomplish many other significant objectives. The Bank is well positioned to fulfill its mission with distinction as we begin the twenty-first century.



Jerry L. Jordan

President