

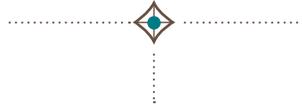
Shrinking the World

Issued in 1876, Alexander Graham Bell's patent for the telephone has been called the most valuable ever issued, revolutionizing the daily lives of ordinary people. In 1935, the first telephone call was made around the world. Although the two men spoke from adjoining rooms in New York, their voices circled the globe.

The Electronic Age

The 1990s to the present are widely considered to be the electronic age: In 1998, Americans averaged 2,300 phone calls a year, and in 2003, computer and Internet capabilities were added to cell phones. One in five people under the age of 30 say the Internet is their main source of information.

President's Foreword

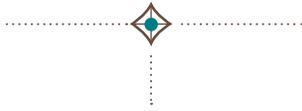


Trade and innovation have profoundly influenced patterns of economic development throughout the ages. The Federal Reserve Bank of Cleveland addressed this topic at some length in our *2003 Annual Report*. We noted that although trade and technological change invariably favor some industries, skills, and locations more than others, they are ultimately the only sources of rising living standards for all Americans.

During the past several decades, we have witnessed an intense period of globalization and technological change. These forces have affected the United States not only on a national level but on a state level as well. The states, in turn, are focused on how they might influence their *own* economic development paths.

The fact is that per capita income differences among the states have declined significantly over time, primarily because the poorest states have improved their relative positions by so much. Income convergence among the states makes sense: People and businesses are free to locate wherever they wish, and the declining costs of transportation and communication foster mobility. But this convergence is far from complete.

This year's *Annual Report* essay examines factors that might account for differences in the evolution of states' income growth. In seeking to understand why some states appear to be faring much better than others, we conclude that innovation and workforce skills make the difference.



I am proud of the significant strides that our Bank has made in achieving its strategic objectives in 2005: leadership in thought and deed, external focus, and operational excellence. In the Operational Highlights section of this report, we focus on some of these achievements: converting a steadily increasing number of paper checks to Automated Clearinghouse (ACH) debits and Check 21 clearings; becoming one of the nation's largest providers of Treasury services; and leading the effort to consolidate savings bond and TreasuryDirect operations into the Federal Reserve's Pittsburgh and Minneapolis offices.



(l-r): Charles E. Bunch, deputy chairman; R. Chris Moore, first vice president and chief operating officer; Sandra Pianalto, president and chief executive officer; and Robert W. Mahoney, chairman.

The completion of the Bank's Learning Center and Money Museum exemplifies all three of our strategic objectives. The center was designed to educate students and visitors of all ages about what gives money value and how the Federal Reserve supports the integrity of money, banking, and the payments system. I hope that all of our constituents in the Fourth District and beyond will take the opportunity to visit this wonderful new facility located in our Bank's main lobby.

The Bank's success last year was sustained by the guidance and support of our boards of directors in the Cleveland, Cincinnati, and Pittsburgh offices and by the members of our advisory councils.

I am especially grateful for the exemplary service of our outgoing chairman of the board, Robert W. Mahoney (retired chairman and chief executive officer, Diebold, Incorporated). Mr. Mahoney has led our board during the past three years and has served as a director since 2000. His wise counsel and skilled leadership have guided us through many important changes, both internal and external.

Thanks also go to another longtime director, Phillip R. Cox (president and CEO, Cox Financial Corporation). Mr. Cox joined the Cincinnati board in 1994 and served two terms there before joining the Cleveland board in 2000. He has been an energetic contributor, member, and chair of several board committees.

I also offer sincere thanks to V. Daniel Radford (executive secretary-treasurer, Cincinnati AFL-CIO Labor Council) for six years of dedicated service on our Cincinnati board and to Martin G. McGuinn (chairman and CEO, Mellon Financial Corporation), who has served with distinction as our Federal Advisory Council representative for the past three years and as chairman of the council in 2005.

Finally, I offer my profound thanks to the officers and staff of the Federal Reserve Bank of Cleveland. Their contributions in every area of our organization are both inspiring to me personally and essential to our Bank's capacity to change and grow. I know that we will not only meet our future challenges, but that we will achieve new levels of success thanks to our employees' skills, energy, pride, and resourcefulness.

Look to the Federal Reserve Bank of Cleveland for a continued focus on the community, region, and nation. This focus helps us to serve our customers well, to inform economic discourse, and to partner with other organizations that are committed—as we are—to promoting economic prosperity for all of our citizens.



Sandra Pianalto
President and Chief Executive Officer