EIR uncovers Fed 'recovery' fraud

by Leif Johnson

Reports of an economic recovery, massively documented by figures published by Paul A. Volcker's Federal Reserve, were creating a national security crisis for the United States on two fronts by the middle of 1983.

The Reagan administration's acceptance of the reported recovery—which the population at large, now preserved from worse economic conditions than existed during the early 1930s only by the existence of social welfare programs, knows to be a hoax—led the administration to believe that there should be no changes in the very Federal Reserve policies which were creating the crisis. This persistence on a course of economic disaster has not only threatened Reagan's reelection effort, but has also, by continuing to undermine the U.S. economy, dangerously curtailed spending on national defense programs at a time when the Soviet Union has put its entire economy on a war-mobilization footing.

The second problem caused by the Fed's reports was a mistaken foreign policy, particularly toward debt-ridden Ibero-America. The purported U.S. economic upswing, these nations were told, would mean increased imports by the industrialized sector and increased exports earnings that would make it possible for the developing sector nations to carry the debt service. As as result of this mistaken policy, and because the United States has failed to carry out the far-reaching debt reorganization and monetary and credit reforms necessary to stop a world financial collapse, the entire debt structure of the nations of Ibero-America is collapsing.

Already by mid-March, *EIR* had enough information to suspect that the Fed's index of industrial output levels was not an accurate measure of the nation's economic activity. The Fed's figures were elaborate and, like the work of any embezzler, each new set of faked figures is used to derive the next one. But even the cleverest embezzler is uncovered when the figures are checked against reality: what sits on the production-yard floor. That is what *EIR* did.

The LaRouche-Riemann economic model—which has consistently produced accurate predictions of the course of the U.S. economy since October 1979—forecast at the end of 1982 that there would be continued slippage in industrial, construction, and agricultural output in 1983. The model showed there would be an output decline of between 3 and 10 percent, depending upon the interest rates and credit availability set by the Federal Reserve Board.

The Fed's figures for the beginning of 1983 gave a very different picture:

1) In March, the Fed announced substantial production increases in construction supplies, despite the fact that homebuilding was below October-November 1982 levels and other construction was down.

2) The Fed reported rises in steel product shipments for January and February that topped the average of such shipments for 1982. The Fed's figures were belied by the steel industry's, which showed shipments off 15 percent from a year earlier and employment down 33 percent.

3) The Fed claimed that household appliance production for the first two months of 1983 was 38 percent over December and 10 percent over the 1982 average. The Department of Commerce reported (in deflated dollars) that January and February sales of furniture, home furnishings, and appliances fell consecutively.

4) Another problem was the curious internal inconsistency in the Fed's own figures that showed increased output of certain items but reduced electrical consumption by the industries producing these items. The Fed could offer no explanation for the discrepancies.

Except for the counter-indications of the LaRouche-Riemann economic model, the discrepancies between the Industrial Production Index and the other data seemed susceptible of explanation. Construction supply products could be rising while actual construction moved contrariwise. Supplies might be stockpiled toward an eventual increase in homebuilding, some of which did in fact materialize. Steel shipments were so incredibly low in the final quarter of 1982, that it seemed, of necessity, they had to rise.

The problem remained that industry figures, although also showing an increase, were far lower than the Fed's. A Fed economist explained the difference by claiming that their figures measure production, not shipments, although ultimately the Fed number is based on the industry's shipments figure, adjusted for inventory.

EIR's doubts were heightened when we discovered that the Department of Commerce figures for inventory (used by the Fed), are, by Commerce's own admission, based on an unreliably small sample and complicated by diverse inventory methods used. Further, an examination of the dollar amounts of monthly orders reported by the steel industry led us to suspect that steel product tonnage shipped was not an accurate measure of actual steel produced. We discovered that the industry was shipping lower-grade steels, so that the tonnage was high relative to the actual value of the steel compared to previous periods.

Finally, it was impossible to reconcile the Fed's increased product and decreased electrical consumption for the same industry. Could the energy-intensive cement industry decline a minimal 0.3 percent while its electrical usage plummeted 12.6 percent?

Reports from basic industry in mid-March through April gave a picture as bad or worse than the first two months. Steel was extremely depressed and the metalworking industries worse. Machine-tool orders continued as bad as 1982, the worst year in memory. Industrial fasteners, forgings, castings, non-ferrous metals, mining, basic chemicals, transportation equipment, and transportation itself were moribund.

There clearly was no recovery: American basic industry was so depressed and such a substantial portion forced out of business, that it would not be possible to regain 1978-79 production levels even after a year of maximum production. Even the homebuilders and auto makers remained far beneath 1978-79 levels. If there was no recovery, then the Federal Reserve Board's Index of Industrial Production was wrong. It soon became apparent that it was an elaborate fraud.

EIR took a set of 18 industrial products from hosiery to bituminous coal, steel products to tires, cooking stoves to newsprint, cardboard boxes to freezers and asked the industry associations for their output figures. In every case we found that the Fed had inflated the actual numbers, in some cases by gross amounts.

The most conspicuous fake was hosiery. On an actual increase in the first six months of 1983 over the last six months of 1983 (the basis for all calculations), of 1.9 percent, the Fed claimed a 12.1 percent jump in output—more than a sixfold error. Refrigerators and freezers output increase was multiplied by nearly three times, while steel product increases were doubled.

The Fed has been systematically lying since the index was set up in 1967. In that year, when the Fed Index for autos was at 100, the United States produced 7.4 million passenger cars. In August 1983 the Fed Index for autos was again 100—but U.S. production was at an annual rate of only 6.1 million cars.

The key was discovering the Fed's method in lying: the "Quality Adustment Factor" (QAF). In collusion with the Labor Department's Bureau of Labor Statistics (BLS), the QAF was devised, beginning in 1967, to distort the most widely used indicators of economic activity, the levels of production and of inflation. The QAF is based on the—demonstrably false—assumption that since 1967 the quality of autos, steel, and so forth has improved, and that this "improvement" should be counted as more goods produced. By the same method, the BLS discounts inflation simply by deducting the QAF from prices, since the consumer gets more "quality" when he buys a product. BLS figures this year claimed a $3,799 "quality improvment" in autos—the difference between the actual price of a car, $10,258, and the BLS's consumer price index for autos, $6,459—since 1967. Cars have, of course, become far smaller and much worse.

The Fed is reported so worried about the findings of *EIR*'s investigation that it has gone to the extreme of telling other government agencies and the White House that it will not tolerate any investigation and, further, that if they have any complaints about the Industrial Production Index, "they should not use it."

The LaRouche-Riemann measure crash-program

by Lyndon H. LaRouche, Jr.

Up to the EIR*'s October 1983 "Quarterly Economic Report on the U.S. Economy," the data employed for the LaRouche-Riemann quarterly forecasts were chiefly supplied by reports of the U.S. federal government and Federal Reserve System. The analysis performed to arrange this data-base for forecasting operations had been accomplished chiefly by recasting the chart of accounts of the National Income Accounting system published by the U.S. government and Federal Reserve. The October report contained a discussion, excerpted here, of improvements in the economic model effected during 1983, and directions in which the work will now move.*

Beginning with the October 1983 quarterly report, a series of changes have been begun, beginning step-by-step improvement in assembly of data-base and in choice of data-base. Because of the monstrous increase of willful fraud in U.S. government and Federal Reserve statistics and reporting during the recent nine months, the data-base supplied from these sources has become worthless even as a crude approximation of actual performance in the U.S. economy. Unemployment was "reduced" by dropping approximately one percent or more of the total labor force from the data-base by the Bureau of Labor Statistics. The rate of inflation was fraudulently cut approximately in half by various tricks, such as the Quality Adjustment hoax. Data supplied by industry associations, already inflated significantly above actual in some cases, were inflated once again by the Federal Reserve, with no explanation of the methods of calculation or assumptions used for manufacturing this hoax.

As a result of these and other extravagant manipulations of data, a grave economic decline—an ominous rate of decline—in the U.S. economy was falsely reported as a significant "economic upswing."

Obviously, such a falsified change in the data-base of reported statistics could not be used for a quality forecast at this juncture. Therefore, the staff of *EIR* deployed a large part of its personnel resources to dig into primary and secondary data on production, employment, and sales in key sectors of the U.S. economy. The purpose was to develop a fair estimate of both the methods and extent of the manipulation of statistics, and by that means to arrive at at least a reasonable estimate of what the actual recent performance has been. Although the *EIR*'s forecasts still reference the statistical reporting by the government and the Federal Re-