How inflation produced the 8.7 percent rise in GNP

by David Goldman and Leif Johnson

With 2 million fewer production workers than 1979, one-third fewer autos produced, 10 percent fewer homes under construction, 40 percent less steel poured, and devastated capital investment, Commerce Secretary Malcolm Baldrige had the nerve to say that the U. S. economy "completely buried the 1981-82 recession" during the second quarter of this year.

The occasion for the Commerce Secretary's euphoric outburst was the publication by his own department of the second-quarter 1983 Gross National Product (GNP) figure for the U.S. economy. According to that yardstick, the total market value of all goods and services produced in the U.S. increased by 8.7 percent over the first quarter of the year.

We can understand the Bureau of Labor Statistics dropping more than 1 million unemployed workers from the workforce since last December to make the unemployment rate look good, or shaving the price index to depress cost-of-living increases. We can even understand the Commerce Department running an "Index of Leading Indicators" which drops items that show a downturn (such as oil prices), on the grounds that indicators showing no recovery must be inappropriate.

But of what possible use is an economic index that shows an increase consumer durable expenditures of 6.7 percent from 1979 to 1983 when the actual production of consumer durables fell 8.6 percent? Or that shows consumer non-durable expenditures up by 8.4 percent in those four years where the real production was only up by 0.5 percent? Or that claims expenditures for producers' durable equipment is down 1.3 percent while in fact production of business equipment is down 12.6 percent since 1979? *And these GNP statistics are supposed to be fully deflated to account for price changes.*

The GNP indicator is truly extraordinary in that it rises while the economy is in depression. Consider the miniscule 0.9 percent GNP drop from 1981 to 1982 compared to the extremely large 8.3 percent drop in total industrial output.

The hoax

The truth is that the GNP does not measure real economic activity (as Commerce Secretary Baldrige asserts) but reflects the admixture of debt into the prices paid for goods, an inflation not measured by the GNP price deflator or by the consumer or wholesale price indices.

The biggest category of Gross National Product is "personal consumption expenditures," which makes up two-thirds of the pot. Of this, the biggest portion is "personal consumption expenditures for durable and non-durable goods."

Supposedly, the "real GNP" takes inflation into account. It does not, except marginally, as is demonstrated by **Figure 1.** Between 1979 and the second quarter of 1983, consumer durable goods production fell 8.6 percent—this reflects the much lower levels of auto, housing, and other consumer durable production since Jimmy Carter gave Paul Volcker the keys to the store. Although auto production and housing production have risen since the abysmal levels of October 1982, they are still well below the 1979 peak level.

However, according to the Commerce Department's GNP tables, "personal consumption expenditures for durable goods" are up by 6.7 percent since 1979—while production fell by 8.6 percent. The combined "error" is 15.3 percent. Where does this come from?

The trick is in difference between cash price and actual contract price of goods, especially durable goods. A measure of the inflation which "prices" goods at their cash sale price instead of adding the cost of credit to the price, is necessarily enormously deficient. For example, a $10,000 cash price for a car, financed at 13 percent (the average current rate) over a 48 month period yields a real price of $12,877. Or suppose you buy a $75,000 home (today's average sale price) financed with a $60,000, 13 percent mortgage: the real price to you, leaving aside the $15,000 down-payment, is $239,638.

The spurt in housing and auto sales this spring (not recovery to 1979 levels) has, despite an abatement of usurious interest rates, increased the overall component of interest in the price of consumer durables. This occurs because consumer credit is repaid in constant monthly or weekly payments, which means that the first payments are almost entirely interest; the principal is only paid off towards the end of the term.

What the GNP does in fact measure, in disguised form, is the implicit increase in prices due to the usury imposed by

Federal Reserve Board chairman Paul A. Volcker since 1979. Today's consumer loan and mortgage loan rates are approximately 5 to 6 percent higher than they were before Volcker took office—and Volcker promised to cure inflation!

Additional interest charges have pushed up your actual cost of buying most durable items by over 15 percent; you are spending (if you are the "average consumer") about 44 cents on the dollar more to buy 9 percent less of the same items. Fifteen cents of that 44 cents represents additional interest charges; the rest is inflation of the base price of the item.

In the case of consumer non-durable items (food, clothing, cosmetics, and so forth), total production is only 1 percent higher than 1979, but "consumer expenditures for non-durable goods" is shown to be 8.4 percent higher.

This is true down the line of the major GNP items, and business investment, as **Figure 1** shows.

If we adjust the GNP tables for the uncounted cost of Volcker's usury since 1979, about $80 billion in "expenditures" goes up in thin air. What is doubly ridiculous is that the GNP tables also include *interest payments* as a "sale of a service." Interest payments, of course, have gone through the ceiling since Volcker took over the Federal Reserve. Interest, rental income, dividends, and "transfer payments" (unemployed and pensioners) now account for $884 billion of Gross National Product, or 27 percent of the total; in 1979, it was only 23 percent.

If we simply adjust GNP since 1979 for the encroachment of payments that represent *expense*, not *income*, another $60 billion goes off Gross National Product.

If it meant anything, we could continue chopping up the Gross National Product tables in this fashion for some time. We have already knocked $140 billion (in 1972 dollars) off GNP, or about 10 percent of the total. And if Secretary Baldrige had only put a in a call next door to Treasury, he would have discovered that while his GNP figures were blooming, Treasury receipts were drying up. Last year Treasury revenues were 20.7 percent of GNP but are running 18.6 percent of GNP this year. Half the 10 percent "swing" in the Treasury receipts/GNP ratio is due to tax cuts and carry-forward losses from the previous year; the other half is due to the fluff in the GNP. While Mr. Baldrige crows of an 8.7 percent GNP rise in the second quarter, the Treasury finds it has lost $40 billion in the first nine months of fiscal 1983 from the continuing depression, as indicated in **Figure 2.**

Figure 1

Comparison between GNP and actual production

	1979	1983	Percent change
GNP consumer expenditures on durable goods (billions of 1972 dollars)	146.6	156.4	6.7%
Actual production of consumer durables (index value)	155.8	142.4	– 8.6%
False increase of GNP (Discrepancy between GNP expenditure claims and real production)	—	—	**15.3%**
GNP consumer expenditures on non-durable goods (in billion 1972 dollars)	354.6	374.3	8.4%
Actual production of consumer non-durable goods (index value)	148.8	150.4	1.1%
False increase of GNP (Discrepancy between GNP expenditure claims and real production)	—	—	**7.3%**
GNP expenditures for producer's durable equipment (in billions 1972 dollars)	114.8	113.3	– 1.3%
Actual business equipment produced (index value)	171.3	149.7	–12.6%
False increase of GNP (Discrepancy between GNP expenditure claims and actual production)			**11.3%**

Why GNP is stupid

An economy is the sum of a population's intervention into nature to sustain itself. Look at an economy as a single agriculture and industrial firm: the industrial and agricultural goods it produces are its *product*. The capital goods it buys and the labor it hires are its *production expenses*. The sales help, clerks, and other white-collar employees are its *overhead*. The overhead cost of white-collar salaries does not represent income in addition to the total value of the firm's physical product, as any plant manager can tell you; they are a fraction of the price of the firm's output.

An economy is no different. Services, which now employ about four-fifths of our workforce, represent an overhead cost for production; the income of the services sector is counted as a fraction of the total price of goods sold.

Of course, the incomes of all employed Americans add up to more than the price of goods sold. That is because people who earn incomes (wages and profits) through production of goods buy services with a portion of their incomes (or have them extracted forcibly, in the case of the service called "rent"). But to simply add up all the goods and services sold and call this a measure of the economy, as GNP does, *double counts* the actual base of income.

Once the Commerce Department does this, the door is open to every sort of fraud and chicanery, including the specimens we examined earlier.

How to measure an economy

A competent measure of economic performance is given, by contrast, by the LaRouche-Riemann economic model, designed by Democratic party figure and economist Lyndon H. LaRouche, Jr.

The LaRouche-Riemann model views the economy as a physical system. Its most basic measure is the rate of free energy of the system: the portion of tangible goods output available to expand future production as a percentage of total output. This defines the economy's potential for future growth as a function of its present output.

This measure is the most accurate "leading indicator" of economic development available. According to the just-released Quarterly Economic Report prepared by the authors and their colleagues at the *Executive Intelligence Review*, the "free energy ratio" stood at -2 percent at the beginning of 1983, moving toward -6 percent at the beginning of 1984. This means that the economy is now destroying its productive capacity at a 2 percent annual rate, trending toward 6 percent. This corresponds to the continued collapse of capital investment, measured against the minimum replacement needs of American industry.

Despite a brief blip upward in some consumer production categories, an event around which the Commerce Department hung tons of tinsel, the underlying deterioration of the economy has continued unabated.

Figure 2

How the continued depression created a $40 billion Treasury loss

(the first nine months of the fiscal year)

Treasury receipts (in billions of current dollars)

Category	Fiscal year 1983	Fiscal year 1982	Reason for shortfall
Corporate taxes	$ 26.7	$ 42.0	Tax cuts, carry-forward losses and continued depression
Individual income taxes	212.8	220.7	Tax cuts, previous year's income, and current depression
Excise taxes	25.1	28.0	Current depression
Customs duties	6.1	6.6	Current depression

Total estimated revenue loss due to continued depression: $10 billion

Treasury outlays (in billions of current dollars)

Category	Fiscal year 1983	Fiscal year 1982	Reason for increase
Defense (DOD)	$152.4	$135.1	Increase in defense programs
Commodity Credit Corporation	18.5	10.4	Collapse of agriculture exports
Unemployment trust fund	26.1	17.5	Depression-level unemployment
Interest on public debt	98.4	90.2	Budget deficit caused by depression

Total estimated outlay increase due to continued pression: $30 billion

Source: U.S. Treasury, Monthly Treasury Statement, June 30, 1983. *EIR* economics staff estimates.

'Volcker is a threat to U.S. national security'

Below are excerpts from the spoken testimony of National Democratic Policy Committee chairman Warren J. Hamerman before the Senate Banking Committee, on July 14, in opposition to the reconfirmation of Paul Adolph Volcker as chairman of the Federal Reserve Board.

Mr. Chairman, the argument has been made that it is necessary to reconfirm Paul Volcker as Federal Reserve chairman on the grounds that he will be a symbol of stability for the international economy. I would argue that it is just the reverse, that the renomination of Paul Volcker could well trigger a world financial collapse.

To that end, I would like to read at the opening a telegram received late last night from Brazil addressed to the Senate Banking Committee. It reads as follows:

"At a meeting held in Brasilia in the month of April, 93 unions representing 1.5 million workers in the Brazilian state enterprises condemned the accord with the International Monetary Fund in light of the damage that this represents for workers and for national sovereignty. At the moment when the U.S. Senate is deciding on the maintenance of Mr. Paul Volcker on the Federal Reserve Board, it is important that we register our protest against the economic directions imposed by the American government on countries such as Brazil." It is signed by Jorge Bittar, president of the Union of Engineers of the state of Rio de Janeiro.

I also received, to be read at the opening of my testimony, a telegram from Bogotá, Colombia:

"In the name of thousands of workers, we reject the policy of high interest rates which has caused poverty, misery, and unemployment. We expect the non-confirmation of Mr. Paul Volcker"—signed by Pedro Rubio and Jorge Carrillo, the president and secretary general of UTRABOC in Bogota. These two gentlemen are also on the National Federation of Trade Unions in Colombia, the UTC, which is the national labor federation associated with President Belisario Betancur.

I also have telegrams from leading industrialists and trade union officials from various nations in Western Europe, including West Germany, France, Italy, Sweden, Spain. One brief telegram: "I support the policy of President Reagan, in particular, for beam weapons. I am opposed to Volker concerning the negative effects of his policy on the world economy and of high interest rates on both civilian and military purposes in the United States and Europe. I oppose Mr. Paul