'Quality Adjustment Factor': how the Fed hides inflation

by Richard Freeman

Since 1967, the Federal Reserve Board, in collusion with the Department of Labor's Bureau of Labor Statistics, has been concocting fraudulent "Quality Adjustment Factors" and then employing them to distort two of the most widely followed gauges of the economy: 1) the level of *production*, and 2) the level of *inflation*. The Fed uses these factors to overstate production levels, and the BLS uses these factors to understate inflation levels. Like two families of the same mafia, they coordinate.

The Quality Adjustment Factor (QAF) works on the fraudulent assumption that since 1967 the quality of various products—cars, steel, and so forth—has improved, and that this improved quality should be counted as more goods produced, since the same unit embodies more quality. By the same reasoning, this Quality Adjustment Factor is also deducted from price increases, since it is assumed that customers get a better quality product for their money.

The Quality Adjustment Factor is produced by the Department of Labor's Bureau of Labor Statistics' Wholesale Price Index division. A source in the BLS who puts together the QAF for the auto industry provided *EIR* with the QAFs for auto for every year since 1967.

In the case of auto, the QAF counts such useless junk as pollution control devices, and such depression-economy adaptations as downsizing, increased mileage efficiency, and bigger warranties (which are just gimmicks to raise sales) as improved quality of the car. Each year, a percentage of the increased price of the automobile—ranging from 10 to 50 percent—is deducted from the price and counted instead as representing the cost of improved quality. Thus, for example, the Commerce Department's Bureau of Economic Analysis computes the average price of a car, which it calls the average transaction price, by taking the average retail price of 125 separate car models. In 1967, the average transaction price or cost of a new car, according to the Commerce Department's Bureau of Economic Analysis (BEA) was $3,212. In the first quarter of 1983, the average transaction price of a new car, according to the same Commerce Department Bureau of Economic Analysis, was $10,258.

However—and here is the clincher—if one applies the consumer price index put together by the BLS to the 1967 car price reported by the BEA, the average price of a new car would be only $6,459 in the first quarter of 1983. The difference between the actual price—$10,258 as reported by the BEA—and the price determined by the BLS's consumer price index for autos—$6,459—is $3,799. *This difference, is the Quality Adjustment Factor. That is, the BLS fraudulently lies that there has been a $3,799 improvement in the quality of cars since 1967,* when in fact, cars have become much worse. **Figure 1** summarizes the case.

Inflation was much higher than the BLS reported, because it used the Big Lie of the Quality Adjustment Factor to hold the inflation rate down. The real consumer price index for first quarter of 1983 should be 319.4 instead of the 201.1, or a level 59 percent higher. That is, for new automobiles, the BLS understated the inflation rate by a staggering 59 percent. If one considers that this QAF was applied to many other industries, *one concludes that the real inflation rate, since 1967, could have been one-third to one half-higher, or double the "official" rate reported.*

The amount that the BLS subtracted as QAF from the increased prices of new cars is greater than the amount it gave out as the increase over these 16 years: the Quality Adjustment Factor is $3,799, and the BLS officially reported the price increase of a new car as $3,247.

An example of how the BLS reports the QAF appears in the November 1982 release issued by the BLS's Wholesale and Consumer Price Index division when the 1983 car models came out. The release, "Report on Quality Changes for 1983 Model Passenger Cars," states that the BLS counted $128.04 out of the $263.92 in manufacturer's list (retail) prices for autos to be attributed to "quality changes," or 49.9 percent of the increase. The BLS release went on to say that of this $128.04 "improvement in quality," $64.65 is represented by improved fuel efficiency and reduced emissions in accordance with current and anticipated federal standards, and $63.39 is "for other changes not related to fuel economy or air quality standards such as changes for improved warranties and for improved corrosion protection."

Because of this "improvement in quality" fraud half the price increase in the 1983 model year car was thrown out.

What 'quality' improvement?

It is more than obvious that cars today are inferior to the cars produced in 1967 in every way imaginable. Consider a few of the features that made 1967 cars superior:

1) According to Ward's *Automotive Yearbook*, in 1967, 83.9 percent of all cars had V-8 engines, today, only 25.6 percent have V-8s. The cars of 1967 were more powerful.

2) The cars of today are more cramped and smaller, by design, to discourage large families. Today, it is impossible to get more than two adults in the front, with three children stuffed in the back. Cars used to be able to accommodate six- or seven-member families with all their gear.

3) The small cars are more unsafe, despite all the lies about "improved safety." The Naderites have been unable to refute Highway Administration reports showing that smaller cars result in a greater number of highway deaths, because the cars, having less metal and being less sturdy, crumble more violently on collision impact.

4) The fuel efficiency argument is a total hoax, and overlooks the central feature that it is the Henry Kissinger-British intelligence 1973-75 oil hoax, and the Aspen Institute-James Schlesinger 1978-79 oil hoax that increased the price of oil, making oil 10 times more expensive than it was in 1972, and gasoline at least 6 to 8 times more expensive.

Take a Brand X car, which got only 10 miles to the gallon in 1967. Let us say that its fuel efficiency has been improved so that it now gets 20 miles to the gallon. Meanwhile, the price of gasoline has increased 6 to 8 times in the same period, so that even if the Brand X car only got 10 miles to the gallon, had the price of oil not been rigged upward, it would be 75 to 80 percent cheaper to drive a car at 10 miles to the gallon, than it is with today's oil prices, getting 20 miles to the gallon.

5) Automobiles today are breaking down much more frequently. Measured by frequency and size of repair bills, and life expectancy of the auto, today's cars are less durable.

In fact, one can go one step further. Look above at the $3,799. What does it really represent? Not an increase in inflation per se, but an *actual increase in overhead-waste.* The $3,799 does not represent a legitimate increase in costs of the car, but rather the adaptation of the United States to a post-industrial economy. Over the last decade, the auto industry has spent a staggering $60 billion on capital spending, most of it to *downsize the car, and meet Naderite environmental conditions, or increase fuel efficiency, which would not have been necessary per se had it not been for the oil crisis.* That is, $60 billion was spent to push the United States into a post-industrial society. Plus, beginning in 1979, the cost of this downsizing and related measures had to be financed at usurious bond market interest rate costs, imposed by Fed chairman Paul Volcker. Thus, the extra $3,799 represents the cost per car the consumer had to pay to get an inferior car, and to pay Volcker's capitalized ground rent.

The BLS chose to cover this cost up by not reporting it.

The double lie

But this is only half the story. Because, once the BLS gets done using the Quality Adjustment Factor to lower the inflation rate by 59 percent, the QAF is turned over to the Federal Reserve Board, and the Fed's Industrial Production Group uses it to overstate production by 50 to 60 percent.

Helmut Wendell, deputy director of research at the Business Conditions Section of the Fed, which has responsibility for the Industrial Production Group and producing the Industrial Production Index, told *EIR* Sept. 5 that the Fed uses the Quality Adjustment Factor to further gear up the industrial production index for cars.

The way this is done, according to a Fed employee, is that the auto industrial production index is increased in some proportion to the increase of the QAF, irrespective of actual car output. The Fed spokesman would not reveal specifically how this is done, but the QAF fraud was used to overstate U.S. auto production by 24.7 percent.

The telltale signs of the Fed's use of the QAF are brought to light in the following manner. Take the number of cars produced for the year 1967 and the first six months of 1983, which are 7,436,000 and 6,400,000, respectively. Then di-

Figure 1
How the Bureau of Labor Statistics understates the inflation rate of new car prices by 100 percent

1967 Bureau of Economic Analysis new car average transaction price	$ 3,212
(Multiplied by) new car Consumer Price Index for first quarter 1983 (1967 = 100)	× 201.1
Estimated 1983 inflation adjusted new car average transaction prices, based on CPI	$ 6,459
Actual first quarter 1983 BEA new car average transaction price	$10,258
Difference	**$ 3,799**

vide these numbers by the Federal Reserve's industrial production index for cars for 1967 and the first six months of 1983, which are 100 and 114.3, respectively. The ratios should be the same. But they are not. The ratio for 1967 represented 7,436 cars for each point of the index. The ratio for 1983 represented 5,640 cars for each point of the index. That means that it took 24.7 percent more cars to move the index one point in 1967 than it does today. *That is the QAF.*

When the Fed's nearly 25 percent overstatement of the industrial production index for autos is corrected for the first six months of 1983, the 114.3 index drops to 86.0. The Fed claims that car production today is above the 1967 production level; *car production has fallen instead.*

More fakery: lawnmowers and textiles

Sources in several divisions of the Producer (Wholesale) and Consumer Price Index divisions of the Bureau of Labor Statistics corroborated the use of the Quality Adjustment Factor to fake inflation rates.

A staff member of the Producer Price Index division of the BLS revealed the guiding principle: "We try to set up the Quality Adjustment Factor so that if reflects a return on capital to the industry concerned. Let's say a company spent $100 to meet a governmental standard. If that company raises the price of its goods by $150, we will only count $50 of the price increase in the Producer Price Index, because the other $100 represents the company's attempt to get to, or cover a good return on its capital."

This perspective was borne out by others with respect to the textile, toy, home appliances, and other industries. What is accounted a QAF in the Producer Price Index division is passed on and amplified in the Consumer Price Index division. Thus, the Consumer Price QAF is a little larger, but basically the same as the Producer Price QAF.

A staffer at the Producer Price Index section of the BLS at first claimed that the only time the QAF was applied was when, "a company discontinues one product line and replaces it with another line which has more value," but then admitted that "there is the example of lawnmowers. Last year, to meet safety standards, the lawnmower producers raised the price of lawnmowers from 20 to 50 percent, with most of the price increases in the high teens or up to 25 percent. We at the Producer Price division counted only 6 percent of that increase." She added that the rest of the price increase was attributed to QAFs and deducted.

A source in the apparels division of the BLS Producer Price Index division said that in order to meet garment inflammability laws, which were passed in the 1970s, several manufacturers increased their prices. She gave this example: "Let's say," she said, "that the price of a piece of apparel was $100 and its price went up to $110. If the company told us that they spent $9 to meet the inflammability codes, then we would only count $1 as part of the price increase, not $10." When asked, "Do you just take the company's figures? Don't you do any check of your own?," she said, "No, we don't."

THE MARC RICH CASE

Dr. K. implicated in dealings with Iran

by Joseph Brewda

In perhaps the biggest case ever conducted for violation of the Trading with the Enemy Act, spot-oil market speculator and Henry Kissinger business partner Marc Rich has been charged with funnelling over $200 million for oil to the Iranian government during the height of the hostage crisis, after trade with Iran was declared illegal. If the U.S. government charges are correct—and Rich's outrageous efforts to evade court subpoenas on a related civil case indicate they are—then Rich's treacherous proclivities help explain why Henry Kissinger and his partners at Kissinger Associates have been so helpful to Rich over the years.

The evidence supporting the hypothesis that Marc Rich has been nothing but an operative and is now a sacrificial lamb for Kissinger Associates and its clients, is already so compelling that it is essential that Congress conduct a thorough investigation of the Marc Rich case. The case could very well be another instance of corrupt behavior on the part of newly appointed Central American commission chairman Henry A. Kissinger jeopardizing national security.

The U.S. government charges

Acting upon evidence compiled by the U.S. Attorney's office of the Southern District of New York, a federal grand jury in Manhattan returned a 51-count indictment Sept. 19 against Marc Rich, Marc Rich and Company International, and Marc Rich and Company A.G. for violating the Racketeer Influenced and Corrupt Organization (RICO) statutes, and against Rich and his business partner Pincus Green for violating the Trading with the Enemy Act. Rich et al. are also charged with evading taxes and multiple mail and wire fraud violations.

According to the Southern District, the racketeering charges against Rich involve his concealment of over $100 million in taxable income from crude oil deals of Rich International—in a large part earned illegally in violation of federal energy laws—by diverting the income through sham transactions offshore to Rich A.G., a foreign corporation which does not file United States income tax returns. As a