# How the Federal Reserve rigs its Industrial Production Index

by Leif Johnson

*EIR* has uncovered sweeping, systematic fakery in the Federal Reserve Board's Industrial Production Index that could produce one of the capital's largest scandals in years.

At the recent International Monetary Fund meeting in Washington, when *EIR* asked Fed chairman Paul Adolph Volcker about the truthfulness of the index, he replied that he would conduct a "full investigation of the matter."

An *EIR* team, working with data assembled by industry associations, has confirmed that much of the "recovery" reported in the Industrial Production Index never occured, and that the Fed overstated every item of production examined in order to produce the false recovery.

The study, to be produced in full in the October issue of the Quarterly LaRouche-Riemann Economic Forecast, notes that the fraud was designed to ensure Fed chairman Paul Adolph Volcker's renomination, and to induce the President to back the economic policies of Volcker and the International Monetary Fund, on the basis that global austerity is a tolerable stopgap while the U.S. "recovery" begins to "take hold," and there is no need for renegotiation of the underdeveloped nations' debt to foster trade and investment.

The fraud capability is now ready to be used in the other direction, to exaggerate the depth of the U.S. depression in order to destroy the President's re-election prospects and meanwhile wreck his energy-beams strategic defense policy with budget cuts.

## Detective work

*EIR* researchers had discovered internal inconsistencies in the Fed's figures by the early spring. We had found numerous instances in which the Fed claimed an increase in industrial production of a commodity between January and February, but at the same time—in the same press release—showed a drop in electrical consumption in that industry. Specifically, the Fed reported that dairy, beverages, paper, newspapers, basic chemicals, acids and fertilizer materials, plastic materials, and cement output rose but that electrical consumption of those industries fell. The two most glaring inconsistencies were in basic chemicals, for which the Fed reported a 7.7 percent increase, but whose electrical consumption fell by 4.1 percent, and cement, which declined 0.3 percent while its electrical usage slipped 12.6 percent.

In an industry as dependent on electrical input as cement, it was impossible that the same amount of cement could have been produced using a magnitude of 10 percent less power. The Portland Cement Association could offer no explanation for the anomaly, nor would the Fed itself.

*EIR* has been repeatedly asked by industry associations, trade unionists, and businessmen, particularly in transportation: "Where is the recovery?" Mild improvement in some industries was reported because of the increase in auto and housing units produced, but others, particularly transportation, were reporting conditions in 1983 as bad as or even worse than the previous year's. Businessmen who in early spring believed that the recovery had "not trickled down" to them are now saying that it "never will."

Most important, the March 1983 LaRouche-Riemann econometric report found that if the Volcker economic policy were continued, the basic goods-producing economy of the United States would decline between 3 and 6 percent over the year. We knew then that, regardless of any short-run blip in selected consumer durables, the underlying economic fabric of the nation was deteriorating.

Perforce, we had to conclude that the Federal Reserve Board Industrial Production Index was false. The question was, how and in what magnitude was the index altered to produce a recovery and hide the continued ruin of the nation's basic industry?

We examined the Fed index to determine which figures could be verified by independent industry sources. We found nearly two dozen sectors of industrial production whose actual output numbers could be obtained, and then checked against the Fed index.

## Long-term and short-term hoaxes

Our work netted two basic findings: Every industrial series examined had been systematically depressed below actual levels of output in the second half of 1982 and then systematically boosted in the first half of 1983 to produce the appearance of a recovery between last year's "trough" and the rising values of the spring and summer.

Secondly, above and beyond that, we discovered that for certain industrial sectors, primarily consumer goods, there

Figure 1

### Auto production

| | Million units produced (Motor Vehicles Manufacturers Association) | Federal Reserve index (1967 = 100) |
|---|---|---|
| July-Dec. 1982 | 2,438 | 82.4 |
| Jan.-June 1983 | 3,236 | 114.3 |
| **Percentage change** | +32.7% | +38.7% |

### Raw steel

| | Millions of net tons (American Iron & Steel Institute) | Federal Reserve index (1967 = 100) |
|---|---|---|
| July-Dec. 1982 | 30.8 | 50.2 |
| Jan.-June 1983 | 40.1 | 68.4 |
| **Percentage change** | +30.0% | +36.3% |

### Bituminous coal

| | Millions of short tons (U.S. Energy Department) | Federal Reserve index (1967 = 100) |
|---|---|---|
| July-Dec. 1982 | 394.4 | 135.0 |
| Jan.-June 1983 | 375.3 | 135.9 |
| **Percentage change** | −4.9% | +0.7% |

### Synthetic rubber

| | Thousands of metric tons (Rubber Manufacturers Association) | Federal Reserve index (1967 = 100) |
|---|---|---|
| July-Dec. 1982 | 826.4 | 75.6 |
| Jan.-June 1983 | 975.3 | 103.5 |
| **Percentage change** | +18.0% | +36.9% |

### Refrigerators and freezers

| | Thousands of units shipped (Association of Home Appliance Manufacturers) | Federal Reserve index (1967 = 100) |
|---|---|---|
| July-Dec. 1982 | 2,890 | 94.3 |
| Jan.-June 1983 | 3,122 | 112.3 |
| **Percentage change** | +8.0% | +19.1% |

was a consistent bloating of the index relative to actual output. This exaggeration was a systematic feature of the index traceable back to 1967, when the index was set at a value of 100.

Thus there are two sources of conspicuous cheating in the index: the short-run "business cycle" fraud that produced the non-existent 1983 recovery, and the secular inflation of industrial series to report production which did not occur.

The Fed's depressing of statistics in the "trough" and the inflation of those figures in the "recovery" produced widespread discrepancies. The smallest was in the auto sector, which increased production by 32.7 percent from the second half of 1982 to the first half of 1983. The Fed claims a 38.7 percent increase based on its index numbers. Raw steel output for the same periods increased from about 30 to 40 million tons, an increase of 30 percent. The Fed's index rose 36.3 percent (see **Figure 1**).

Refrigerators and freezers produced went from 2.890 million in the second half of 1982 to 3.122 million in the first half of 1983, an increase of 8.0 percent. The Fed index parlayed that increase into a 19.1 percent upturn. Similarly, in synthetic rubber, the Fed used an actual increase of 18.0 percent to create a reported rise of 36.9 percent, exactly double the actual rise. The Fed even managed to take a 4.9 percent decline in bituminous coal output and create a 0.7 percent upswing.

To examine the second, long-term fraud it is necessary to understand the meaning of an index. When dealing with such disparate items as those in an industrial production index, it is cumbersome to report the actual production figures, especially if several series, a subset of chemical products for example, are subsequently grouped together to produce a larger category, of let us say, chemical products as a whole. Therefore the output numbers are expressed in a ratio tied to a base year.

In the Fed index, the output of each industry in 1967 is 100. Hence, if production of a sector of industry rose by 10 percent, the Index would show 110. If the output rose by 50 percent, the Index would stand at 150. Instead of maintaining the original 1967 ratio of output to Index, the Fed altered the ratio to produce non-existent production.

If the Fed had maintained the original ratio of output to the index (as all indices must), the Index would be corrected as shown in **Figure 2.** The most flagrant example is that of hosiery production, which if corrected would stand at an index number of 130.8. The Fed reports a level of 237.9. The Fed has falsified a 30.8 5 percent increase in hosiery output since 1967 into an increase of 137.9 percent

It is unfortunate that the actual output figures available from independent industry trade association sources comprise less than 10 percent of all industrial output (at least according to Fed figures). Because of their diversified nature, we cannot as yet obtain unit data on such key areas as machine tools, infrastructure, forgings, electrical and electronic equipment, and other machinery. The level of actual fraud could be even larger than we have documented.

Figure 2

### The Fed's credibility gap
(selected categories)

| Industrial sector | Federal Reserve index (Jan.-June 1983) | Corrected Federal Reserve index (Jan.-June 1983) |
|---|---|---|
| **Cooking stoves** | 147.2 | 87.4 |
| **Plywood** | 231.1 | 163.8 |
| **Laundry appliances** | 140.4 | 110.6 |
| **Hosiery** | 237.9 | 130.8 |
| **Tires** | 153.7 | 116.8 |