The gross fraud of Gross National Product

by Dennis Roland and David Goldman

When the public press makes chopmeat out of the latest Gross National Product figures release, it's hard not to agree. However, the attack on the credibility of the government's first-quarter GNP estimate, released May 20, has restricted itself to the narrowest features of what is, otherwise, a monstrous hoax.

Numerous economists have pointed out that more than the entire reported growth in GNP during the first quarter resulted from inventory accumulation. Where inventories fell by \$6.3 billion during the last quarter of 1984, they rose by \$33 billion during the first quarter, creating a net swing of \$39.3 billion. But the increase in GNP as a whole was only \$32.7 billion.

As various economists pointed out to the financial press, falling retail sales during the first quarter make clear that the rise in inventories was involuntary, reflecting economic weakness, not strength. Uniformly, the economists predicted a compensating decline during the second quarter.

Little noted was the report that non-residential investment reportedly fell from \$486.5 to \$469.8, or a 3.4% annual rate of decline.

Since industrial production declined during February and March, the credibility of a substantial increase in GNP over the period was strained. Every physical index of economic activity, including such basics as railroad and highway freight, electricity consumption, and so forth, was stable or declined during the first quarter.

However, the issue is not merely the hash in the first-quarter data.

The GNP numbers, such as they are, reflect a declining economy. As it is, the government's data are totally unreliable, where not outright fraudulent. *EIR* has, from time to time, dissected the government's data, showing staggering discrepancies; nowhere is this more outrageous than in the case of the inflation data, where so-called quality adjustment factors have produced a 100% divergence between the inflation indices and actual prices paid by consumers during the period since 1967.

However, the broadest failure in Gross National Product is traceable not to the manipulation or incompetence of federal statistical agencies, but, instead, to the

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A street peddler in New York City: Millions could be making a living this way because farms and factories are shutting down—but "Gross National Product" would still be rising!

prejudice built into the GNP concept in the first place. GNP is the outgrowth of the radical hedonist philosophy introduced into economics by the "philosophical radicals" Jeremy Bentham, James Mill, and J. S. Mill, leading to the so-called utility theory of value. This states that any good or service is valued according to the price an individual will pay for it, to derive pleasure from its consumption. From this standpoint, a gambling casino, or a distributor of pornographic videotapes, contributes as much to economic growth as a machine-tool plant; indeed, if economic conditions shut down the machine-tool plant, the pornographer will contribute much more to GNP.

Robert Mundell, the guru of "supply-side economics," used to express this with the quip: "The ideal economy would be based on playing basketball and going to the beach." Who would make the basketballs, or how we might get to the beach, never entered into his calculations.

The first thing we demand of any index of economic performance is that it tell us how the change in the index affects our chances of being around at any point in the future. GNP fails this reality test: It rises quite handily while unproductive, often deleterious "service industry" expansion coincides with the collapse of the economy's physical production base.

We have performed a set of calculations employing GNP data from 1963 to 1984, which documents the divergence between GNP and the real world. These data examine the content of GNP from the standpoint of the economy's physical production capacity.

We begin by treating the economy as a consolidated agroindustrial firm, in which all payment derives from the sale of the physical product produced, and cost of sales, clerical labor, and so forth, are treated as overhead costs. The firm's income is, simply, the income produced by the productive sector which includes the following.

- 1) Agriculture, forestry, fisheries
- 2) Mining
- 3) Construction
- 4) Manufacturing
- 5) Transportation
- 6) Telephone and telegraph
- 7) Electric, gas, sanitation

We include infrastructure as production expenses, in the same fashion that a firm would include the improvement of land as part of its investment costs for production.

From this standpoint, we can isolate from GNP data, the direct cost of production. This includes the cost of wages, investment in equipment and structures, expenditures for research and development. This must be adjusted for net exports. We then subtract this cost of production from the gross profit of the productive sector, to obtain the monetary cost of the net production of physical-goods output.

We then sub-divide the remaining portion of the total GNP into four categories:

- 1) Non-government overhead
- 2) Government overhead (economic)
- 3) Government overhead (administrative)
- 4) Waste

Non-government overhead consists of the following categories in the GNP data:

- 1) Wholesale trade
- 2) Retail trade
- 3) Finance, insurance, and real estate
- 4) Services
- 5) Interest

Government overhead (economic) includes those functions of government which contribute indirectly to the production of physical goods, namely:

- 1) Research and development
- 2) Education
- 3) Health

Government overhead (administrative) includes:

- 1) Central executive, legislative, and judicial activities
- 2) National defense
- 3) Income support and welfare
- 4) Veterans benefits and services
- 5) Energy
- 6) Commercial activities

- 7) Interest
- 8) Postal service
- 9) Economic development
- 10) Labor training
- 11) Civilian safety
- 12) Other unallocable

We counted as waste two categories of expenditure. The first is unemployment and related income-support, which reflect the waste of citizens' activity. The second is the excess of interest payments over and above the 1963 level, or 3% of GNP. This is an arbitrary but sound estimate of the volume of usury in the national economy.

How to damage future growth

To show the actual content of GNP, we present these basic categories as a proportion of total GNP for the years 1963, 1967, 1971, 1977, 1978, 1979, 1980, 1981, 1982, 1983, and 1984. The simple use of proportionalities permits us to use current (undeflated) dollars only, eliminating concern over the enormous errors in the inflation data.

What we find is a drastic reduction in the physical-goods component of GNP, in favor of a drastic increase of overhead and waste categories. To the extent that GNP growth is wasteful, or merely adds to excessive corporate or governmental bureaucracy, an increase in GNP—quite apart from sideissues such as the counting of inventories—reflects economic decline rather than growth.

The productive sector's output (in dollars over years stated) went from 43.5% of GNP in 1963, to 37.1% in 1983, to 37.2% in 1984. In other words, the production-content of GNP fell by 6.1% in productive output (**Figure 1**).

Productive costs (graph not shown) went from 19.4% in 1963, to 22.2% in 1981, to 18.8% in 1983, to 20.3% in 1984. The primary cause of the increase in the cost of production was the rise in net imports.

Economic overhead rose from 15.6% to 20% (**Figure 2**). Meanwhile, administrative overhead rose much faster,

i.e., from 56.7% of GNP to 67.9% of GNP, i.e., an increase of 11.2% (**Figure 3**).

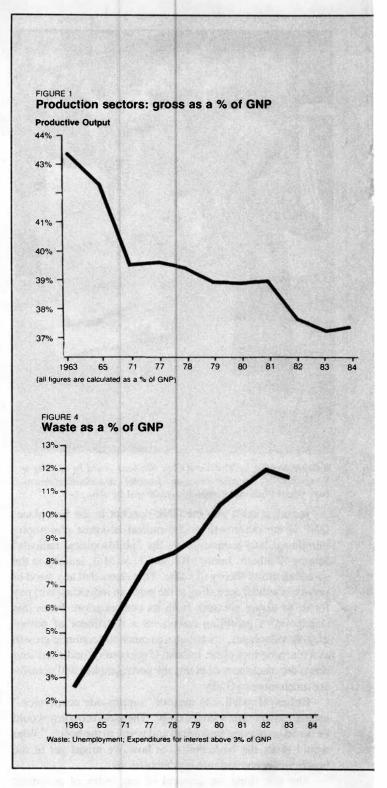
Waste was also a growth category, from 2.8% of GNP to 12.3% of GNP (**Figures 4**).

Productive sector wages fell from 13.9% of GNP to 8.9% of GNP (**Figure 5**).

In sum, the various non-productive sectors increased their share of GNP by 24.1%, while the productive sectors of GNP fell by 10.2%.

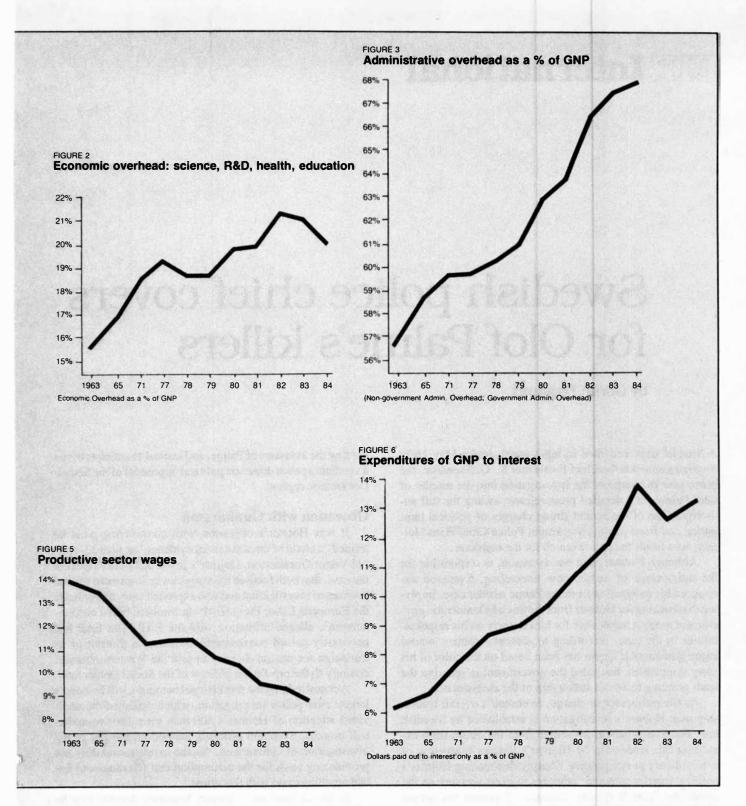
The increase in government's administrative overhead occurred while defense spending's share of GNP continued to decline. Defense fell from a high in 1967 of 9% of GNP, to a low in 1978 of 4.8%. It then rose to 6.3% of GNP in 1983 and 1984, still far below its 1967 level.

In fact, the largest single component of the increase in government administrative overhead was debt service. This is also true for the private sector. Interest as a proportion of total GNP rose from 6.2% in 1963, to 13.7% in 1982, at



which level it appears to have stabilized (Figure 6).

We have also not included in this analysis the so-called underground economy. By definition, this is not included in GNP, since it is based on unreported transactions. However, it is unquestionably the fastest growing sector of the economy. Narcotics traffic alone rose from about \$100 billion in



1978 to about \$250 billion in 1986, i.e., much faster than the overall growth of GNP. A good rough guess is that the underground economy comprises \$500 billion in annual transactions, equal to roughly one-seventh of GNP. The proportion of waste in GNP would not be 12%, but 23%.

The 23% of waste—including interest, rent, narcotics,

and other costs which bear neither directly nor indirectly on productive activity—exceeds the 20% of direct production costs. In other words, the United States economy spends more per annum for things that damage our future capacity to grow, than for things that increase our future capacity to grow.

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