How Inflation in the U.S. Economy Is Hidden

by Richard Freeman

The Monday night news announcer with the blow-dried hairdo, adjusts his fixed smile, and leans into Camera 1, saying, "We have good economic news, tonight. The national inflation rate, the government's Consumer Price Index, rose only one-tenth of a percent last month; for the past 12 months, it has averaged just 2.1%. The government says that the days of high inflation are over." Across Washington, there are official sighs of relief; that for one more month, they have pulled the wool over citizens' eyes. Around the United States and the world, it is trumpeted that the U.S. economy is sound.

It is time to put an end to this confidence game that has gone on for more than a quarter of a century. The U.S. inflation rate, the Consumer Price Index (CPI) published by the Bureau of Labor Statistics (BLS) of the Department of Labor, is a fraud. The real inflation rate is a multiple of the reported 2.1%. The BLS does not seek to measure and then report inflation; it seeks to deny that it exists, and make it disappear under a blizzard of counterfeit data.

To accomplish that end, the BLS uses a falsifying procedure called the Quality Adjustment Method (sometimes also labeled the Quality Adjustment Index, or Quality Adjustment Factor). Not one in a million Americans or citizens in the world, knows what the QAM is. But it enables government statisticians willfully to lie about most of the important economic indicators which are on the tips of their tongues. The QAM needs to be exposed and discarded, for the health of the nation and its citizens.

Making Price Rises Disappear

Suppose the price of a product, such as a car, has risen by $500 from one year to the next. Using the QAM, a BLS team can ascribe anywhere from 20% to 70% of this actual increase in price to a supposed "improvement in quality" of the vehicle. Often, there is no improvement, or even a retrogression, in the quality of the good (the veracity of the claim of improvement will be explored below). But the BLS takes the license to refuse to count that portion of the car's increase in price which they have disguised as being due to "improved quality." They only report that portion of the price increase which the BLS has not so disguised. In this example, suppose the BLS team ascribes $300 of the $500 price increase to improved quality; it then only counts $200 as the car's price increase for the year. Expertly manipulating this craft, the BLS eliminates as much as one-half to two-thirds of the actual inflation that took place!

However, lying about inflation is only one part of the skullduggery that the QAM is used for. The BLS devises Quality Adjustment Factors (QAFs) for hundreds of items, which it uses to reduce the reported "official" rate of inflation. It turns over the QAFs to the U.S. Department of Commerce and the Federal Reserve Board of Governors. These two agencies publish two of the most widely watched measures of economic activity: The former agency publishes the Gross Domestic Product; the latter publishes the Industrial Production Index. *EIR* has shown that both GDP and the Industrial Production Index, as constructed, have deep methodological flaws. Putting those aside for the moment, let's see how the QAM distorts the reported performance of those measures.

The Gross Domestic Product is supposed to measure the economy's output of goods and services. If the BLS determines that the quality of one of the goods that makes up GDP has improved by 4%—whether it has or not—the economists at the Commerce Department will work from the following assumption: A 4% increase in quality is equivalent to a 4% increase in the value of the good, which is equivalent to a 4% increase in the economy's production of the good. They will apply the same formula to hundreds of goods and services. Even though the performance of the economy may have fallen, when stated in GDP, nonetheless through the fraudulent QAM, the Commerce Department is able to show an increase in GDP on paper.

Employing the same procedure, the Fed economists get an increase in industrial production. The data released on inflation, GDP, and industrial production, are preposterous, and hardly credible.

A Weapon of Control

Consider that for the British-American financier oligarchy, the Quality Adjustment Method is more than a method of falsification; it is a means to keep economic and social control, a strategic asset as important as a military armamentarium. Let us look at three of the major purposes to which it is put:

1. In the case of inflation reporting, the QAM is used to cover up the consequences of the destructive policies of the Federal Reserve Board. Fed Chairman Alan Greenspan, acting on behalf of the financier oligarchy, has printed walls of money to hold up the utterly bankrupt post-Bretton Woods floating-exchange-rate financial system. This policy is locking the United States, and the world, onto a hyperinflationary spiral which follows the trajectory of the hyperinflation which ravaged Weimar Germany from March through November 1923. But Greenspan supporters will say, "But where is the inflation? The CPI rate is only 2.1%." Most has been hidden by the QAM.

2. The QAM-adulteration of the CPI defrauds tens of millions of American workers, elderly, et al., of their rightful wages and/or benefits, whose level of disbursal is tied to a

cost-of-living adjustment (COLA) escalator clause, which is based on the performance of the CPI. If inflation rises by *x*, but the QAM-altered CPI says it only rose by ⅓ of *x*, then workers and elderly get only ⅓ of what they are supposed to in inflation-adjustments. The BLS document, "Understanding the Consumer Price Index: Answers to Some Questions," explains that "The CPI affects the income of almost 80 million persons, as a result of statutory action: 48.4 million Social Security beneficiaries, about 19.8 million food stamp recipients, and about 4.2 million military and Federal Civil Service retirees and survivors. Changes in the CPI also affect the costs of lunch at school, while collective bargaining agreements that tie wages to the CPI, cover over 2 million workers." *EIR* has calculated that the BLS's use of the QAM to lower the CPI inflation rate cheats American out of more than $150 billion in wages and benefits annually.

3. The United States is able to draw in dollar investment from around the world, and to some extent, solicit support for military adventures, based on claims of America's "economic soundness," resting upon QAM-despoiled CPI, GDP, and Industrial Production Index data. To foreign investors, America's "economic soundness" is presented as a reason that their dollar-denominated investments are safe in the United States. This financed America's $470 billion physical goods trade deficit in 2002; without that foreign inflow, the dollar would have collapsed by 40-50%, bringing down with it the bankrupt dollar-based world financial system. The Anglo-American imperium could not survive such an explosion.

Unmasking the QAM

For two decades, economist and 2004 Presidential candidate Lyndon LaRouche has continuously unmasked the dangerous sham of the QAM. In 1983, LaRouche commissioned an exposé (see *EIR*, Oct. 4, 1983, " 'Quality Adjustment Factor': How the Fed Hides Inflation"). On Feb. 4, 1984, then-Democratic Party Presidential pre-candidate LaRouche, in a half-hour national broadcast on ABC television, exposed this fraud to the nation. "At the end of the first quarter of 1983," LaRouche told the television audience, "we were shocked to notice that both the Federal Reserve and Bureau of Labor Statistics were faking the figures for both industrial output and for unemployment by very wide margins. Later we discovered also that the reported rate of inflation was being faked as well. It was being faked by as much as three times, that is, the rate of inflation during 1983 was about three times as much as the government has reported to you."

And as recently as an address to a seminar in Berlin, Germany on Dec. 18, 2002, LaRouche stated, "Someone will tell you, the United States has . . . no inflation. . . . We lie! . . . We're suffering up to 10-20% inflation."

Over the next few weeks, *EIR* will present a series of articles exposing, once again, the QAM. We present here an overview, and the case of the QAM's lies about auto inflation.

The "donut" spare tire, at left, which has replaced the regular-sized spare on most new automobiles, is designated a "quality improvement" and subtracted from the car's price increase, in Bureau of Labor Statistics records—an absurd epitome of the widespread falsification of inflation by the so-called Quality Adjustment Method.

The BLS has gone to almost any length to suppress an accurate reporting of the real rate of inflation of new automobiles. Since 1967, the real increase in the average price of new cars—actually paid by purchasers—has been 2.5 times greater than the Consumer Price Index's subindex for new cars reports. That there is such a large discrepancy between reality and fantasy can only be explained by the fact that there was a three-decade deliberate attempt by the BLS to distort inflation.

The CPI tracks thousands of commodities, whose prices it combines on a weighted basis, to determine the overall CPI rate. A new car constitutes, on a weighted basis, 4.604% of the entire composition of the Consumer Price Index; $1 out of every $20 that consumers spend, is for a new car. So suppressing the inflation rate for new cars would have great importance in holding down the combined inflation rate for all commodities. Here, the Quality Adjustment Method was the BLS's ace in the hole.

According to one BLS analyst, the BLS talks to individuals from several of the auto manufacturers, both foreign and domestic, which manufacture cars in American plants. These manufacturers' representatives report the price increases in the new model cars, and also what physical changes have been made in the models, and what each change costs. The BLS analysts then look at the new physical changes and assess whether they constitute quality improvements. In almost every case—with a few notable exceptions—they count the physical changes as representing quality improvement. They add up all the costs of the physical changes, and call the sum, the cost of the quality improvement.

Take, for example, the 1994 model year car; it had a price increase of $612.74, on average, over the same model 1993 car. The BLS claimed that $363.93 of this was the cost of physical changes for "quality improvement." The BLS reported as the price increase of the 1994 model year car, not $612.74, but only $249.11, the balance after the alleged "quality improvement" had been deducted.

Thus, in the 1994 model year car, 59.3% of the actual price increase was deducted and excluded.

What Is the Standard of Quality Improvement?

One can only discuss the issue of quality improvement within the environment that has governed the United States since the mid-1960s, when America's financial powers-that-be began to force the shift from a producer to a consumer society. This has seen practices such as accountants' cost-cutting, and computer benchmarking become dominant. The latter involves designing products predominantly with computer simulations; the process of engineering and machine-tool design, where the validity of the designs is tested in the real world of physical models, and real testing is minimized or skipped over. This process produced the Mercedes Klasse A and the Ford Explorer SUV. Each was generated by benchmarking, but when put onto the road, each flipped over under certain configurations of weight and speed. The Ford Explorer SUV had never been tested; according to reports, Ford tested instead the Ford Ranger 150 pick-up truck (which has the same chassis as the Explorer); and the road tests were usually conducted at top speeds of 45-55 miles (72-89 kilometers) per hour. Yet the instabilities in the Ford Explorer manifested themselves at speeds over 60 mph (96 kph); but the engineers, insanely, had taken the road test results from the lower speeds, and used them merely for computer simulations of what would happen at higher speeds, never subjecting the vehicle to higher speeds in the real world.

This process does not represent "improvement in quality"—though the BLS would think it did—but quality degradation.

Or, take the automakers' campaign to build lighter passenger cars, in part to meet fuel-economy standards, and in part to chisel down costs of materials. A car that weighs less than 2,500 pounds (1,133 kilograms), even with certain structural improvements, will have a higher chance to cause serious injury to its driver and passengers, when it collides with a truck, or an immovable object, such as a cement wall. This process does not represent "improvement in quality," but quality degradation.

But the BLS has opened the floodgates by identifying things as "quality improvements," which are merely nice accessories, such as "CD players and leather seats." The BLS tried to appear to draw a line, by saying that "styling changes" would not be quality improvements. But then in its "Handbook of Methods," the BLS abandons even this appearance of rectitude by saying that chrome trim could be considered to be a quality improvement, if "offered as options and purchased by customers."

Who Donut?

Perhaps nothing better likens the insanity of quality adjustment to the pages of "Ripley's Believe It or Not," than the BLS assertion that the "donut" spare tire constitutes a quality improvement. Up until the 1980s, every car came equipped with a real spare tire, equal in size, tire pressure, and strength to the four tires already installed on the automobile. If one had a flat tire, and changed it, one could then drive several thousand more miles.

Then, some cost-cutting accountant dreamed up the "donut" substitute for the regular spare tire. It is a scourge of the American driver. The donut is a small kiddy-car-like tire. After putting it on, one's car has three real tires and a kiddy tire, causing it to wobble and making the maximum safe speed 45 mph. Unfortunately, if one gets a flat tire on a Sunday, or after 10 p.m. on a week-night, or in the backwoods, one may not be able to find an establishment to sell or fix a real tire, so one is stuck.

The BLS considers the donut a "quality improvement," because the automaker had to redesign the tire well of the trunk to accommodate the little tire instead of a regular one. This cost is deducted by the BLS from the cost of the new model car. Suppose the cost of redesigning the tire well was $150. The carmaker knew that he would sell new cars with donut tires, which are cheaper than real spare tires, and that over 20 years, he would make many times more in profit than what it cost to redesign the tire well of the trunk.

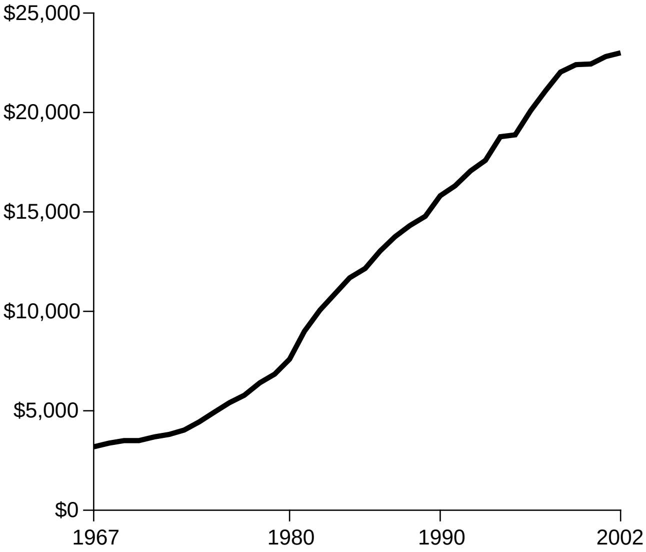
On Feb. 3, this reporter talked to a BLS specialist, describing a car wobbling along on three real tires and a donut: "This restricts the car's movement, is less safe, and is a degradation of the quality of the car. Yet, the BLS calls it a quality improvement." The BLS analyst, after consulting a supervisor, replied, "I understand what you're saying. But we have to go by our method."

The Real Price

We can show how BLS statisticians and economists have mowed down inflation with the QAM. **Figure 1** establishes a basis of reality. It shows the actual average retail price charged for a new car in America, as compiled by an accurate survey by the U.S. Commerce Department. In 1967, the average retail price was $3,199; in 2002, it had climbed up to $23,005. During this period, the BLS's Consumer Price Index sub-index for new cars, rose from 49.3 in 1967, to 137.3 in 2002. *EIR* converted the actual price of a car from dollars into an index, with 1967=1.00; at the same time, it re-indexed the CPI sub-index for cars, also setting the value of 1967=1.00. **Figure 2** shows the comparison.

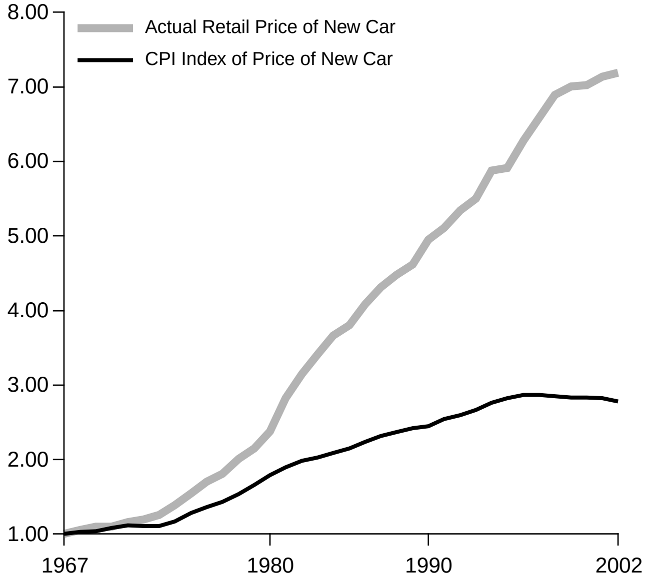
The upper curve, which represents the real retail price of a car, and the lower curve—the CPI sub-index for the same car—start to diverge significantly in the period 1979-82. This is the time interval that Fed Chairman Paul Volcker sent interest rates into the stratosphere as part of his implementation of the policy of "controlled disintegration of the economy."

FIGURE 1
Actual U.S. Average Retail Price of New Car, 1967-2002
(Dollars)



Source: U.S. Department of Commerce.

FIGURE 2
Index of Actual New Car Retail Price vs. Official CPI Index of New Car Retail Price
(1967=1.00)



Sources: U.S. Department of Commerce; U.S. Department of Labor, Bureau of Labor Statistics; *EIR.*

Following that period, the two curves diverged even more considerably.

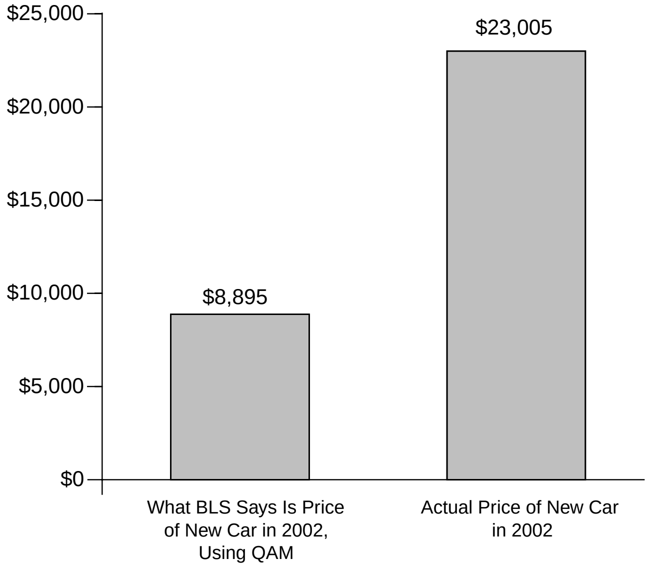
Secondly, from 1996, the curve representing the CPI sub-index starts to show a price decline, even while the curve representing the *actual* price of a new car continues rising. That is, during the mid-1990s, there was a particular attempt by the Fed and BLS, artificially to suppress the statistical reporting of inflation.

Overall, the actual price of a new car had risen more than seven-fold, from 1.00 in 1967 to 7.19 in 2002; but the CPI sub-index only rose less than three-fold in the same time. The CPI sub-index only acknowledged about one-third of the real inflation in a new car's price, and suppressed two-thirds. By such fakery, the U.S. government reports that inflation is under control.

Figure 3 highlights how absurd the application of the QAM is. It shows that the real average retail price of a car is $23,005. It then takes an average 1967 car and multiplies its cost, $3,199, by the amount the CPI *claims* car prices have increased by since 1967, which is 2.78 times. Were the QAM a true determination of price, the average new 2002 car would have cost a mere $8,895. Try to find such a price; perhaps you could get half a car.

The Quality Adjustment Method is a colossal lie, which is disarming the nation. It is time to report the actual surge in inflation, which will wake up the country, so that it can solve the economic breakdown crisis that is producing it.

FIGURE 3
BLS Fakery in Price of New Car



Sources: U.S. Department of Commerce; U.S. Department of Labor, Bureau of Labor Statistics; *EIR.*