

Wharton's Diemex model

Timothy Rush's multi-section report on how and why Lawrence Klein has sold incompetence as economic science.

The Wharton School of Pennsylvania, through its special econometric model for Mexico called "Diemex," is one of the foremost voices today warning that Mexico's oil is more a curse than a blessing for the future of that nation.

The Wharton line, taken from Henry Kissinger's peculiar version of the "lessons of Iran," is that a modernization drive based on oil revenues necessarily breeds high rates of inflation, greater inequalities of wealth, and more intense social unrest. In Wharton's view, Mexico must cut back on both its oil program and its rate of development if it is "to escape the fate of Iran."

It is probably not immediately obvious to many *EIR* readers why someone approaching Mexican planners with this litany would not simply be laughed out of town. Certainly, as Mexico has poured its oil wealth into steel, capital goods, petrochemicals, and increasingly into agriculture and transportation, it is running into severe bottlenecks. Inflation has leaped from 20 percent in 1979 to 30 percent last year.

But most Mexicans will tend to view these problems as growing pains, and President López Portillo has been emphatic that the solution to the inflation is *more* production and productivity, not less. Oil is not the problem; it is a unique source of capital, alone capable at this point of making Mexico's dream of becoming an advanced industrial republic a reality. The issue is the proper investment of the revenue generated by the oil.

Yet the peddlers of the "poor Mexico" litany are *not* being laughed out of town. In fact, the Wharton School's Kissingerian theories are gaining credence and followers on both the "right" and the "left" of the political spectrum.

An important example from the center-left is Industry Minister José Andrés de Oteyza. De Oteyza has been a consistent proponent of industrial expansion and rapid growth rates. But he has increasingly emerged as the foremost government advocate of keeping oil export levels low—a measure that will eventually gut his own state strategy. In the middle of January he officially announced the end of Mexico's "oil-for-technology" export policy, which had been the underpinning of much of Mexico's modernization drive and increasing diplomatic clout.

He stated to the press that Mexico "has no more oil

to sell"; it was reaching the 1.5 million barrels per day export ceiling stipulated in the recent Energy Program (see *EIR*, Dec. 30, 1980).

His blunt statement that the "for sale" sign on the oil had been taken down came on the eve of López Portillo's latest major diplomatic effort, a trip to oil-deficient India. Just one day after he spoke, Japanese Foreign Trade Minister R. Tanaka arrived with new investment proposals from Japan, which has long sought increased oil shipments from Mexico.

Most important, it came just after López Portillo and Ronald Reagan had set the potential for a historic turnaround in U.S.-Mexico relations at their Ciudad Juárez meeting—a potential which depends on an oil-for-technology framework for successful fulfillment.

The irony of this defensive "left" stance is that it is receiving the wholehearted support of such pillars of the conservative U.S. financial community as the *Journal of Commerce*. The *Journal* editorialized the day after the López Portillo-Reagan meeting that Mexico's decision to hold back further exports was wise indeed. The New York daily approvingly cited a recent article in *Foreign Policy* magazine, written by a husband-and-wife duo, the Redclifts, sent into Mexico by the Ford Foundation. In this important, policy-defining article, the Redclifts argue that Mexico's and America's common interests will best be served by devolving the Mexican economy back to a "more stable" agricultural stage based on labor-intensive technologies. The oil-export program, the lever for a contrary policy of high-technology industrial growth, must be hobbled, they argued.

'Die Mex': a command?

Wharton bears a heavy responsibility for this pervasive disorientation within Mexico. Its quackery has run unchecked through Mexico's "body economic" for over a decade, after it was spun out of Lawrence Klein's U.S.-oriented econometrics program in the late 1960s. Today it counts among its 75 clients several of the most important Mexican government ministries and economic institutions, as well as a top echelon of private corporate and banking giants. A group of U.S. multinationals operating in Mexico similarly contract for Wharton's work.

What is not directly Wharton in the econometric field in Mexico is "Son-of-Wharton." The giant computer models used by both of Mexico's leading planning efforts, the National Industrial Development Plan (PNDI) and the Global Development Plan (PGD), incorporated substantial elements of Wharton methodology. And for a full generation, a large number of economists, on both the private sector and public sector side, have received their training at Wharton.

Only now, with the application of the LaRouche-Riemann model to the Mexican economy, has Wharton's stranglehold on the field in Mexico been challenged. The LaRouche-Riemann entry into the field is due to be presented in a Mexico City conference at the end of February.

How Diemex works

In the late 1960s, Lawrence Klein assigned to some of his graduate students the task of adapting Wharton econometric analysis, up until then reserved for advanced industrial economies, to selected developing sector nations.

He worked particularly closely with Abel Beltrán del Río, a Mexican who received his Ph.D. under Klein's direction in 1969. Beltrán, from a landed family in Chihuahua, had connections in both Mexico City and Monterrey who aided the launching of the project in Mexico. Help was also provided by the dean of foreign economists in Mexico, Redvers Opie. Opie, from an earlier generation of Keynesians than Klein, had personally collaborated at the Bretton Woods conference of 1944 with Lord John Maynard Keynes. In the postwar period Opie helped found Business International and then gave up his British citizenship to live permanently in Mexico.

By 1971, Klein and Beltrán's model for Mexico was in full gear, and in fact became a separate division of Wharton Econometrics Forecasting Associates. With relatively modest changes, the 1971 Diemex version is the same one used by Wharton today.

The model is based on some 140 equations, with 46 "exogenous variables" organized, for flowchart purposes, into "six endogenous blocks." The resulting projections cover, in Beltrán del Río's words, "the components of aggregate demand, the external balance on current account, aggregate output, labor force, certain demographic variables, accumulation of capital and creation of productive capacity, public finances, prices and wages."

Forecasts are established on three tracks: "short-term" (one year or less), "medium-term" (2-3 years), and "long-term" (10 years). The small-print pages of computer runs produced by this system are distributed to

clients four times a year, along with a shorter, highly evaluative "analysis of results" prepared by Beltrán and his staff.

What kind of model is this behind its facade of computerized "objectivity"?

The basic theory of how the economy works is *Keynesian*. It takes demand as the primary motor of the economy and traces out an intricate series of correlations and relations with other variables in the economy from demand. From the array of Keynesian categories thus employed, Beltrán singles out a much smaller number for actual intensive analysis in each forecast. These he calls "the four most general economic indicators." They are 1) growth in gross domestic product; 2) inflation; 3) job creation; and 4) current account deficit.

Immediately dropped from analysis is any measure of productivity. Even the word "productivity" does not occur in standard Wharton/Diemex analyses. Similarly, questions of rate of investment and kind of investment are treated as secondary, derived matters. The issue of rate of technological innovation is, in consequence, entirely left out.

It follows as no surprise that Lawrence Klein should make the devastating newspaper admission recently that Diemex has run into problems because Mexico has "an economic structure in rapid change."

Based on this decayed Keynesianism, the model then projects forward on the basis of purely linear extrapolations of previous data. As the time frame moves farther away from the present, in the "medium-" and "long-term" forecasts, the accuracy of such predictions is approximately that of crystal ball gazing.

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Beltrán del Río himself suggests in a revealing 1979 essay, "Econometric Forecasting for Mexico: an Analysis of Errors in Prediction," that the reason for such embarrassing discrepancies over time is that the technique used is "mechanical." Further, Beltrán notes that the model's better record in short-term prediction "is apparently due to the method of incorporating the latest information available from experts and other data sources external to the model."

This gets to the heart of the Wharton consumer fraud. Stripped of its "econometric" pretensions it is nothing more than a foreign-intelligence operation which channels high-grade information from its own clients out of the country and into Wharton's computer facilities in Pennsylvania. The director of the whole affair, Lawrence Klein, is a veteran of 35 years of top-level intelligence-linked activity.

Beltrán del Río calls this core intelligence function "the group." "The group consists of more than one hundred economists and non-economic professionals of the private and public sectors of Mexico, which through quarterly meetings provide detailed information and criticism of the preliminary forecasts produced by the econometricians of Diemex. The corrections and suggestions, gathered in these meetings, after further discussion and re-evaluation, are fed into the model to generate revised projections. The main kind of information secured in the meetings refers to the probable conduct of economic policy by the Mexican authorities. Oil policy, public expenditures, wage policy, monetary and tax policies are among the important elements discussed."

For this sophisticated economic espionage scam, each client pays Wharton over \$4,000 per year.

If it's Wharton, it's slow growth

The advice that Wharton feeds back has one common denominator: go slow. This was built into Diemex from its inception. Wrote Klein and Beltrán in a 1971 paper, "Macroeconomic Model Building in Latin America: The Mexican Case": "High growth combined with stability, especially external stability, seems unattainable for the major developing Latin American economies at their present capacity-creation stage."

The econometrics work that Wharton was embedded in then had the closest possible connection to the notorious neo-Malthusian manifestos of the Club of Rome. The first Nobel economics prize, a category created in 1971, went to Club of Rome economist Jan Tinbergen for his "contributions to the development of econometric analysis." A year later, MIT's resident Club of Rome econometricians, Meadows and Forrester, published the famous *Limits to Growth* tract.

In the early 1970s, Wharton pegged its "go slow" demands to the rapidly increasing trade deficits. As surging oil revenues in the later 1970s took the string

out of the balance-of-trade argument, the choice of bogeyman shifted to inflation. The insistent warnings today about "the oil syndrome" are the latest euphemism for slow-growth.

These warnings are coupled with Wharton's notorious obsession with devaluation. In its mid-1980 forecast, Wharton offers "three alternative projections" to its Basic Projection. The basic model "forecasts" an approximate 20 percent devaluation of Mexico's peso for mid-1981 and several further devaluations later in the decade. Alternatives 1 and 2 differ from the Basic Projection only by positing different frameworks for devaluation. Alternative 3 moves the first devaluation "forecast" up to December 1980.

Thus a Wharton client is induced to focus on the issue of peso devaluation as the *only* policy variable at issue in economic planning—even as the differences in Wharton's own long-term projections using the three alternatives turn out to be marginal!

As Beltrán del Río knows better than anyone, the issue of a devaluation is political, not fundamentally economic. It is even more so the case in Mexico today, where it is universally recognized that a peso devaluation will not significantly boost exports, the ostensible goal of the exercise. But it will throw a wrench into the government's rapid growth plans.

In the end, Mexico's only serious "limit to growth" may be the conceptual influence of the Wharton model on its private and public sector planners.

Wharton in its own words

"In an economy that develops rapidly, every day there are more cases of conspicuous consumption. People become divided, jealousy is unleashed. Every citizen, even the poorest, thinks he should progress rapidly, like the country, since the country is rich. Then the citizen becomes disillusioned. People take to the streets. They scream their demands. . . . If the pauperized groups don't ascend rapidly in Mexico, it runs the risk of an outcome like Iran."

—Lawrence Klein, interview with *Proceso* magazine, Nov. 10, 1980.

"Mexico has much greater internal stability than other Latin American countries. Nevertheless, we [of Wharton] have the feeling that Mexican politics are less stable, and experience greater fluctuation, than is recognized in other research centers which run projects similar to ours."

—Lawrence Klein, interview with *El Sol*, Nov. 30, 1980.

"The principal problems [of the Diemex model in Mexico] include . . . an economic structure in rapid change."

—Lawrence Klein, *El Sol*.