

Germans Expose U.S. GDP Fraud, Imply Threat to Dollar

by Paul Gallagher

Monetary authorities in Germany have begun to expose and criticize as fraudulent, the United States' statistics on Gross Domestic Product and inflation. Their criticism is more than true, as regular readers of *EIR* know; and, it implies a European warning that the dollar is greatly overvalued and set to fall. The same warning, in fact, is also coming from columns of the *Financial Times* of London.

Any serious dollar fall would be combined with a sharp drop in the huge volumes of capital flowing into the U.S. economy from abroad, and could crash the equally huge bubble in U.S. markets.

The central focus of these severe criticisms of U.S. economic-statistical cheating, is the information technology sector—computer hardware and software—which occupies a bigger and bigger chunk of the globalized free-trade economies of the West. One very prominent German bank economist has written a letter to newspapers, asserting that one-third of the claimed growth of U.S. gross domestic product (GDP) since 1997, is purely the result of accounting fakery. The nasty character of the fakery, is that it presents the appearance of GDP growth, without there being any growth of *incomes* underlying it.

Menace of Hedonistic Accountants

Since an August report issued on this subject by the Bundesbank (Germany's central bank), the fraud known as "hedonic price indexing" in the computer sector of the U.S. economy, has been widely exposed in the German media. No, "hedonic indexing," despite the sound of it, does not refer to lists of prostitutes, casinos, and massage parlors; rather, it's a series of accounting tricks which make computer hardware dramatically and magically cheaper, computer software far more valuable, and the productivity of computer employees much higher.

No other Western power uses these "hedonic" forms of creative accounting, and none has as thoroughly a computer-

ized a post-industrial economy as the United States. It is, according to the German exposés and their echoes in the British financial press, making U.S. inflation look artificially low, and U.S. productivity and GDP appear artificially high.

The Bundesbank pointed to the strange fact that according to U.S. statistics, the average prices for computers and computer equipment fell by 80% during 1991-99, while German data show the prices of the very same equipment falling by only 20% during that period. If Germany used the U.S. government and business accounting tricks on computer hardware, "German information technology investment [would amount] to an estimated DM 64 billion [roughly \$29 billion] in 1998, more than twice as much as the amount of real investment cited in official [German] statistics," the Bundesbank's report concluded. The German economy would show a much faster-growing GDP, as the U.S. economy claims to do, if the same accounting fraud were used.

U.S. Inflation Covered Up

On Sept. 4, this charge circulating in German government and business circles was reflected in an editorial in London's *Financial Times*, "America's Hedonism Leaves Germany Cold." It repeated that the United States, when it announces "official inflation rates," is *not using the actual prices of computers and computer equipment, but rather using only a fraction of those real prices*, justifying this by the fact that computer power is increasing.

EIR has, for years, exposed this to be a general pattern and practice of phony inflation statistics, in product categories across the board, from autos to new homes. U.S. agencies use "quality adjustment factors" which keep assigning higher and higher values (hence, lower relative prices) to new products, on the grounds that they are somehow "better" than last year's.

But as computer technology occupies such a large and increasing part of the U.S. economy, the published rates of U.S. inflation are being jacked down by this "hedonic index-

ing,” helping to cover up the reality of accelerating inflation.

On Sept. 5, *Financial Times* columnist David Hale followed with the warning, “Dollar in Danger.” The apparent strength of the U.S. dollar, with capital flooding into the U.S. economy from all over the world, has been allowing America to run gargantuan trade deficits and current account deficits, living on looting the world’s produce, cheap. Claims of high worker productivity growth and low inflation, especially in the “New Economy,” have been used to keep the dollar artificially high.

On Sept. 6, the *Financial Times* published the sharpest attack, by the highest-ranking German banker, on the American information-technology accounting fraud, an attack which labelled current U.S. statistics “propaganda.”

The author of the letter was Kurt Richebächer, former chief economist of the largest German bank, Deutsche Bank. Richebächer added a second broad category of statistical fraud, the treatment of computer *software* purchases by American firms as capital investments instead of business expenses, as Europe and Japan account them. The specifics of both frauds were exposed last year by *EIR* (see Richard Freeman, “It’s Time To Scrap GDP,” Dec. 10, 1999). But the exposure of the “propaganda” now, by high-ranking European government and private financial circles, is connected to the immediate potential for a hyperinflationary blowout of the dollar.

Pointing to Greenspan

Richebächer wrote, “In his speech given in Jackson Hole, Wyoming, Alan Greenspan claimed that Europe fails to reap the big productivity gains that the new economy has brought to the U.S., because labor market inflexibility in Europe destroys the incentive to invest in cost-saving technology. Considering that European businesses have sacked millions, it is a strange argument. At issue, however, is his assertion . . . that high-tech capital spending is far lower in Europe than in the U.S., and that this largely explains the tremendous difference in economic and productivity growth. In reality, the great digital and productivity divide between Europe and the U.S. is least of all in the economies. It is overwhelmingly in the statistics and the propaganda.”

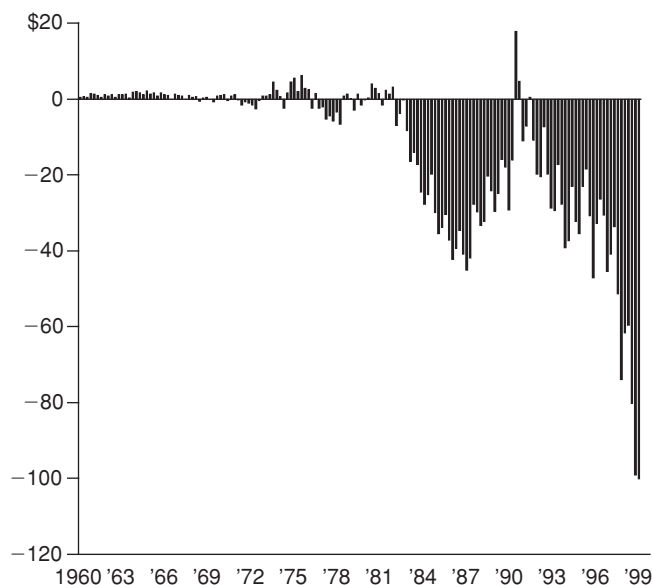
The first fraud, deflating of computer hardware prices across the entire economy, balloons the apparent U.S. productivity and GDP growth, and hides inflation, Richebächer explained. The second fraud, counting computer software as capital investment, further “adds heavily to U.S. GDP growth.”

“To give an idea of these effects,” he continued: “Between end-1998 and mid-2000, business spending on computers rose, in current dollars, by \$23 billion. . . . But the hedonistic deflator puffed this modest amount up to a massive increase [of] \$120 billion. As to software spending, . . . it added another \$95 billion to GDP growth in dollars. Together, the two components swelled real GDP growth by \$215 billion, as against an actual [growth of] \$23.8 billion.” In plain terms, U.S. GDP growth in the information technology sector of the

FIGURE 1

U.S. Current Account Balance, 1960-99

(Billions \$)



Source: U.S. Department of Commerce.

economy is made to look ten times as large as it is, by the propaganda of the accountants of the government and the private sector.

Growth Without Income

“Finally,” concluded Richebächer, “this raises the question of whether the American measuring method makes economic sense. The answer is: no, not at all. The reason is, that it creates more and more fictitious ‘real’ GDP growth, and, in line with it, more and more fictitious productivity growth—but this is growth that occurs without any correlated income growth. But is it not income growth that matters? Since the third quarter of last year, [American] growth in real disposable income has been rapidly falling behind GDP growth. In June, it was zero, and in July 0.1%, and that in a booming ‘New Economy.’ ”

These European fingers, exposing the emperor’s “new clothes” and implicitly proposing a dollar devaluation, are being pointed only six weeks after *EIR* led the way with the publication (first in Germany) of its Special Report, “The New Economy Is Doomed: The Fraud of the Information Society.” The report explodes, from the inside out, the universally accepted myths of super-high productivity, high incomes, and rapid growth in GDP, supposed to be flowing out of the “New Economy,” especially in the United States. That devastating exposure is now finding its reflections in semi-official warnings from Europe, of this heel of the Achilles of the American economic bubble.