pared to undo the cultural paradigm-shift which has taken over the nation during the recent thirty-five years, this nation were soon doomed. Yes, there were terrible faults in U.S. culture of 1945-1965; but, the worst problem of all, was that that culture allowed the 1965-2000 cultural paradigm-shift to occur.

The nature of this moral and cultural retrogression of the recent thirty-five years, is to be recognized as, predominantly, a lunatic's lurch into the state of depravity typical of a distant past condition of humanity, to the condition of Europe during the Fourteenth Century, a return from a world whose leading institutions are those of the modern sovereign nation-state, to a self-doomed form of medieval feudal society.

This degeneration has been brought about in exactly the way in which Vice-President Al Gore's parody of "Mein Kampf," his ***Earth in the Balance,*** explains his motive for turning back the clock. Gore cites the same chart which I have used frequently, showing the great gains in condition of life under modern European civilization's influence, beginning with the Fifteenth-Century Renaissance (**Figure 3**). Gore condemns that progress, and proposes methods to turn back the clock to the Middle Ages. His policies, which are typical among the lunatic fads of the past thirty-five years' cultural paradigm-shifters, represent, and that explicitly, cultural warfare against the existence of modern civilization.

Thus the lying lunacies known as the Quality Adjustment Factor and "bench-marking" were allowed to develop out of the "systems analysis" first popularized during the 1940s and 1950s, and out of the ecology cults which sprang up like mushrooms in a manure-pile, during the later 1960s and early 1970s. This could not have occurred without uprooting every institution responsible for progress since the beginning of Europe's Fifteenth Century. In the language of a psychologist, this cultural downshift, merely typified by the case of Gore's advocacy, is a change in society analogous to a shift to psychosis in the case of a neurotic individual personality.

It has been the exclusion of sane standards of deliberation, from the selection of leading candidates and policies, which has prevented the implications of the recent policy trends from being addressed in the political process. That has been the essential depravity of the trajectory followed by the U.S. political process since about the time of the assassination of President Kennedy. That thus typifies the cause for the threatened doom of civilization, now menacing us during the short term immediately ahead. Only rejecting that recent trend, will save this civilization from a global catastrophe it will have brought upon itself.

It is not necessary that God bring an Apocalypse into being. Uncontrollable natural catastrophes aside, no Apocalypse has occurred, or will occur, except one that foolishly stubborn popular opinion brings upon itself. Such is the essence of the awful crisis now onrushing; such is the presently perilous condition of all existing cultures of this planet considered as a whole.

The Quality Adjustment Method

How Statistical Fakery Wipes Out Inflation

by Richard Freeman

The actual U.S. rate of inflation is higher by 3 times or more, than the Consumer Price Index (CPI) official rate of 3.4% posted by the Bureau of Labor Statistics of the U.S. Department of Labor. The CPI is corrupted by the Quality Adjustment Method (formerly called the Quality Adjustment Factor), which covers up and hides inflation, and also distorts U.S. Gross Domestic Product and industrial production.

Americans and others are kept in the dark about the U.S. inflation rate through the debasing influence of the Quality Adjustment Method (QAM). Perhaps one citizen in 100,000 has heard of the QAM, yet the Department of Labor, Department of Commerce, and the U.S. Federal Reserve Board of Governors each has a staff devoted predominantly to the application of this method of statistical fraud.

The successful functioning of the U.S. economy is incompatible with the continued application of the QAM. Introduced in 1967 by the financier oligarchy during Arthur Burns's regime at the Federal Reserve, and spread by statisticians, it is set up to exclude anywhere from one-quarter to three-quarters of true inflation. It works from the continuous *assumption* that the quality of goods is improving: therefore, if the price of a product rose 10%, and the statisticians of the BLS claim two-thirds of the price increase was due to improved quality (the veracity of that statement will be explored below), the inflation of that product's price is reported as only 3.3%

But this is only half the use of the QAM; it represents another major problem. As Lyndon LaRouche shows in this *Feature,* any accounting system that attempts to measure footprints of economic activity, rather than the transformative activity of human beings who make the footprints, has a fundamental problem.

The pricing results of the Quality Adjustment Method, once fabricated, are turned over the Commerce Department's Bureau of Economic Analysis. The BEA makes the assumption that improved quality is the equivalent of increased output. So, if it is assumed that the *quality* of the product cited above improved by 6.7% per year, then the *output* is assumed to have increased by 6.7% (or more) per year. The BEA will apply this method to hundreds of products, and the increased output attributed to each of these products is added to Gross

Domestic Product (GDP). That is a prime reason why real physical production is falling, but GDP is rising.

Further, the QAM is turned over to the Federal Reserve Board of Governors, which publishes the Industrial Production Index. The Fed uses the QAM to "increase" industrial production in a manner similar to the Department of Commerce's hiking of GDP.

Therefore, the QAM is central in the calculation of three of the most important and closely-watched gauges of the economy: inflation, GDP, and industrial production. The fraud of pervades each of these three.

Exposing the QAM

Lyndon LaRouche and *EIR* brought to light the charlatanry of the Quality Adjustment Method in 1983 (see R. Freeman, "'Quality Adjustment Factor': How the Fed Hides Inflation," *EIR,* Oct. 4, 1983). On Feb. 4, 1984, then-Democratic Party Presidential pre-candidate LaRouche brought the exposé of the QAM to the nation in a half-hour broadcast on ABC television. LaRouche said: "At the end of the first quarter of 1983, 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."

While the QAM is a statistical fraud of considerable importance, for the City of London-Wall Street financier oligarchy, it takes on the character of a strategic weapon. Three examples stand out.

First, it is being used to loot the American population. More than 100 million Americans are covered by cost-of-living adjustments in their wage contracts, and programs such as Social Security, Medicare, Unemployment Insurance, etc., which are supposed to protect them against inflation. *EIR* has calculated that BLS lying about the rate of inflation, in which the QAM plays a great role, has this year stolen between $278 and $328 billion from these Americans.

Second, the QAM is being applied to cover up the hideous consequences of the policy adopted by Federal Reserve Board Chairman Alan Greenspan. In the third quarter 1998, acting on behalf of the financier oligarchy, Greenspan desperately revved up the printing presses, in order to hold up the bloated mass of speculative financial property titles, which were at the point of disintegration following the September 1998 Long Term Capital Management hedge-fund failure. That policy put the world on the path toward a hyperinflationary spiral, which will have the same devastating consequences as the hyperinflation which ravaged Weimar Germany from March through November 1923. Even though the prices of basic commodities, such as oil and polyvinylchloride, and consumer products, such as housing, are rising in the range of 15% to 180% per year, the BLS insists that inflation is only 3.4%.

Third, the QAM is a vital element in the fake claim of a U.S. "noninflationary economic expansion." The QAM underreports inflation, and helps overstate GDP and industrial production. The lie of economic growth has a strategic implication: it is being employed to draw foreign funds into the United States, to cover over a projected $430 billion annual current account deficit in 2000. This foreign funds inflow helps the United States to hold up the value of the dollar and to import a large volume of goods. Were the myth about the U.S. economy shattered, it would precipitate a dollar crisis and the withdrawal of foreign funds, which would puncture the U.S. financial system.

How the QAM Distorts Inflation

The QAM is used to adjust the reporting of prices on both a producer level and on a retail/consumer level. The BLS reports two types of price indexes: the Producer Price Index (PPI), which measures the change of price of a good at the producer level; and the Consumer Price Index (CPI), which measures the change of price of a market basket of goods at the retail level. Both divisions work on the same principle.

Between 1980 and 1981, for example, the average transaction price of a new car rose from $7,574 to $8,910, an increase of $1,336. Based on that, it is possible to calculate the rate of car-price inflation for 1981, at 17.6%, a very substantial increase.

But the wizards at the BLS got rid of most of that increase. In a BLS document, "Quality Changes for Passenger Cars, 1969-99," the BLS initially attributed 99% of the price increase to "improved quality." Then, after it made further adjustments, the BLS finally attributed 66% of the 1981 increase in the price of a car to "improved quality," and 34% to actual price increase. The BLS reported to the BEA, that only $454 of the $1,336 price increase in 1981 was actually an increase in price. Thus, *the BLS threw away two-thirds, or $882, of the price increase you paid in 1981*. It reported an auto-price inflation rate of just 6.0%.

What is considered improved quality? There are various things that the BLS, and other agencies consider quality improvements, including: a new catalytic converter to meet an "air-quality-emissions" code set by the Congress; the change of a material from a metal to plastic; the change of a truck to a sport utility vehicle; the "upgrading" of a "convenience package," which might include power door locks, a security alarm, power steering and power seats, or the introduction of CD players. In effect, the manufacturer is allowed to deduct all his costs in these areas (which costs he has passed on to consumers), from the BLS reporting of his price.

Many of what are counted as improvements, are not improvements at all. Consider the overall construction of a car. Since 1967, there has been a general reduction in the weight of a car by more than one-third of a ton. In part, this has been done in order to increase mileage efficiency. Yet, despite the lies of the Naderites, highway safety tests show that lighter cars suffer far worse damage in collisions with cars which weigh 3,000 pounds or more, or with inanimate objects, such as trees or walls.

The recasting of light trucks into sports utility vehicles is no improvement, as the fundamental design flaw in the Ford Explorer SUV shows. That SUV has a tendency to roll over under certain speed and load conditions, and, when paired with Firestone tires, has resulted in many unnecessary deaths. The "upgrading" of a convenience package, so that a car has a better security alarm or other accessories, does not constitute a fundamental improvement.

The Reality of Product Improvement

But let us grant, for a moment, that all the above-alleged improvements were improvements. For centuries in America, there have been improvements in the quality of products, and crucially, in the production and engineering processes which generated those improved products. This is not an exception, but the normal feature of a developing society. The basis of all economics starts with the sovereign individual mind creating new validatable scientific discoveries of fundamental principle. These discoveries are then transmitted into the economy through newly incorporated scientific advances in machine-tool design, or upgraded infrastructure. In America, during periods when revolutionary advance in machine-tool design improved products, this was considered normal. The revolutionary process would reduce the actual price paid for products.

Then in 1967, the QAM was manufactured by the oligarchy at the time of a paradigm shift imposed on the United States toward a post-industrial society. The fact that this shift would build a speculative bubble, which would feed inflation, had to be concealed somehow.

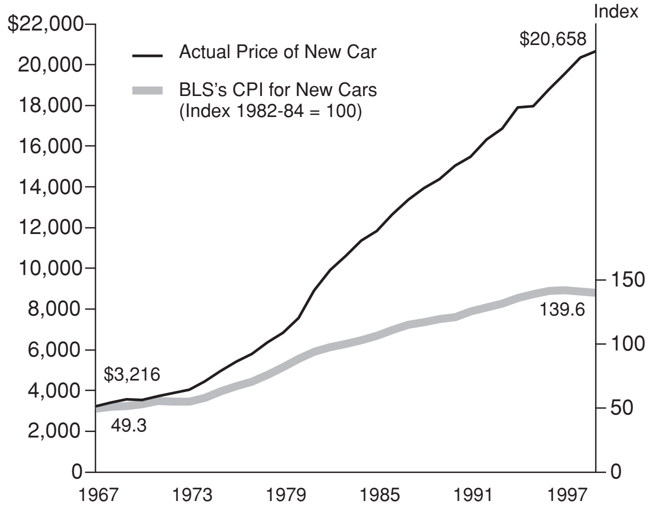
In the development of the automobile, since the 1890s, many fundamental improvements were made, from the electric starter motor, replacing the hand crank, around 1911-12; to the system of transmission to replace the earlier direct linkage of the engine to the driving wheels; to the introduction of the independent front suspension as universal during the 1930s; to the myriad progressions in engine design and function. There was a revolution in the automobile, in particular, up through 1950.

But since 1967, when the QAM was instituted, the improvements have not been of the dimension of the accumulated fundamental changes of the period from 1890 through 1950. Why should there be a QAM after 1967, when most of the fundamental changes occurred before 1967? There is no need for a QAM. In fact, for nearly two centuries of the history of the United States until 1967, there was no QAM for anything, and for a sound reason: Improved quality should be treated as an inherent feature of a healthy economy.

In fact, since 1967, several fundamental features of the car have deteriorated, not improved. Cars which weigh one-third to one-half ton less than they did 30 years ago, are more likely to sustain more serious damage to the car and passenger, when they collide with a stationary object. In many instances, the cost of car repair, because of the design problem of the cars, has risen sharply.

FIGURE 1

Increase of Actual New Car Price Compared to BLS Computation of CPI for New Cars



Sources: Department of Commerce's Bureau of Economic Analysis; Department of Labor's Bureau of Labor Statistics; *EIR*.

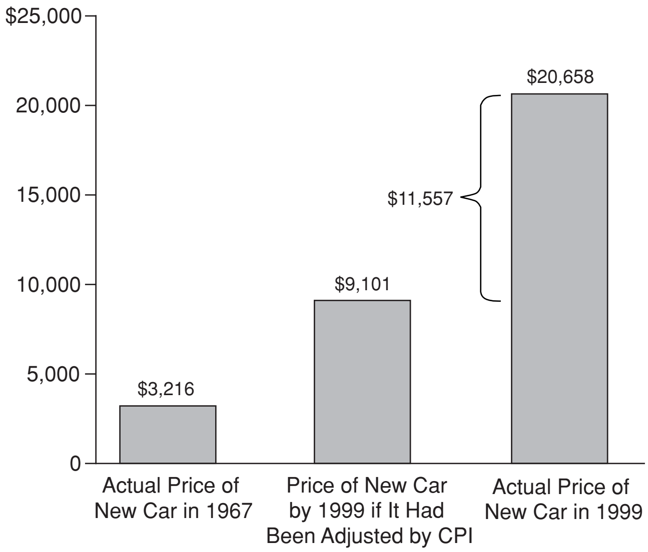
Now, let us return to what has happened in the reporting of the increase of car prices, considered over the period 1967-99. **Figure 1** shows that, according to the BEA, the average transaction price of a new car was $3,216 in 1967 (the BEA bases its data on a survey of 125 car models every year). By 1999, the transaction price of a new car had jumped to $20,658. This is the price that a consumer pays for a car—an increase of 6.42 times.

In the same figure, using the same starting point on the graph, look at the BLS Consumer Price Index for the cost of a new car. Based on an index, in which the value of the years 1982-84 is set equal to 100, the index level was at 49.3 in 1967. By 1999, the index had trudged up to 139.6—an increase of only 2.83 times.

Compare the two curves. They're both supposed to be measuring the same thing, but the curve of the transaction price of a new car represents reality: what makes the path of the CPI curve so much slower, is the QAM. The CPI index for the cost of a new car only accounted for 44% of the actual price increase over the past 30-plus years. It attributed 56% of the actual price increase to alleged "improved quality," and excluded it from counting. Between 1967 and 1999, the actual increase of the price of a new car was 2.27 times greater than

FIGURE 2

BLS Makes Disappear $11,557 in Increase in Price of New Car Since 1967



Sources: Department of Commerce's Bureau of Economic Analysis; Department of Labor's Bureau of Labor Statistics; *EIR*.

what the CPI fraudulently reported.

Figure 2 shows the ability of the BLS to cut down inflation. The first bar graph shows that the transaction cost of a new car was $3,216 in 1967. It then shows what the car would cost in 1999 if it had been "adjusted" by the CPI index: $9,101. No such vehicle was to be found in 1999, even by believers in the statistics of the BLS. It is only in its published reports that the BLS "made disappear" the $11,557 in the actual cost of a car.

A BLS analyst reported on Oct. 10, "The BLS has quality adjustments for probably thousands of products." Every home appliance has a quality adjustment, as do furniture and clothing, the home itself, telecommunications equipment and computers (the quality adjustment for the computer is called the hedonic index, as will be reported below).

Additional Distortions of Inflation

But the BLS has still other weapons to "reduce" inflation. In the 1990s, the Senate Finance Committee established the Advisory Commission to Study the Consumer Price Index, which was staffed by people whose aim was to reduce the inflation rate further, through various shams and ruses. The Commission issued its final report on Dec. 4, 1996, calling for a series of changes which would lower the CPI by 1.1%. In January 1999, the BLS instituted one of these changes, called the "consumer substitution" change. This assumes that if prices rise, the consumer will strive to make a constant level of expenditures for a certain category of goods. So, if the price of one item goes up, the consumer will substitute another item, which is cheaper. This may not be at all what happens in reality; but, the BLS made an assumption, which pre-programs in that the consumer would not be paying more for certain categories of goods. A spokesman for the BLS told *EIR* on Sept. 11, 2000, that this assumption alone will permanently take 0.2% per year off the CPI rate.

By use of such gimmicks, and above all the QAM, the BLS has whittled down consumer inflation, from August 1999 through August 2000, to an average of 3.4%. But, as *EIR* has reported, the rate of inflation for certain commodities, such as housing, energy, etc., has risen at rates of 15-180% per year. *EIR* estimates that the true rate of inflation is 10%, three times the official rate.

The oligarchs, and their hired statisticians, are aware of what lying about inflation does. The Advisory Commission to Study the Consumer Price Index, in its December 1996 final report, stated, "Corrections . . . in the CPI . . . would also contribute importantly to reductions in federal budget deficits and the national debt." In particular, "reductions" would cause "lower outlays," which would be lower through "cuts in indexed federal spending programs." That means that many federal programs, such as Social Security, Medicare, Unemployment Insurance, Food Stamps, and so forth, are adjusted by a cost-of-living adjustment, which is pegged to the CPI. By artificially cutting the CPI, the cost-of-living adjustment is lowered, and the expenditures for these programs are lowered. *EIR* documented in a Sept. 28 study, that lying about inflation in this way will gouge between $278 and $328 billion from the U.S. population in 2000 (see "Lies About Inflation Are Being Used to Loot the Population").

The QAM Manipulates GDP Growth

But once the QAM is used to depress the reported level of inflation, it is then used to pump up the level of GDP, and in parallel, the Industrial Production Index.

Let us consider the question of computers and accessories, including software. It is the QAM modification of computers and accessories that had an enormous false effect on alleged U.S. GDP growth.

On Oct. 11, an analyst at the National Income and Wealth Division of the Bureau of Economic Analysis of the Department of Commerce, explained how the QAM index for computers is used to increase GDP. It is the same principle by which the QAM for other products is used to increase GDP. The pith of the conversation has been presented in **Table 1.** Assume, stated the analyst, that in the United States, in 1998, total U.S. computer sales were $100 billion, in current (nominal) dollars, and in 1999, total U.S. computer sales were $100 billion in current (nominal) dollars. This is line 1 in Table 1. Assume further, he said, that computers as a whole were "20% more powerful" in 1999, than they were in 1998. Then, one assumes that computers cost 20% less in 1999 than they did

TABLE 1

The QAM-Hedonic Index Makes Computer Output 'Grow'

(Billions $)

	1998	1999
Computer sales in current dollars	$100	$100
Computer sales in "real" dollars after QAM adjustment	$100	$125

Source: Bureau of Economic Analysis of the Department of Commerce.

TABLE 2

The QAM-Hedonic Index Swells Capital Investment Portion of GDP

(Billions $)

	2nd Q 1998	2nd Q 2000	Increase
Business capital investment in computers in current dollars	85.5	114.2	28.7
Business capital investment in computers in 1996 inflation-adjusted dollars	144.0	298.5	154.5

Sources: Bureau of Economic Analysis of Department of Commerce; *EIR.*

in 1998. This is standard QAM procedure, and one deducts 20% from the Producer Price Index for computers in 1999. So, if the producer price index for computers was equal to 100 in 1998, it would be set equal to 80 in 1999. This example assumes that the actual price of a computer has not fallen; it is the quality adjustment that has lowered the price.

However, the analyst now posited a second step, now taken by the Commerce Department: to increase GDP growth. As a result of the QAM, the price of the computers in 1999 is only 80% of what it was in 1998. Therefore, he explained, the output in 1999, of $100 billion, is worth more. He proposed dividing $100 billion by 0.8 (80%), and this yields a new adjusted output of computers in 1999 of $125 billion (that is, $100 billion divided by 0.8). The rationale is that if prices are only 80% of what they appear to be in 1999, then the $100 billion in current dollars output is only 80% of what the adjusted output would be, $125 billion. Thus, by use of the QAM, computer output in 1999 has been increased from $100 billion to $125 billion; this represents an increase of 25%. So, the analyst pointed out, prices fell by 20%, but output increased by 25%, through the application of the QAM.

With computers, a process called the hedonic index is applied. In its application to prices, it has the same conceptual overview as the QAM, but there are a few differences. To explain the hedonic index briefly: A computer is thought of as a bundle of characteristics, such as speed, expandable memory, CD drive, etc. In the case where a computer exists in 1999, but a comparable computer did not exist in 1996, then the BEA constructs an "imputed" computer model for 1996, which has the same characteristics, features, and performance as the computer that exists in 1999. Each characteristic has a coefficient that links it to the computer's overall price. An "imputed" price for the 1996 computer is constructed. It is then compared to the 1999 computer. A prime purpose is to compare the prices of the two computers, so that a quality adjustment can be made, showing how superior the 1999 computer is to the 1996 computer.

Some years, computers' prices fall; some years, they rise. But using the hedonic method, as a form of the QAM, the Commerce Department always makes the price of a computer fall 3 to 4 times what it actually fell, if it did fall (or, it makes it fall, if the actual price rose). What the BEA is most interested in, is using a big quality-adjusted fall in price, to create a big quality-adjusted increase in output.

Now, we will look at what effect the hedonic adjustment/quality adjustment upon computers, had on GDP. We will look at this in conjunction with the fact that the United States, alone among major countries, counts computer software as a form of capital spending/investment. That fact, together with hedonic adjustment, made up a huge amount of the supposed increase of real GDP in the United States, between the second quarter of 1998 and the second quarter of 2000.

The predominant way of computing GDP is by the method of the "expenditure system." This adds together four elements: 1) Gross Private Domestic Investment, which includes business capital investment; 2) Personal Consumption Expenditures, which represents personal or consumer expenditures for consumer/personal goods or services; 3) Government Expenditures; and 4) Net Exports. Items 1 and 2 make up the bulk of GDP, and here we are concerned with item 1.

The business expenditure for computers, which is classified as capital investment, is counted as part of Gross Private Domestic Investment. If it rises, GDP rises. **Table 2** shows the Commerce Department's report of the level of business capital investment for computers. It is expressed two ways: in current dollars, and in real (chained) 1996 inflation-adjusted dollars. In the case of the real (chained) 1996 inflation-adjusted dollars, this has already been subjected to the hedonic index quality adjustment. Business capital investment for computers, when stated in current actual dollars, rose, between the second quarter of 1998 and the second quarter of 2000, from $85.5 billion to $114.2 billion, an increase of $28.7 billion. However, when stated in 1996 (chained) inflation-adjusted dollars, the same business capital investment for computers rose, between the second quarter of 1998 and the second quarter of 2000, from $144.0 billion to $298.5 billion, an increase of $154.5 billion.

Amazingly, one can see that business capital investment

TABLE 3
GDP Growth Is Based on Fakery
(Increase Between 2nd Quarter 1998 and 2nd Quarter 2000, Billions 1996 inflation-adjusted dollars)

Counterfeit increase in business expenditures for capital investment in computers	$125.8
Increase in business expenditures for alleged capital investment in computer software	80.8
Subtotal	206.8
Increase in GDP	843.2

Sources: Bureau of Economic Analysis of Department of Commerce; *EIR.*

for computers rose by $125.8 billion more ($154.5 billion minus $28.7 billion), when stated in 1996 (chained) inflation-adjusted dollars than when stated in current dollars. But this is the same capital investment! The reason for this is the application of the QAM/hedonic index, which took a $28.7 billion increase in actual current dollars, and turned it into a $154.5 billion increase in "real" inflation-adjusted dollars. The QAM/hedonic index, all by itself, caused the increase in the level of business expenditure in capital investment for computers, to grow five-fold. The QAM/hedonic index manufactured a counterfeit $125.8 billion increase in alleged business capital spending for computers.

Now, add in the second element, that the United States is alone among major nations in counting business expenditures for computer software as if it were a capital investment. Between the second quarter 1998 and the second quarter 2000, when stated in 1996 (chained) inflation-adjusted dollars, the business expenditure for so-called capital investment in computer software rose from $146.7 billion to $227.5 billion, an increase of $80.8 billion. This increase of $80.8 billion increased the capital investment portion of the Gross Domestic Private Investment part of GDP. This in turn increased GDP. But in all other major nations, this investment in computer software would be counted as a business expense, and not as a capital investment, and therefore it would not increase GDP. Therefore, the increase in capital investment for computer software of $80.8 billion is a fake, unique to the United States.

For the period between the second quarter 1998 and the second quarter 2000, **Table 3** lists the counterfeit $125.8 billion increase in business expenditures for capital investment in computers which is due solely to the QAM/hedonic index; the $80.8 billion increase in capital investment for computer software, which is fake and unique to the United States; and the increase of total GDP of the United States in real 1996 inflation-adjusted dollars, of $843.2 billion. The combination of these first two items totals $206.6 billion. Thus, between the second quarter 1998 and the second quarter 2000, these two bits of fakery made up 24.5% of all the alleged real GDP growth of the United States.

But that is just the beginning. In addition to computers, the Quality Adjustment Method is applied to thousands of other products, which artificially increases the alleged output of GDP. This is true for cars, houses, household appliances, furniture, and so forth. A significant part of alleged GDP growth is due to the application of the QAM.

But GDP has deep methodological flaws, and does not measure the performance of the real economy. A good part of GDP growth is the speculative financial cancer, and non-productive overhead services, which is embellished by much statistical foolery. The QAM is central here.

Yet, the story does not end there. The QAM is turned over to the Federal Reserve Board of Governors, which publishes the Industrial Production Index. According to a discussion with Carol Corrado, chief of the Industrial Output Section at the Federal Reserve, on Oct. 10, the Federal Reserve follows the basic method of the Commerce Department, and uses the QAM to increase the reported industrial production of different sectors of the economy.

Thus, the QAM fraud is central in three of the most important parts of the economy—inflation, GDP, and industrial production. It invalidates much that is published about any of these areas. It is a piece of statistical fakery that is destroying the nation.