U.S. Third-Quarter GDP Fraud Stands Exposed by Bad October

by Richard Freeman

The U.S. economy took a sharp downturn during October: Auto sales fell by 27.3%; manufacturing employment suffered a loss for the 27th consecutive month; and overall employment fell. Ford Motor Company, the fifth largest company in the world, moved deeper into financial-economic crisis. New orders to factories plunged. The bad October, following the stock market plunges of September, pointed clearly to the fraudulence of the officially claimed 3.1% GDP growth rate for the third quarter.

Refusing to address reality, on Oct. 31, the Bush Administration had the Commerce Department release a report purporting to show that during the third quarter, Gross Domestic Product had grown by 3.1%. In fact, the only conclusion to be drawn from this report, is that American "growth" is based on fakery and unsound practices. The danger is that the Anglo-American financier oligarchy, through the Bush Administration, is pursuing a policy that will trigger a financial disintegration, and destroy the human race.

The interconnected processes of the shortcomings of the U.S. economy revealed by the faked GDP data; the swelling of unemployment; and the sharp contraction of the auto industry, powerfully underscore the encompassing breakdown crisis.

This crisis has a solution. 2004 Presidential candidate Lyndon LaRouche told a youth cadre school Nov. 2, that the current crisis is *systemic* and far more severe than 1929-32, "You are in a breakdown crisis. You are not in a depression—a cyclical depression [such as 1929-32] where things will eventually bounce back. It will *never* bounce back. . . . And you have to create a replacement system, based on the best experience of humanity to date. And you must do it on the basis of agreement among nations, which recognize what their common interests are."

The Commerce Department's official GDP numbers actually revealed the dysfunctional basis of the U.S. economy, as well as the spuriousness of GDP as a measure of economic well-being. Released just before the election, the numbers may have been intended to allay Americans' fears about the sinking economy, before any competent economist could check into this "3.1% growth."

According to the Commerce Department, real, inflation-adjusted (constant 1996 dollars), Gross Domestic Product grew from $9,392.4 billion in the second quarter of 2002, to $9,465.2 billion in the third quarter, a supposed increase of $72.8 billion (or 3.1%). *EIR*'s economics staff found that of the alleged GDP growth, 85% is attributable to the sales of only two items: motor vehicles and computers; and that the growth of each was achieved by faked or unsound means. At the same time, there was a sharp cut-back in business structures, which is a good indicator of the collapse of industry. First, we take apart the alleged GDP growth:

Motor Vehicles. During the third quarter, motor vehicle sales, and therefore production, grew as a result of a massive campaign of incentives offered by the major automakers, which included 0% financing, and in some cases, 0% down. For these incentives, the auto companies must pay up $2,300 per vehicle, which often causes them to lose money on each vehicle sold on that basis. This method is unsustainable.

Further, the Commerce Department applies its fraudulent Quality Adjustment Method (QAM) to motor vehicles. Here's how it works. When an auto company builds in an environmental feature, for example, this is counted as improved quality. Commerce does two things with this "improved quality": deduct a "value" of it from the price of the car, thus reducing inflation; and and at the same time, treat the "improved quality" as added production, artificially swelling reported auto production. In inflation-adjusted dollars, motor vehicle sales/production increased from $369.1 billion in the second quarter, to $407.1 billion in the third quarter, an increase of $38 billion. That represented a whopping 52.2% of the alleged $72.8 billion increase in third quarter GDP for the entire economy.

Computers. In current (non-inflation-adjusted) dollars, computer (and peripheral) sales rose from $72.8 billion in the second quarter, to $77.4 billion in the third quarter, an increase of $4.8 billion. But when the Commerce Department supposedly corrects the sales figures for inflation, it simultaneously applies the fraudulent "hedonic index," which is a variant of the QAM. This swells production by a massive amount without any actual increase in computer sales. Thus, according to Commerce, in "inflation-adjusted" dollars (which incorporates the hedonic index), computer sales rose from $271.6 billion in the second quarter, to $299.9 billion in the third quarter, an increase of $28.3 billion. A $4.8 billion sales increase in current dollars became, by the hedonic index's magic, while "adjusting for inflation," a $28.3 billion increase! This fake $23.5 billion computer sales growth represented 32.2% of the alleged $72.8 billion third quarter increase in GDP for the entire economy.

Thus, using 0% financing, the fraudulent Quality Adjustment Method, and its phony cousin the hedonic index, auto and computer sales accounted for 84.4% of the American economy's supposed third-quarter growth. The GDP data, and the method by which it was assembled, discredits any argument that the U.S. economy is growing.

At the same time, the construction of non-residential structures fell, on a real, inflation-adjusted basis, from $231.7 billion in the second quarter, to $221.8 billion in the third quarter, a fall of $9.9 billion, which on an annualized basis, is more than 16%.

Unemployment

The pattern of employment, especially manufacturing employment, shows the activity of the U.S. economy. On Nov. 1, the Department of Labor's Bureau of Labor Statistics (BLS) reported that U.S. official unemployment had risen in October by a large 117,000 workers, from 8.092 million workers in September, to 8.209 million workers in October.

Most noteworthy is what happened to manufacturing. The manufacturing sector eliminated 49,000 jobs, of which 36,000 were *manufacturing production worker jobs,* those workers who physically alter nature to improve mankind's existence. Since the start of 2002, the Bush Administration and the financial gurus have insisted that manufacturing employment would turn around. Instead, it has continued to collapse. October marked the 27th consecutive month of loss of manufacturing jobs. **Table 1** shows that since July 2000, manufacturing worker employment has been cut by 10.5%, and that 12.2% of the production manufacturing workforce has been cut out of the heart of the economy.

TABLE 1

Loss of U.S. Manufacturing Jobs Since July 2000

(Millions of Workers)

Month	Manufacturing Worker Employment	Production Worker Employment
July 2000	18.554	12.688
October 2002	16.602	11.141
Jobs Lost Since July 2000	1.952	1.547
Percentage of Jobs Lost	10.5%	12.2%

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

Under the influence of the bankers' "post-industrial society" policy, there has been a dramatic manufacturing shift downward over the 35 years. In 1967, manufacturing workers and production manufacturing workers, represented 23.8% and 18.5% of the U.S. civilian labor force, respectively. Today, that productive part has been more than halved: Only 11.6% of the civilian labor force are manufacturing workers, and only 7.8% are production manufacturing workers.

An economy's productive activity is the only source of an advancing scientific mode of manufacturing, agriculture, mining, construction, transportation, and power generation, of which manufacturing is critical. Today a mere 7.8% of America's workforce engages in the manufacturing production that produces the majority of the goods that make up the consumer and producer market baskets, upon which the population's existence depends.

Big Problems for Ford

America's over-dependence on auto production and zero-financing sales to prop up the economy, is coming unglued, with nasty implications for Ford Motor Company. The unsustainable third-quarter level could not continue.

During October, the sale of automobiles and light trucks inside the United States totalled 1.30 million, falling 27.3% from the 1.72 million sold during October 2001. Though sales during October 2001 had hit a peak—as, following Sept. 11, consumers withheld purchases for a few weeks, and then bought at a heavy pace during October—auto executives were expecting a fall this October of no more than 15-20% at worst. They were shocked by a fall of 27.3%, which occurred even as auto companies were offering massive consumer incentives to spur sales. Ford Motor Company had offered buyers a loan for six years at 1.9% interest, the first car loan for that long a term ever offered in the United States.

The sales fall for Ford was steep, and has severe consequences. Comparing this October to October last year, Ford's car sales fell by 36.6%, and its light truck sales (which includes light trucks, vans, and SUVs) fell by 32.2%.

On Oct. 25, Standard & Poor's rating service cut its rating on the long-term debt of Ford Motor Company, to BBB, which is just two levels above junk-bond status. This is pushing several internal problems at Ford to a head. Ford is America's fourth largest company, and is the second largest auto company in the world, owning the Ford, Lincoln and Mercury brands, Aston Martin, Jaguar, and Volvo, and having a 33% stake in Mazda.

Ford has $162 billion of debt outstanding, of which a stunning $22-32 billion must be rolled over in 2003. Ford's debt is already being treated by bankers as effectively "junk status." Ford Credit, which is the financing arm of Ford Motor, has now had to issue ten-year bonds which yield 9.55%. Ten-year U.S. Treasury bonds have a yield of 4.10%; thus, Ford's bonds sell at a "premium" of 5.45 percentage points (545 basis points) above Treasuries of a comparable maturity. The "premium" of Ford bonds is above those of several Third World countries.

Based on its earnings alone, Ford cannot pay the interest on its debt. According to Egan-Jones Ratings, a Pennsylvania-based independent credit analysis firm, back in December 2000, Ford's operating earnings were just about double its interest expense. Recently, Egan-Jones reported, *Ford's earnings have sunk to less than half its interest expense.* Ford does have a cash reserve, estimated at between $15 and $20 billion, but it appears poised to burn through that quickly. Ford's approach to this problem is fierce budget cutting. Ford's chairman, William Clay Ford, Jr., announced last year that the company would cut $6 billion from expenses, including laying off 30,000 workers. During the last week of October, Ford announced $1 billion more in cuts.In 2001, Ford lost $5.1 billion. For the year 2002, though Ford's sales had fallen through September compared to 2001, they had not crumbled. But Ford discontinued many of the 0% financing and other incentives through which it, like the other automakers, had achieved many of its sales; it was losing money on each car sold that way. Now, during October, Ford's sales crashed by more than 30%, cutting its ability to pay debt service expense on its $162 billion debt load.

This has huge implications for the U.S. bond market, financial system, and economy as a whole. For the past five years, the U.S. economy has maintained only one functioning segment, consumer sales of autos and homes financed through a credit bubble. Now, with the auto sector prop knocked out from under the economy—and it is just a matter of time before the housing bubble pops—the *physical economy*'s collapse will be that much more severe.

The downturn of the real economy underlying the debt bubble, is further anecdotally shown by the October manufacturing index of the Institute for Purchasing Supply (formerly the National Association of Purchasing Management) for the Chicago area falling to 45.9, the second-lowest level of this year. The September 2.3% fall in new factory orders is expected to have gotten worse in October. The U.S. economic depression is accelerating; trumpeting non-existent growth based on GDP fakery cannot hide that.