roughly an error of beteen 3.2 percent and 12.4 percent in GNP as a whole!

The Fed's associate research director, Helmut Wendel, admitted that the Fed does not wish anyone to know how it gets its statistics-fudging factor (*Production Adjustment Factors*) because they are making the figures up. "They are all judgmental," he said, "almost entirely our own guesswork." He added that the Fed should not disclose its equations for the factors "because they don't really work; most of what goes into the PAFs is judgmental. We consider the equations as such a preliminary and vague guide to forming a PAF that they don't really work."

What these fellows do is to start with a set of sample figures they don't believe themselves, and then change those figures to work out to whatever upward or downward trend in the economy they decide to put out to President Reagan and the public as their current propaganda line. Then, all of the official statistics are faked to fit that picture. It is exactly what any company's embezzler does to fool the outside accounting firm.

One of the *EIR* research staff has written a 5,500-word report on the history and recent effects of the Fed's fudge factor. It's technical, but to anyone who knows the business, it's a real eye-opener.

The recent hoax began last summer, when some of the boys in the back room in Switzerland, London, and Wall Street were afraid President Reagan might react to the Mexican debt crisis by launching a genuine recovery program. They dreamed up the tactic of convincing him that Fed chairman Volcker's measures had started an economic upswing at last, and that if the President would just listen to Henry Kissinger on how to deal with Latin America, and listen to Paul Volcker on "how to keep the upswing going," everything would be just nice and dandy for the President's 1984 election campaign. So, between the State Department and Treasury, the Federal Reserve, the New York bankers, and a bunch of statistical bureaucrats who knew what was expected of them, the wildest orgy of figure-faking since the middle 1960s was turned loose.

Economic upswing? Never actually happened. *EIR* estimates that what did happen is a slowing of the rate of economic collapse, from about a 12 percent rate during the early part of the last quarter of 1982, to a rate of decline of between 2 percent and 4 percent during the first half of 1983. That half-truth behind the "upswing" story is that the rate of collapse slowed down significantly, temporarily. Now, the rate of collapse is beginning to accelerate again—now that Fed chairman Paul Volcker has just been reconfirmed, as the fellows in the back rooms intended to manipulate President Reagan into doing.

The question is, how long will President Reagan believe that what his re-election campaign advisers wish were true? If he doesn't wake up soon, the voters next fall will be voting *against* Herbert Hoover, not *for* anybody at all.

Staking out the 'fudge Volcker's faked recovery

by Kathy Burdman

A senior official of Paul Volcker's Federal Reserve admitted Aug. 26 that the Fed's figures on U.S. industrial production are "totally unreliable," and that the key U.S. Industrial Production Index, upon which claims of a U.S. economic recovery are based, is "entirely guesswork."

The admissions by Federal Reserve Board Associate Director of Research and Statistics Helmut Wendel in an interview with this author, along with an in-depth investigation by *EIR* of the makeup of the index, show that large parts of the U.S. recovery data *may have been* faked. What is clear is that the Federal Reserve cannot and will not demonstrate the accuracy of the figures published in its Industrial Production Index over the past year and a half, and that within the Fed staff's "guesswork" may be contained a large margin of fakery.

"We make judgmental adjustments to the index which are almost entirely our own guesswork," Wendel stated. Especially the "first release" figures, the newest figures which make press headlines each month from which the financial media has proclaimed the Great Recovery, are "totally unreliable," he stated. "They can mean anything. When we calculate the 'month one' figures, we just arrive at a number and we figure, 'Okay, if it's wrong, we'll correct it the next month—it doesn't matter.' "

The news media does the rest of the job, by publicizing only the first-month estimates, and burying the corrections on the inside page. It is from first-month data that U.S. policy is made.

Any honest American, a category which excludes most statisticians and employees of the Volcker Fed, can see that the U.S. economy continues to collapse around our ears with one look at the unemployment lines, closed factories, and the decay of our cities.

But even Fed officials admitted last month that over the last year, between 0.8 percent and 3.1 percent of the rise in the U.S. Industrial Production Index as published by the Fed, was due to "guesswork." Economist Lyndon LaRouche estimated today that the introduction of such an annual fudge factor in the Industrial Production Index "means roughly an error of between 3.2 and 12.4 percent in GNP as a whole." (See article page 11.)

'Phudge Addition Factor'

In fact, since Volcker began to claim that he has created

factor' in of U.S. economy

an economic recovery in March 1982, between 1.3 and 5.3 percent of the rise in the Industrial Production index was purely a result of the Fed's Production Adjustment Factor (PAF), more appropriately known as the Phudge Addition Factor.

For example, in the series agricultural chemicals, for which the Fed has released the PAF adjustment factor, the rise in the index of agricultural chemical production which may be attributed solely to the PAF factor was a full 2.9 percent during the 17 months from March 1982 to July 1983.

The PAF fudge factor works as follows:

First, the Fed does not collect a great deal of actual data from industry. During the first early month of estimates, data on actual production of real goods comes from only 13 percent of all industries. The other 87 percent of the Industrial Production Index is calculated by sheer extrapolation from the number of manhours worked in a given industry in only one week of each month. These figures the Department of Labor gathers in a spot survey once a month.

"It's cheaper not to have to gather production data," one Fed economist told *EIR*. Corrections are done three months later from actual production data, after the press headlines are long dead, but only for 45 percent of all industrial sectors in the index.

Even after the fourth month of corrections, when the numbers are considered final, the rest of the 55 percent of the index's industrial sectors are still merely estimated. Production indices for these sectors are extrapolated from data on manhours worked in the industry one week in the month, or on the number of kilowatts of electricity consumed by the industry over the month, a slightly more reliable figure.

In the case of manhour-based series, the margin for fudging is enormous. The Fed takes the monthly manhour data, which may or may not bear any relationship to what was produced, and compares it to the previous month's equally questionable data, to get a rate of rise or "rough index." Then they take a series of PAFs and multiply them by the rough index, which usually "adjusts" the index significantly upward.

For example, for the year measured from August 1982 to July 1983, the aggregate PAF factor for the range of 27 industries whose production data is calculated using manhours rose by 3.9 percent. Over the year and a half from March 1982 through July 1983, it rocketed by 6.6 percent. This rise in the adjustment factor alone caused a 0.8 to 3.1 percent rise in the Industrial Production Index.

Top secret

Much of U.S. politics and foreign policy now rests on statistics like the Fed's Industrial Production Index. Whether it rises or falls may determine the outcome of the 1984 presidential election and how long some nations will continue to submit to International Monetary Fund austerity conditions. Yet, the Federal Reserve won't tell exactly how they have calculated the data. Finding out how the Fed constructs its Industrial Production Index each month is more difficult than getting the specifications for the neutron bomb.

"We simply don't release our adjustment factors," said Fed economist Mary Hillard of the Fed's PAF fudge factors. "It's privileged information, private information."

"We compile this index for our own purposes," said another Fed economist, Dickson Tranum. "We want to see what our monetary policy is doing to the economy. So, we do it as we find convenient. If other people want to use it, fine, but

Typical PAF adjustment factors

MONTH "1"	Agricultural chemicals	Composite of 27 industries estimated from manhour data
3/82	1.—*	1.534
4/82	1.—	1.532
5/82	1.—	1.540
6/82	1.—	1.559
7/82	1.365	1.570
8/82	1.365	1.574
9/82	1.365	1.570
10/82	1.365	1.569
11/82	1.365	1.581
12/82	1.370	1.592
1/83	1.375	1.587
2/83	1.380	1.592
3/83	1.385	1.603
4/83	1.390	1.595
5/83	1.395	1.610
6/83	1.400 prelim.	1.625 prelim.
7/83	1.405 est.	1.635 est.

* decimals not available

Source: Federal Reserve Board of Governors, Washington D.C.

This table shows the fractions by which rises in the Industrial Production Index are added by PAF factors. For example, assuming that the index for the 27 sectors measured by manhour data was 100 in March 1982; adjusted by its PAF, it became 153.4. Merely by the rise in the PAF from 1.534 in March 1982 to 1.635 in July 1983—that is, even if the unadjusted index remained utterly flat at 100—there was a rise of 1.635 − 1.534 = .101; .101/1.534 = 6.6 percent in industrial production in those 27 industries, exclusively due to the PAF adjustment, over the 17-month period. Over the year August 1982–July 1983, the PAF for these sectors accounted for 3.9 percent of the rise in production in these sectors.

we don't make any promises to the public. Whoever doesn't like it shouldn't use it."

When Tranum's boss, Helmut Wendel, was threatened with a suit by *EIR* under the Freedom of Information Act, he explained that the Fed can't release their "classified" formulas to the public, because they don't in any event derive much on the basis of the formulas—they just make the numbers up.

With the maddening logic of a Dr. Strangelove, Wendel politely explained, "We can't release the equations which we use for the PAFs, because they don't really work. We consider them preliminary, a vague guide. Mostly, we just make our own judgments, and do a lot of estimates."

Wendel gave an example of how the Fed comes up with numbers for a key industry in the IP index, the category of Metalworking Machinery, relied on as an indicator of whether production and investment in basic capital goods is taking place.

Metalworking—which includes machine tool production—is one of the industries for which the Fed has decided not to monitor real production of units of machines. They make early estimates, instead, by counting manhours worked, one week in a month. "We get in the manhour data from surveys completed by the companies, and we never really know what they mean," Wendel confided. "They don't mean much about what was really produced, but we compare them to the manhours the previous month. Say, there was a rise of 0.5 percent in July '83 manhours versus June '83—a 6 percent annual rate. Well, from that, we could *assume a 6 percent rise in production*."

Next, the Fed staff chooses the adjustment to make based on the "business cycle," an invention of the University of Chicago monetarists which says that the economy moves in yin-yang cycles. If it's falling now, it will "eventually" rise again, goes the line.

If the Fed staff decides that an "upswing" is occurring in the businesss cycle, they simply begin to adjust that 6 percent rate upwards. That is, *if they say it's a recovery, they make the numbers fit.*

"We make an upward business cycle adjustment for recovery," Wendel stated. "We assume that since it's a recovery, production per manhour must be rising, because each plant is producing more with the same number of workers. So, we add 3 percent for productivity. Then we have 3 percent plus 6 percent equals a 9 percent annual rate of growth in machine tools. But then someone might say, 'orders are down' for machine tools. So we decrease it to 7.5 percent."

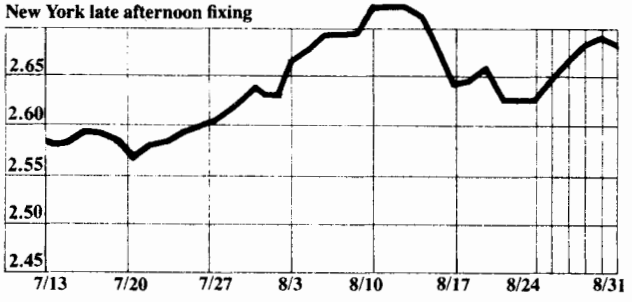
Asked where these seemingly quite precise percentages come from, Wendel replied. "You don't really use formulas. You just pull that number out of your head. You just say this first number doesn't line up with everything we know, and we just look at it and change it without even a calculation."

In this case, that is, the Fed's totally fudged PAF adjustment factor is the difference between the observed 6 percent rise in the raw data, and 7.5 percent—that is, a full 1.5 percent manufactured out of thin air.

Currency Rates

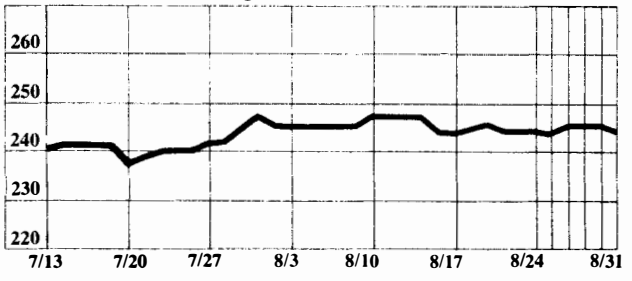
The dollar in deutschemarks

New York late afternoon fixing



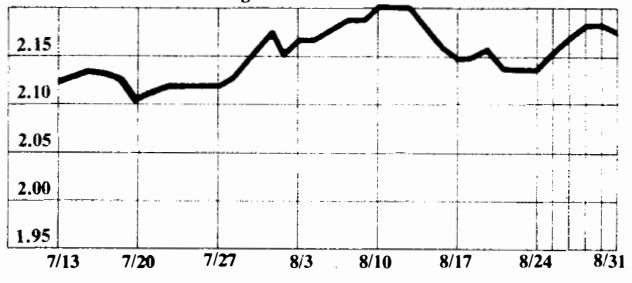
The dollar in yen

New York late afternoon fixing



The dollar in Swiss francs

New York late afternoon fixing



The British pound in dollars

New York late afternoon fixing