

# **But Is It Economics?**

## **Handling Economic "Junk" Science**

by

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In recent years, estimates produced by plaintiffs' personal injury "economists" have been successfully critiqued on significant factual matters.

However, changing circumstances now make it imperative to confront the economic assumptions and methodologies employed by these "economists".

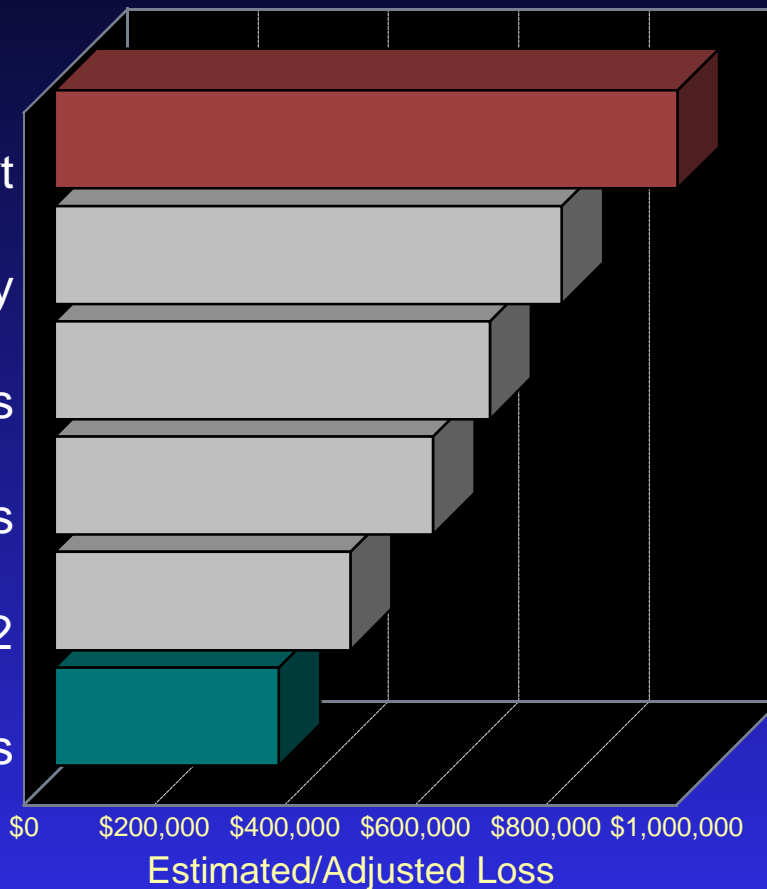
## There Are "Facts" and "Opinions"

Numerous techniques for calculating damages in FEELA cases entail estimating 7 basic variables for pre- and post-injury scenarios.

- Worklife - Fact
- Earnings - Fact
- Benefits - Fact
- Household Services - Opinion
- Earnings Growth - Opinion
- Interest Rates - Opinion
- Alternative earnings - Opinion

# Getting the "Facts" Straight Can Make a Big Difference

- Loss Estimated by Plaintiff's Expert
- Eliminate Double-Counting of Disability
- Receive Retirement in Retirement Years
- Deduct Employee Retirement Contributions
- Retire at Age 62
- Make Other Adjustments



# Some "Economists" Have Been Partially Reformed

With the exception of a few "die-hard" plaintiffs' personal injury economists, experts have acknowledged reality regarding a number of "facts". Most notably:

- Retirement age
- Employee business expenses
- Retirement benefits

## However . . .

We still haven't gotten many plaintiffs' experts to live on the same planet with the mainstream of the economics profession. Important flights of fancy are in the areas of:

- Interest Rates
- Earnings Growth
- Alternative Earnings and Benefits

These "issues" are particularly important in the case of younger workers.

**The important point is that while everyone can have an opinion on these matter, that opinion is not necessarily valid.**

Professional economists rely upon scientific theories and procedures which are accepted and documented in authoritative economic literature.

Personal Injury economists, however, often base their work not on authoritative economic theory, but court decisions or the practices of other personal injury economists as the basis for their professional practices. Indeed, some have even pointed to surveys of personal injury economists.

# "Expert" Economic Testimony

Many techniques employed by individuals providing expert economic testimony, particularly for use by plaintiffs' attorneys, share the following characteristics:

- Simplistic methods
- Lack of reference to general practice
- Reliance upon legal rather than economic arguments

Such techniques are NOT ECONOMICS and are often merely an attempt to inflate economic damages.

# Historical Net Discount Rate

The exceptionally low net discount rates used by some personal injury economists are typically derived by relying on historical data. Going further back in time results in:

1. Lower real interest rates
2. Higher rates of real earnings growth

Though proponents of long-term historical averages claim to be merely capturing the relationship between earnings growth and interest rates, such "economists" are implicitly forecasting future earnings growth and interest rates which are wildly at odds with professional forecasters.

The final result is simply inflated damages.

## Net Discount Rates Calculated Over Different Time Periods

<b>Historical Timeframe</b>	<b>10-Year T's</b>	<b>Hourly RR Earnings Growth</b>	<b>Implied Net Discount</b>
<b>Avg 54-94</b>	7.02%	5.55%	<b>1.39%</b>
<b>Avg 64-94</b>	8.11%	6.15%	<b>1.85%</b>
<b>Avg 74-94</b>	9.13%	5.56%	<b>3.39%</b>
<b>Avg 84-94</b>	7.99%	2.32%	<b>5.55%</b>

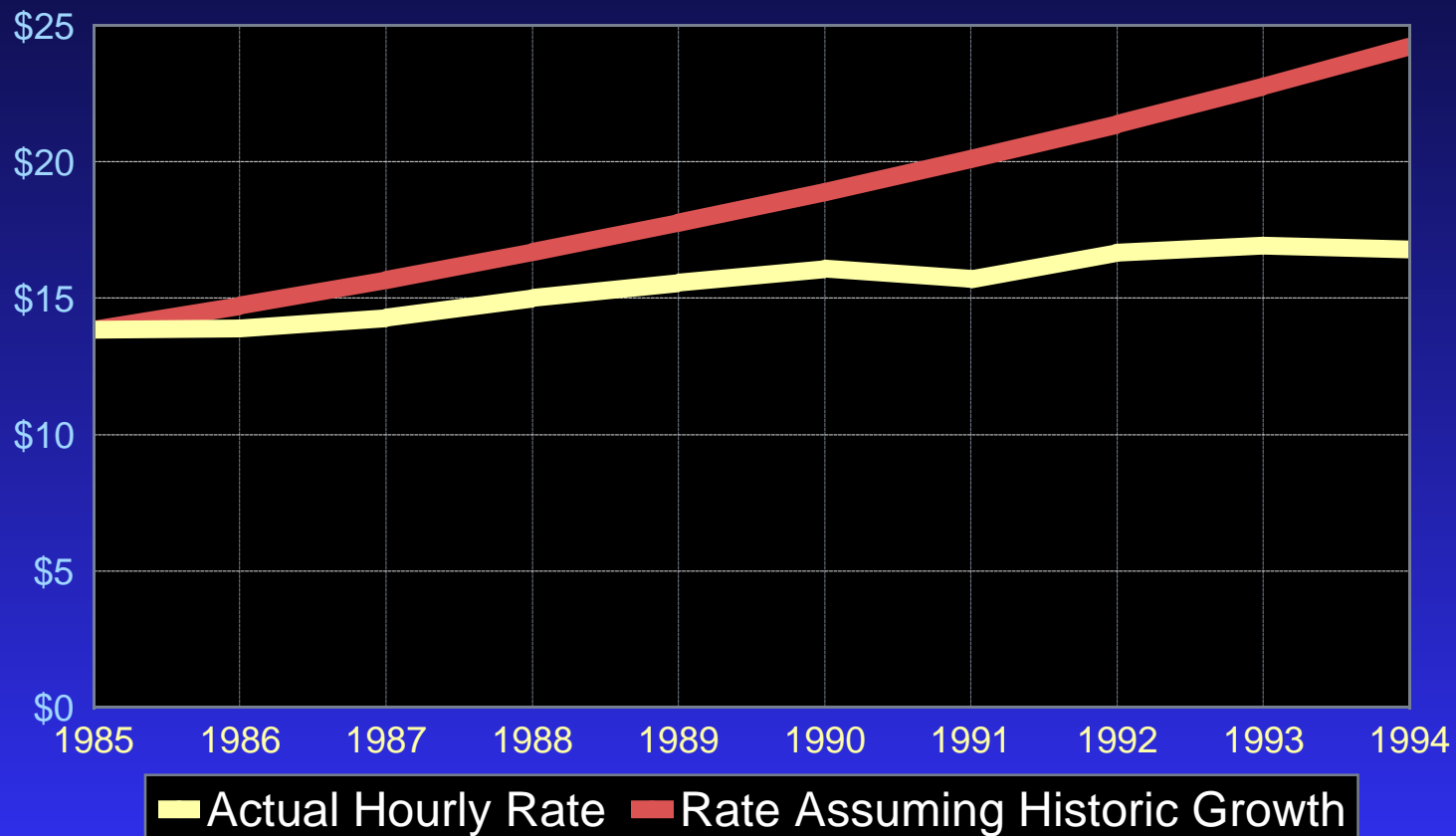
## Real Interest Rates Calculated Over Different Time Periods

<b>Historical Timeframe</b>	<b>10-Year T's</b>	<b>Inflation Rate</b>	<b>Implied Real Interest Rate</b>
<b>Avg 54-94</b>	7.02%	4.36%	<b>2.55%</b>
<b>Avg 64-94</b>	8.11%	5.35%	<b>2.62%</b>
<b>Avg 74-94</b>	9.13%	5.66%	<b>3.29%</b>
<b>Avg 84-94</b>	7.99%	3.62%	<b>4.22%</b>
<b>Blue Chip Consensus</b>	6.50%	3.20%	<b>3.20%</b>

**And, using historical averages doesn't work.**

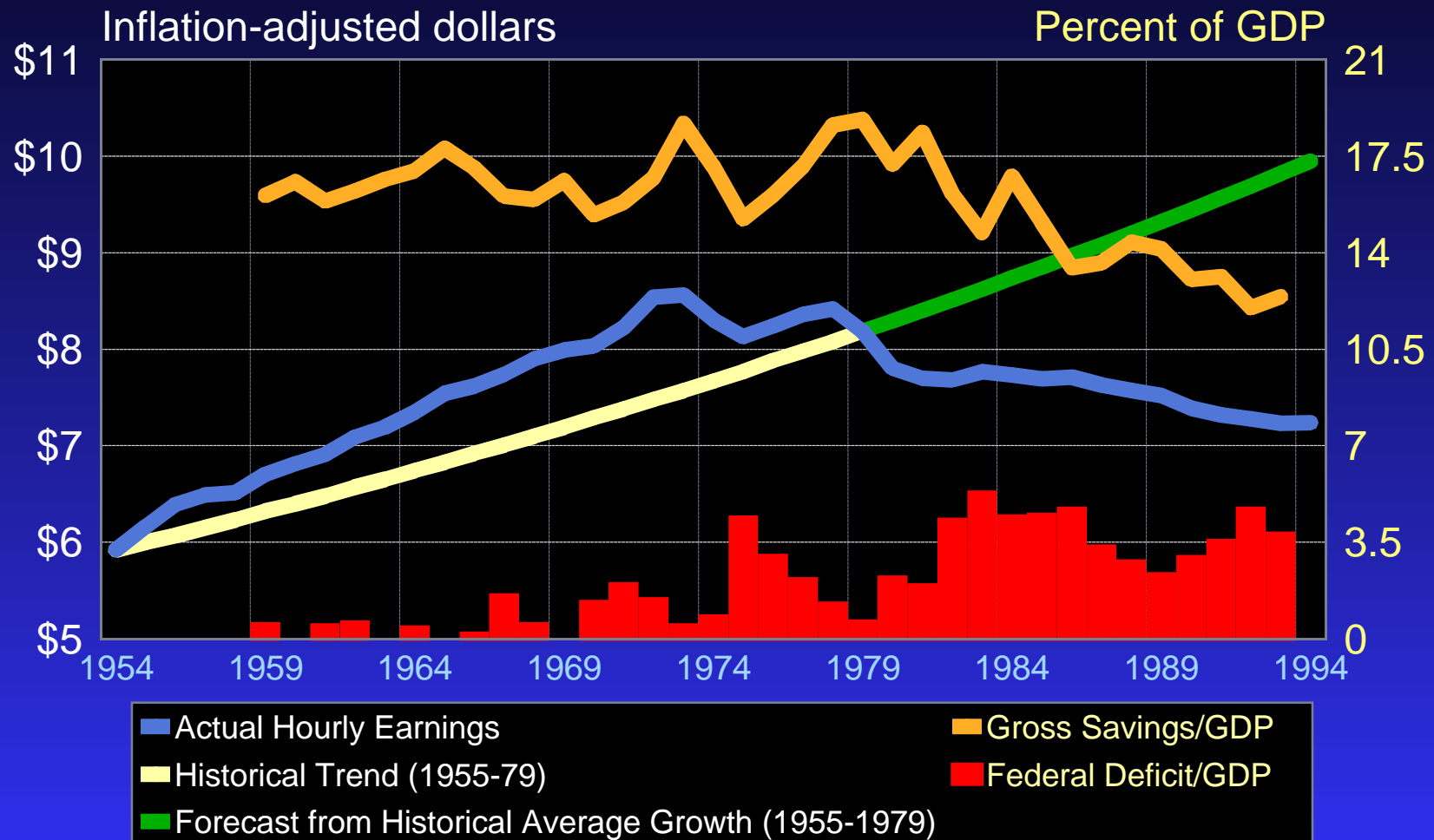
# Actual v. Projected RR Earnings

Extrapolating earnings growth between 1950 and 1985 into future years implies an earnings forecast 45% higher than actual earnings by 1994.



# Real Hourly Earnings

The use of historical averages results in considerable inaccuracies as it fails to consider structural changes in the economy, such as the federal budget deficit and the effect on net savings.



# Real Economics

The science of economic forecasting entails the following general process for developing economic models and forecasts for practical application:

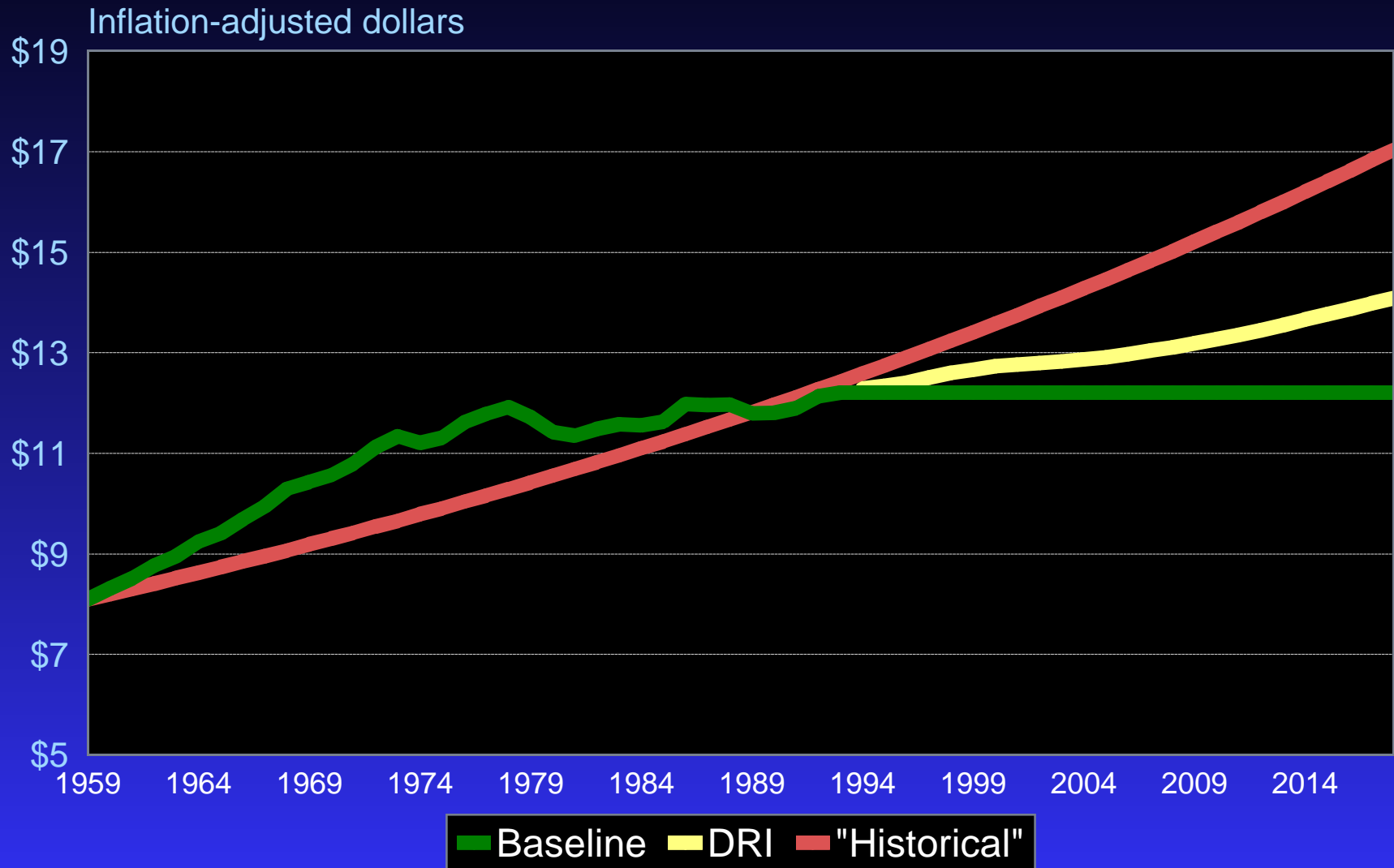
1. Identify economic problem/uncertainty
2. Using economic theory, infer possible variables and relationships
3. Arrange information and assumptions into economic model
4. Develop statistical model from economic model
5. Gather data
6. Develop estimation rule with sound properties, including precision
7. Obtain estimates and test hypothesis
8. Analyze and evaluate results for implications and consistency
9. If inconsistencies exist, identify problems and suggestions for future analysis

# Forecasting Techniques Emphasized at Business Schools

In 1983, a survey business schools found that regression analysis and other complex statistical methods were the techniques emphasized most in practical forecasting projects as part of graduate and undergraduate forecasting courses. **Note that taking a 40-year average is not among them.**

Technique	Number of Responses	Percent Responding
Regression analysis	62	44
Box Jenkins	28	20
Time series	25	18
Exponential smoothing	16	11
ARIMA	9	6
Moving averages	8	6
Model selection	9	6
Autocorrelation	7	5
Census II	4	3
Judgmental methods	0	0

# Real Compensation Growth: DRI vs. "Historical"



## Economic Assumptions of Personal Injury Economists

Forecasts of personal injury economists are typically at odds with those of professional forecasters and reality.

Expert	Real Earnings Growth Rate	Real Discount Rate	Net Discount Rate	Fringe Benefits
Evenson	5.30%	5.30% - 6.30%	0 - 1%	39.22%
Gamboa, Berla, Vogenthaler	"can't predict the future in terms of... wage growth and real rates of interest"		0.00%	22.00%
Grossman			1.50%	Assumed away by saying it equals the tax rate
Johnson	1.00%	0.87% (after-tax)	(0.13%)	\$ amount of health insurance
Linke			0 - 1%	21.00%
Olson	6.01% (historical nominal)	6.10% (current nominal)	0.08%	33.03%
Sherman	5.10% - 5.58%	5.91% - 8.49%	0.00% - 2.76%	\$ amount of health insurance & retirement
Ward	0.60%	1.40%	0.80%	\$ amount of health & unemployment insurance
Imputed from DRI, Blue Chip	0.43%	3.20%	2.76%	