

Economics: Just Because It's Dismal Doesn't Mean It Has To Be Junk

by

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Presented to:

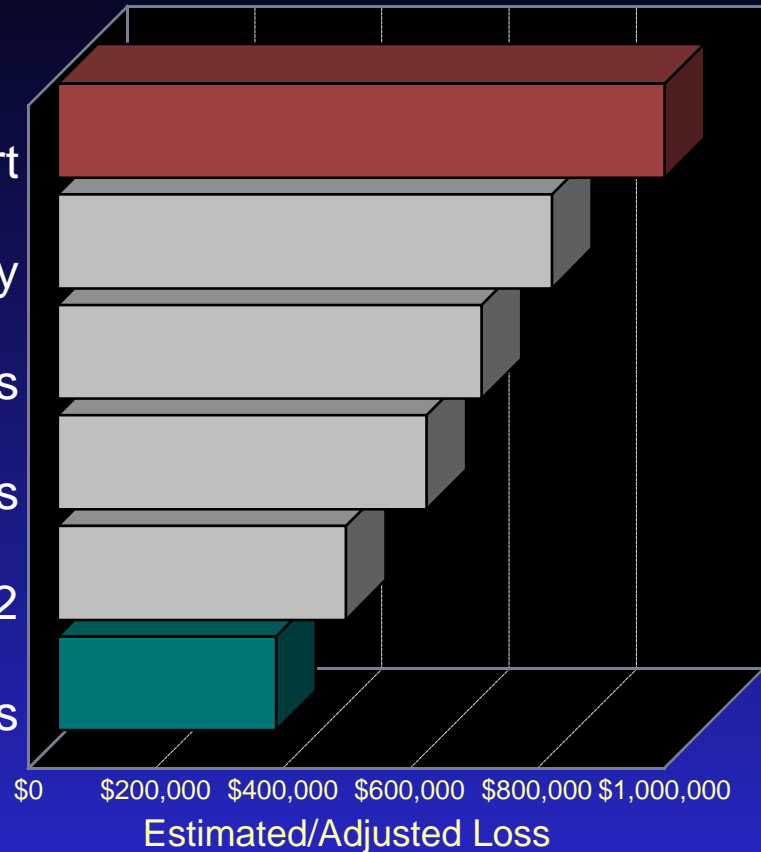
National Association of Railroad Trial Counsel

1997 Winter Meeting at Park City, Utah

February 7, 1997

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



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

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.

What Is Economics?

Though the opinions expressed by certain "experts" might suggest otherwise, **Economics is a SCIENCE.**

As with other acknowledged sciences:

- There exist "scientific methods" for analyzing economic problems
- There is an accepted body of economic theory and procedures found in textbooks, journal articles and other publications
- There is no special or different theory of economics as it would apply to litigation-related engagements

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.

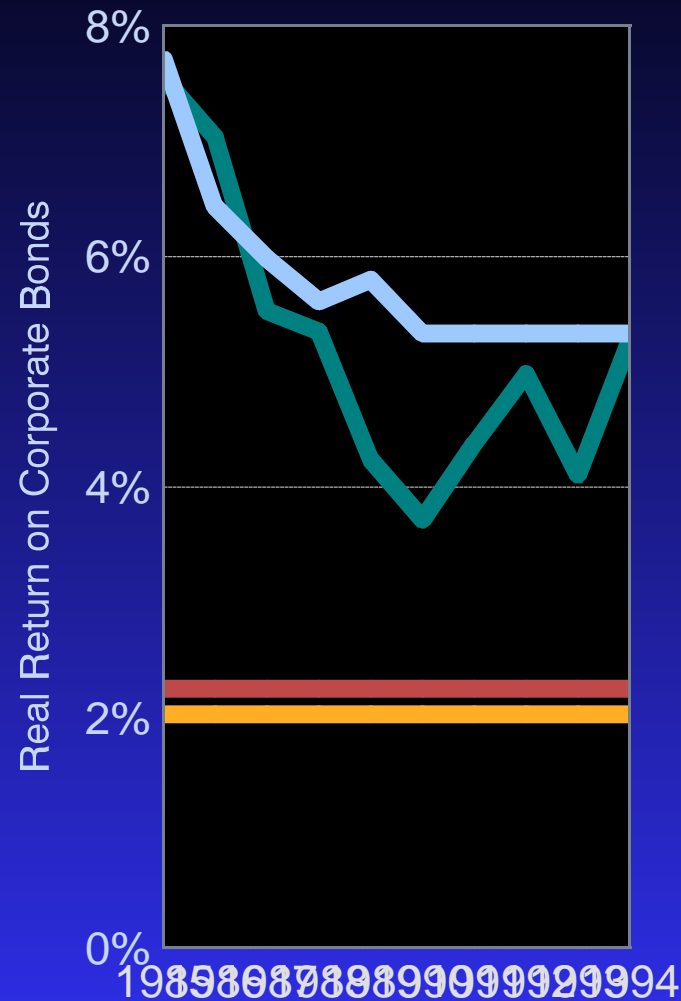
Real Interest Rates Calculated Over Different Time Periods

Historical Timeframe	10-Year T's	Inflation Rate	Implied Real Interest Rate
Avg 54-94	7.02%	4.36%	2.55%
Avg 64-94	8.11%	5.35%	2.62%
Avg 74-94	9.13%	5.66%	3.29%
Avg 84-94	7.99%	3.62%	4.22%
Blue Chip Consensus	6.40%	3.00%	3.30%

Net Discount Rates Calculated Over Different Time Periods

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

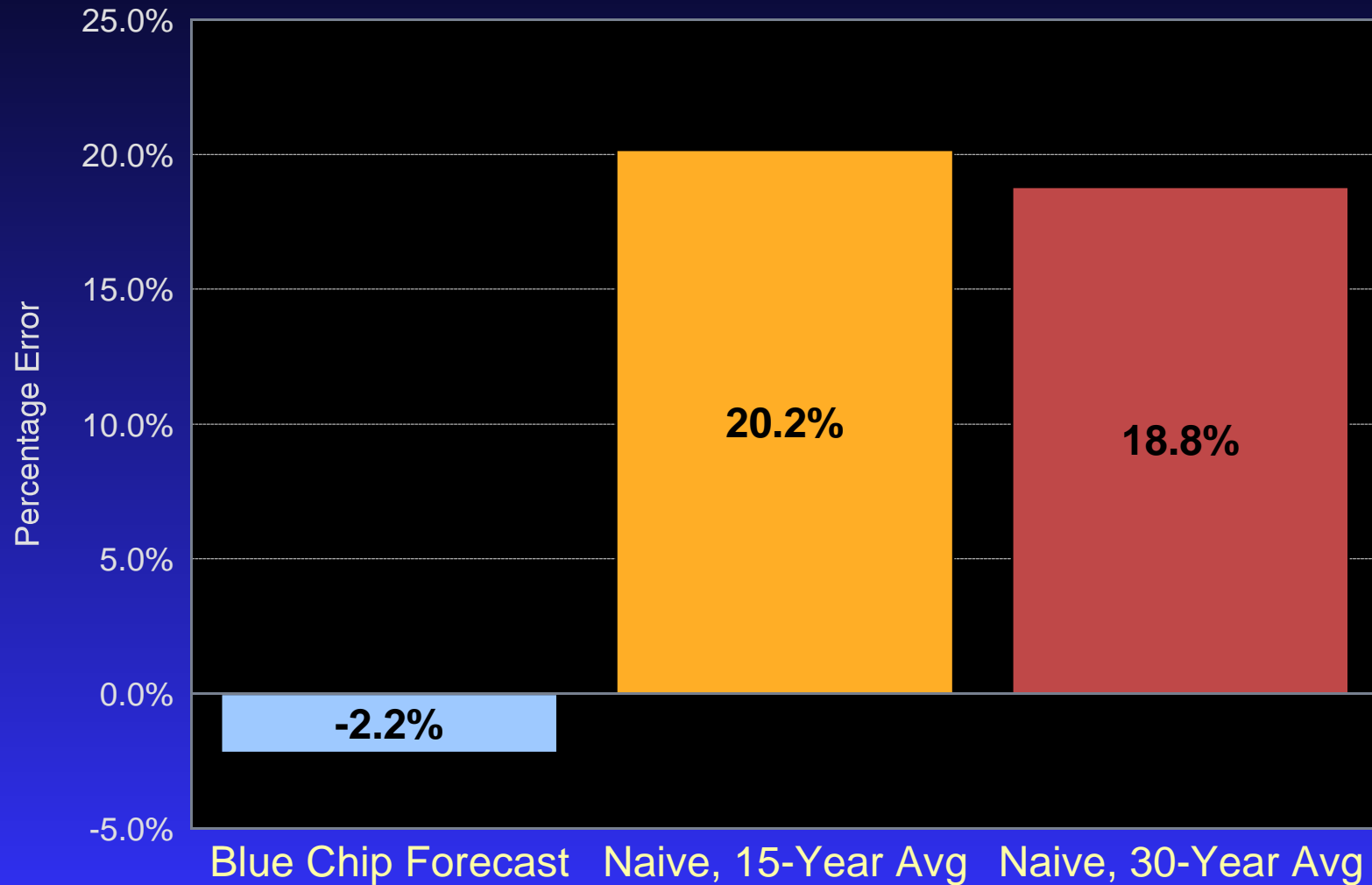
Blue Chip Forecasts v. Naive Historical Averages



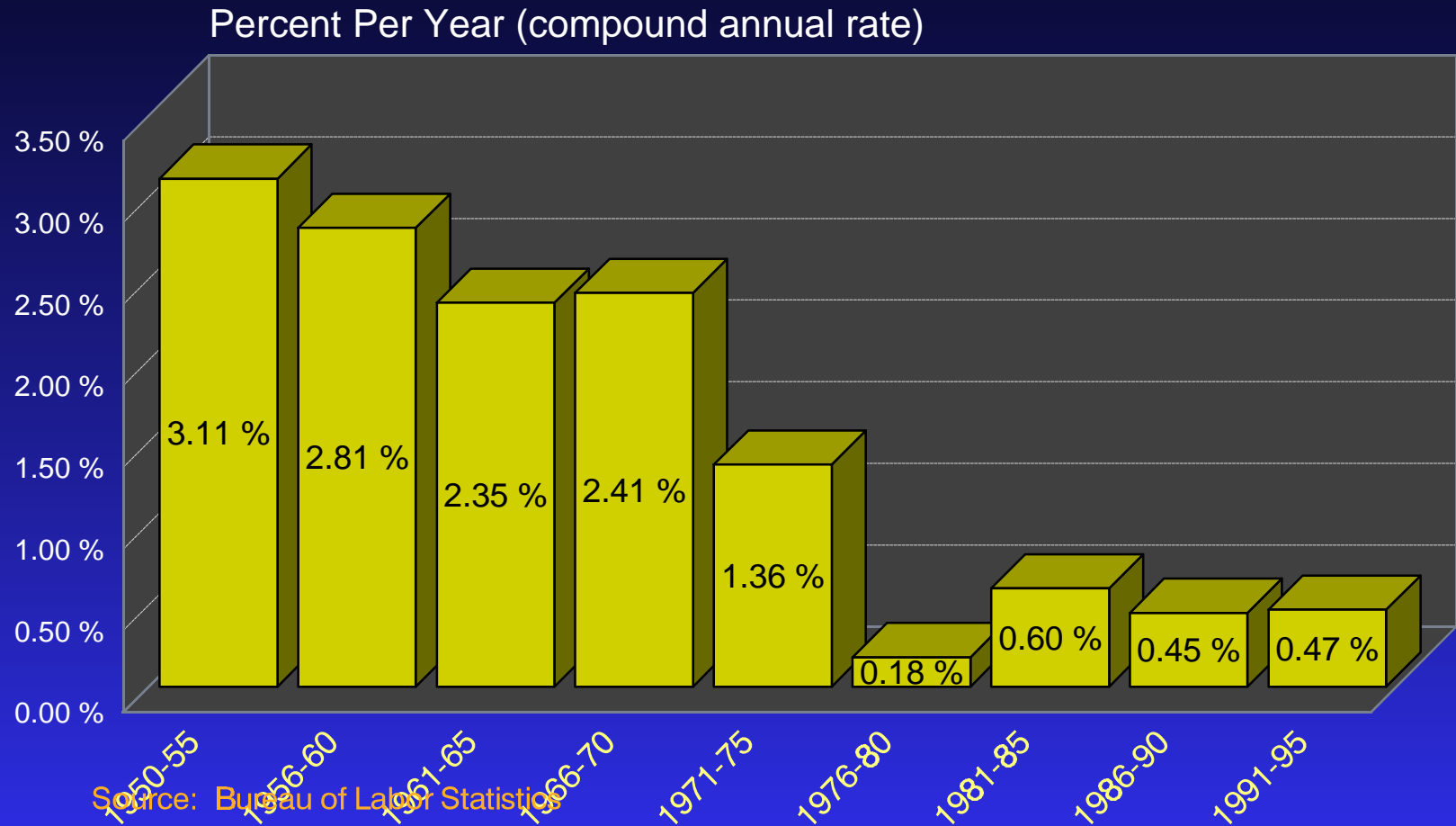
Blue Chip Long-Term Forecast Actual Real Interest Rates Naive, 30-Year Average Naive, 15-Year Average

Impact of Blue Chip & Naive Estimates

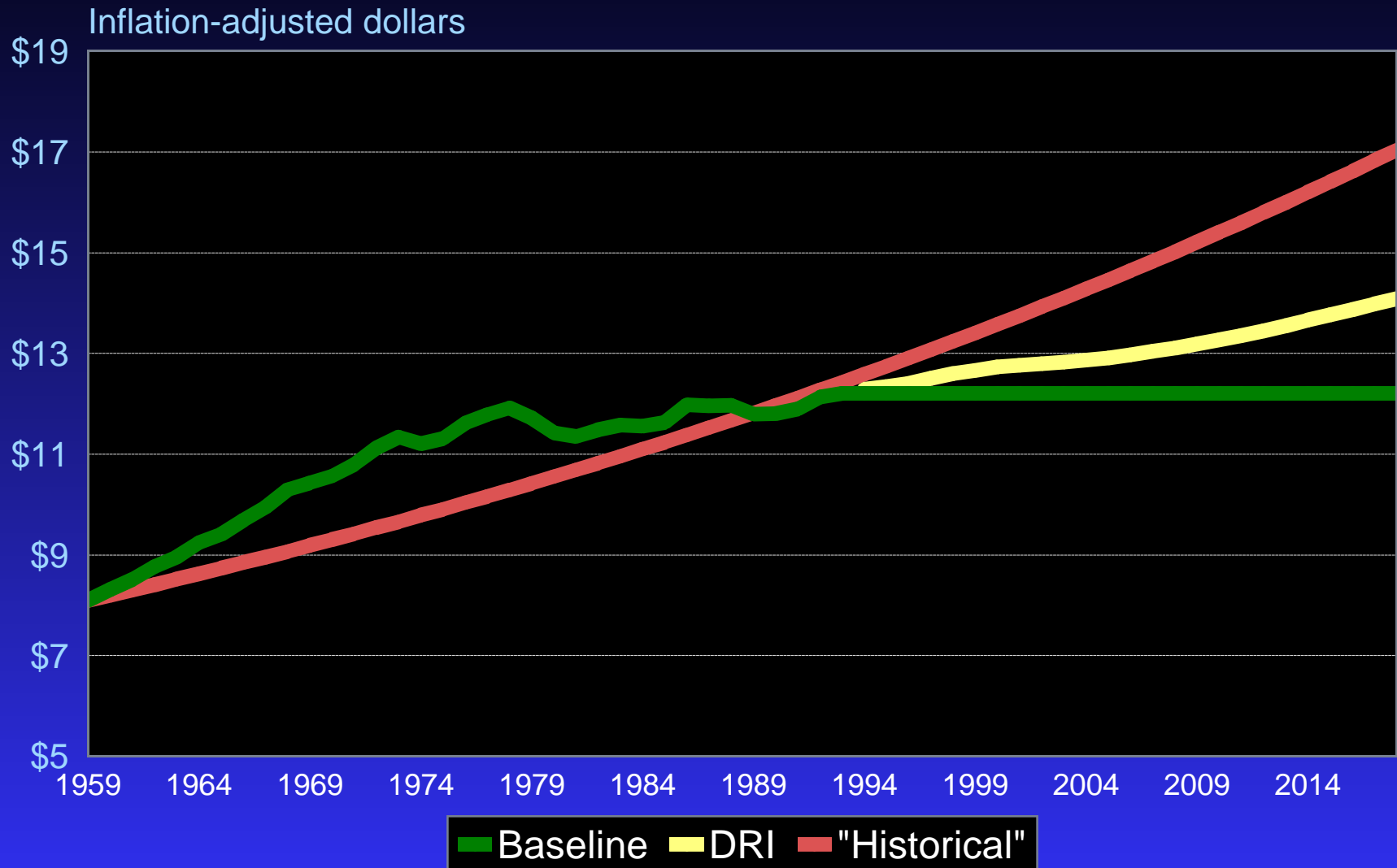
Present Value of Damages (vs. Actual Rates)



Real Hourly Compensation Growth (Non-Farm Business Sector)

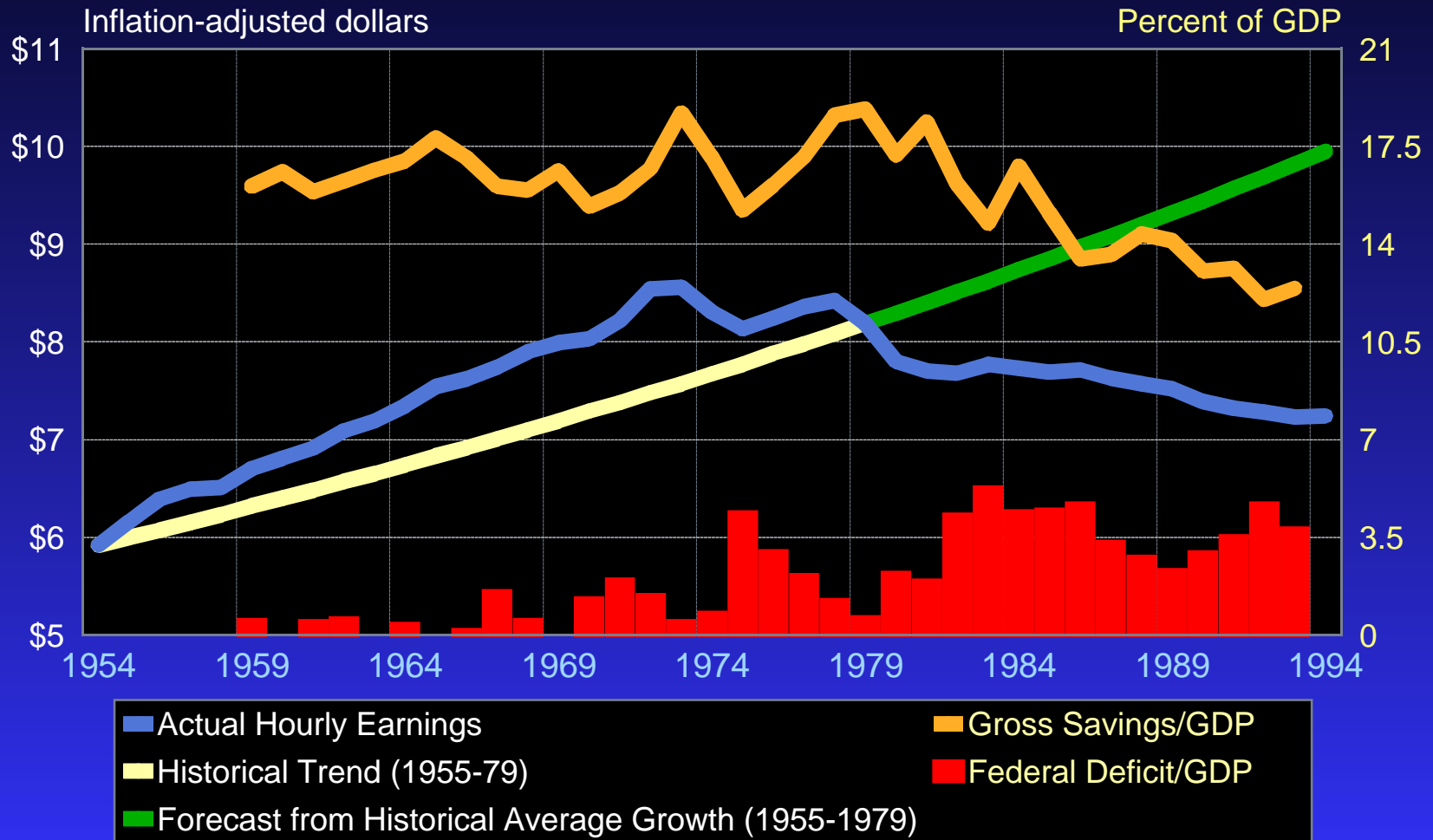


Real Compensation Growth: DRI vs. "Historical"



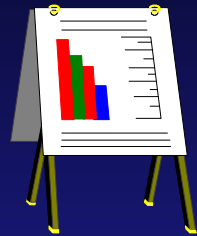
Real Hourly Earnings

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.

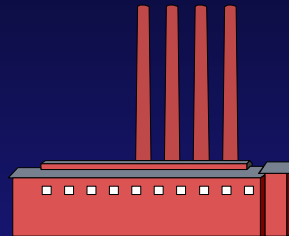


**In recent years we have seen
"economic" flights of fancy
creeping their way into
business litigation as well.**

A Business Plan Is Not A Business



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Ventures proposed in business plans:

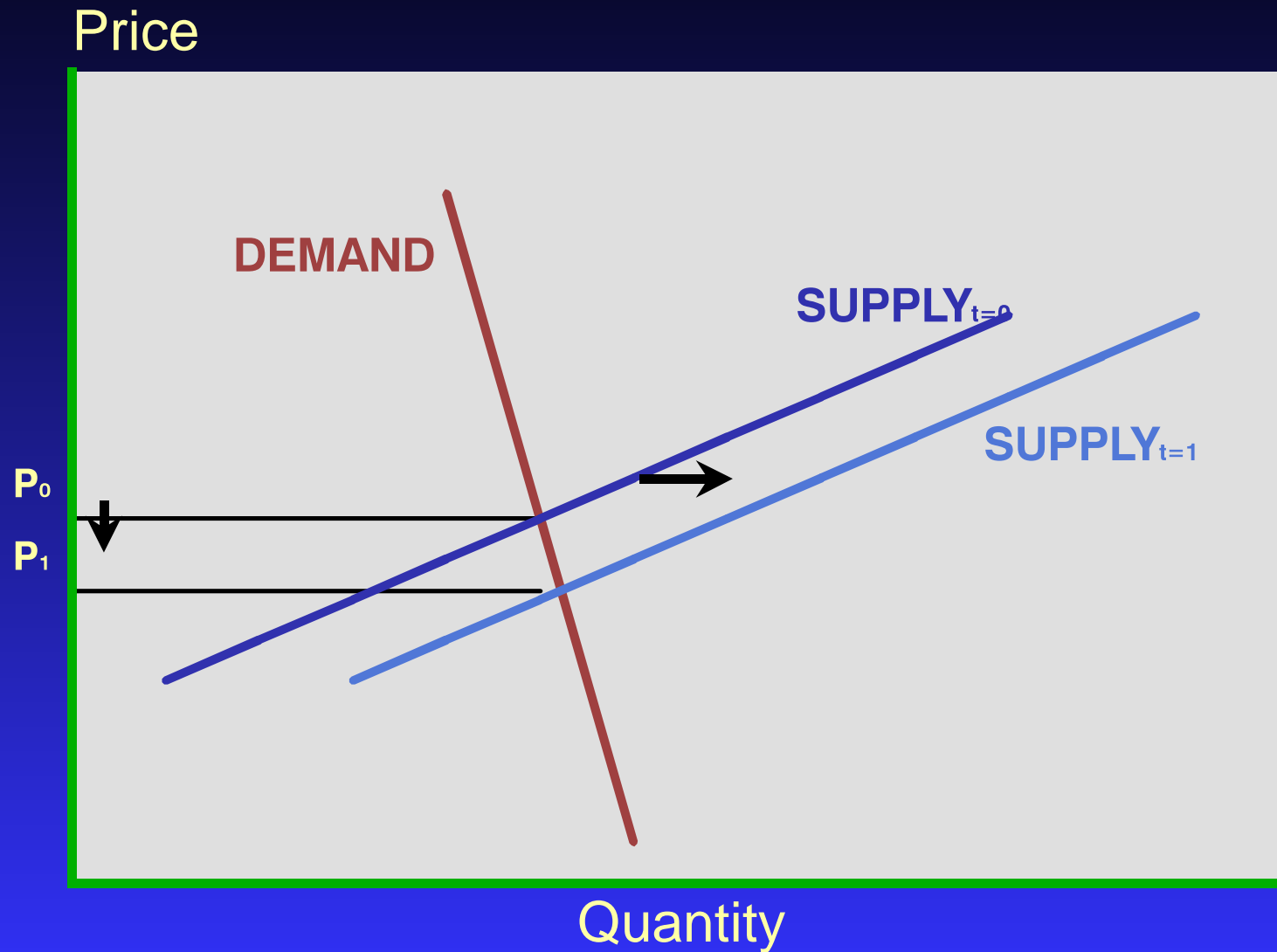
- Have no operating history
- Have no management in place
- Have little or no capital
- Venture capital discount rates apply
- Out-of-date business plans are irrelevant to existing conditions

Existing companies:

- Have proven operating history
- Have proven management in place
- Have obtained necessary capital
- Can be valued without speculation
- React to changing circumstances on a daily basis

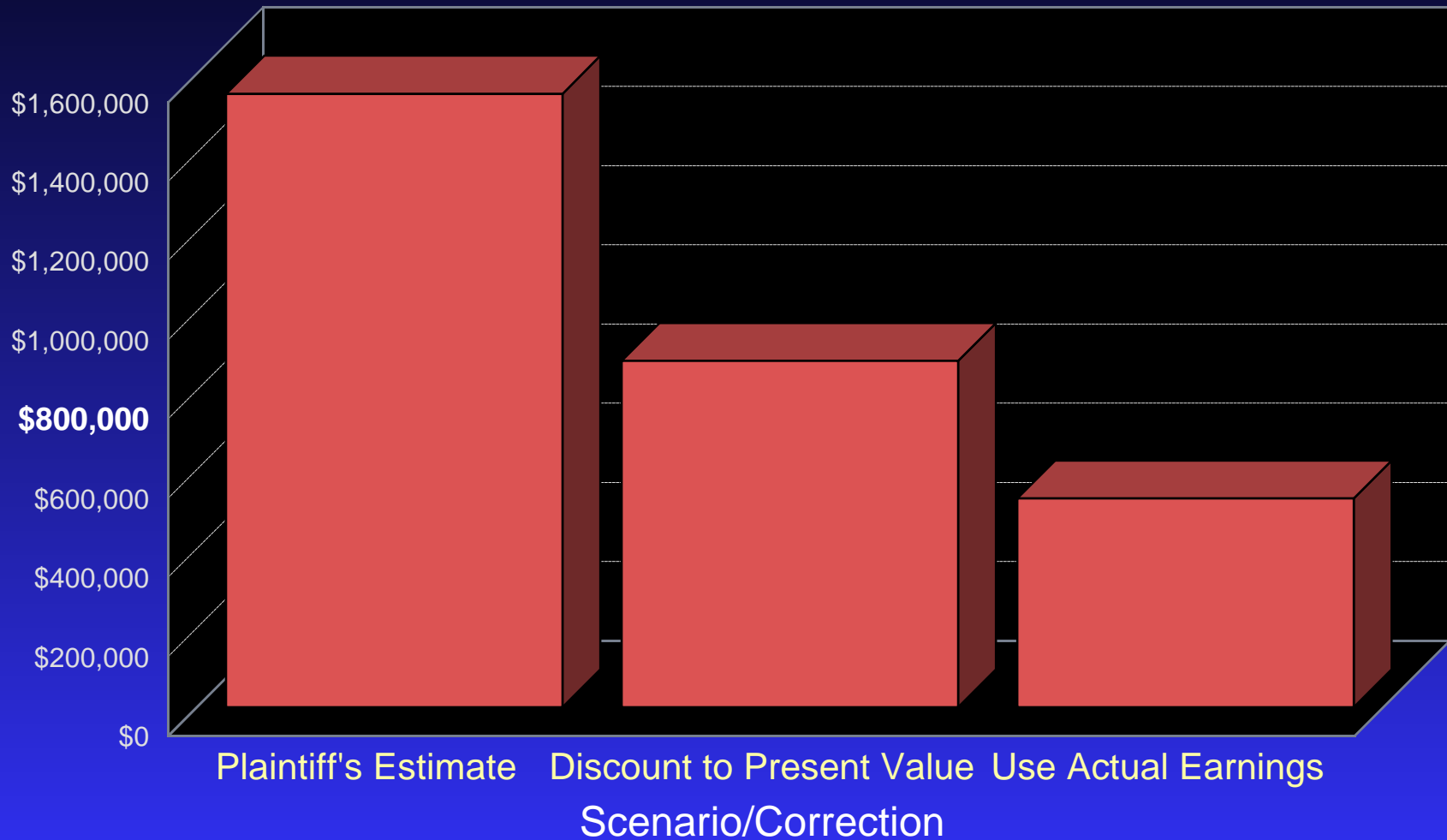
Local Grape Market

Failure to Analyze Impact from New Competitors



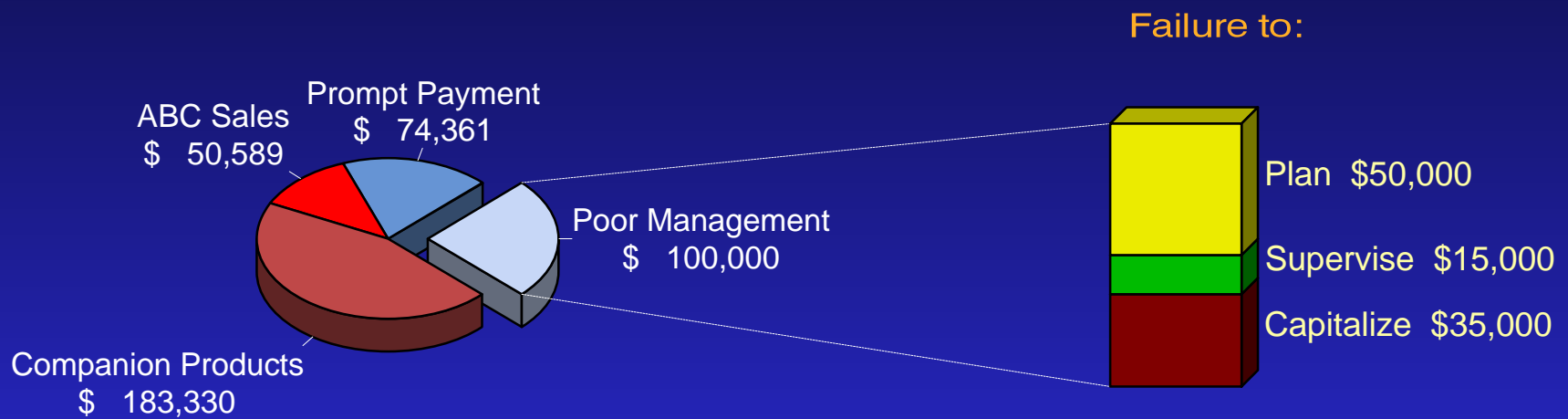
Value of 20% Interest Estimated by Plaintiff's Expert

Estimate After Correcting Errors



Failure to Prosper

(For Losses & Unrealized Profits, 1985-88)



Statistical analysis is a powerful tool for valuing businesses and estimating lost future profits.

However, it is also susceptible to technical incompetence and misuse.

Figure 1
Original Data

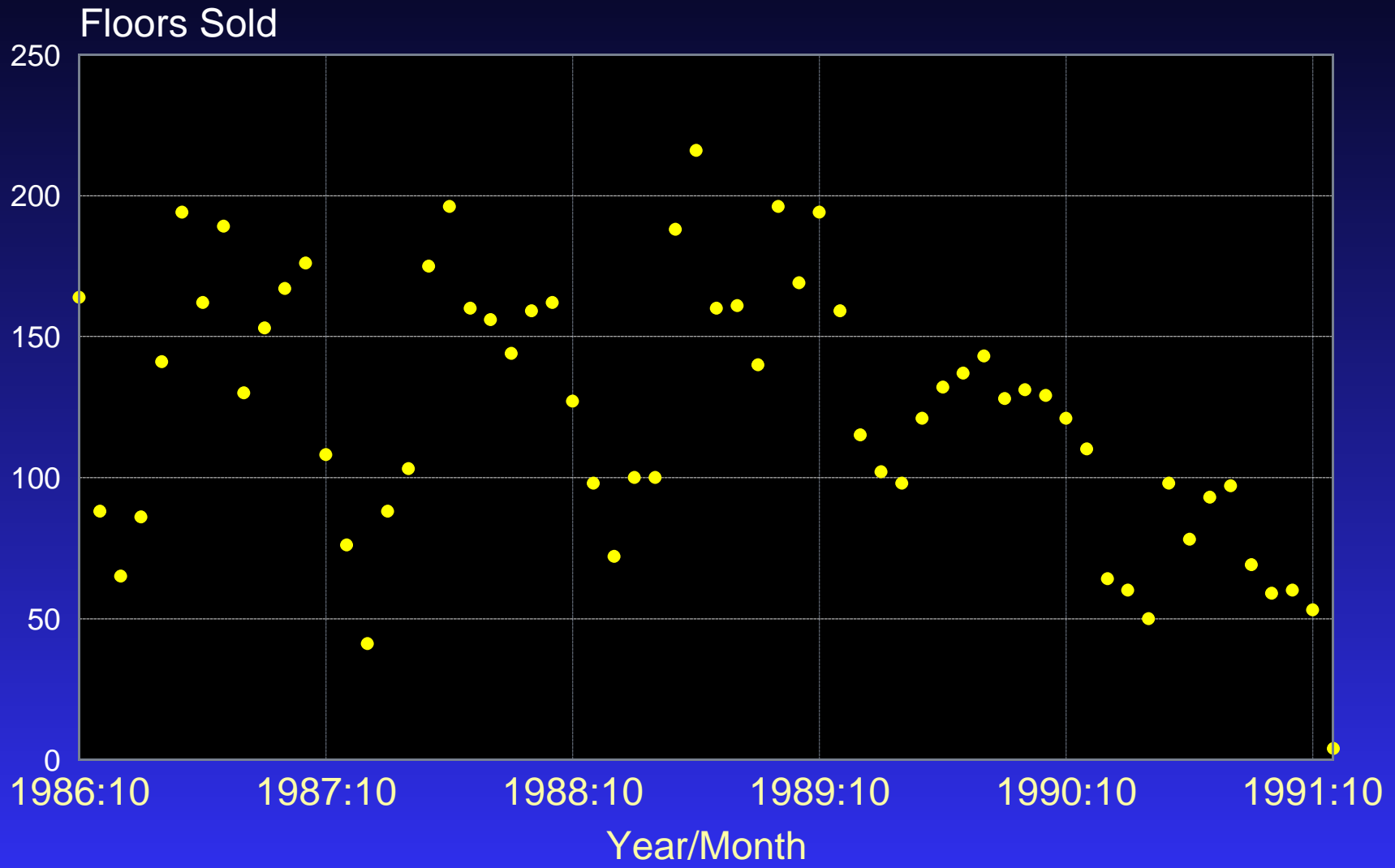


Figure 2
Seasonally Adjusted Data

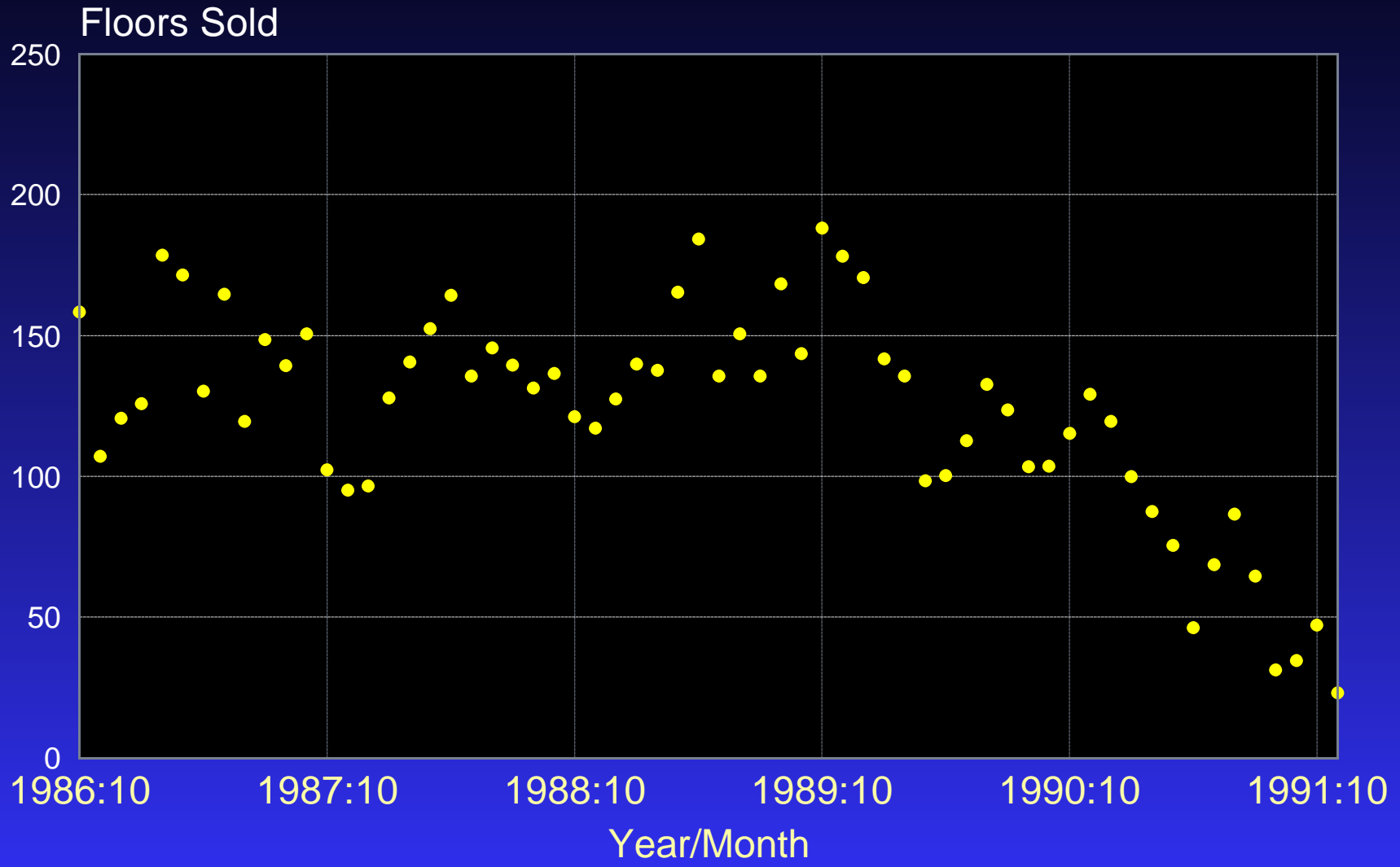


Figure 3

Intercept Shift Model

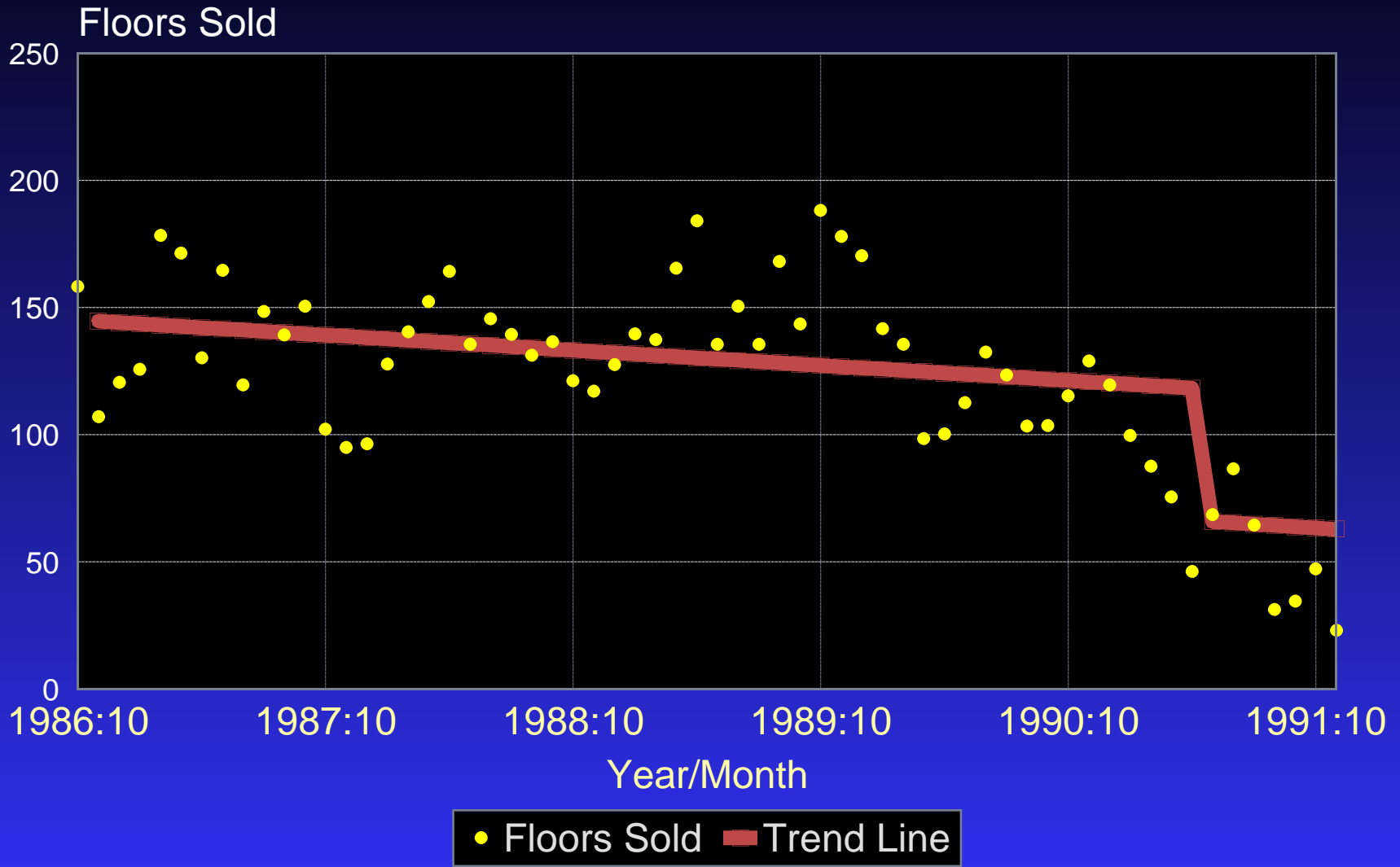
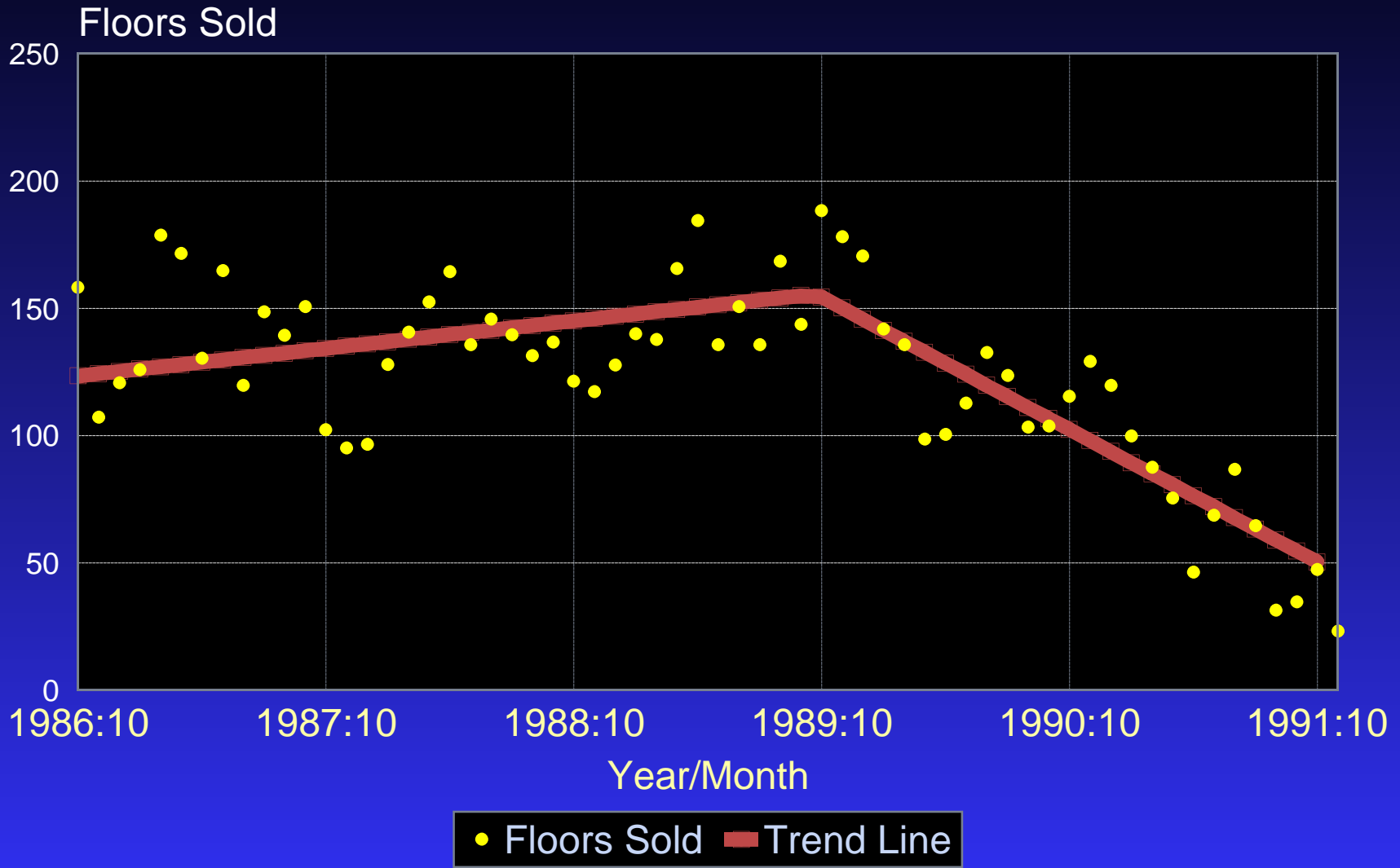


Figure 4
Seasonally Adjusted Data



"For years we have been saying, without much visible effect, that people who want damages have to prove them, using methodologies that need not be intellectually sophisticated but must not insult the intelligence... Post hoc ergo propter hoc will not do; nor the enduing of simplistic extrapolation and childish arithmetic with the appearance of authority by hiring a professor to mouth damages theories that make a joke of the concept of expert knowledge."

- U.S. Court of Appeals, Seventh Circuit, 1992, Schiller & Schmidt v. Nordisco