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Practice Tips

Spotting Bias in Plaintiffs' Economic Loss Reports: A Primer for Both Sides

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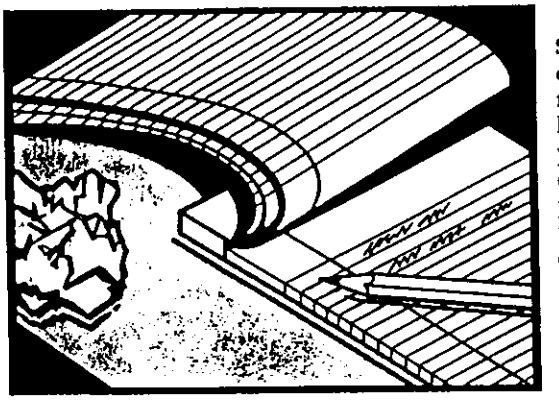

The increased use of economic experts in personal injury and wrongful death cases calls for increased vigilance by defense attorneys against biases in assumptions and methodology. But plaintiffs' attorneys will also want to know the degree of neutrality exercised by their own expert. Obvious biases will almost certainly prolong the dispute and make it more expensive to resolve. While in the past a defense attorney might rely on ridicule to discredit an economist in front of a jury, the defense increasingly relies on retaining an expert to counter outlandish claims by plaintiffs' economists.

Both plaintiffs' and defense attorneys have a stake in plaintiffs' economists making fair and neutral economic assessments. The defense stake is obvious: plaintiff-biased estimates can hurt the defendant. But the plaintiff's attorney's dividend from a fair report is manifold: 1) the expert will be more easily accepted by a jury, 2) the defense is less likely to retain an economist, (3) the case is more likely to be settled, and (4) claims by the plaintiff's attorney in future cases will be taken more seriously.

The societal benefits also cannot be ignored: the resulting increased fairness in jury awards will reduce the clamor for limits on damages. We are all served by adhering to standards of fairness in the system.

The primary claim by injured plaintiffs is for lost wages. There are four main determinants of lost wages: the base wage, the worklife, the wage growth rate, and the discount rate. Calculations of each can vary substantially. Even modest biases in any one factor can lead to significant biases in the overall result. Economists who use bias in several factors can waylay an entire jury unless effectively checked. Fortunately, these biases are not difficult to detect.

Base Wage

The estimate of the wage that would have been received in the first year of loss is the platform upon which all else is built. However, the last year of pre-injury wages is not necessarily the best predictor of the first year of post-injury wage loss. Often there are several prior years of earnings history upon which to make this estimate.

Consider a worker whose salary over a five-year period has been $40,000, $43,000, $45,000, $47,000, and $48,000. This looks like a healthy growth pattern — one that would encourage a casual observer to believe that an estimate for the next year could easily be $50,500, since wages increased by about 5 percent per year. But this simplified approach does not take inflation into account: the wages must be compared in the *same year's (constant) dollars*.

If inflation for the preceding four years has been 10 percent, 7 percent, 5 percent, and 3 percent respectively, the wages all denominated in today's (constant) dollars are $50,917, $49,760, $48,668, $48,410, and $48,000, a distinctly declining pattern of real wages. Purchasing power has declined by over 1.5 percent per year. If inflation is anticipated to be 2 percent the following year, we know that the real wage increase is likely to be close to zero, which is 5 percent less than a "reasonable" $50,500 estimate.

A plaintiff's economist's report should show past wages denominated in current dollars or any alleged trend might be spurious. Other common biases are to erroneously assume that recessions will not affect wages and that greater than average hours worked for hourly workers will not decrease to a long-term average. Sometimes an economist will use just one strong month's wage to project a whole year, even though seasonal layoffs and periods of reduced working hours are common in an industry.

In fatality cases, the proper personal consumption must also be deducted: 30 percent for married people with no minor children. Deviations from commonly used consumptions tables are difficult to justify; nonetheless, some economists attempt it without any justification.

Wage Growth Rates

Nothing can compound the bias of an inflated wage base like an inflated wage growth rate. Wages can grow based on increases in the cost of living (inflation), merit, longevity (time-in-grade), firm productivity, industry productivity, and rising general economic prosperity. Over most time periods wages have grown faster than inflation, but the selection of the time period is important. Real wage growth rates (actual wage growth over and above inflation) were quite

high in the 1950s and 1960s, averaging approximately 3.5 percent and 2.75 percent respectively during those two decades. As of 1991, they have averaged out at almost exactly 2 percent since the end of the Korean War.

Since 1970, however, the rates have averaged out at 0.64 percent. Some years have been negative, including 1989 and 1991. Of course, negative real wage growth cannot continue forever, but reaching back four decades to capture wage growth of a bygone era is not at all fair. The grand sweep of the last 40 years is not representative of the future. There is no theory of a cyclical nature of wage growth rates, but recent recessionary times are likewise not expected to persist over the long term. A fair estimate is to use the last 20 years or so as a standard. The 20 year average has been shown to be a good predictor.

What is the effect of assuming 2 percent wage growth rate instead of 0.64 percent? Huge. Increasing a $48,000 wage base by 2 percent for 30 years versus a $48,000 base at 0.64 percent for 30 years produces $86,945 versus $58,124. If we had used the $50,500 inflated wage base along with the 2 percent growth rate, the figure would be $90,930 — higher than the fair estimate by over 50 percent.

Discounting to Present Value

Discounting to present value means taking into account the fact that an award invested safely will earn interest. Awards for future losses must be reduced (or discounted) to take the interest earnings into account. One of the common plaintiff biased approaches is to use the total offset method which assumes that the discount rate is equal to the wage growth rate.

This fantasy is a standard assumption made by vocational experts or others (e.g., CPAs and mathematicians) who lack economic training but attempt to *act* as economists. Since they lack serious economic training they cannot justify the selection of individualized growth and discount rates. By assuming rates to be offsetting, presto — the problem of explaining the choice of specific growth and discount rates disappears.

The problem is that these rates are not offsetting. You would have to go back all the way to 1957 to find a year when the average of the past rates were completely offsetting. Accepting this simple but powerful assumption is to lose another 40 percent or more. All major texts in economic damages assessment recognize that this approach is patently plaintiff biased. Even to show this method as one plausible alternative is to demonstrate bias. Since 1970, discount rates have exceeded growth rates by more than 1.08 percent. The discount rate should be greater than the wage growth rate by more than 1 percent, unless the specific assumptions are rigorously justified by the particular circumstances at hand.

What is the effect of assuming a total offset versus a discount rate greater than the growth rate by 1.08 percent over a 30-year period? Again, huge; $50,500 in wages today, using total offset, is still worth $50,500 in present value terms. A wage base of $48,000 dollars increasing at 0.64 percent for 30 years and discounting at 1.72 percent (0.64 percent plus 1.08 percent) is worth $34,847. The total offset produces a 35 percent upward bias on a $48,000 wage base. On an inflated wage base of $50,500, the total upward bias is now 45 percent.

Worklife Effects

Most economists use worklife tables published by the federal government which show the total number of future years of participation in the labor force. These certainly should be adjusted for age, race, and gender. Alternatively, they can be adjusted for age, gender, and education, but not race. Sometimes an attempt is made to "interpolate" the tables for all four variables, but there is no reliable basis for doing so, or the government economists would have done so themselves. Such worklife estimates should be rejected as unreliable and invalid.

More importantly, these worklife tables do not take into account unemployment, but incredibly, most economists fail to reduce the worklife for this factor. This has the effect of providing a 5 percent to 7 percent upward bias for white males, and more for other categories of people in the workforce.

Further, economists typically "front load" the worklife. The worklife estimate for a 30-year-old white male is 30 years (before taking into account unemployment). However, it is not proper to assume that this person would work solidly over the next 30 years. It is statistically true that the person will work 30 years cumulatively during the remaining 44 years of life expectancy. But by assuming that it will be the very next 30 years significantly increases the present value of the wages. The 30 years of wages should be spread out over all future years in a manner equal to the statistical worklife expectation of an average worker, using life expectancy, participation, and employment schedules.

Front loading worklife assumptions has the effect of biasing present value upward between 7 percent to 10 percent. Adding in the omission of the unemployment statistic produces a total upward bias of between 12 percent to 15 percent. This is in addition to the total offset bias of 45 percent, for a cumulative bias of between 57 percent and 60 percent.

Other Biases

Another possible source of bias is the application of taxes to the economic loss. It would seem to the casual observer that tax affecting the loss would generally lower the present value. But because taxes lower not only the wage base but also the assumed after-tax interest earned on an award (and hence the discount rate), tax effects on a wage loss generally *raise* the present value of lost wages for workers under the age of 45.

Proper calculation of fringe benefits likewise requires scrutiny. Tables published by government, industry, and the U.S. Chamber of Commerce value the pay for vacation and other periods of time not worked as if it were actually paid *in addition* to salary. This is widely regarded by economists as a clear double counting; time not worked must be subtracted from benefits. Failure to adjust for this can add another 10 to 15 percent to any other wage bias. (Imagine the value of the time not worked for a part-time worker.)

Another bias commonly arises in catastrophic injury cases. First, many of the services required by catastrophically injured parties are custodial, not true medical services. Yet the cost is often erroneously projected to grow at

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the much higher expected rate of growth of medical care services. Secondly, the institutional care provides for the personal consumption costs of the injured party, whereas economists seldom deduct the expected personal consumption from lost wages in an injury case. In this instance, it is not only appropriate, but required.

Conclusion

You do not have to be an economist to recognize basic methodological flaws and biases in a plaintiff's economic loss report. The simple biases discussed here are easy to detect and should not be tolerated by either side. More subtle biases in these areas probably require expert economic assessment with computer-generated verification of economic calculations. Biases can exist also in the calculation of household services losses, post-injury wage earnings as a setoff to pre-injury wages, and in other types of losses as well.

Whether you retain an economist and pay for a loss estimate as a plaintiff's attorney or review the opposing side's economic report as a defense attorney, you should demand that certain standards be met. Most economists do meet these standards, but by keeping in mind some simple principles you will help to insure it.

Should the defense retain an expert economist? If the plaintiff's economist does not issue a revised report in response to your pointing out biases at the deposition, you should consider generating a "fair" loss estimate. The expense may be only a small percentage of the bias, and the savings can be substantial. Laid head to toe, all the biased economists of the world may never reach a fair conclusion. Nevertheless, you should not be forced to accept anything less.

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