

Dynamics of Earning Capacity

By Sara A. Ford

In many cases of permanent disability or death, a lifetime loss of expected earnings results. In domestic cases, the building blocks of earning capacity can help establish reasonable alimony payments. Understanding the components of earning capacity is essential to litigation involving lost wages or future payments.

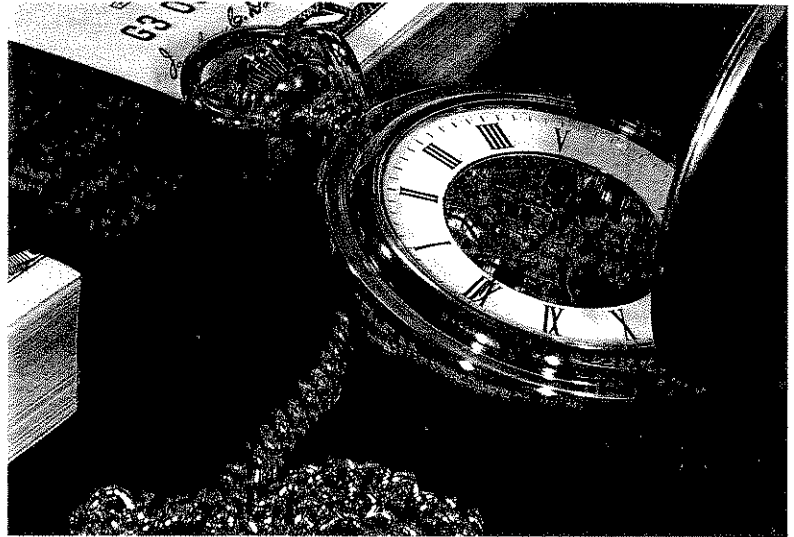
The U.S. Supreme Court's decisions in *Daubert* (1993) and *Kumho* (1999) require that expert testimony meet the general tests of "reliability" and "relevancy." The U.S. Supreme Court, however, has recognized the inexact nature of assessments for lost earnings. In *Jones and Laughlin Steel v. Pfeifer* (1983) the Court stated that:

By its very nature, the calculation of an award for lost earnings must be a rough approximation. Because the lost stream can never be predicted with complete confidence, any lump sum represents only a "rough and ready" effort to put the plaintiff in the position he would have been in had he not been injured.

While no statistic (no matter how fine-tuned) can provide an exact predictor of an individual's future, statistical averages—life expectancy, earnings, and others—have long been accepted as a means for prediction and for use in the courts. In conducting an earning capacity assessment, vocational and economic experts consider the unique characteristics of the individual in combination with relevant career development and economic theory. To predict their lifetime earning streams, experts then apply population statistics for earnings and the probability of working.

Earnings proxies and employment estimates are derived from average rates from various populations. Experts use available statistics about populations and apply them to meet the specifics of the case by considering how earnings statistics match the individual's circumstances and characteristics. Data is used by persons who understand the principles on which they are based, and the population to which they are applied.

As an example, the U.S. Census Bureau's American Community Survey (ACS) provides regular, up-to-date data on demographic, housing, social, and economic characteristics every year for all states, as well as for all cities, counties, metropolitan areas, and population groups. As a replacement for the long form of the Decennial XE "Census, Decennial" Census, the ACS, is by necessity, an extremely large survey. In 2005, it began producing data on about 3 million households on an annual basis, making it



the largest disability survey in the world and an excellent source for population averages for earnings and employment.

Earning capacity represents an individual's ability or power to earn money. It is the sum total of what one brings to the marketplace intellectually, emotionally, and physically. Education, skills, general learning ability, drive, experience, and the like comprise intellectual capacity. Ability to perform the physical activities associated with various jobs constitutes physical abilities. These physical and intellectual attributes comprise human capital, and it is this human capital that enables an individual to produce cash flows over a worklife.

Education

A person's earnings and probability of working have strong positive correlations to his or her level of education. This results from a number of factors, including:

- Intellectual Human Capital – The more education a worker has the more valuable he or she is in the workforce, and the more saleable to an employer.
- Physical Human Capital – Persons with lower levels of education are more likely to be restricted to manual, more physical labor, resulting generally in lower earnings and in less of an ability to continue in the workforce for an extended worklife.

Gender

Although strides continue to be made in this area, the gender gap exists. Currently, research shows that full-time, female wage

earners can be expected to earn approximately 20% less than their male counterparts. This gap is decreasing among younger workers, with females between the ages of 25 to 34 earning approximately 11% less, and females between the ages of 16 to 24 earning approximately 7% less when working year-round full-time.

Age

It should be of no surprise that the likelihood of employment is strongly dependent upon one's age. Both genders realize their highest employment rates from ages 25 through 55, with males peaking in their thirties, and females peaking in their forties after prime child-bearing years. The curves shift steeply downward starting at the age of 55 for both genders.

Disability

If a person sustains a closed head injury that limits the ability to focus on a task, remember details, or relate to others, that person may sustain an impairment of mental ability. If, on the other hand, the person sustains a permanent injury limiting the ability to lift, climb, balance, stand, sit, etc., then physical ability is reduced. What remains to be determined in a case of permanent impairment is whether or not the injury in question has reduced or destroyed earning capacity.

A non work-disabling permanent impairment, wrongfully incurred, may require compensation (pain and suffering, medical expenses) but clearly does not affect earning capacity. In order for a permanently disabling injury to affect earning capacity, it must be work disabling. Therefore, data which address the effects of work disability in terms of earnings and employment, such as the ACS, would appear to comprise an essential consideration for any forensic expert assessing lost earning capacity in personal injury litigation.

The above elements are used by the vocational or economic expert in considering the best representation of an individual's earning capacity. Sometimes, especially in the case of older workers, actual earnings may reflect a reasonable lifetime average. That is to say, the combination of the above—education, gender, age, and disability status—are all reflected in what the individual is actually earning in the competitive labor market. An exception is those individuals who are self-employed and the individuals who may not be working at a full-time rate. In those instances, it is important to rely on the building blocks as described above, to provide a proper earning capacity estimate.

Often, individuals who are young, self-employed, or not working full-time show actual earnings that are low. An individual who is capable of full-time, year-round employment has an earning capacity of at least the federal minimum wage at the full-time (2,080 hours per year) rate. This is a common mistake in assessing an individual's earning capacity and a flag that a vocational or economic expert who is familiar with the elements of assessing earning capacity may need to be consulted.



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