

The Economic Contribution of Slippery Rock University

MAIN REPORT



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**ECONOMIC GROWTH &
INVESTMENT ANALYSIS**

The Economic Contribution of Slippery Rock University

Main Report

Analysis of Investment Effectiveness and Economic Growth

March-10

Economic Modeling Specialists, Inc.
1187 Alturas Dr.
Moscow, ID 83843
208-883-3500
www.economicmodeling.com

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Introduction

Study overview

Slippery Rock University (SRU) generates a wide array of benefits. Students benefit from higher personal income, and society benefits from cost savings associated with reduced welfare and unemployment, improved health, and reduced crime. Education, however, requires a substantial investment on the part of students and taxpayers. All stakeholders, therefore, want to know if they are getting their money's worth. In this study, SRU investigates the attractiveness of its returns as a public training provider relative to alternative public investments. The following two analyses are presented: 1) investment analysis, and 2) economic growth analysis.

The investment analysis captures private and public benefits that accrue to students and taxpayers in return for their educational support. Private benefits include higher income of students, while public benefits include growth in income plus an assortment of positive externalities such as improved health and lifestyle habits, reduced crime, and fewer claims for social assistance. All of these annual benefits continue and accrue into the future for as long as students are in the workforce. To determine the feasibility of the investment, the model projects benefits into the future, discounts them back to the present, and compares them to present costs. Results are displayed in the four following ways: 1) net present value, 2) rate of return, 3) benefit/cost ratio, and 4) payback period.

The economic growth analysis focuses on the role SRU plays in promoting economic development by increasing consumer spending and raising the skill level of the labor force. This in turn leads to more jobs, increased business efficiency, greater availability of public investment funds, and eased tax burdens. In general, university-linked income falls under the following four categories: 1) income generated by annual SRU operating expen-

ditures, 2) income generated by the spending of SRU students; 3) income generated by the spending of SRU visitors; and, 4) income generated by SRU skills embodied in the workforce.

A note of importance: although the reports generated for SRU are similar to those prepared for other colleges and universities, the results differ widely. *These differences, however, do not necessarily indicate that some institutions are doing a better job than others.* Results are a reflection of location, student profile, and other factors that have little or nothing to do with the relative efficiency of the institutions. For this reason, comparing results between colleges and universities or using the data to rank institutions is strongly discouraged.

Organization of the report

This report has four chapters and seven appendices. Chapter 1 provides an overview of SRU and the regional economy. Chapter 2 presents the investment analysis results from the students' and taxpayers' perspectives. Chapter 3 considers the impact of SRU on economic growth in the SRU Service Area. Finally, Chapter 4 provides sensitivity analyses of some key variables on both the student and taxpayer investment sides.

The appendices include a list of resources and references in Appendix 1, a glossary of terms in Appendix 2, a discussion of the EMSI input-output model in Appendix 3, a detailed explanation of the shutdown point (an adjustment factor) in Appendix 4, an overview of the data and assumptions used in calculating the non-economic (*i.e.*, social) benefits of education in Appendix 5, a short primer on the investment analysis results in Appendix 6, and an explanation of the alternative education variable in Appendix 7.

Chapter 1: Profile of SRU & the Regional Economy

Introduction

Slippery Rock University is located in the rolling hills of western Pennsylvania and is the westernmost institution of the fourteen-campus Pennsylvania State System of Higher Education. The Princeton Review cites SRU as one of the 218 best colleges and universities in the Northeast. The public residential university boasts more than 60 programs of study in four colleges (Education; Business, Information and Social Sciences; Health, Environment and Science; and Humanities, Fine and Performing Arts) in addition to its Graduate Studies program. Founded as Slippery Rock State Normal School in 1889, SRU was granted university status in 1983. Today the university plays an important part in serving the educational, economic, cultural, and social needs of western Pennsylvania.

Estimating the benefits and costs of SRU requires the following three types of information: (1) the profile of the university and its students, (2) the economic profile of the region and the state, and (3) statistics relating education to improved social behavior. For the purposes of this study, information on the university and its students was obtained from SRU; data on the regional and state economy were drawn from public databases; and statistics on social behavior were provided by national studies and surveys.

University profile

Revenues

Table 1.1 shows the annual revenues of SRU and its component units by funding source—a total of \$149.0 million in FY 2008–09. These data are critical in identifying the

Table 1.1: Revenue by source, FY 2008–09 (\$ thousands)

Source	Total	%
Student revenue		
Tuition and fees	\$47,824	32%
Total student revenue	\$47,824	32%
Local government revenue		
Capital grants and appropriations	\$0	0%
All other grants and contracts (incl. student aid)	\$3,468	2%
Total local government revenue	\$3,468	2%
State government revenue		
Capital grants and appropriations	\$40,096	27%
All other grants and contracts (incl. student aid)	\$9,281	6%
Total state government revenue	\$49,377	33%
Federal government revenue		
Capital grants and appropriations	\$0	0%
All other grants and contracts (incl. Pell)	\$8,995	6%
Total federal government revenue	\$8,995	6%
All other revenue		
Auxiliary revenue, sales and services, etc.	\$39,355	26%
Total other revenue	\$39,355	26%
Grand total revenue	\$149,018	100%

Source: Data supplied by SRU. Reflects FY 2008–09 revenue of SRU, the SRU Foundation, the SRU Alumni Association, and the Student Government Association (SGA)

annual costs of educating students from the perspectives of students and taxpayers alike. As indicated, tuition and fees comprised 32% of total revenue, local government revenue another 2%, revenue from state government 33%, federal government revenue 6%, and all other revenue (*i.e.*, auxiliary revenue, sales and services, interest, and donations) the remaining 26%.

Expenditures

SRU employed 1,208 faculty, staff, and managers as well as 2,148 students in the 2008 calendar year. The univer-

Figure 1.1: Student origin and settlement patterns

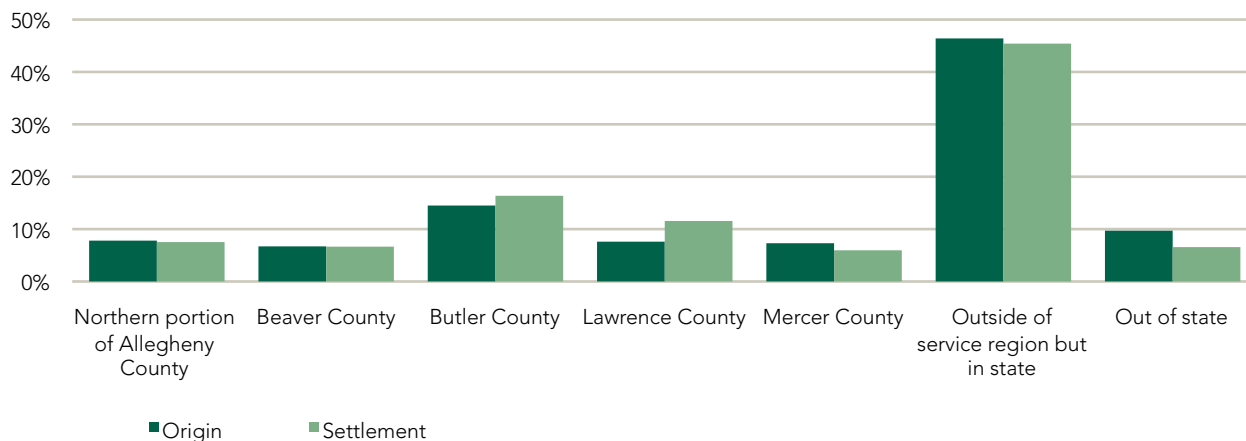


Table 1.2: Expenses by function, FY 2008–09 (\$ thousands)

Source	Total	%
Salaries, wages, and benefits	\$91,930	61%
Travel and transportation	\$1,731	1%
Utilities	\$4,479	3%
Rental lease	\$279	<1%
Student aid expense	\$5,903	4%
Depreciation	\$7,791	5%
Capital expenditures	\$130	<1%
All other non-pay expenditures	\$38,002	25%
Total expenses	\$150,243	100%

Source: Data supplied by SRU.

sity was among one of only 150 colleges and universities nationally to be recognized as a Great Place to Work by The Chronicle of Higher Education as a result of SRU being ranked in the top 10 in five of 26 categories in the “2009 Great Colleges to Work For Survey.”

The combined payroll at SRU amounted to \$91.9 million. Other operating expenditures, including purchases of supplies and services, made up \$58.3 million. These budget data appear in Table 1.2.

Student profile

Demographics

SRU served 9,843 credit students and 4,585 non-credit students in the 2008 calendar year (unique headcount). The breakdown by gender was 43% male and 57% female. The breakdown by ethnicity was 85% Caucasians, 7.2% minorities, and 1.2% non-resident aliens. The remaining 7.1% did not report their ethnicity. The overall average age of the student population was 22.¹

Figure 1.1 presents the origin and settlement patterns of SRU’s credit student population. As indicated, 44% of students came from the SRU Service Area (note that these data are divided by county). Most of these in-region students came from Butler County, where SRU is located. Another 46% of students came from outside the region but inside the state, and the remaining 10% came from outside the state.

Note that SRU keeps more graduates in the region (48%) than come from the region (44%). This phenomenon is particularly pronounced in Butler and Lawrence Counties, where the percent of students who settle in the county exceeds the percent of students who come from the county by 1.9% and 4%, respectively. All of these students settle in the area and become taxpaying citizens. The same trend also occurs at the state level, where the

¹ Demographic data are based on the university’s credit student population.

Table 1.3: Student achievements by education level, 2008

Category	Head-count	Total CHEs	Average CHEs
DPT graduates	49	1,208	24.7
Master's degree graduates	270	3,415	12.6
Bachelor's degree graduates	1,654	33,001	20.0
Certificate graduates	25	170	6.8
Continuing students	7,845	134,399	17.1
Workforce students	4,400	3,637	0.8
Personal enrichment students	185	992	5.4
Total/average	14,428	176,822	12.3

Source: Data supplied by SRU.

percent of students who settle in Pennsylvania (93%) is greater than the percent of students who come from Pennsylvania (90%).

Achievements

SRU's mission is to provide an interactive undergraduate education along with select high-quality graduate programs. It is a traditional four-year university with degree offerings ranging from bachelor's degrees to a doctoral degree in Physical Therapy. The university also offers special affiliation programs that lead to professional degrees at an accelerated pace. Students may enroll in one of several baccalaureate degree programs that precede SRU's postgraduate Physical Therapy program, including the 3+3 (three years of undergraduate work and three years of professional/graduate study) accelerated options in biology, exercise science, and other allied health and safety programs.

Table 1.3 summarizes the breakdown of student achievements by degree level. As indicated, SRU served 49 Doctor of Physical Therapy (DPT) graduates, 270 master's degree graduates, 1,654 bachelor's degree graduates, and 25 certificate graduates in the 2008 calendar year. Degree-seeking students who did not receive a credential during the analysis year comprised an additional 7,845 students.

SRU is also affiliated with the Lake Erie College of Medicine in Erie, Pennsylvania for students pursuing a Doctor of Osteopathy degree or a Doctor of Pharmacy degree; and with Logan College of Chiropractic in Chesterfield,

Missouri, for students pursuing a Doctor of Chiropractic degree.

The non-credit student population is divided into students who enrolled for workforce and professional development (4,400 in total), and those who enrolled for leisure and personal enrichment purposes (185 in total). In the analysis, we exclude the credit production of personal enrichment students under the assumption that they do not attain workforce-related skills that will increase their earnings.

Altogether, SRU students completed 176,822 credit hour equivalents (or CHEs) during the 2008 calendar year. The average number of CHEs per student (excluding personal enrichment students) was 12.3.

Athletics and Recreation

SRU's athletic department comprises 17 teams (10 for women, 7 for men) and competes at the NCAA Division II level. It is the only university in the Pennsylvania State System of Higher Education to be fully Title IX compliant. SRU was named the winner of the 2007-08 Dixon Trophy, given to the most successful overall athletic program in the Pennsylvania State Athletic Conference. For that same period, a school-record 181 student athletes were named recipients of Pennsylvania State Athletic Conference "Scholar-Athlete" honors, while 79 received Academic Achievement Awards from the Division II Athletic Directors Association.

The university's comprehensive Abersold Student Recreation Center, funded by student fees, provides students with an array of recreational, intramural, and fitness experiences. A new intramural complex with multiple ball fields, play courts, and facilities is under construction to provide more outdoor recreational opportunities for students.

Regional profile

SRU serves an area comprised by northern Allegheny County and Beaver, Butler, Lawrence, and Mercer Counties in western Pennsylvania. The university's 660-acre main campus is situated in Slippery Rock, a borough

Table 1.4: Labor and non-labor income by major industrial sector in SRU Service Area, 2009 (\$ millions)*

Industry Sector	Labor income	Non-labor income	Total income	% of total
Agriculture, forestry, fishing and hunting	\$106	\$103	\$209	1%
Mining	\$277	\$617	\$894	4%
Utilities	\$249	\$905	\$1,153	5%
Construction	\$1,208	\$33	\$1,240	5%
Manufacturing	\$2,048	\$1,439	\$3,486	15%
Wholesale trade	\$898	\$637	\$1,536	7%
Retail trade	\$1,297	\$774	\$2,072	9%
Transportation and warehousing	\$762	\$234	\$996	4%
Information	\$209	\$279	\$487	2%
Finance and insurance	\$726	\$531	\$1,257	5%
Real estate and rental and leasing	\$264	\$913	\$1,178	5%
Professional and technical services	\$1,290	\$211	\$1,501	6%
Management of companies and enterprises	\$540	\$177	\$717	3%
Administrative and waste services	\$533	\$131	\$663	3%
Educational services	\$380	\$17	\$397	2%
Health care and social assistance	\$2,179	\$290	\$2,469	11%
Arts, entertainment, and recreation	\$107	\$65	\$172	1%
Accommodation and food services	\$402	\$175	\$577	2%
Other services, except public administration	\$587	\$66	\$652	3%
Federal government	\$249	\$63	\$312	1%
State and local government	\$1,246	\$124	\$1,370	6%
Total	\$15,555	\$7,784	\$23,339	100%

* Data reflect the most recent year for which data are available. EMSI data are updated quarterly.

† Numbers may not add due to rounding.

Source: EMSI.

with approximately 3,000 residents in Butler County. The campus is less than an hour north of Pittsburgh, one hour south of Erie, and 45 minutes east of Youngstown, Ohio. Two major interstate highways, I-79 and I-80, intersect within seven miles of the university, conveniently linking it to the entire commonwealth and its contiguous regions.

In addition, SRU offers numerous service learning and nonprofit opportunities in the community, including a community center in nearby New Castle, Pennsylvania. The university's extensive and expanding international studies program, recently ranked 35th nationally by the Institute for International Education for the number of students who participate in learning abroad programs, offers educational opportunities for students in 21 countries.

Area economy by major industrial sector, with details on labor and non-labor income. Labor income refers to wages, salaries, and proprietors' income; while non-labor income refers to profits, rents, and other income. Together, labor and non-labor income comprise a region's total gross regional product, or GRP.²

As shown in Table 1.4, the SRU Service Area's GRP is approximately \$23.3 billion, equal to the sum of labor income (\$15.6 billion) and non-labor income (\$7.8 billion). In Chapter 3, we use the SRU Service Area's gross regional product as the backdrop against which we measure the relative impacts of the university on economic growth in the region.

Table 1.4 summarizes the breakdown of the SRU Service

² See the glossary of terms in Appendix 2 for a full definition of GRP.

In addition to the academic programs on the main campus, SRU provides programs in several other locations. Students interested in marine sciences have the opportunity to participate in summer school sessions at Wallops Island Marine Science Center in Virginia or to utilize the instructional facilities at nearby Lake Arthur and the Jennings Environmental Education Center. SRU also operates the McKeever Environmental Learning Center in Sandy Lake, Pennsylvania; and the Center for Lifelong and Community Learning in Slippery Rock. In addition, SRU manages the Regional Learning Alliance in Cranberry Township, Pennsylvania.

Conclusion

This chapter presents the broader elements of the database used to determine the results. Additional detail on data sources, assumptions, and general methods underlying the analyses are conveyed in the remaining chapters and appendices. The core of the findings is presented in the next two chapters—Chapter 2 looks at SRU as an investment, while Chapter 3 considers SRU’s role in economic growth. The appendices detail a collection of miscellaneous theory and data issues.

Chapter 2: Investment Analysis

Introduction

Investment analysis is the process of evaluating total costs and measuring these against total benefits to determine whether or not a proposed venture will be profitable. If benefits outweigh costs, then the investment is worthwhile. If costs outweigh benefits, then the investment will lose money and is thus considered infeasible.

In this chapter, we consider SRU as an investment from the perspectives of students and taxpayers, the major stakeholders. The backdrop for the analysis is the entire state of Pennsylvania.

Student perspective

Analyzing the benefits and costs of education from the perspective of students is the most obvious—they give up time and money to go to the university in return for a lifetime of higher income. The benefit component of the analysis thus focuses on the extent to which student incomes increase as a result of their education, while costs comprise the monies they invest.

Linking education to earnings

The correlation between education and earnings is well documented and forms the basis for determining the benefits of education. As shown in Table 2.1, mean income levels at the midpoint of the average-aged worker’s career increase for individuals who have attained higher levels of education. These numbers are derived from EMSI’s industry data on average income per worker in the SRU Service Area,³ broken out by gender, ethnicity, and education level using data supplied by the U.S. Census Bureau.

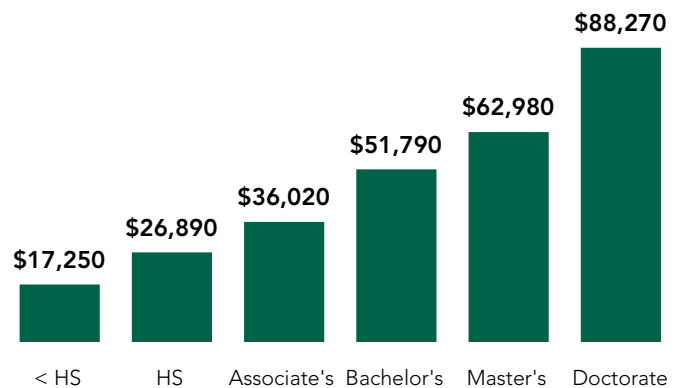
³ It is important to note that wage rates in the EMSI model combine state and federal sources to provide earnings that reflect proprietors, self-employed workers, and others not typically included in state data, as well as benefits and all forms of employer contributions. As such,

Table 2.1: Expected income at midpoint of individual's working career by education level in SRU Service Area

Education level	Income	Difference
Less than high school	\$17,250	n/a
High school or equivalent	\$26,890	\$9,640
Associate's degree	\$36,020	\$9,130
Bachelor's degree	\$51,790	\$15,770
Master's degree	\$62,980	\$11,190
Professional/doctoral degree	\$88,270	\$25,290

Source: Derived from data supplied by EMSI industry data and the U.S. Census Bureau. Figures are adjusted to reflect average earnings per worker in the SRU Service Area.

Figure 2.1: Average income at career midpoint in SRU Service Area



The differences between income levels define the value of moving from one education level to the next. For example, students who move from a high school diploma to an associate’s degree may expect approximately \$9,130 in higher annual income. The difference between a high school diploma and the attainment of a bachelor’s degree is even greater—up to \$24,900 in higher income.

Of course, several other factors such as ability, socio-economic status, and family background also positively

EMSI industry earnings-per-worker numbers are generally higher than those reported by other sources.

Table 2.2: Aggregate higher student income at career midpoint and average value per CHE

	Total/Avg
Higher annual income, aggregate (thousands)	\$34,914
Total non-leisure credit hour equivalents (CHEs)	175,830
Average value per CHE	\$199

Source: EMSI impact model.

correlate with higher earnings. Failure to account for these factors results in what is known as an “ability bias.” A literature review by Chris Molitor and Duane Leigh indicates that the upper limit benefits defined by correlation should be discounted by 10%.⁴ As such, we adjust the gross increase in income downward by 10%.

Determining the value per CHE

Not all students who attended SRU in the 2008 calendar year obtained a degree or certificate in the course of the year. Some may have returned the following year to complete their education goals, while others may have taken a few courses and entered the workforce without achieving a credential. As such, the only way to measure the value of the students’ achievement is through their credit hour equivalents, or CHEs. This allows us to see the benefits to all students, not just to those who earn an award.

In the model, we calculate the value of the students’ CHE production through a complex process that involves dividing the education ladder into a series of individual steps, each equal to one credit. We then spread the income differentials from Table 2.1 over the steps required to complete each education level, assigning a unique value to every step in the ladder.⁵ Next, we apply a continuous probability distribution to map the students’ CHE production to the ladder, depending on their level of achievement and the average number of CHEs they achieve. Finally, we sum the number of CHEs earned at each step and multiply them by their corresponding

4 Chris Molitor and Duane Leigh, “Estimating the Returns to Schooling: Calculating the Difference Between Correlation and Causation” (Pullman, WA: by the authors, March 2001). Report available upon request.

5 Students who obtain a certificate or degree during the analysis year are granted a “ceremonial boost” in the calculations in recognition of the fact that an award has greater value than the individual steps required to achieve it.

value to arrive at the students’ average annual increase in income.

Table 2.2 displays the aggregate annual higher income for the SRU student population. Also shown are the total CHEs generated by students and the average value per CHE. Note that, although each step in the education ladder has a unique value, for the sake of simplicity, only the total and average values are displayed.

Here a qualification must be made. Research shows that earnings levels do not remain constant; rather, they start relatively low and gradually increase as the worker gains more experience. Research also indicates that the earnings increment between educated and non-educated workers grows through time. This means that the aggregate annual higher income presented in Table 2.2 will actually be lower at the start of the students’ career and higher near the end of it, gradually increasing at differing rates as the students grow older and advance further in their careers. To model this change in earnings, we use the well-known and well-tested Mincer function, which we discuss more fully in the next section.

Generating a benefits stream

The two names most often associated with human capital theory and its applications are Gary Becker and Jacob Mincer.⁶ The standard human capital earnings function developed by Mincer appears as a three-dimensional surface with the key elements being earnings, years of education, and experience. Figure 2.2 shows the relationship between earnings and age, with age serving as a proxy for experience. Note that we are using the graph strictly for illustrative purposes, so the numbers on the axes do not represent those of any particular individual or institution.

Figure 2.2 illustrates several important features of the Mincer function. First, earnings initially increase at a faster rate, later increase at a decreasing rate, reach a maximum somewhere after the midpoint of the working

6 See Gary S. Becker, *Human Capital: a Theoretical Analysis with Specific Reference to Education* (New York: Columbia University Press for NBER, 1964); Jacob Mincer, “Schooling, Experience and Earnings” (New York: National Bureau of Economic Research, 1974); and Mincer, “Investment in Human Capital and Personal Income Distribution,” *Journal of Political Economy*, vol. 66 issue 4, August 1958: 281–302.

career, and then decline in later years. Second, at higher levels of education, the maximum level of earnings is reached at an older age. And third, the benefits of education, as measured by the difference in earnings for two levels, increase with age.

In the model, we employ the Mincer function as a smooth predictor of earnings over time,⁷ for as long as students remain active in the workforce. Using earnings at the career midpoint as our base (Table 2.1), we derive a set of scalars from the slope of the Mincer curve to model the students' increase in earnings at each age within their working careers. The result is a stream of projected future benefits that follows the same basic shape as the Mincer curve, where earnings gradually increase from the time students enter the workforce, come to a peak shortly after the career midpoint, and then dampen slightly as students approach retirement at age 65.

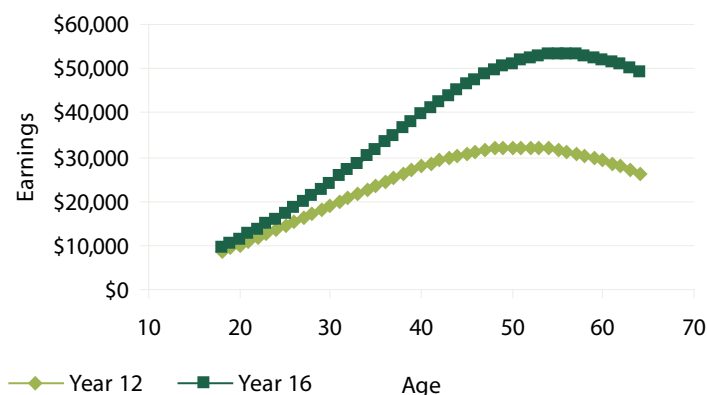
The benefits stream generated by the Mincer curve is a key component in deriving the students' rate of return. However, not all students enter the workforce at the end of the analysis year, nor do all them remain in the workforce until age 65. To account for this, we discount the students' benefit stream in the first few years of the time horizon to allow time for those who are still studying at the university to complete their educational goals and find employment. Next, we discount the entire stream of benefits by the estimated number of students who will die, retire, or become unemployed over the course of their working careers.⁸ The likelihood that students will leave the workforce increases as they age, so the older the student population is, the greater the attrition rate applied by the model will be.

Having calculated the students' benefits stream and

⁷ The Mincer equation is computed based on estimated coefficients presented in Robert J. Willis, "Wage Determinants: A Survey and Reinterpretation of Human Capital Earnings Function" in *Handbook of Labor Economics*, Vol. 1 (Amsterdam: Elsevier Science Publishers, 1986): 525–602. These are adjusted to current year dollars in the usual fashion by applying the GDP implicit price deflator. The function does not factor in temporary economic volatility, such as high growth periods or recessions. In the long run, however, the Mincer function is a reasonable predictor.

⁸ These data are provided by a variety of sources, including the Center for Disease Control and Prevention (CDC), the Social Security Administration (SSA), and the Bureau of Labor Statistics (BLS).

Figure 2.2: Earnings for 12 vs. 16 years of education



adjusted for attrition, we next turn to student costs. These are discussed more fully in the next section.

Calculating student costs

Student costs comprise tuition and fees, books and supplies, and the opportunity cost of time. Tuition and fees amount to \$47.8 million (see Table 1.1). Full-time students also spend an average of \$1,322 per year on books, supplies, and equipment (see Table 3.2). Multiplying this figure by the number of full-time equivalents (FTEs) achieved by the student population yields approximately \$7.8 million spent on books and supplies in FY 2008–09.

Opportunity cost is the most difficult component of student costs to calculate. It refers to the value of time and earnings forgone by students who choose to attend the university rather than work full-time. We derive opportunity costs by establishing the full earning potential of students at their current age (22) and education level, and then comparing this to what they are actually earning while attending the university.

We begin with the average annual incomes by education level from Table 2.1 and weight these according to the students' education level at the start of the analysis year.⁹ However, recall that Table 2.1 displays earnings at the midpoint of the individual's working career, not immediately upon exiting the university. To arrive at the full earning potential of students while enrolled, we must

⁹ Based on the number of students who reported their entry level of education to SRU.

condition the earnings levels to the students' age, which we accomplish simply by applying a scalar derived from the Mincer curve described above.

Another important factor to consider is the time that students actually spend at the university, as this is the only part of the year that they would potentially be required to give up earnings as a result of their education. We use the students' CHE production as a proxy for time under the assumption that the more CHEs students earn, the less time they have to work, and, consequently, the more earnings they potentially have to give up.

Note that the opportunity cost calculations only apply to students who are economically active, *i.e.*, those who work or are seeking work. SRU estimates that 68% of its students are employed while attending.¹⁰ For those who are not working, we assume that they are either seeking work or will seek work once they complete their educational goals (with the exception of personal enrichment students, who are not being considered in this calculation).

The differentiation between working and non-working students is important because they are treated differently in the model. Non-working students are assumed to give up their entire earning potential while enrolled. Working students, on the other hand, are able to maintain all or part of their income, so their opportunity cost is not as high. However, many of them give up a significant portion of their leisure time,¹¹ while others hold jobs that pay less than statistical averages (usually because they can only find work that fits their course schedule). To account for both of these factors, we assume that working students give up 60% of their full earning potential while attending the university, depending on their age and education level.¹²

10 Based on the number of students who reported their employment status to SRU.
 11 See James M. Henderson and Richard E. Quandt, *Microeconomic Theory: A Mathematical Approach* (New York: McGraw-Hill Book Company, 1971).
 12 This assumption is based on the following: (1) the value of leisure time, assumed to have a value equal to 20% of students' full earning potential, and (2) the percent of earnings forgone by students who work at jobs that pay less than statistical averages while enrolled. This latter assumption, equal to 40%, is derived from data supplied by approximately 200 institutions previously analyzed by EMSI.

Table 2.3: Student costs, FY 2008–09 (\$ thousands)

	Total
Education cost	
Tuition and fees	\$47,824
Books and supplies	\$7,849
Opportunity cost	
Working students	\$32,543
Non-working students	\$25,434
Adjustments	
Less monies paid by leisure students	-\$312
Less grants and scholarships refunded to students	-\$1,770
Total student costs	\$111,567

Source: Based on data supplied by SRU and outputs of the EMSI impact model.

Discount Rate

The discount rate is a rate of interest that converts future costs and benefits to present values. For example, \$1,000 in higher earnings realized 30 years in the future is worth much less than \$1,000 in the present. All future values must therefore be expressed in present value terms in order to compare them with investments (*i.e.*, costs) made today. The selection of an appropriate discount rate, however, can become an arbitrary and controversial undertaking. As suggested in economic theory, the discount rate should reflect the investor's opportunity cost of capital, *i.e.*, the rate of return one could reasonably expect to obtain from alternative investment schemes. In this study we assume a 4% discount rate from the student perspective and a 3% discount rate from the taxpayer perspective. The discount rate from the taxpayer perspective is lower because governments are large and can therefore spread their risks over a larger and more diverse investment portfolio than the private sector can.

Total opportunity cost for working and non-working students appears in Table 2.3. Also shown are the cost of tuition and fees and the cost of books and supplies, less monies paid by personal enrichment students. Finally, we net out grants and scholarships refunded to students, as these represent a gain and not a cost to students. Total student costs thus come to \$111.6 million, as shown in the bottom row of Table 2.3.

Return on investment

Having calculated the students’ future benefits stream and the associated costs, the next step is to discount the results to the present to reflect the so-called time value of money. For this we assume a discount rate of 4% (see the “Discount Rate” box). Present values of benefits are then collapsed down to one number and compared to student costs to derive the investment analysis results, expressed in terms of benefit/cost ratios, rates of return, and payback periods. The investment is feasible if returns match or exceed the minimum threshold values, *i.e.*, a benefit/cost ratio greater than 1, a rate of return that exceeds the discount rate, and a reasonably low payback period.

As shown in Table 2.4, higher student income is projected across the working life of students, discounted to the present, and added together to yield a cumulative sum of \$562.1 million, the present value of all of the future income increments. This may also be interpreted as the gross capital asset value of the students’ higher income stream. Accordingly, the aggregate 2008–09 student population is rewarded with a capital asset valued at \$562.1 million as a result of their attendance at SRU.

Next, we compare the benefits to the associated costs to judge whether attending the university is a good investment. Costs are provided in the second row of Table 2.4, equal to \$111.6 million. Note that costs only occur in the single analysis year and are thus already in current year dollars, so their present value equals what is reported in Table 2.3. Comparing costs with the present value of benefits yields a student benefit/cost ratio of 5.0 (equal to \$562.1 million in benefits divided by \$111.6 million in costs).

The rate of return is perhaps the most recognized indicator of investment effectiveness. Given the cost of education and the stream of associated future benefits, the rate of return indicates how much a bank would have to pay a depositor of like amount to yield an equally rewarding stream of future payments.¹³ Table 2.4 shows

Table 2.4: Present value of benefits and costs, student perspective (\$ thousands)

	Total
Present value of future benefit stream	\$562,066
Present value of costs	\$111,567
Net present value	\$450,499
Benefit/cost ratio	5.0
Internal rate of return	14.3%
Payback period (no. of years)	10.7

Source: EMSI impact model.

SRU students earning average returns of 14.3% on their investment of time and money. This is indeed an impressive return compared, for example, to 1% on a standard bank savings account, or approximately 7% on stocks and bonds (thirty-year average return).

The payback period is defined as the length of time it takes to entirely recoup the initial investment.¹⁴ Beyond that point, returns are what economists would call “pure costless rent.” As indicated in Table 2.4, students at SRU see, on average, a payback period of 10.7 years on their forgone earnings and out-of-pocket costs.

Social perspective

Any benefits that impact the state as a whole—whether students, employers, taxpayers, or whoever else stands to benefit from the activities of SRU—are counted as benefits under the social perspective. We subdivide these benefits into the following two main components: (1) increased income in the state, and (2) social externalities stemming from the improved lifestyles of students, such as better health, reduced crime, and fewer incidences of unemployment (see the “Beekeeper Analogy” box).

investor, on the other hand, receives a stream of periodic payments that include the recovery of the principal as part of the periodic payments, but there is no principal recovery at the end. These differences notwithstanding, comparable cash flows for both bank and education investors yield the same internal rate of return.

14 Payback analysis is generally used by the business community to rank alternative investments when safety of investments is an issue. Its greatest drawback is that it takes no account of the time value of money.

13 Rates of return are computed using the familiar “internal rate of return” calculation. Note that, with a bank deposit or stock market investment, the depositor puts up a principal, receives in return a stream of periodic payments, and then recovers the principal at the end. An education

Beekeeper Analogy

A classic example of positive externalities (sometimes called “neighborhood effects”) in economics is the private beekeeper. The beekeeper’s intention is to make money by selling honey. Like any other business, the beekeeper’s receipts must at least cover his operating costs. If they don’t, his business will shut down.

But from society’s standpoint, there is more. Flower blossoms provide the raw input bees need for honey production, and smart beekeepers locate near flowering sources such as orchards. Nearby orchard owners, in turn, benefit as the bees spread the pollen necessary for orchard growth and fruit production. This is an uncompensated external benefit of beekeeping, and economists have long recognized that society might actually do well to subsidize positive externalities such as beekeeping.

Educational institutions are in some ways like beekeepers. Strictly speaking, their business is in providing education and raising people’s incomes. Along the way, however, external benefits are created. Students’ health and lifestyles are improved, and society indirectly enjoys these benefits just as orchard owners indirectly enjoy benefits generated by beekeepers. Aiming at an optimal expenditure of public funds, the impact model tracks and accounts for many of these external benefits and compares them to public costs (what taxpayers agree to pay) of education.

Increased income

Income growth occurs as the higher earnings and added skills of SRU students stimulate the production of income in the state. Students earn more because of the skills they learned while attending the university, and businesses earn more because student skills make capital more productive (*i.e.*, buildings, machinery and everything else). This in turn raises profits and other business property income. Together, increases in labor and capital income are considered the effect of a skilled workforce.

Estimating the effect of SRU on income growth in the state begins with the projected higher student income

from Table 2.4. Not all of these benefits may be counted as benefits to the public, however. Some students leave the state during the course of their careers, and any benefits they generate leave the state with them. To account for this dynamic, we combine student origin data from SRU with data on migration patterns from the U.S. Census Bureau to estimate the number of students who leave the state workforce over time.

Once we have adjusted for regional attrition, we derive a stream of earnings benefits that accrue to the public. These comprise the direct effect of SRU on state income growth. Indirect effects occur when students spend more money on consumer goods, while the increased output of businesses that employ them also creates a demand for inputs and, consequently, input spending. The effect of these two spending items (consumer and business spending) leads to still more spending and more income creation, and so on. To quantify the impact of these several rounds of spending, we apply a multiplier¹⁵ derived from EMSI’s specialized input-output (IO) model, described more fully in Appendix 3.

With an increase in labor income (both direct and indirect) comes an increase in capital investment,¹⁶ thereby generating even more growth in the non-labor (or “non-earnings”) share of the economy. Non-labor income consists of monies gained through investments, including dividends, interests, and rent. To derive the growth in non-labor income, we multiply the direct and indirect labor income figures by a ratio of Pennsylvania’s gross state product (equal to labor income plus non-labor income) to total labor income in the state.

Table 2.5 summarizes the average annual increase in state income due to the higher earnings of SRU’s 2008–09 student population. Note that, for the sake of consistency with the annual student benefits discussed earlier in this chapter, the table only shows the aggregate increase in state income at the midpoint of the students’ careers. As

15 Multipliers are common to economic impact analysis and are used to measure how money cycles through the economy.

16 In the production process, skilled labor and capital complement each other (*i.e.*, they have a relatively low elasticity of substitution). Accordingly, an increase in skilled labor increases the productivity and income of existing capital while encouraging additional capital investment.

before, these figures must be projected out into the future and discounted to the present before weighing them against the costs. Before doing so, however, we must first turn to the social externalities, as these comprise another key component of the benefits that accrue to the public.

Table 2.5: Aggregate added state income at career midpoint (\$ thousands)

	Total
Labor income	\$35,433
Non-labor income	\$18,696
Total added state income	\$54,129

Source: EMSI impact model.

Social externalities

In addition to higher income, education is statistically correlated with a variety of lifestyle changes that generate social savings, also known as external or incidental benefits of education. These social savings represent avoided costs that would have otherwise been drawn from private and public resources absent the education provided by SRU.

It is important to note that calculating social externalities is not a straightforward task of counting actual monies saved. The process is difficult because of the uncertainties about what data to include, what methodologies to employ, and what assumptions to make. Because of this, results should not be viewed as exact, but rather as indicative of the impacts of education on health and well-being.

Data relating education to improved social behavior are available from a variety of sources, including the U.S. Census Bureau, the U.S. Department of Labor, and national studies and surveys analyzing the impacts of substance abuse, crime, and unemployment on society. Data on social costs are also relatively abundant. By combining these data sets, we are able to quantify how education contributes to the lowering of social costs and, ultimately, improves quality of life.

Social benefits break down into three main categories: 1) health savings, 2) crime savings, and 3) welfare and unemployment savings. Health savings include avoided

medical costs associated with tobacco and alcohol abuse. Crime savings consist of avoided police, incarceration, prosecution, and victim costs, as well as benefits stemming from the added productivity of individuals who would have otherwise been incarcerated. Welfare and unemployment benefits comprise avoided costs due to the reduced number of social assistance and unemployment insurance claims.

In the model, we quantify the effect of social externalities first by calculating the probability at each education level that individuals will have poor health, commit crimes, or claim welfare and unemployment benefits. Deriving the probabilities involves assembling data at the national level, breaking them out by gender and ethnicity and adjusting them from national to state levels. We then spread the probabilities across the education ladder and multiply the marginal differences by the corresponding CHE production at each step. The sum of these effects counts as the upper bound measure of the number of individuals who, due to the education they received at SRU, will not have poor health, commit crimes, or claim welfare and unemployment benefits.

Of course, there are other influences that impact an individual’s behavior, and separating these out from the non-economic benefits of education is a challenging task. For the purpose of this analysis, we dampen the results by the “ability bias” adjustment discussed earlier in this chapter to account for other influences besides education that correlate with an individual’s quality of life, such as socio-economic status and family background.

The final step is to express the results in dollar terms by multiplying them by the associated costs per individual, based on data supplied by national studies and surveys.¹⁷ These comprise the overall savings to society. Results of the analysis are displayed in Table 2.6. As before (and again for the sake of consistency), only the estimated savings that occur at the students’ career midpoint are shown.

Smoking- and alcohol-related savings amount to \$14.0

¹⁷ For more information on the data and assumptions used in estimating the social externalities, please see Appendix 5 and the resources and references list in Appendix 1.

Table 2.6: Aggregate avoided social costs at career midpoint (\$ thousands)

	Total
Health	
Smoking-related savings	\$10,206
Alcohol-related savings	\$3,798
Total health savings	\$14,004
Crime	
Incarceration savings	\$69
Crime victim savings	\$60
Added productivity	\$126
Total crime savings	\$255
Welfare/unemployment	
Welfare savings	\$48
Unemployment savings	\$260
Total unemployment savings	\$308
Total avoided social costs	\$14,567

Source: EMSI impact model.

million, including avoided social costs due to a reduced demand for medical treatment and social services, improved worker productivity and reduced absenteeism, and a reduced number of vehicle crashes and alcohol or smoking-induced fires. Since the probability that individuals will manifest poor health habits is greater than the probability that they will be incarcerated or become unemployed, the savings associated with health are also considerably greater.

Crime savings sum to \$254,600. These reflect avoided social costs associated with a reduced number of crime victims, added worker productivity, and reduced expenditures for police and law enforcement, courts and administration of justice, and corrective services. Finally, welfare and unemployment savings amount to \$308,000, stemming from a reduced number of persons in need of income assistance.

All told, avoided social costs for the aggregate 2008–09 student population equal approximately \$14.6 million. These savings accrue for years out into the future, for as long as students remain in the workforce.

Total benefits to the public

By combining our income growth calculations with the social externalities, we are able to estimate the total benefits to the public. To this we apply a reduction factor to account for the students’ alternative education opportunities. The assumption is that any benefits generated by students who could have received an education elsewhere, even if SRU and the other publicly funded institutions in the state did not exist, cannot be counted as new benefits to the public.¹⁸ For this analysis, we assume an alternative education variable of 26%, meaning that 26% of the student population at SRU would have generated benefits anyway even without the university. For more information on the calculation of the alternative education variable, please see Appendix 7.

We also apply an adjustment called the “shutdown point,” which is designed to net out benefits that are not directly linked to the state and local government costs of supporting the university. As with the alternative education variable, the purpose of this adjustment is to account for benefits that would accrue to the public anyway. To estimate the shutdown point, we apply a sub-model that simulates the students’ demand curve for education by reducing state and local support to zero and progressively increasing student fees. As student fees increase, enrollment declines. For SRU, the shutdown point adjustment is 5%, meaning that all results must be discounted by 5% to account for the benefits that the university could still potentially generate even without state and local government support. For more information on the theory and methodology behind the estimation of the shutdown point, please see Appendix 4.

Having accounted for the adjustments just described, we discount all benefits to the present using a discount rate of 3%. This yields a present value of \$763.6 million due to income growth, as indicated in Table 2.7. Also shown is a present value of \$216.7 million due to future savings

¹⁸ A situation in which there are no public institutions in the state is virtually impossible. The adjustment is entirely hypothetical and is used merely to examine SRU in standard investment analysis terms by accounting for benefits that would have occurred anyway, even if the university did not exist.

Table 2.7: Present value of benefits and costs, social perspective (\$ thousands)

	Total
Present value of future added income	\$763,647
Present value of future avoided social costs	\$216,716
Total benefits, present value	\$980,362
Total state and local gov't costs, present value	\$52,844
Net present value	\$927,518
Benefit/cost ratio	18.6

Source: EMSI impact model.

Table 2.8: Aggregate taxpayer benefits at career midpoint (\$ thousands)

	Total
Added tax revenue	\$5,080
Reduced government expenditures	
Health savings	\$840
Crime savings	\$73
Unemployment savings	\$8
Total reduced government expenditures	\$921
Total taxpayer benefits	\$6,001

Source: EMSI impact model.

to the public. Altogether, the present value of all public benefits equals roughly \$980.4 million.

State and local government support of SRU also appears in Table 2.7, listed as the present value of total costs. While this is technically correct, it is important to note that, unlike streams of benefits that go on into the future, the state and local government contribution of \$52.8 million was made in the single analysis year. Its present value and nominal dollar value are thus the same.

Having now defined present values of costs and benefits, the model forms a benefit/cost ratio of roughly 18.6 (= \$980.4 million worth of benefits ÷ \$52.8 million worth of state and local government support). Recall that this ratio reflects the measure of all benefits generated regardless of those to whom they may accrue. Students are the beneficiaries of higher income, employers are beneficiaries of lower absenteeism and increased worker productivity, still others are beneficiaries of improved health, and so on. These are widely dispersed benefits that do not necessarily return to taxpayers, who pay costs at full mea-

sure. Inasmuch as investors and beneficiaries are not the same individuals, measures common to standard investment analyses such as rate of return, payback period, and net present value no longer apply. From the social perspective, therefore, the benefit/cost ratio should be viewed strictly as a comparison between public benefits and taxpayer costs.

Taxpayer perspective

From the taxpayer perspective, the situation is different, since investors and beneficiaries are one and the same. The pivotal step here is to limit overall public benefits shown in Tables 2.5 and 2.6 to those that specifically accrue to state and local government. For example, benefits resulting from income growth are limited to increased state and local tax payments. Similarly, savings related to improved health, reduced crime, and fewer welfare and unemployment claims are limited to those received strictly by state and local government. In all instances, benefits to private residents, local businesses, or the federal government are excluded.

Table 2.8 presents taxpayer benefits at the students' career midpoint. Added tax revenue appears in the first row. These figures are derived by multiplying the income growth figures from Table 2.5 by the prevailing state and local government tax rates in the state. For the social externalities, we claim only those benefits where the demand for government-supported social services is reduced, or where the government benefits from improved productivity among government employees. The total undiscounted value of future tax revenues and avoided social costs at the career midpoint thus comes to approximately \$6.0 million.

Projecting the benefits in Table 2.8 out to the future and then discounting them back to the present gives the time value of all future benefit increments that accrue strictly to state and local government. Results appear in Table 2.9. As indicated, the future stream of benefits provides an overall asset value of \$85.4 million stemming from a year's support of SRU. Costs, on the other hand, come

Table 2.9: Present value of benefits and costs, taxpayer perspective (\$ thousands)

	Total
Present value of future added tax revenue	\$71,675
Present value of future reduced government expenditures	\$13,700
Total benefits, present value	\$85,375
Total state and local gov't costs, present value	\$52,844
Net present value	\$32,531
Benefit/cost ratio	1.6
Internal rate of return	5.5%
Payback period (no. of years)	19.9

Source: EMSI impact model.

to only \$52.8 million, equal to the annual contribution of state and local government to SRU (note that this number is repeated from Table 2.7). In return for their public support, therefore, taxpayers are rewarded with an investment benefit/cost ratio of 1.6 (= \$85.4 million ÷ \$52.8 million), indicating a most profitable investment.

At 5.5% the rate of return to state and local taxpayers is also favorable. Economists typically assume a 3% rate of return when dealing with government investments and public finance issues. This is the return governments are assumed to be able to earn on generally safe investments of unused funds, or alternatively, the interest rate for which governments, as relatively safe borrowers, can obtain funds. A rate of return of 3% would mean that the university just pays its own way. In principle, governments could borrow monies used to support SRU and repay the loans out of the resulting added taxes and reduced government expenditures. A rate of return of 5.5%, on the other hand, means that SRU not only pays its own way, but it also generates a surplus that state and local govern-

ment can use to fund other programs. It is unlikely that other government programs could make such a claim. Considerable funds are spent on public parks or on state prisons, for example, yet they yield little or no direct returns—certainly not enough to recover the cost of the original investment or generate a surplus.

Note that returns reported in Table 2.9 are real returns, not nominal. When a bank promises to pay a certain rate of interest on a savings account, it employs an implicitly nominal rate. Bonds operate in a similar manner. If it turns out that the inflation rate is higher than the stated rate of return, then money is lost in real terms. In contrast, a real rate of return is on top of inflation. For example, if inflation is running at 3% and a nominal percentage of 5% is paid, then the real rate of return on the investment is only around 2%. In Table 2.9, the 5.5% taxpayer rate of return is a real rate. With an inflation rate of 3.1% (the average rate reported over the past 20 years as per the U.S. Department of Commerce, Consumer Price Index), the corresponding nominal rate of return is 8.6%, substantially higher than what is reported in this analysis.

With and without social benefits

Earlier in this chapter, social benefits attributable to education (reduced crime, lower welfare, lower unemployment, and improved health) are defined as externalities, incidental to the operations of the university. Some would question the legitimacy of including these benefits in the calculation of rates of return to education, arguing that only direct benefits, *i.e.*, higher income, should be counted. Tables 2.7 and 2.9 are inclusive of social benefits reported here as attributable to SRU. Recognizing the other point of view, Table 2.10 shows rates of return

Table 2.10: Taxpayer perspectives with and without social externalities (\$ thousands)

	Social perspective		Taxpayer perspective	
	with social savings...	with social savings...	with social savings...	with social savings...
	included	excluded	included	excluded
Net present value	\$927,518	\$710,802	\$32,531	\$18,831
Internal rate of return	n/a	n/a	5.5%	4.5%
Benefit/cost ratio	18.6	14.5	1.6	1.4
Payback period (no. of years)	n/a	n/a	19.9	22.7

Source: EMSI impact model.

for both the social and taxpayer perspectives exclusive of social benefits. As indicated, returns are still above threshold values (a benefit/cost ratio greater than 1 and a rate of return greater than 3%) confirming that taxpayers receive value from investing in SRU.

Conclusion

This chapter has shown that SRU is an attractive investment to its major stakeholders—students as well as taxpayers. Rates of return to students invariably exceed alternative investment opportunities. At the same time, state and local government can take comfort in knowing that their expenditure of taxpayer funds creates a wide range of positive social benefits and, perhaps more importantly, actually returns more to government budgets than it costs. Without these increased tax receipts and avoided costs provided by SRU education, state and local government would have to raise taxes to make up for lost revenues and added costs.

Chapter 3: Economic Growth Analysis

Introduction

SRU promotes economic growth in the SRU Service Area in a variety of ways. The university is an employer and a buyer of goods and services. In addition, SRU is a primary source of education to area residents and a supplier of trained workers to local industry.

The economic impact of education may be calculated in different ways. The approach we use in this study is to express results in terms of income rather than sales, the more common measurement. The reason for this is that measuring impacts in sales terms does not account for monies that leave the economy, which makes results appear larger than they really are. Income, on the other hand, presents a more accurate picture of the university's actual impacts.

Results of the economic growth analysis are broken down according to the following four effects: (1) the university operations effect, stemming from SRU's payroll and purchases; (2) the student spending effect, due to the spending of students for room and board and other personal expenses; (3) the visitor spending effect, resulting from the expenditures of visitors for lodging, food, transportation, *etc.*; and, finally, (4) the productivity effect, comprising the income growth that occurs as SRU alumni deepen the economy's stock of human capital.

University operations effect

Nearly all employees of SRU (83%) live in the SRU Service Area. Faculty and staff earnings become part of the region's overall income, while their spending for groceries, apparel, and other household expenditures help support local businesses.

In addition to being an employer, SRU is also a pur-

chaser of supplies and services. Many of SRU's vendors are located in the SRU Service Area, creating a ripple effect that generates additional jobs and income throughout the economy.

Calculating the impacts

The impact of SRU operations is subdivided into the following two main effects: the direct effect and the indirect effect. The direct effect, equal to \$91.5 million, comprises the university's payroll and employee benefits, less monies paid to individuals who work outside the region (see Table 3.1). The indirect effect refers to the additional income created in the economy as SRU and its employees spend money in the region for supplies and services.¹⁹

Estimating the indirect effect requires use of a specialized input-output (IO) model that shows the interconnection of industries, government, and households in the area. The factor of change that occurs in a region's industries as a result of economic activity in another industry is most commonly known as the multiplier. In this study, the IO model uses common "data-reduction" techniques to generate multipliers that are similar in magnitude to those of other popular regional IO modeling products, such as the IMPLAN and RIO models. For more information on the EMSI IO model, please see Appendix 3.

To calculate the multiplier effects, we take SRU's payroll and purchases (equal to \$150.2 million from Table 1.2) and map them to the 21 top-level industry sectors of the IO model. Next we adjust them to account for spending that occurs locally.²⁰ We then run the data through the

19 Note that the direct effect of SRU payroll is based on earnings by place of work; the indirect effect of SRU payroll is based on earnings by place of residence.

20 The amount of payroll that occurs locally is based on the percent of employees who live in the SRU Service Area (83%). For non-pay expenditures, we estimate local spending based on regional purchase coefficients (RPCs), controlled to data supplied by the university. RPCs reflect the portion of total demand for a product or service that is supplied by producers within the region. For example, if the RPC for

Table 3.1: University operations effect, FY 2008–09 (\$ thousands)

	Labor income	Non-labor income	Total	% of Total
Total income in service region	\$15,555,049	\$7,783,833	\$23,338,882	
Direct effect of university payroll	\$91,471	\$0	\$91,471	0.4%
Indirect effect	\$12,320	\$5,691	\$18,011	<0.1%
Gross total	\$103,791	\$5,691	\$109,482	0.5%
Adjust for alternative fund uses	-\$12,297	-\$5,290	-\$17,587	<0.1%
Net total	\$91,494	\$401	\$91,895	0.4%

Source: EMSI impact model.

model's multiplier matrix to estimate how the spending of the university and its resident employees affects the output of other industries in the area. Finally, we convert the sales figures to income by means of earnings-to-sales and value added-to-sales ratios, also provided by the IO model.

Here a qualification must be made. It has been argued that multiplier effects, such as those just described, overstate net effects. The reason is that while the economy is stimulated and incomes increase, factors of production receiving these increased incomes abandon lower paying next-best opportunities. At some level, jobs and uses of capital that are left behind are simply left undone, or perhaps outsourced overseas. The result is that gross multiplier effects need to be reduced to reflect this opportunity cost of taking a newly created job. Accordingly, the model applies a downward adjustment suggested by the literature²¹ and discards all but 33% of the indicated indirect impact.

The direct and indirect effects of SRU operations are displayed in Table 3.1. The gross total impact amounts to \$109.5 million, equal to the direct effect of university payroll plus the indirect effect generated by the off-campus spending of SRU and its resident employees. These monies make up a part of the SRU Service Area's overall gross regional product. The lower section of the table shows the adjustment for alternative use of funds, which we discuss more fully in the following section.

utilities is 0.6, that means that 60% of the demand for services in the utilities sector is satisfied by local suppliers, while the remaining 40% is met by imports.

21 See, for example, J. R. Hamilton et al, "Economic Impacts, Value Added and Benefits in Regional Project Analysis," *American Journal of Economics*, 31 no. 2, 1991: 334–344.

Adjusting for alternative uses of funds

SRU received an estimated 34% of its funding from sources in the SRU Service Area. This funding may have come from students living in the region, local sales and services, or from local businesses. A portion of the state funding received by SRU also originated from local taxpayers.²²

Devoting local funds to SRU means that they are not available for other uses, e.g., consumer spending on the part of students or public projects on the part of government. Monies that are injected into the economy on the one hand are thus withdrawn on the other. Because of this, a portion of SRU's impact on the economy cannot be considered as new monies brought to the region.

To determine the "net" impact of SRU operations, we take the estimated portion of SRU funding that originated from local sources and convert it to spending. We then bridge the spending figures to the individual sectors of the IO model, calculate the multiplier effect, and convert the amounts to income. The result, \$17.6 million, allows us to see what impacts would have occurred in the SRU Service Area anyway, even if SRU did not exist. This value is subtracted from the gross effect of SRU to arrive at the true or "net" impact of university operations in FY 2008–09—a total of \$91.9 million.²³

22 Local taxpayers must pay state taxes as well, so it is fair to assume that a certain portion of state appropriations received by SRU comes from local sources. The portion of state revenue paid by local taxpayers is derived by applying a ratio of state taxes paid by local workers to total taxes in the state. Tax information is supplied by the U.S. Department of Commerce, Regional Economic Information System (REIS).

23 This number should not be confused with the SRU payroll, which is also approximately equal to \$91.9 million (rounded). The two figures, though similar, reflect entirely different measures.

Slippery Rock area sees economic boom

In the last decade, the Slippery Rock area has experienced an economic development boom driven by collaboration between community and Slippery Rock University leaders.

From 2001–2009, more than \$250 million in new capital construction has been invested in the community—the bulk of which (\$226.1 million) has been centered on the SRU campus. Planned improvements include a medical center that will provide the community its first-ever 24-hour urgent care facility and a new hotel/restaurant complex with a retail center that will be finished in 2010.

The investment is a result of years of planning. Since 1999, a group of Slippery Rock community leaders—including university leadership—has met monthly to discuss key economic development issues.

One of the early outcomes of those meetings was a bold plan to concentrate on the downtown redevelopment. Infrastructure improvements were needed, as well as a visible statement that change was possible if local residents wanted it to come to fruition.

An early positive sign came on May 16, 2001, when the borough passed a referendum to allow bars and restaurants to serve alcohol for the first time since Slippery Rock was founded in 1798.

Then, in 2002, SRU announced a dramatic strategic plan for major increases in enrollment, expansion of capital projects, and confidence in the future economy of the Slippery Rock region. Along with Slippery Rock Development, the two organizations fueled confidence in the business and development communities to invest in Slippery Rock’s growth.

In the following years, the Slippery Rock Development and Slippery Rock University visions have resulted in new businesses, permanent outdoor art pieces, new family festivals, and a vibrant spirit within the community.

Other ongoing or planned construction include a new University Union (\$37.2 million), renovation of the Vincent Science Hall (\$16 million), a new Performing Arts Center (\$23.5 million), renovation of the existing University Union (\$12 million), and renovation of the McKay Education Building.

Table 3.2: Average annual student cost of attendance, FY 2008–09

Spending item	Total
Books and supplies	\$1,322
Room and board	\$8,066
Personal expenses	\$993
Transportation	\$685
Total	\$11,066

Source: Data supplied by SRU.

Table 3.3: Off-campus spending of out-of-region students, FY 2008–09

	Total
Number of out-of-region students	5,522
Number of students who live off-campus	1,600
Average expenses per student	\$9,700
Total gross spending	\$15,588,000
Less wages paid to out-of-region students	\$590,100
Less leakage	\$3,645,300
Total net spending	\$11,352,600

Source: Derived from data supplied by SRU and outputs of the EMSI impact model.

Student spending effect

An estimated 56% of SRU’s credit students came from outside the SRU Service Area in FY 2008–09. Of these students, approximately 63% lived in campus residence halls or university-owned apartments, while 29% lived in the region but off-campus. The remaining 8% lived outside the region. Average living expenses for students attending SRU appear in Table 3.2.

Based on the figures in Table 3.2, we estimate that the gross (*i.e.*, unadjusted) off-campus spending generated by out-of-region students in FY 2008–09 was \$15.6 million. This appears in the fourth row of Table 3.3. Note that the \$15.6 million does not include room and board expenses for students living on campus, nor does it include expenses for books, supplies, and equipment. Many of these monies are paid to the university and are thus already reflected in the operations effect discussed in the previous section. We also exclude the expenses of in-commuters, as these students spend very little in the

Table 3.4: Student spending effect, FY 2008–09 (\$ thousands)

	Labor income	Non-labor income	Total	% of Total
Total income in service region	\$15,555,049	\$7,783,833	\$23,338,882	
Direct effect of student spending	\$2,073	\$5,384	\$7,457	<0.1%
Indirect effect	\$856	\$452	\$1,308	<0.1%
Total	\$2,929	\$5,836	\$8,765	<0.1%

Source: EMSI impact model.

Table 3.5: Average and total visitor spending, FY 2008–09

Spending item	Overnight	Day trippers
Lodging	\$80	-
Eating and drinking	\$40	\$40
Retail	\$94	\$23
Misc. (parking, gas, entertainment, etc.)	\$59	\$59
Daily rate	\$273	\$123

Source: Derived from data supplied by SRU.

region compared to students who live in the SRU Service Area.²⁴

The bottom section of Table 3.3 displays the net spending of off-campus students, a total of \$11.4 million. This figure is discounted to account for wages paid to out-of-region students who work on campus. This is because student wages and their associated impacts are captured in the operations effect, so they must be excluded to avoid double-counting. We further adjust the off-campus spending to account for monies that leak from the trade sector.²⁵

Estimating the impacts generated by the \$11.4 million in net off-campus student spending follows a procedure similar to that of the operations effect described above. We begin with the direct effect, which we calculate by mapping the \$11.4 million in sales to the industry sectors in the IO model, and then converting them to income

²⁴ This estimate is derived from the percent of students from outside the region, under the assumption that the more out-of-region students SRU serves, the more out-of-region visitors come to the university.

²⁵ In arranging data for inclusion in the impact model, only the trade margin is allocated to the trade sector. Modelers customarily assume a 25% mark-up. Accordingly, an item with a retail selling price of \$100 but costing the retailer \$80 will enter the economic model as \$20 (= \$80 × 25%) to the retail trade sector, and \$80 to the manufacturer of the item. If the manufacturer is located outside the region, only the \$20 trade margin is added: in this case the \$80 is spending that is said to “leak” from the regional economy.

through the application of earnings-to-sales and value added-to-sales ratios.

The indirect effect comprises the additional income that is created as the businesses patronized by SRU students also spend money in the region. We derive this effect by running the net sales figure through the multiplier matrix, and again applying earnings-to-sales and value added-to-sales ratios from the IO model to convert the results to income.

Summing together the direct and indirect effect yields a total of \$8.8 million in added income generated in the SRU Service Area due to the off-campus spending of students. This result is presented in Table 3.4. The majority of these impacts occur in Butler County, where SRU is located and where most of SRU’s out-of-region students attend. However, a significant portion goes beyond Butler County to the surrounding counties in the region.

Visitor spending effect

Each year, SRU draws thousands of visitors who attend the events and activities hosted by the university. Visitors come to tour the campus, participate in conferences and seminars, listen to lectures and presentations, and attend commencement. Based on information provided by SRU, a total of 311,461 visitors came to the university in FY 2008–09. While the majority of these visitors were local residents, an estimated 40% of them were from outside the SRU Service Area.

Table 3.5 presents the average daily expenditures of out-of-region visitors for lodging, eating and drinking, transportation, retail, and other personal expenses. These data are estimates based on information supplied by SRU, bro-

Table 3.6: Visitor spending effect, FY 2008–09 (\$ thousands)

	Labor income	Non-labor income	Total	% of Total
Total income in service region	\$15,555,049	\$7,783,833	\$23,338,882	
Direct effect of visitor spending	\$8,041	\$3,503	\$11,545	<0.1%
Indirect effect	\$1,428	\$801	\$2,229	<0.1%
Total	\$9,469	\$4,305	\$13,774	<0.1%

Source: EMSI impact model.

ken out into two types of visitors—those who stay over-night and those who come for a day trip. The assumption is that visitors who travel longer distances are likely to stay for longer durations and spend more on travel, food, and other personal expenses, while those within driving distance are more likely to come to the region and leave on the same day.

Based on these figures, we estimate that the total sales generated by visitor spending in FY 2008–09 was \$31.4 million, net of monies paid to the university for ticket sales, gifts and souvenirs, and food. We also discount the gross sales figure to account for leakage in the trade sector. This yields net sales of \$21.2 million due to the direct off-campus expenditures of SRU visitors.

Calculating the net increase in regional income as a result of visitor spending requires use of the IO model. As before, we begin by bridging the net sales figure to the sectors of the IO model, and then converting it to income to arrive at the direct effect. Finally, we run the net sales figure through the multiplier matrix to arrive at the indirect effect. With this methodology, we estimate that the net impact of visitor spending on regional income amounted to \$13.8 million in FY 2008–09.

Productivity effect

SRU’s impact on the economy is most prevalent in its capacity to provide education, skills training, and career enhancement opportunities to area residents. Since SRU was established, students have studied at the university and entered the workforce, bringing with them the skills they acquired while in attendance. Over time, the skills of SRU alumni have accumulated, steadily increasing the

training level and experience of the SRU Service Area workforce.

As the skills embodied by SRU alumni stockpile, a chain reaction occurs in which higher student incomes generate additional rounds of consumer spending, while new skills and training translate to increased business output and higher property income, causing still more consumer purchases and regional multiplier effects. The sum of all these direct and indirect effects comprises the total impact of student productivity on regional income.

Should SRU cease to exist, the alumni who remain actively engaged in the workforce would continue to contribute to the economic growth of the region through their added skills. This is what sets the productivity effect apart from the effect of university operations, which would disappear immediately, should SRU hypothetically need to shut down. Without replenishment, however, the supply of SRU skills in the workforce would gradually dissipate over time, and the student productivity effects would disappear along with it.

Calculating the direct effect

Assigning a dollar value to the direct effect of student productivity requires an estimation of the number of SRU skills still active in the workforce, with CHEs serving as a proxy for skills. To calculate this, we begin with the historical student headcount at the university over the past thirty-year period, from AY 1979–80 to AY 2008–09.²⁶

Of course, not all students remain in the workforce until

²⁶ Where historical enrollment data were not available, we projected the numbers backward based on the average annual change in headcount. We use thirty years’ worth of data because projecting the headcount data further back than that would unnecessarily increase the uncertainty of the assumptions.

retirement age, nor do all students enter the workforce immediately upon exiting the university. Other students leave the SRU Service Area and find employment outside the region. In the model, we adjust for these factors by applying yearly attrition rates derived from the probability that individuals will die, retire, or become unemployed over the course of their working careers. To these we combine migration data supplied by the university and the U.S. Census Bureau to estimate the number of students who leave the SRU Service Area over time. This allows us to estimate the net number of students who were still active in the SRU Service Area workforce in FY 2008–09.

The next step is to multiply the net number of alumni still working in the SRU Service Area by the average number of CHEs achieved per student per year (see Table 1.3). Using this methodology, the estimated number of SRU CHEs still active in the regional workforce in FY 2008–09 comes to 1.6 million. This figure appears in the top row of Table 3.7.

Recall from Chapter 2 that we reduce the benefits to taxpayers by the estimated amount of benefits that would have occurred anyway even if the publicly funded training providers in the state did not exist. We apply the same adjustment here, reducing the gross number of active CHEs by 26%. This yields a net of 1.2 million CHEs that are currently embodied by SRU alumni in the regional workforce.

The second half of Table 3.7 demonstrates how we arrive at the direct labor income added to the regional economy due to SRU’s historical CHE production. This is a simple calculation that begins by taking the average value per CHE from Table 2.2 (\$199) and multiplying it by the 1.2 million CHEs in the workforce. This yields a gross value of \$239.2 million in added labor income. We then adjust this figure downward by 50% to account for substitution effects, *i.e.*, the substitution of out-of-area workers for in-area workers.²⁷ The reason for this is that if SRU did not exist and there were fewer skilled workers in

27 The 50% adjustment is an assumption—there is no way to determine precisely how many workers could have been recruited from outside the region if SRU did not exist.

Table 3.7: Number of CHEs still active in regional workforce and direct added income (thousands)

	Total
Number of CHEs in workforce, gross	1,624
Adjust for alternative education opportunities	26%
Number of CHEs in workforce, net	1,204
Average value per CHE (actual value)	\$199
Direct labor income	\$239,168
Adjustment for substitution effects	50%
Direct labor income, net	\$119,584
Direct non-labor income	\$57,335
Total direct income (labor and non-labor)	\$176,919

* Numbers may not add due to rounding.

Source: EMSI impact model.

the region, businesses could still recruit and hire some of their employees from outside the SRU Service Area. With the 50% adjustment, the net labor income added to the economy thus comes to \$119.6 million, as shown in Table 3.7.

But there is more. Added to the direct effect on labor income is another \$57.3 million in non-labor income, representing the higher property values and increased investment income stemming from the direct income of students and enhanced productivity of the businesses that employ them. Non-labor income attributable to past student skills is obtained by disaggregating higher student income to the industrial sectors of the IO model and multiplying it by the associated value added-to-earnings ratios.²⁸ Summing labor and non-labor income together gives a direct effect of past student productivity equal to approximately \$176.9 million in FY 2008–09.

Calculating the indirect effect

Economic growth stemming from a skilled workforce does not stop with the direct effect. To calculate the indirect effect, the model allocates increases in regional income to specific industrial sectors and augments these to account for both demand-side and supply-side multiplier effects. Demand-side effects refer to the increased

28 There are twenty-one top-level industry sectors in the EMSI IO model. Disaggregating direct student earnings in this fashion avoids aggregation error. See chapter 5 in Ron Miller and Peter Blair, *Input-Output Analysis: Foundations and Extensions* (Englewood Cliffs, NJ: Prentice Hall, 1985).

Table 3.8: Student productivity effect, FY 2008–09 (\$ thousands)

	Labor income	Non-labor income	Total	% of Total
Total income in service region	\$15,555,049	\$7,783,833	\$23,338,882	
Direct effect of student productivity	\$119,584	\$57,335	\$176,919	0.8%
Indirect effect	\$28,335	\$14,741	\$43,075	0.2%
Total	\$147,919	\$72,076	\$219,994	0.9%

Source: EMSI impact model.

Regional Learning Alliance works as a hub for regional training

The Regional Learning Alliance in Cranberry Woods, managed by SRU, is the nation’s largest collaborative learning campus with 14 educational partners. The RLA provides workforce skills and training to adult learners through its unique partnerships with business, industry, and educational partners. Last year 37,568 participants received training and 209,612 person-hours of training were delivered. Since its inception in 2004, the RLA has provided more than 1 million people hours of professional development training to regional businesses. Westinghouse cited the RLA as one of the eight reasons why it retained its world headquarters in Pennsylvania rather than moving out-of-state. More details concerning the facility can be accessed from its website at: <http://www.therla.org/>.

In addition to the RLA, SRU is in process of designing and constructing a \$4.5 million business incubator. The incubator site will also house outreach medical services for Butler Memorial Hospital.

demand for consumer goods and services as the higher incomes of skilled workers and their employers are spent in the local economy. For example, the increased output of businesses is associated with an increased demand for inputs, which in turn produces a set of regional economic multiplier effects that are all captured as part of demand-side indirect effects. In the model, these are estimated by converting higher student income into direct increased industry sales, running these through an indirect multiplier matrix, and converting them to regional income by

applying earnings-to-sales and value added-to-sales ratios supplied by the regional IO model.

Supply-side effects occur through a process of “cumulative causation,” or “agglomeration,” whereby growth becomes in some degree self-perpetuating. The presence of one industry, for example, attracts other industries that use the first industry’s outputs as inputs, which produces subsequent rounds of industry growth, and so on.²⁹ To estimate agglomeration effects, the model converts the direct income of past students to industry value added and applies this to a set of supply-driven multipliers provided by the regional IO model. To increase the plausibility of this assumption, the model applies only direct effects associated with industries in the highest stages of development.³⁰

The sum of demand-side and supply-side effects constitutes the indirect effect of SRU education, equal to \$28.3 million of all labor income and approximately \$14.7 million of all non-labor income (Table 3.8). Adding these to the direct effects of student productivity yields a grand total of \$220.0 million in added income attributable to the accumulation of SRU skills in the regional workforce. This figure appears in the bottom row of Table 3.8.

Note that the \$220.0 million omits the effect of educated workers on innovation and technical progress. This effect

²⁹ For a more complete discussion of agglomeration and cumulative causation, see Masahisa Fujita, Paul Krugman, and Anthony Venables, *The Spatial Economy: Cities, Regions, and International Trade* (Cambridge: Massachusetts Institute of Technology, 1999).

³⁰ Parr (1999) describes the following four stages of economic development: primary production, process manufacturing, fabricative manufacturing, and producer services and capital export. The model applies “development scores” to Parr’s stages, *i.e.*, low scores for lower stage sectors and higher scores for higher development sectors. Only those industries with the highest scores are applied to the supply-driven multipliers of the IO model. For additional detail on the use of this approach for classifying industries by industrial stage, see Rutgers et al, 2002.

Table 3.9: Total effect, FY 2008–09 (\$ thousands)

	Total	% of Total
Total income in service region	\$23,338,882	
University operations effect	\$91,895	0.4%
Student spending effect	\$8,765	<0.1%
Visitor spending effect	\$13,774	<0.1%
Student productivity effect	\$219,994	0.9%
Total	\$334,428	1.4%

Source: EMSI impact model.

is generally labeled as “external” because it is uncertain in nature and spills beyond businesses employing skilled workers. For this reason it is excluded from the analysis. To the extent there are such effects, and theory suggests that there are, the overall results can be considered conservative.

Conclusion

Table 3.9 displays the grand total of SRU’s impact on the SRU Service Area in FY 2008–09, including the university operations effect, the student spending effect, the visitor spending effect, and the student productivity effect. Altogether, the average annual added income due to the activities of SRU and its students and visitors equals \$334.4 million. This is approximately equal to 9,020 average-wage jobs, or 1.4% of the total regional economy.

These results demonstrate several important points. First, SRU promotes regional economic growth through its own operations spending and through the increase in productivity as SRU alumni remain active in the regional workforce. Second, the student productivity effect is by far the larger and more important impact of SRU, stemming from higher incomes of students and their employers. And third, regional income in the SRU Service Area would be substantially lower without the educational activities of SRU.

Chapter 4: Sensitivity Analysis

Introduction

This study concludes with a sensitivity analysis of some key variables on both the student and taxpayer investment sides. The purpose of the sensitivity analysis is to set the approach apart from “advocacy” education impact analyses that promote education. These studies often use assumptions that do not stand up to rigorous peer scrutiny and generate results that overstate benefits. The approach here is to account for relevant variables on both the benefit and cost sides as reflected in the conservatively estimated base case assumptions laid out in Chapters 2 and 3.

The sensitivity tests include the following: a) the impacts associated with changes in the student employment variables for the investment analysis, and b) the sensitivity of results associated with the alternative education variable.

Student employment variables

Student employment variables are difficult to estimate either because many students do not report their employment status or because universities generally do not collect this kind of information. These variables include the following: 1) the percentage of students employed, and 2) of those employed, what percentage they earn rela-

tive to earnings they would have received if they were not attending SRU. Both employment variables relate to earnings forgone by students, *i.e.*, the opportunity cost of time; and they affect the investment analysis results (net present value, rate of return, benefit/cost ratio, and payback period).

Percent of students employed

Students incur substantial expense by attending SRU because of the time they spend not gainfully employed. Some of that cost is recaptured if students remain partially (or fully) employed while attending. It is estimated that 68% of students who reported their employment status are employed, based on data provided by SRU. This variable is tested in the sensitivity analysis by changing it first to 100% and then to 0%.

Percent of earnings relative to full earnings

The second opportunity cost variable is more difficult to estimate. For SRU, it is estimated that students working while attending classes earn only 60%, on average, of earnings they would have statistically received if not attending SRU. This suggests that many students have part-time jobs that accommodate their SRU attendance, though it is at an additional cost in terms of receiving a wage that is less than what they might otherwise make. The model captures these differences and counts them as part of the opportunity cost of time. As above, this variable is tested in the sensitivity analysis by changing the assumption to 100% and then to 0%.

Results

The changed assumptions generate results summarized in Table 4.1, with “A” defined as the percent of students employed and “B” defined as the percent that students earn relative to their full earning potential. Base case results appear in the shaded row – here the assumptions remain unchanged, with A equal to 68% and B equal to

Table 4.1: Sensitivity analysis of student perspective

Variables	Rate of return	Benefit/cost ratio	Payback period (yrs)
Base case: A = 68%, B = 60%	14.3%	5.0	10.7
Scenario 1: A = 100%, B = 60%	15.1%	5.5	10.2
Scenario 2: A = 68%, B = 100%	16.3%	6.3	9.6
Scenario 3: A = 100%, B = 100%	18.9%	8.1	8.4
Scenario 4: A = 0%, B = 0%	12.8%	4.2	11.7

* A = percent of students employed; B = percent earned relative to statistical averages

Table 4.2: Sensitivity analysis of alternative education variable, taxpayer perspective (\$ millions)

	-50%	-33%	-17%	Base Case	17%	33%	50%
Alternative education variable	13%	17%	22%	26%	30%	34%	39%
Net present value	\$47.4	\$42.4	\$37.5	\$32.5	\$27.6	\$22.6	\$17.7
Rate of return	6.5%	6.2%	5.9%	5.5%	5.2%	4.8%	4.5%
Benefit/cost ratio	1.9	1.8	1.7	1.6	1.5	1.4	1.3
Payback period (years)	18.1	18.6	19.2	19.9	20.6	21.3	22.2

60%. Sensitivity analysis results are shown in non-shaded rows. Scenario 1 increases A to 100% while holding B constant, Scenario 2 increases B to 100% while holding A constant, Scenario 3 increases both A and B to 100%, and Scenario 4 decreases both A and B to 0%.

1. Scenario 1: Increasing the percent of students employed (A) from 68% to 100%, the rate of return, benefit/cost ratio, and payback period results improve to 15.1%, 5.5, and 10.2 years, respectively, relative to base case results. Improved results are attributable to a lower opportunity cost of time—all students are employed in this case.
2. Scenario 2: Increasing earnings relative to statistical averages (B) from 60% to 100%, the rate of return, benefit/cost ratio, and payback period results improve to 16.3%, 6.3, and 9.6 years, respectively, relative to base case results—a strong improvement, again attributable to a lower opportunity cost of time.
3. Scenario 3: Finally, increasing both assumptions A and B to 100% simultaneously, the rate of return, benefit/cost ratio, and payback period results improve yet further to 18.9%, 8.1, and 8.4 years, respectively, relative to base case results. This scenario assumes that all students are fully employed and earning full salaries (equal to statistical averages) while attending classes.
4. Scenario 4: Finally, decreasing both A and B to 0% reduces the rate of return, benefit/cost ratio, and payback period results to 12.8%, 4.2, and 11.7 years, respectively, relative to base case results. These results are reflective of an increased opportunity cost—none of the students are employed in this case.³¹

It is strongly emphasized in this section that base case results are very attractive in that results are all well above their threshold levels, and payback periods are short. As is clearly demonstrated here, results of the first three alternative scenarios appear much more attractive, although they overstate benefits. Results presented in Chapter 2 are realistic, indicating that investments in SRU generate excellent returns, well above the long-term average percent rates of return in stock and bond markets.

Alternative education variable

The alternative education variable (26%) is characterized as a “negative benefit” used to account for students who can obtain a similar education elsewhere absent the publicly funded training providers in the state. Given the difficulty in accurately specifying the alternative education variable, the obvious question is the following: how great a role does it play in the magnitude of the results?

Variations in the alternative education assumption are calculated around base case results listed in the middle column of Table 4.2. Next, the model brackets the base case assumption on either side with a plus or minus 17%, 33%, and 50% variation in assumptions. Analyses are then redone introducing one change at a time, holding all other variables constant. For example, an increase of 17% in the alternative education assumption (from 26% to 30%) reduces the taxpayer perspective rate of return from 5.5% to 5.2%. Likewise, a decrease of 17% (from 26% to 22%) in the assumption increases the rate of return from 5.5% to 5.9%.

³¹ Note that reducing the percent of students employed to 0% automatically negates the percent they earn relative to their full earning potential, since none of the students receive any earnings in this case.

³¹ Note that reducing the percent of students employed to 0% automati-

Based on this sensitivity analysis, the conclusion can be drawn that SRU investment analysis results from the taxpayer perspective are not very sensitive to relatively large variations in the alternative education variable. As indicated, results are still above their threshold levels (net present value greater than 0, benefit/cost ratio greater than 1, and rate of return greater than the discount rate of 3%) even when the alternative education assumption is increased by as much as 50% (from 26% to 39%). The conclusion is that although the assumption is difficult to specify, its impact on overall investment analysis results for the taxpayer perspective is not very sensitive.

Conclusion

The results of this study demonstrate that SRU is a sound investment from multiple perspectives. The university enriches the lives of students and increases their lifetime incomes. It benefits taxpayers by generating increased tax revenues from an enlarged economy and reducing the demand for taxpayer-supported social services. Finally, it contributes to the vitality of both the local and state economies.

Appendix 1: Resources & References

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Appendix 2: Glossary of Terms

Alternative education A “with” and “without” measure of the percent of students who would still be able to avail themselves of education absent the publicly funded educational institutions in the state. An estimate of 10%, for example, means that 10% of students do not depend directly on the existence of the university in order to obtain their education.

Alternative use of funds A measure of how monies that are currently used to fund the university might have been used if the university did not exist.

Asset value Capitalized value of a stream of future returns. Asset value measures what someone would have to pay today for an instrument that provides the same stream of future revenues.

Attrition rate Rate at which students leave the local region due to out-migration, retirement, or death.

Benefit/cost ratio Present value of benefits divided by present value of costs. If the benefit/cost ratio is greater than 1, then benefits exceed costs, and the investment is feasible.

Credit hour equivalent Credit hour equivalent, or CHE, is defined as 15 contact hours of education if on a semester system, and 10 contact hours if on a quarter system. In general, it requires 450 contact hours to complete one full time equivalent, or FTE.

Demand Relationship between the market price of education and the volume of education demanded (expressed in terms of enrollment). The law of the downward-sloping demand curve is related to the fact that enrollment increases only if the price (student fees and charges) is lowered, or conversely, enrollment decreases if price increases.

Direct effect Jobs and income directly generated by the university and its students.

Discounting Expressing future revenues and costs in present value terms.

Economics Study of the allocation of scarce resources among alternative and competing ends. Economics is not normative (what ought to be done), but positive (describes what is, or how people are likely to behave in response to economic changes).

Elasticity of demand Degree of responsiveness of the quantity of education demanded (enrollment) to changes in market prices (student fees and charges). If a decrease in fees increases total revenues, demand is elastic. If it decreases total revenues, demand is inelastic. If total revenues remain the same, elasticity of demand is unitary.

Externalities Impacts (positive and negative) for which there is no compensation. Positive externalities of education include improved social behaviors such as lower crime, reduced unemployment, and improved health. Educational institutions do not receive compensation for these benefits, but benefits still occur because education is statistically proven to lead to improved social behaviors.

Full-time equivalent A metric used to measure student enrollment. An FTE of 1.0 or greater indicates that a student is enrolled full-time, while an FTE of less than 1.0 means that a student is enrolled part-time. One FTE is equal to 450 contact hours of instruction, or 30 CHEs.

Gross Regional Product Measure of the final value of all goods and services produced. Alternatively, GRP equals the combined incomes of all factors of production, *i.e.*, labor, land and capital. These include wages, salaries, proprietors' incomes, profits, rents, and other.

Indirect effect Jobs and income that result from the direct spending of the university and its students.

Input-output analysis Relationship between a given set of demands for final goods and services, and the implied amounts of manufactured inputs, raw materials, and labor that this requires. In an educational setting, when universities pay wages and salaries and spend money for supplies in the local region, they also generate earnings in all sectors of the economy, thereby increasing the demand for goods and services and jobs. Moreover, as students enter or rejoin the workforce with higher skills, they earn higher salaries and wages. In turn, this generates more consumption and spending in other sectors of the economy.

Internal rate of return Rate of interest which, when used to discount cash flows associated with investing in education, reduces its net present value to zero (*i.e.*, where the present value of revenues accruing from the investment are just equal to the present value of costs incurred). This, in effect, is the breakeven rate of return on investment since it shows the highest rate of interest at which the investment makes neither a profit nor a loss.

Labor income Income which is received as a result of labor, *i.e.*, wages.

Multiplier The number of times a dollar cycles through the economy, generating additional income and jobs, before leaving the economy. Therefore, a multiplier of 1.7 estimates that a dollar will generate an additional \$0.70 in the economy before leaving.

Net cash flow Benefits minus costs, *i.e.*, the sum of revenues accruing from an investment minus costs incurred.

Net present value Net cash flow discounted to the present. All future cash flows are collapsed into one number, which, if positive, indicates feasibility. The result is expressed as a monetary measure.

Non-labor income Income which is received from investments (such as rent, interest, and dividends) and

transfer payments (payments from governments to individuals).

Opportunity cost Benefits forgone from alternative B once a decision is made to allocate resources to alternative A. Or, if an individual chooses not to attend the university, he or she forgoes higher future earnings associated with education. The benefit of education, therefore, is the “price tag” of choosing not to attend the university.

Payback period Length of time required to recover an investment—the shorter the period, the more attractive the investment.

Appendix 3: EMSI Input-Output Model

Introduction and data sources

EMSI’s input-output model represents the economic relationships among a region’s industries, with particular reference to how much each industry purchases from each other industry. Using a complex, automated process, we can create regionalized models for geographic areas comprised by counties or ZIP codes in the United States.

Our primary data sources are the following:

1. The Industry Economic Accounts from the Bureau of Economic Analysis (BEA); specifically the “make” and “use” tables from the annual and benchmark input-output accounts.
2. Regional and national jobs-by-industry totals, and national sales-to-jobs ratios (from EMSI’s industry employment and earnings data process).
3. Proprietor earnings from State and Local Personal Income Reports (BEA).

Creation of the national Z matrix

The BEA “make” and “use” tables (MUTs) show which industries make or use which commodity types. These two tables are combined to replace the industry-commodity-industry relationships with simple industry-industry relationships in dollar terms. This is called the national “Z” matrix, which shows the total amount (\$) each industry purchases from others. Industry purchases run down the columns, while industry sales run across the rows.

The value 1,532.5 in this table means that Industry 2 purchases \$1,532,500,000 worth of commodities and/or services from Industry 1.

The whole table is basically an economic double-entry accounting system, configured so that all money inflows have corresponding outflows elsewhere.

Table 1: Sample “Z” matrix (\$ millions)

	Industry 1	Industry 2	...	Industry N
Industry 1	3.3	1,532.5	...	232.1
Industry 2	9.2	23.0	...	1,982.7
...
Industry N	819.3	2,395.6	...	0

In addition to regular industries (such as “oil and gas extraction,” “machinery manufacturing,” “food and beverage stores,” “hospitals,” and so on), there are three additional rows representing labor earnings, profits, and business taxes, which together represent industry “value added” and account for the fact that industries do not spend all of their income on inputs from other industries. There are also three rows and columns representing federal, state, and local government (we later separate federal government into civilian and military sectors).

We create two separate Z matrices since there are two sets of MUTs—annual and benchmark. The benchmark data are produced every five years with a five-year lag and specify up to 500 industry sectors; annual data have a one-year lag but specify only 80 industrial sectors.

The basic equation is as follows:

$$Z = VQ^{-1}U$$

where V is the industry “make” table, Q^{-1} is a vector of total gross commodity output, and U is the industry “use” table.

In reality, this equation is more complex because we also need to “domesticate” the Z matrix by removing all imports. This is needed because we are creating a “closed” type of national model.

In addition, there are a number of modifications that need to be made to the BEA data before the calculations can begin. These are almost all related to the conversion

Table 2: Sample “A” matrix

	Industry 1	Industry 2	...	Industry 1125
Industry 1	.001	.112035
Industry 2	.097	0065
...
Industry 1125	.002	.076	...	0

of certain data in BEA categories to new categories that are more compatible with other data sets we use in the process, and describing them in detail is beyond the scope of this document.

Disaggregation of the national Z matrix

The previous step resulted in two national Z matrices—one based on the benchmark BEA data (five years old, approximately 500 industries) and the other based on the annual BEA data (one year old, but only about 80 industries). These initial national Z matrices are then combined and disaggregated to 1,125 industry sectors. Combining them allows us to capitalize on both the recency of the annual data and the detail of the benchmark data. The disaggregation is performed for each initial Z matrix using probability matrices that allow us to estimate industry transactions for the more detailed sectors based on the known transactions of their parent sectors. The probability matrix is created from detailed EMSI industry earnings data, which are available for all 1,125 sectors and are created using a separate process.

Creation of the national A matrix

The national disaggregated Z matrix is then “normalized” to show purchases as percentages of each industry’s output rather than total dollar amounts. This is called the national “A” matrix.

Each cell value represents the percentage of a row industry’s output that goes toward purchasing inputs from each column industry. Thus, the cell containing .112 above means that Industry 1 spends 11.2% of its total output to obtain inputs from Industry 2.

At this point, our additional rows representing earnings, profits, and business taxes are removed. However, we will use them in a different form later.

Regionalization of the A matrix

To create a regional input-output model, we regionalize the national A matrix using that region’s industry mix.

The major step in the process is the calculation of per-industry out-of-region exports. This is performed using a combination of standard techniques that are present in the academic literature:

1. Stevens regional purchase coefficients (RPCs)
2. Simple location quotient of value-added sales
3. Supply/demand pools derived from the national A matrix

We try to maximize exports in order to account as fully as possible for “cross-hauling,” which is the simultaneous export and import of the same good or service to/from a region, since it is quite common in most industries.

Another major part of the process is the regionalization of consumption, investment, and local government “row industries” (rows referring to the rows of the A matrix). These represent the percentage of each industry’s sales that end up going toward consumption, capital purchases, and taxes to local government, respectively. They are created from the “value added” rows that we removed earlier. Consumption is calculated using each industry’s earnings and profits, as well as a constant called “the average propensity to consume,” which describes the approximate percentage of earnings and profits that are spent on consumption. Investment and local government rows are calculated by distributing the known total investment and endogenous local government for the entire region to individual industries proportionally to their value added.

The A-matrix regionalization process is automated for any given region for which industry data are available. Although partially derived from national figures, the regional A matrix offers a best possible estimate of regional values without resorting to costly and time-consuming survey techniques, which in most cases are completely infeasible.

Creating multipliers and using the A matrix

Finally, we convert the regional “A” matrix to a “B” matrix using the standard Leontief inverse $\mathbf{B} = (\mathbf{I} - \mathbf{A})^{-1}$. The “B” matrix consists of inter-industry sales multipliers, which can be converted to jobs or earnings multipliers using per-industry jobs-to-sales or earnings-to-sales ratios.

The resulting tables and vectors from this process are then used in the actual end-user software to calculate regional requirements, calculate the regional economic base, estimate sales multipliers, and run impact scenarios.

Appendix 4: Shutdown Point

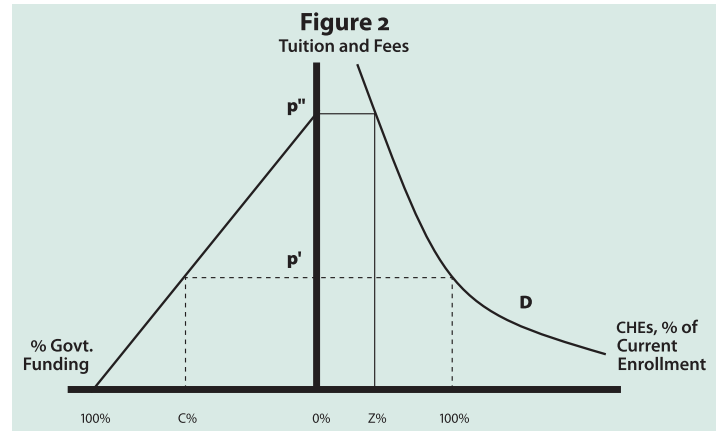
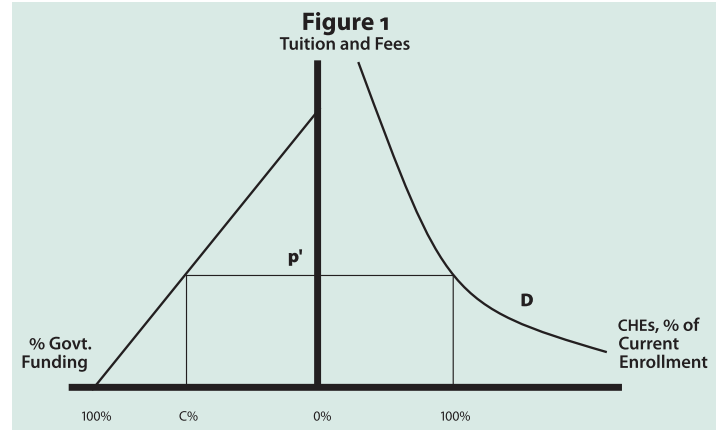
Introduction

The investment analysis weighs benefits of enrollment (measured in terms of CHEs) against the support provided by state and local government. This adjustment factor is used to establish a direct link between the costs of supporting the university and the benefits it generates in return. If benefits accrued without taxpayer support, then it would not be a true investment.³²

The overall approach includes a sub-model that simulates the effect on student enrollment should the university lose its state and local funding and have to raise student fees and charges in order to stay open. If the university can still operate without state and local support, then any benefits it generates at that level are discounted from total benefit estimates. If the simulation indicates that the university cannot stay open, however, then benefits are directly linked to costs, and no discounting applies. This appendix documents the procedure for making these adjustments.

State and local government support versus student demand

Figure 1 presents a simple model of student demand and state and local government support. The right side of the graph is a standard demand curve (D) showing student enrollment as a function of student fees and other charges. Enrollment is measured in terms of total CHEs generated and expressed as a percentage of current CHE production. Current student fees and charges are represented by p' , and state and local government support covers $C\%$ of all costs. At this point in the analysis, it is assumed that



the university has only two sources of revenues: student fees and state and local government support.

Figure 2 shows another important reference point in the model—where state and local government support is 0%, student fees are increased to p'' , and enrollment is $Z\%$ (less than 100%). The reduction in enrollment reflects price elasticity in the students’ education vs. no-education decision. Neglecting for the moment those issues concerning the university’s minimum operating scale (considered below in the section called “Shutdown Point”), the implication for the investment analysis is that benefits of state and local government support must be adjusted to

³² Of course, as a public training provider, SRU would not be permitted to continue without public funding, so the situation in which it would lose all state support is entirely hypothetical. The purpose of the adjustment factor is to examine SRU in standard investment analysis terms by netting out any benefits it may be able to generate that are not directly linked to the costs of supporting it.

net out benefits associated with a level of enrollment at Z% (i.e., the university can provide these benefits absent state and local government support).

From enrollment to benefits

This appendix focuses mainly on the size of enrollment (i.e., CHE production) and its relationship to student versus state and local government funding. However, to clarify the argument it is useful to briefly consider the role of enrollment in the larger benefit/cost model.

Let B equal the benefits attributable to state and local government support. The analysis derives all benefits as a function of student enrollment (i.e., CHE production). For consistency with the graphical exposition elsewhere in this appendix, B is expressed as a function of the percent of current enrollment (i.e., percent of current CHE production). Accordingly, the equation

1)
$$B = B (100\%)$$

reflects the total benefits generated by enrollments at their current levels.

Consider benefits now with reference to Figure 2. The point at which state and local government support is zero nonetheless provides for Z% (less than 100%) of the current enrollment, and benefits are symbolically indicated by the following equation:

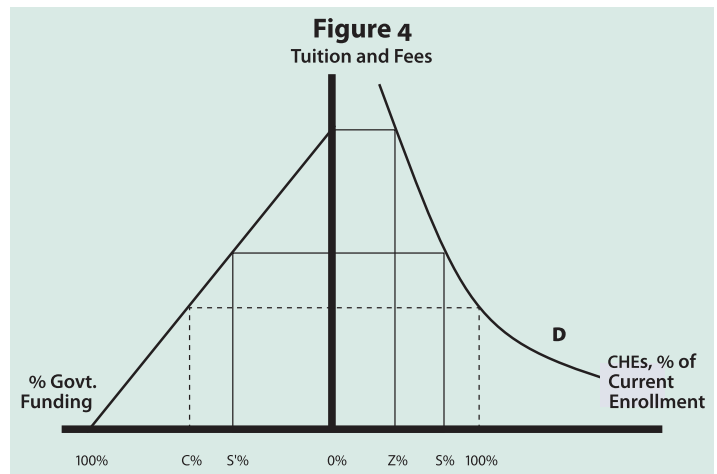
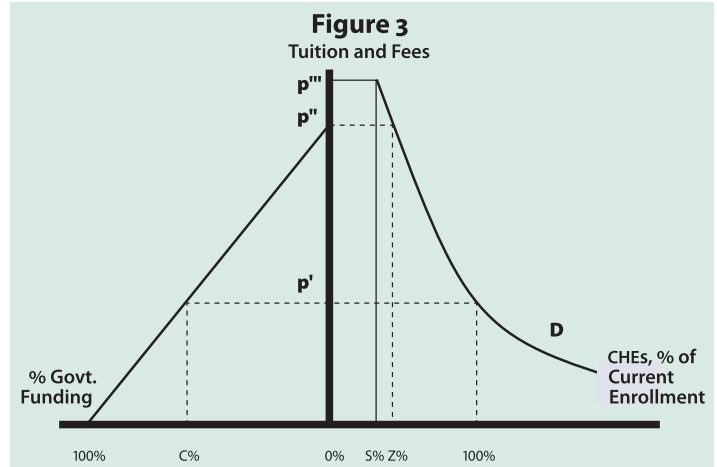
2)
$$B = B (Z\%)$$

Inasmuch as the benefits in (2) occur with or without state and local government support, the benefits appropriately attributed to state and local government support are given by the following equation:

3)
$$B = B (100\%) - B (Z\%)$$

Shutdown point

University operations cease when fixed costs can no longer be covered. The shutdown point is introduced graphically in Figure 3 as S%. The location of point S% indicates that the university can operate at an even lower enrollment level than Z% (the point of zero state funding). At point S%, state and local government support is still zero, and the student fees have been raised to p'''. With student



fees still higher than p''', the university would not be able to attract enough students to keep the doors open, and it would shut down. In Figure 3, point S% illustrates the shutdown point but otherwise plays no role in the estimation of taxpayer benefits. These remain as shown in equation (3).

Figure 4 illustrates yet another scenario. Here the shutdown point occurs at an enrollment level greater than Z% (the level of zero state and local government support), meaning some minimum level of state and local government support is needed for the university to operate at all. This minimum portion of overall funding is indicated by S% on the left side of the chart, and as before, the shutdown point is indicated by S% on the right side of chart. In this case, state and local government support is

appropriately credited with all the benefits generated by enrollment, or $B = B (100\%)$.

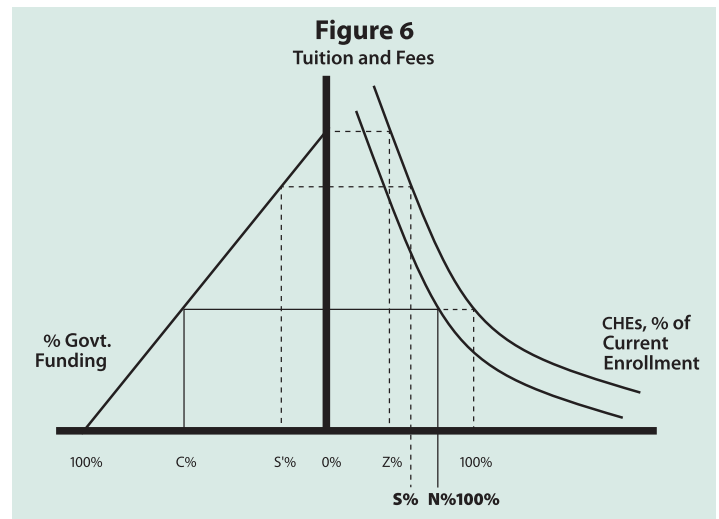
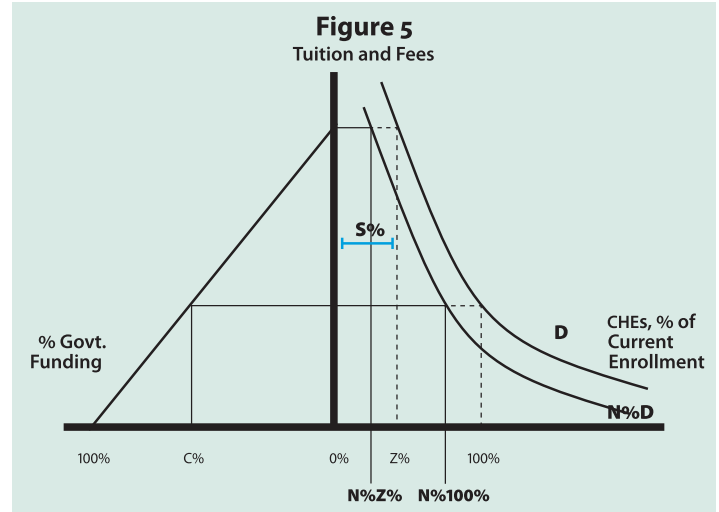
Adjusting for alternative education opportunities

Because some students may be able to avail themselves of an education even without the publicly funded training providers in the state, the benefits associated with these students must be deducted from the overall benefit estimates. The adjustment for alternative education is easily incorporated into the simple graphic model. For simplicity, let $A\%$ equal the percent of students with alternative education opportunities, and let $N\%$ equal the percent of students without an alternative. Note that $N\% + A\% = 100\%$.

Figure 5 presents the case where the university could operate absent state and local government support (*i.e.*, $Z\%$ occurs at an enrollment level greater than the shut-down level $S\%$). In this case, the benefits generated by enrollments absent state and local government support must be subtracted from total benefits. This case is parallel to that indicated in equation (3), and the net benefits attributable to state and local government support are given by the following equation:

4) $B = B (N\% \times 100\%) - B (N\% \times Z\%)$

Finally, Figure 6 presents the case where the university cannot remain open absent some minimum $S\%$ level of state and local government support. In this case, taxpayers are credited with all benefits generated by current enrollment, less only the percent of students with alternative education opportunities. These benefits are represented symbolically as $B (N\% \times 100\%)$.



Appendix 5: Social Externalities

Introduction

Education has a predictable and positive effect on a diverse array of social benefits. These, when quantified in dollar terms, represent significant avoided social costs that directly benefit the public as whole, including taxpayers. In this appendix we discuss the following three main benefit categories: 1) improved health, 2) reductions in crime, and 3) reductions in unemployment and welfare.

It is important to note that the data and estimates presented here should not be viewed as exact, but rather as indicative of the positive impacts of education on an individual’s quality of life. The process of quantifying these impacts requires a number of assumptions to be made, creating a level of uncertainty that should be borne in mind when reviewing the results.

Health

Statistics clearly show the correlation between increases in education and improved health. The manifestations of this are found in two health-related variables, smoking and alcohol. There are probably several other health-related areas that link to educational attainment, but these are omitted from the analysis until we can invoke adequate (and mutually exclusive) databases and are able to fully develop the functional relationships.

Smoking

Despite declines over the last several decades in the percentage of the U.S. population who smoke, a sizeable percentage of the U.S. population still use tobacco. The negative health effects of smoking are well documented in the literature, which identifies smoking as one of the most serious health issues in the United States.

Figure 1 reports the prevalence of cigarette smoking

Figure 1: Prevalence of smoking by education level

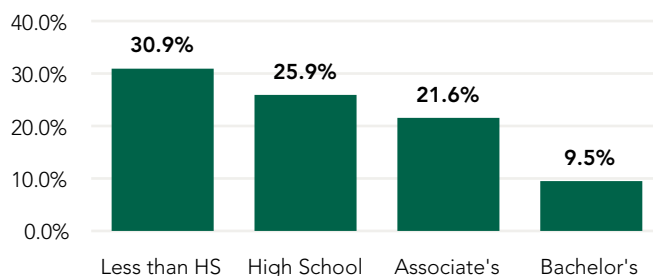
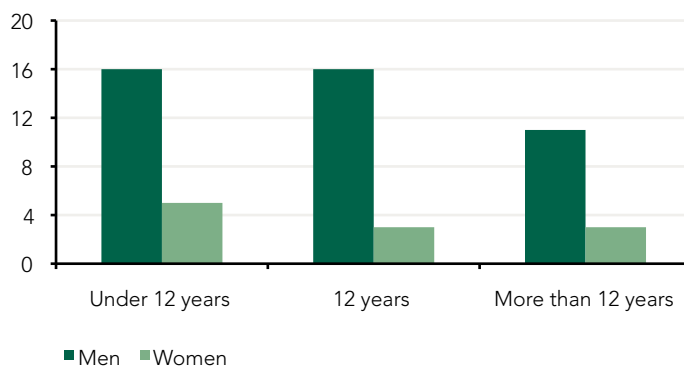


Figure 2: Prevalence of heavy drinking by gender and education level



among adults aged 25 years and over, based on data provided by the National Health Interview Survey. As indicated, the percent of persons who smoke cigarettes begins to decline beyond the level of high school education.

The CDC reports the percent of adults who are current smokers by state.³³ We use this information to create an index value by which we adjust the national prevalence data on smoking to each state. For example, 20.1% of Ohio’s adults were smokers in 2008, relative to 18.3% for the nation. We thus apply a scalar of 1.1 to the national

³³ Center for Disease Control and Prevention (CDC), Prevalence and Trends Data, Tobacco Use—2008, Adults who are current smokers (accessed June 2009).

probabilities of smoking in order to adjust them to the state of Ohio.

Alcohol

Alcoholism is difficult to measure and define. There are many patterns of drinking, ranging from abstinence to heavy drinking. Alcohol abuse is riddled with social costs, including health care expenditures for treatment, prevention and support; workplace losses due to reduced worker productivity and premature mortality; and other costs related to vehicle crashes, fire destruction, and social welfare administration.

Figure 2 presents the percent of the adult population that are heavy drinkers, by gender and education level.³⁴ These statistics give an indication of the correlation between education and the reduced probability of alcohol abuse. As indicated, heaving drinking among males falls from a 16% prevalence rate among individuals with fewer than 12 years of education, to an 11% prevalence rate among individuals with more than 12 years of education. The probability of being a heavy drinker also falls on a sliding scale for women, from 5% to 3%. Note that women are less likely to be heavy drinkers than men.

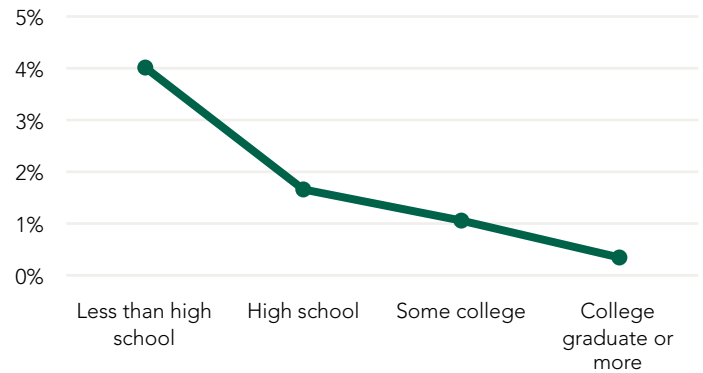
Crime

As people achieve higher education levels, they are statistically less likely to commit crimes. The analysis identifies three types of crime-related expenses: 1) incarceration, including prosecution, imprisonment, and reform, 2) victim costs, and 3) productivity lost as a result of time spent in jail or prison rather than working.

Figure 3 displays the probability that an individual will be incarcerated by education level. Data are derived from the breakdown of the inmate population by education level in state, federal, and local prisons (as provided by the Bureau of Justice Statistics), divided by the total population. As indicated, incarceration drops on a sliding scale as education levels rise.

³⁴ Data are supplied by the National Institute of Alcohol Abuse and Alcoholism.

Figure 3: Incarceration rates by education level



Victim costs comprise material, medical, physical, and emotional losses suffered by crime victims. Some of these costs are hidden, while others are available in various databases. Estimates of victim costs vary widely, attributable to differences in how the costs are measured. The lower end of the scale includes only tangible out-of-pocket costs, while the higher end includes intangible costs such as future loss of productivity resulting from traumas, crimes not handled or prosecuted through the judicial system, and money spent on personal security that would otherwise have been spent on other, more productive endeavors.³⁵

Yet another measurable benefit is the added economic productivity of people who are now gainfully employed, all else being equal, and not incarcerated. The measurable productivity benefit here is simply the number of additional people employed multiplied by the average income in their corresponding education levels.

Welfare and Unemployment

Statistics show that, as education levels increase, the number of welfare and unemployment applicants declines. Welfare recipients can receive assistance from a variety of different sources, including TANF (Temporary Assistance for Needy Families), food stamps, Medicaid, Supplement-

³⁵ The model makes use of tangible, lower end costs that can be directly measured without controversy. Thus, 2.0 million inmates (in 1999) divided into \$105 billion costs an average of roughly \$52,000 per inmate. From this we derive an estimate of \$85,000, assuming that the 1999 study was based on at least two- to three-year-old data.

Figure 4: Probability of claiming welfare, by education level

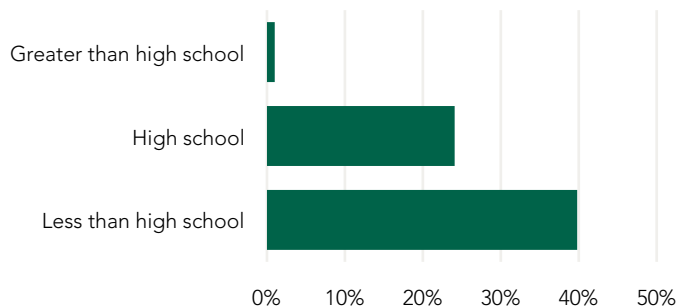
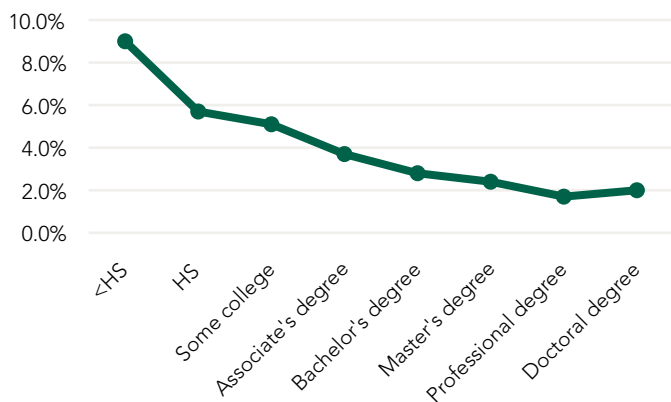


Figure 5: Unemployment rates by education level



than a high school diploma to 2% for those at the doctoral degree level.

Conclusion

The statistical databases bear out the simple correlation between education and improved health, lower incarceration rates, and reduced welfare and unemployment. These by no means comprise the full range of benefits one possibly can link to education. Other social benefits certainly may be identified in the future as reliable statistical sources are published and data are incorporated into the analytical framework. However, the fact that these incidental benefits occur and can be measured is a bonus that enhances the economic attractiveness of university operations.

tal Security Income (SSI), housing subsidies, child care services, weatherization programs, and various educational programs.

Figure 4 relates the probabilities that an individual will apply for welfare by education level, derived from data supplied by the Department of Health and Human Services. As shown, the probability of claiming welfare drops significantly as individuals move to higher levels of education. Note that these data are based on TANF recipients only, as these constitute the most needy welfare recipients and are the point of departure for the allocation between the other ethnic groups in the model.

Unemployment rates also decline with increasing levels of education, as illustrated in Figure 5. These data are supplied by the Bureau of Labor Statistics. As shown, unemployment rates range from 9% for those with less

Appendix 6: Investment Analysis – a Primer

The purpose of this appendix is to provide some context and meaning to the investment analysis results in general, using the simple hypothetical example summarized in Table 1 below. The table shows the projected (assumed) benefits and costs over time for one student and associated investment analysis results.³⁶

Assumptions are as follows:

1. The time horizon is 10 years—*i.e.*, benefits and costs are projected out 10 years into the future (Column 1). Once education has been earned, benefits of higher earnings remain with the student into the future. The objective is to measure these future benefits and compare them to the costs of education.
2. The student attends the university for one year, for which he or she pays total fees of \$1,500 (Column 2).
3. The opportunity cost of time (earnings forgone while attending the university for one year) for this student is estimated at \$20,000 (Column 3).
4. Together, these two cost elements (\$21,500 total) represent the out-of-pocket investment made by the student (Column 4).
5. In return, it is assumed that the student, having completed the one year of study, will earn \$5,000 more per year than he/she would have without the education (Column 5).
6. Finally, the net cash flow column (NCF) in Column 6 shows higher earnings (Column 5) less the total cost (Column 4).
7. The assumed “going rate” of interest is 4%, the rate of return from alternative investment schemes, for the use of the \$21,500.

Table 1. Costs and benefits

Year	Tuition	Opportunity cost	Total cost	Higher earnings	Net cash flow
1	2	3	4	5	6
1	\$1,500	\$20,000	\$21,500	\$0	-\$21,500
2	\$0	\$0	\$0	\$5,000	\$5,000
3	\$0	\$0	\$0	\$5,000	\$5,000
4	\$0	\$0	\$0	\$5,000	\$5,000
5	\$0	\$0	\$0	\$5,000	\$5,000
6	\$0	\$0	\$0	\$5,000	\$5,000
7	\$0	\$0	\$0	\$5,000	\$5,000
8	\$0	\$0	\$0	\$5,000	\$5,000
9	\$0	\$0	\$0	\$5,000	\$5,000
10	\$0	\$0	\$0	\$5,000	\$5,000
Net present value			\$20,680	\$35,753	\$15,080
Internal rate of return			18%		
Benefit/cost ratio			1.7		
Payback period			4.2 years		

Results are expressed in standard investment analysis terms, which are as follows: the net present value (NPV), the internal rate of return (IRR, or simply RR), the benefit/cost ratio (B/C), and the payback period. Each of these is briefly explained below in the context of the cash flow numbers in Table 1.

Net present value (NPV)

“A bird in hand is worth two in the bush.” This simple folk wisdom lies at the heart of any economic analysis of investments lasting more than one year. The student in Table 1 can choose either to attend the university or to forgo post-secondary education and maintain present employment. If he or she decides to enroll, certain economic implications unfold: student fees and charges must be paid, and earnings will cease for one year. In exchange, the student calculates that with post-secondary education,

³⁶ Note that this is a hypothetical example. The numbers used are not based on data collected from an existing university.

his or her income will increase by at least the \$5,000 per year as indicated in the table.

The question is simple—will the prospective student be economically better off by choosing to enroll? If he/she adds up higher earnings of \$5,000 per year for the remaining nine years in Table 1, the total will be \$45,000. Compared to a total investment of \$21,500, this appears to be a very solid investment. The reality, however, is different—benefits are far lower than \$45,000 because future money is worth less than present money. Costs (student fees and charges plus forgone earnings) are felt immediately because they are incurred today—in the present. Benefits (higher earnings), on the other hand, occur in the future. They are not yet available. All future benefits must be discounted by the going rate of interest (referred to as the discount rate) to be able to express them in present value terms.³⁷ Let us take a brief example—at 4%, the present value of \$5,000 to be received one year from today is \$4,807. If the \$5,000 were to be received in year ten, the present value would reduce to \$3,377. Put another way, \$4,807 deposited in the bank today earning 4% interest will grow to \$5,000 in one year; and \$3,377 deposited today would grow to \$5,000 in ten years. An “economically rational” person would, therefore, be equally satisfied receiving \$3,377 today or \$5,000 ten years from today given the going rate of interest of 4%. The process of discounting—finding the present value of future higher earnings—allows the model to express values on an equal basis in future or present value terms.

The goal is to express all future higher earnings in present value terms so that they can be compared to investments incurred today—student fees and forgone earnings. As indicated in Table 1, the cumulative present value of \$5,000 worth of higher earnings between years 2 and 10 is \$35,747 given the 4% interest rate, far lower than the undiscounted \$45,000 discussed above.

³⁷ Technically, the interest rate is applied to compounding—the process of looking at deposits today and determining how much they will be worth in the future. The same interest rate is called a discount rate when the process is reversed—determining the present value of future earnings.

The net present value of the investment is \$14,247. This is simply the present value of the benefits less the present value of the costs, or $\$35,747 - \$21,500 = \$14,247$. In other words, the present value of benefits exceeds the present value of costs by as much as \$14,247. The criterion for an economically worthwhile investment is that the net present value is equal to or greater than zero. Given this result, it can be concluded that, in this case, and given these assumptions, this particular investment in education is very strong.

Internal rate of return (IRR)

The internal rate of return is another way of measuring the worth of investing in education using the same cash flows shown in Table 1. In technical terms—the internal rate of return is a measure of the average earning power of money used over the life of the investment. It is simply the interest rate that makes the net present value equal to zero. In the NPV example above, the model applies the “going rate” of interest of 4% and computes a positive net present value of \$14,247. The question now is what the interest rate would have to be in order to reduce the net present value to zero. Obviously it would have to be higher—18% in fact, as indicated in Table 1. Or, if a discount rate of 18% were applied to the NPV calculations instead of the 4%, then the net present value would reduce to zero.

What does this mean? The internal rate of return of 18% defines a breakeven solution—the point where the present value of benefits just equals the present value of costs, or where the net present value equals zero. Or, at 18%, higher incomes of \$5,000 per year for the next nine years will earn back all investments of \$21,500 made plus pay 18% for the use of that money (\$21,500) in the meantime. Is this a good return? Indeed it is. If it is compared to the 4% “going rate” of interest applied to the net present value calculations, 18% is far higher than 4%. It may be concluded, therefore, that the investment in this case is solid. Alternatively, comparing the 18% rate of return to the long-term 7% rate or so obtained from investments in stocks and bonds also indicates that the investment in education is strong relative to the stock market returns (on average).

A word of caution—the IRR approach can sometimes generate “wild” or “unbelievable” results—percentages that defy the imagination. Technically, the approach requires at least one negative cash flow (student fees plus opportunity cost of time) to offset all subsequent positive flows. For example, if the student works full-time while attending the university, the opportunity cost of time would be much lower; the only out-of-pocket cost would be the \$1,500 paid for student fees and charges. In this case, it is still possible to compute the internal rate of return, but it would be a staggering 333% because only a negative \$1,500 cash flow will be offsetting nine subsequent years of \$5,000 worth of higher earnings. The 333% return is technically correct, but not consistent with conventional understanding of returns expressed as percentages. For purposes of this report, therefore, all results exceeding 100% are expressed simply as: “n/a” or “>100%.”

Benefit/cost ratio (B/C)

The benefit/cost ratio is simply the present value of benefits divided by present value of costs, or $\$35,747 \div \$21,500 = 1.7$ (based on the 4% discount rate). Of course, any change in the discount rate will also change the benefit/cost ratio. Applying the 18% internal rate of return discussed above would reduce the benefit/cost ratio to 1.0—or the breakeven solution where benefits just equal costs. Applying a discount rate higher than the 18% would reduce the ratio to lower than 1.0, and the investment would not be feasible. The 1.7 ratio means that a dollar invested today will return a cumulative \$1.70 over the ten-year time period.

Payback period

This is the length of time from the beginning of the investment (consisting of student fees plus earnings forgone) until higher future earnings give a return on the investments made. For the student in Table 1, it will take roughly 4.2 years of \$5,000 worth of higher earnings to recapture his or her investment of \$1,500 in student fees and the \$20,000 earnings he or she forgoes while attending the university. Higher earnings occurring beyond 4.2 years are the returns that make the investment in education in this example economically worthwhile. The pay-

back period is a fairly rough, albeit common, means of choosing between investments. The shorter the payback period, the stronger the investment.

Appendix 7: Alternative Education Variable

Introduction

The alternative education variable is the percent of students who would still be able to avail themselves of education absent the publicly funded colleges and universities in the state. This variable is estimated in the model through a regression analysis based on data supplied by 117 colleges previously analyzed by EMSI. The purpose of this appendix is to lay out the theoretical framework for determining the alternative education opportunity variable and the data used to make this determination.

Alternative education variable in function form

The alternative education variable is the dependent variable, expressed in functional form as:

$$1) \quad Y = b_1X_1 + b_2X_2 + b_3X_3 + e$$

Where:

Y = Dependent variable

b_i = partial regression coefficients

e = standard error

Independent variables

The three independent variables reflect the explanatory parameters that form the theoretical backdrop to the internal estimation of the dependent variable based on 117 observations. The three independent variables include the following:

X_1 = Population per square mile in the service region

This variable defines the population density of the service region. A positive coefficient (b) is expected; *i.e.*, the more densely populated the area, the more numerous the alternative education opportunities will be.

X_2 = Number of private school employees per 1,000 population per square mile in the service region

This variable is a proxy for the availability of private educational institutions providing alternative education opportunities in the region. A positive coefficient (b) is expected; *i.e.*, the more private school employees, the more alternative education opportunities there are in the area.

X_3 = Personal income

The average personal income of residents in the region serves as a measure of the relative economic well-being of the area. A positive coefficient (b) is expected; *i.e.*, the higher the average earnings in the area, the more the students will be able to avail themselves of the alternative education opportunities. This number is expressed in thousands.

Example of analysis and results

The procedure used to estimate the parameters was the ordinary least squares procedure (OLS). Fitting the equation by OLS yielded the following results:

$$2) \quad Y = 3.43E - 05X_1 + 0.023565X_2 + 0.005748X_3 + 0.064722$$

(2.723) (1.4765) (3.1326)

R_2 = .458 (coefficient of determination)

F = 31.84 (Fischer test statistic)

The numbers in parentheses below the coefficients are the “ t ” values (all statistically significant). The R_2 measures the degree to which the independent variables explain the variation in the dependent variable. The maximum R_2 attainable (1.00) is the case in which all observations fall on the regression line and all variability is explained. The .458 R_2 obtained in equation (2) indicates that nearly 46 percent of the variation in the alternative education opportunity is explained by the variables. The F-ratio indicates that the equation can be considered a good predictor of the alternative education opportunity.

The positive signs of the regression coefficients agree with expected relationships. As population density, the number of private school employees, and personal income increase, so does the provision of alternative education opportunities.

For example, suppose the college or university has a service region of five counties. The total population of the five counties is 188,341, while the size of the region is 3,754 square miles; the average population per square mile is therefore a little over 50. Within this region, there is 1 higher education private school employee for every 3,000 residents. Finally, the average income per person within the region is \$21,869 per year. Using these data, the following results are produced:

$$3) \quad Y = (3.43E - 05 \times 50.2) + (0.023565 \times .3318) + (0.005748 \times 21.869)$$

$$4) \quad Y = 13.5\%$$

Thus, according to these calculations, an estimated 13.5% of the student population would have been able to receive an education elsewhere if there were no publicly funded colleges and universities in the state.