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## ABSTRACT

This study uses data collected from Mt. Hood Community College (MHCC) (Washington) databases to analyze the socioeconomic impact of its educational services upon the larger community. Data was collected from an unduplicated enrollment of 31,072 at all MHCC colleges, applying analysis to 100% of those enrollees. It is estimated that 60% of students remain in the local community and thereby generate local community benefits. The paper argues that an increased demand for goods and services is associated with the increased earnings attributable to the acquisition of skills at MHCC. In analyzing the data, benefits and costs was projected over 10 years for 1 student, with the objective of measuring future benefits and comparing them with the cost of education. The study found an improvement in health, and a reduction in smoking and alcohol abuse, welfare assistance, and incarceration associated with higher education levels. The study also found that improved health, lower welfare and unemployment, and lower crime will result in annual taxpayer savings for the community of \$7.3 million. In addition, the paper asserts that the returns are attractive to the private sector as well as to the public sector. (Contains 26 tables and 37 references.) (NB)



# The Socioeconomic Benefits Generated by Mt. Hood Community College

*State of Oregon*

## Volume 1: Main Report

17-Apr-2002

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CCbenefits Inc. is a company created in collaboration with the Association of Community College Trustees (ACCT) to provide economic analysis services to community and 2-year community colleges. Questions of a technical nature concerning the approach, assumptions, and/or results should be directed to CCbenefits, Inc., c/o Drs Kjell Christophersen and Hank Robison, 121 Sweet Ave., Moscow ID 83843, phone: 208-883-3500, fax: 208-885-3803, e-mail: ccb@turbonet.com.

## ACRONYMS

MHCC	Mt. Hood Community College
AD	Associate Degree
ABE	Adult basic education
ACCT	Association of Community College Trustees
B/C	Benefit–cost ratio
CC	Community College
CHE	Credit hour equivalent
ESL	English as a second language
GED	General Equivalency Diploma (also Education Development Certificate)
HS	High school
IO	Input–output analysis
NCF	Net cash flow
NPV	Net present value
REIS	Regional Economic Information System
RR	Rate of return
TC	Technical College
TD	Technical Diploma

## Preface

The Association of Community College Trustees (ACCT) contracted with the authors in 1999 to create the model used in this study. The original vision was simple—to make available to colleges a generic and low cost yet comprehensive tool that would allow them to estimate the economic benefits accrued by students and taxpayers as a result of the higher education achieved. In short: it only makes economic sense for the students to attend college if their future earnings increase beyond their present investments of time and money; likewise, taxpayers will only agree to fund colleges at the current levels or increase funding if the economic benefits exceed the costs.

An important requirement of the ACCT vision was that the model reach beyond the “standard” study—the computation of the simple multiplier effects stemming from the annual operations of the colleges. Although the standard study was part and parcel of the model ultimately developed, it was only a relatively small part. The current model also accounts for the economic impacts generated by past students who are still applying their skills in the local workforce; and it accounts for a number of external social benefits such as reduced crime, improved health, and reduced welfare and unemployment, which translate into avoided costs to the taxpayers. All of these benefits are computed for each college and analyzed. To the extent possible, the analysis is based on regional data adjusted to local situations.

Although the written reports generated for each college are similar in text, the results differ widely. **This, however, should not be taken as an indication that some colleges are doing a better job than others in educating the students.** Differences among colleges are a reflection of the student profiles, particularly whether or not the students are able to maintain their jobs while attending, and the extent to which state and local taxpayers fund the colleges. Some students give up substantial earnings while attending college because employment opportunities are few and far between. In other cases they are able to work while attending because the area has an abundance of opportunities. That the average student rate of return of 15% for college A is different from the rate of return of 20% for college B, therefore, does not mean that B is doing a better job than A. Rather,

it is attributable to the employment opportunities in the region, and to the fact that one college may cater more to women than to men, or to minorities, and/or to different kinds of students such as transfer, workforce or retired, etc. In turn, the student body profiles are associated with their own distinct earnings functions reflecting these employment, gender and ethnicity differences. The location of the college, therefore, dictates the profile of the student body, which, to a large extent, translates into the magnitudes of the results. In this sense, it could well be that College A with a 15% student rate of return is actually a better or more efficiently managed school than College B with a 20% student rate of return. The qualitative difference in management efficiency is not equal to the difference between the two returns.



# Chapter 1

## INTRODUCTION

### OVERVIEW

Community colleges (CCs) generate a wide array of benefits. Students benefit directly from higher personal earnings and society at large benefits indirectly from cost savings (avoided costs) associated with reduced welfare and unemployment, improved health, and reduced crime. Higher education, however, requires a substantial investment on the part of the students and society as a whole. Therefore, all education stakeholders – taxpayers, legislators, employers, and students – want to know if they are getting their money’s worth. In this study, Mt. Hood Community College (MHCC) investigates the attractiveness of its returns relative to alternative public investments. The benefits are presented in three ways: 1) annual benefits, 2) present values of future annual benefits (rates of return and benefit-cost ratios, etc.), and 3) regional economic benefits.

The study has four chapters and two appendices. **Chapter 1** is an overview of the benefits measured. **Chapter 2** details the major assumptions underlying the analysis. **Chapter 3** presents the main socioeconomic and regional economic results. Finally, **Chapter 4** presents a sensitivity analysis of some key assumptions – tracking the changes in the results as assumptions are changed. **Appendix 1** is a short primer on the context and meaning of the investment analysis results – the net present values (NPV), rates of return (RR), benefit/cost ratios (B/C), and the payback period. **Appendix 2** explains how the earnings related to higher education data were derived.

### ANNUAL PRIVATE AND PUBLIC BENEFITS

Private benefits are the higher earnings captured by the students; these are well known and well documented in the economics literature. Less well-known and documented is a collection of public benefits captured by society at large, the indirect benefits, or what economists call *positive externalities*, such as improved health and lifestyle habits, lower crime, and lower

incidences of welfare and unemployment. These stem from savings to society from reduced burdens on taxpayer-provided services. The dollar savings (or avoided costs) associated with reduced arrest, prosecution, jail, and reform expenditures are estimated based on published crime statistics arranged by education levels. Likewise, statistics that relate unemployment, welfare, and health habits to education levels are used to measure other savings. The annual economic impacts are presented in three ways: 1) per credit-hour equivalent (CHE), defined as a combination of credit and non-credit attendance<sup>1</sup>, 2) per student, and 3) in the aggregate (statewide).

## PRESENT VALUES OF FUTURE BENEFITS

The annual impacts continue and accrue into the future and are quantified and counted as part of the economic return of investing in education. This lifetime perspective is summarized as *present values*—a standard approach of projecting benefits into the future and discounting them back to the present. The present value analysis determines the economic feasibility of investing in CC education—i.e., whether the benefits outweigh the costs. The time horizon over which future benefits are measured is the retirement age (65) less the average age of the students.

The values of future benefits are also expressed in four ways: 1) net present value (NPV) total, per CHE, and per student, 2) rate of return (RR) where the results are expressed as a percent return on investment, 3) benefit/cost (B/C) ratio—the returns per dollar expended, and 4) the payback period—the number of years needed to fully recover the investments made (see **Appendix 1** for a more detailed explanation of the meaning of these terms).

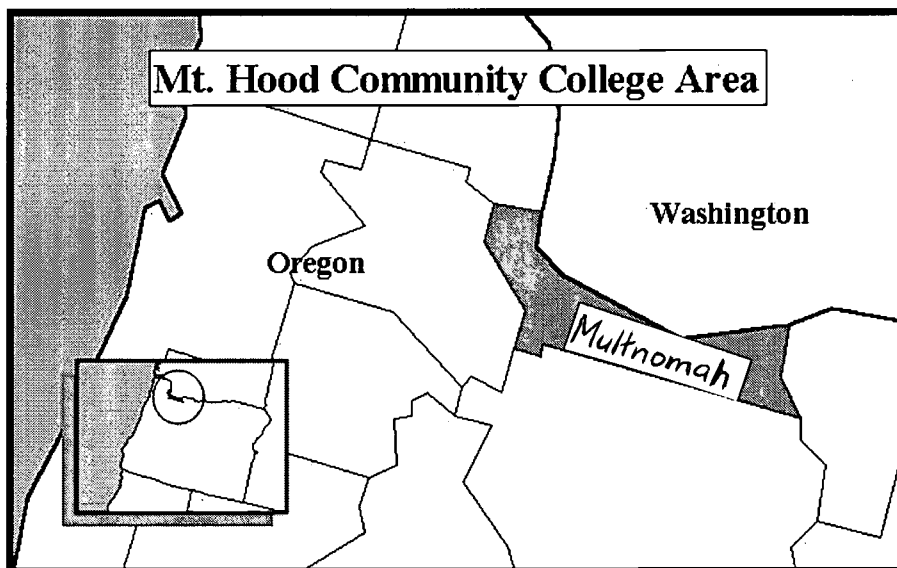
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<sup>1</sup>Instruction hours are not the same as credit hours. CCs prepare people for jobs and are less concerned with (ceremonial) degrees. Many attend for short periods and then leave to accept jobs without graduating. Others simply enroll in non-academic programs. Nonetheless, the CHEs earned will positively impact the students' lifetime earnings and social behavior.

## REGIONAL ECONOMIC BENEFITS

The benefits of a robust local economy are many: jobs for the young, increased business revenues, greater availability of public investment funds, and eased tax burdens. In this study we estimate the role of MHCC in the local community economy in terms of its share of total community earnings, defined as indicated in **Figure 1.1**. In general, these CC-linked regional earnings fall under two categories: 1) earnings generated by the annual operating expenditures of the college, and 2) earnings attributable to the CC skills embodied in the local workforce.

Figure 1.1: The Economic Region



Note: the map shows both the district boundary and the whole counties included as a backdrop for the calculation of the economic impacts. The calculated impacts are adjusted to the actual college district.

## Chapter 2

# DATA SOURCES AND ASSUMPTIONS

### INTRODUCTION

**T**o the extent possible, documented statistics obtained from several databases and from the colleges themselves are used to craft the assumptions on which the results are based. In the few cases where hard data are scarce, however, institutional researchers on the scene apply best judgments and estimations on the basis of their intimate knowledge of the college and the student body.

This chapter contains six assumption sections, all based on various data imbedded in the analytic model: 1) the MHCC profile; 2) annual earnings by education levels; 3) the social benefit assumptions (health, crime and welfare/unemployment); 4) education costs; 5) other assumptions (the discount rate used, health, crime, and welfare cost statistics, etc.); and 6) assumptions pertaining to regional economic effects.

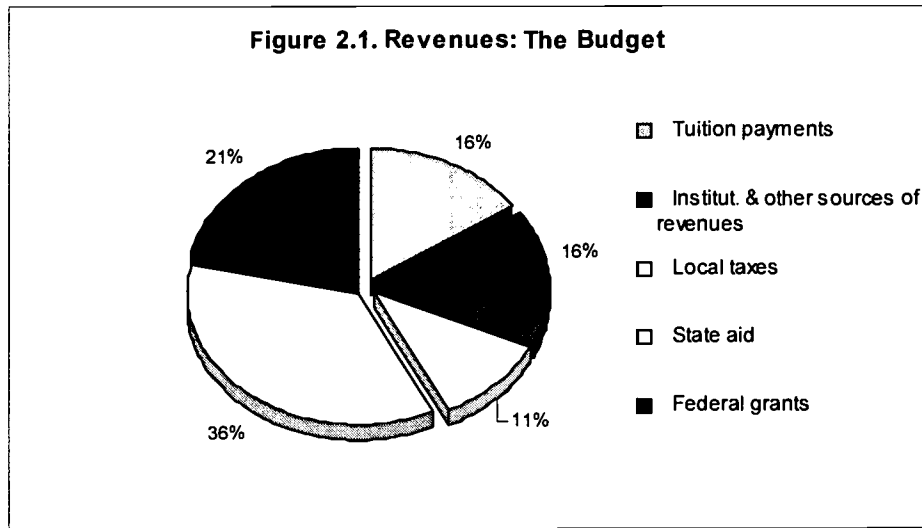
### COLLEGE PROFILE

#### Faculty, Staff, and Operating Budget

MHCC employed 620 full- and 749 part-time faculty and staff in year 2001 amounting to a total annual payroll of some \$36.9 million. **Table 2.1** shows MHCC's annual revenues by funding source: a total of \$64 million. Two main revenue sources – private and public – are indicated. Private sources include tuition and fees (15.5%) plus 16.4% from other private sources (such as contract revenues, interest payments and the like). Public funding is comprised of local taxes (10.9%), state aid (35.7%), and federal grants (21.5%). These budget data are critical in identifying the annual costs of educating the CC student body from the perspectives of the students and the taxpayers alike.

Table 2.1. Aggregate Revenues, the Budget

Sources	Revenues	Total	% of Total
<b>Private Funding</b>			
Tuition payments	\$9,968,083		15.5%
Institut. & other sources of revenues	\$10,512,785	\$20,480,868	16.4%
<b>Public Funding</b>			
Local taxes	\$6,999,014		10.9%
State aid	\$22,942,605		35.7%
Federal grants	\$13,769,959	\$43,711,578	21.5%
<b>Total</b>		<b>\$64,192,446</b>	<b>100%</b>



### The Students

Students attend community colleges for different reasons: to prepare for transfer to four-year institutions, to obtain Associate Degrees or Certificates, obtain basic skills, or perhaps most importantly, to take refresher courses or participate in non-credit programs. Students also leave for various reasons; they may have achieved their educational goals or decided to interrupt their college career to work full-time. Tables 2.2 - 2.4 summarize the student body profile. The MHCC unduplicated student body (headcount) is 31,072 (FY00-01 enrollment). This total consists of both credit and non-credit students.

Some students forego earnings entirely while attending college while others may hold part- or full-time jobs. Information about student employment plays a role in determining the *opportunity cost* of education incurred by the students while attending MHCC<sup>2</sup>. Table 2.2 rows labeled: “% Employed While Attending” and “% of Full-Time Earning Potential” provide the percentage estimates of the students who held jobs (75%) while attending MHCC, and how much they earned (65%) relative to full-time employment (or what they would statistically be earning if they did not attend MHCC). The former is a simple percent estimate of the portion of the student body working full or part time. The latter is a more complex estimate of their earnings relative to their earning power if they did not attend college (i.e., recognizing that several students may hold part time jobs working for minimum wage while attending college).

Table 2.2. Student Body Profile

		Values
Total unduplicated enrollment, all campuses		31,072
Enrollment on campus for which analysis is carried out	100%	31,072
% of students employed while attending college		75%
% of full-time earning potential		65%
Students remaining in the local community after leaving		60%
Attrition rate over time (leaving local community)		40%
"Settling In" factors (years):		
Completing Associate Degree		0.5
Completing Certificate		0.5
Non-completing transfer track		2.5
Non-completing workforce		0.0
ABE/ESL/GED		0.5

As indicated in the table, it is estimated that 60% of the students remain in the local community (as defined in Figure 1.1) and thereby generate local community benefits. The remaining 40% leave the community and are not counted as contributing to regional economic development. The 60% local retention rate applies only to the first year, however. We assume that 40% of the students, and associated benefits, will leave the area over the next 30 years due to attrition (e.g., retirement, out-migration, or death).

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<sup>2</sup> The opportunity cost is the measure of the earnings foregone; the earnings the individual would have collected had he or she not attended MHCC.

The last five items in **Table 2.2** are *settling-in* factors – the time needed by students to settle into the careers that will characterize their working lives. These factors are adapted from Norton Grubb (June 1999). Settling-in factors have the effect of delaying the onset of the benefits to the students and to society at large. Thus, we assume that for transfer track students, the earnings benefits will be delayed for at least 2.5 years to account for the time spent subsequently at 4-year colleges.

### Entry-Level Education, Gender, and Ethnicity

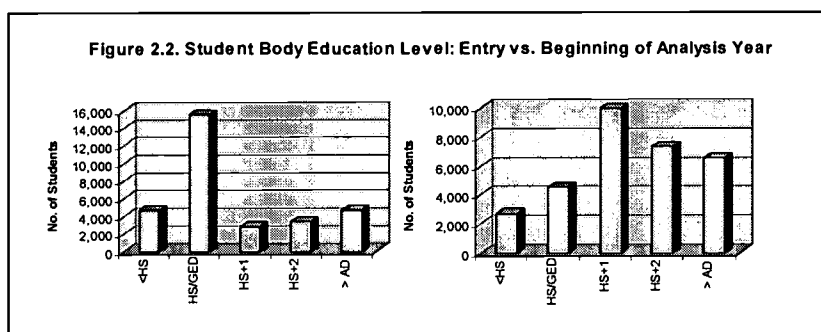
**Table 2.3** shows the education level, gender, and ethnicity of the MHCC student body. This breakdown is used only to add precision to the analysis, not for purposes of comparing between different groups. Five education entry levels are indicated in approximate one-year increments, ranging from less than HS to post AD. These provide the platform upon which the economic benefits are computed.

The *entry level* characterizes the education level of the students when they first enter the college; this is consistent with the way most colleges keep their records. The analysis in this report, however, is based on the educational achievements of the students during the current year. As not all students reported in the enrollment figures for the fiscal year are in their first year of college, an adjustment was made to account for upper class students who had accumulated credits during their community college experience and moved up from the <HS/GED category. For this reason, the education levels of the student body must also be estimated for the beginning of the analysis year. Thus, of the 5,593 white males who first entered with HS/GED, it is estimated that only 1,531 still remain in that category at the beginning of the analysis year, meaning that 4,062 students have actually moved up from the “HS/GED equivalent” category to the “1-year post HS or less” category or beyond since they first entered MHCC. Note that the “Entry Level” and “Begin Year” columns always add to the same total. Differences between the two columns reflect a redistribution of students from entry level to where they are at the beginning of the analysis year. The assumptions underlying the process of redistributing the students from the “Entry Level” to “Begin Year” columns are internal to the economic model – they are designed to

capture the dynamics of the educational progress as the students move up the educational ladder beyond their initial entry level.

Table 2.3. Education Entry Level of Student Body

Entry Level	White Male		Minority Male		White Female		Minority Female		Total	
	Entry Level	Begin Year	Entry Level	Begin Year	Entry Level	Begin Year	Entry Level	Begin Year	Entry Level	Begin Year
< HS/GED	1,243	725	932	544	1,554	906	932	544	4,661	2,719
HS/GED equivalent	5,593	1,531	1,243	487	7,457	2,018	1,243	487	15,536	4,522
1 year post HS or less	843	3,473	488	953	1,021	4,589	488	953	2,841	9,969
2 years post HS or less	1,021	2,383	444	878	1,465	3,163	444	878	3,374	7,302
> AD	1,554	2,142	621	867	1,864	2,684	621	867	4,661	6,560
<b>Total</b>	<b>10,254</b>	<b>10,254</b>	<b>3,729</b>	<b>3,729</b>	<b>13,361</b>	<b>13,361</b>	<b>3,729</b>	<b>3,729</b>	<b>31,072</b>	<b>31,072</b>



## The Achievements

Table 2.4 shows the student breakdown in terms of analysis year academic pursuits and/or achievements according to six categories: 1) retirees who attend largely for self enrichment, 2) Associate Degree completers, 3) Diploma and Certificate completers, 4) all transfer students, 5) all workforce students, and 6) ABE/ESL students<sup>3</sup>.

As indicated in the table, students achieving their graduation goals would be those completing Associate Degrees or Certificates (2.1% and 0.1%, respectively). The majority of students complete college credits, and either fulfill their educational needs, or return the following year to continue to work toward their goals (27.5% + 42.1% = 69.6% in the transfer track and workforce categories, respectively). The retired (9.5%) and ABE/ESL/GED students (18.7%) complete the breakdown of the student body. The retired

<sup>3</sup> ABE/ESL = Adult basic education and English as a second language



students are simply backed out of the analysis altogether on the assumption that they do not attend MHCC to acquire skills that will increase their earnings. ABE/ESL/GED students are assumed to have a lower percentage impact than other students, because the end product of their education is to arrive at the "starting gate" on an equal basis with others. This does not mean that ABE/ESL/GED education has lower value; it simply means that these students must complete an extra step before they can compete effectively in the job market and reap the benefits of higher earnings.

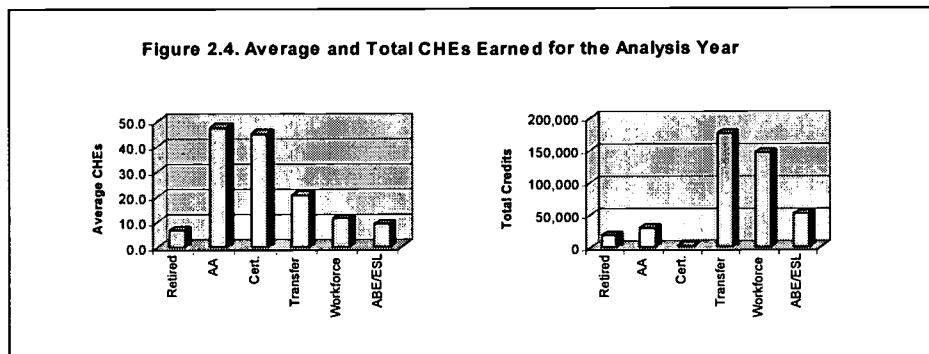
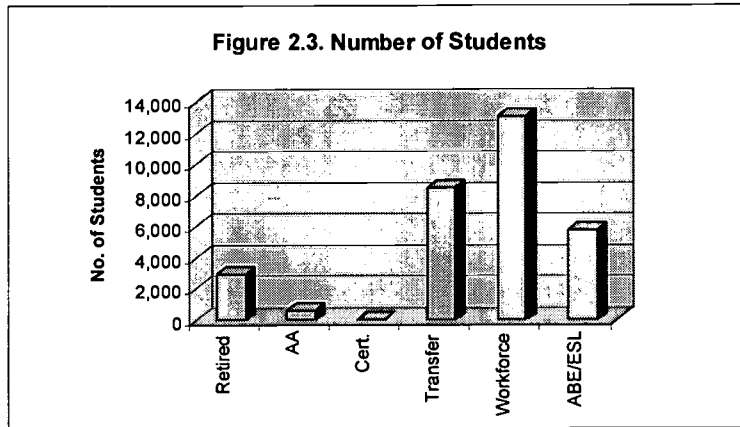
The third column shows the average age of the students generating the benefits (excluding retirees). The difference between the average age (32.7 years) and retirement at 65, or 32.3 years is the time horizon for the analysis.

As indicated in column four, the average Associate Degree and Certificate student completed 47.5 and 45.0 CHEs of study, respectively, during the analysis year. The total number of CHEs completed during the year of analysis for the entire student body is 429,500. Finally, the last column shows the average time the students are actually in residence on campus during the analysis year. This information is needed to determine the opportunity cost of their education.

Table 2.4. Levels of Achievement

Student Body	%	St. Body	Avg. Age	CHEs This Year	Total Credits	# Years Resid.
Retired + recreation students	9.5%	2,943	63	6.7	19,600	0.15
Completing AA	2.1%	653	27	47.5	30,985	1.05
Completing Certificate	0.1%	29	32	45.0	1,305	1.00
Non-completing transfer track	27.5%	8,537	26	20.7	176,716	0.46
Non-completing workforce	42.1%	13,090	39	11.3	148,048	0.25
ABE/ESL/GED	18.7%	5,820	30	9.1	52,846	0.20
<b>Total or weighted averages</b>	<b>100.0%</b>	<b>31,072</b>	<b>32.7</b>	<b>14.6</b>	<b>429,500</b>	
<b>Credits required for one full-time year equivalent of study</b>					<b>45</b>	

Note: weighted average of "CHEs per year does not include the retired students



## ANNUAL PRIVATE BENEFITS

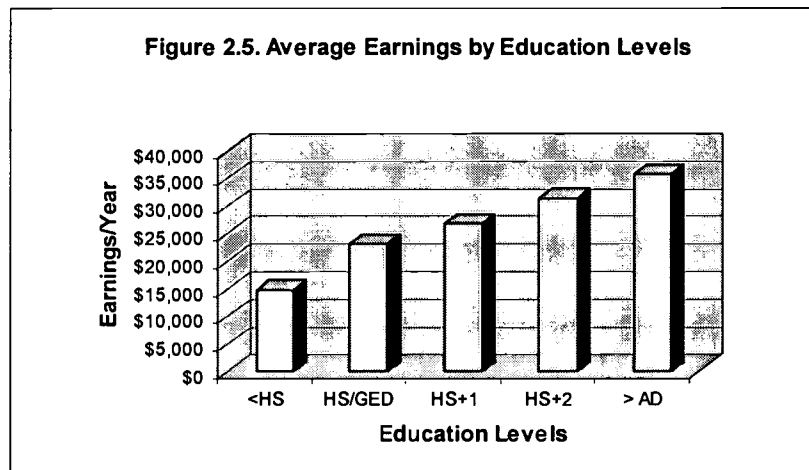
The earnings statistics in **Table 2.5**, on which the benefit estimates (reported in **Chapter 3** below) are based, reflect all occupations (technical and non-technical). The lower the education level, the lower the average earnings, regardless of the subject matters studied. The distinguishing feature among the achievement categories, therefore, is the number of CHEs completed. Statistics indicate that earnings are highly correlated with education. Correlation does not necessarily equal causation, however. Higher education is not the only factor explaining the private and public benefits reported in the statistics. Other variables such as ability, family background, and socioeconomic status play significant roles. The *simple correlation* between higher earnings and education nonetheless defines the *upper limit* of the effect

measured. Our estimates of higher education’s impact on earnings are based on a survey of recent econometric studies. A literature review by Chris Molitor and Duane Leigh (March, 2001) indicates that the upper limit benefits defined by correlation should be discounted by 10%. Absent any similar research for the social variables (health, crime, and welfare and unemployment), we assume that the same discounting factor applies as well to the public benefits.

As education milestones are achieved, students move into higher levels of average earnings. **Table 2.5** shows average earnings by one-year education increments, linked to the gender and ethnicity profile of the MHCC student body. The differences between the steps are indicated in the last column. We also assume that *all* education has value; and thereby attribute value to students completing less than full steps as well. Specific detail on **Table 2.5** data sources and estimating procedures are found in **Appendix 2: Methodology for Creating Income Gains by Levels of Education by Gender and Race.**

**Table 2.5. Weighted Average Earnings**

Entry Level	Average Earnings	Diff.
1 short of HS/GED	\$14,772	NA
HS/GED equivalent	\$23,019	\$8,247
1-year Certificate	\$26,705	\$3,686
2-year Associate Degree	\$31,400	\$4,696
1 year post Associate Degree	\$35,754	\$4,353



## ANNUAL PUBLIC BENEFITS

Students and society at large both benefit from higher earnings. Indeed, the principal motivation for publicly funded higher education is to raise the productivity of the workforce and the incomes the students will enjoy once they complete their studies. Society benefits in other ways as well. Higher education is associated with a variety of lifestyle changes that generate savings; e.g., reduced welfare and unemployment, improved health, and reduced crime. Note that these are *external* or *incidental* benefits of education (see box). Colleges are created to provide education, not to reduce crime, welfare and unemployment, or improve health. The fact that these incidental benefits occur and can be measured, however, is a bonus that enhances the economic attractiveness of the college operations. It should not be taken to mean that taxpayers should channel more money to colleges on the strength of these external benefits. Our purpose is simply to bring to the attention of education stakeholders that the activities of MHCC impact society in many more ways than simply the education it provides. In so doing, we have identified and measured some social benefits obviously related to

### Box: The Beekeeper Analogy

The classic example of a positive externality (sometimes called "neighborhood effect") in economics is that of the private beekeeper. The beekeeper's only 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, he 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.

CCs are in some ways like the beekeepers. Strictly speaking, their business is in providing education and raising the incomes of the young. Along the way, however, external benefits are created. Students' health and other lifestyles are improved, and society indirectly benefits from these just as orchard owners indirectly benefit from the location of beekeepers. Aiming at an optimal expenditure of public funds, the CCbenefits model tracks and accounts for many of these external benefits, and compares them to the public cost (what the taxpayers agree to pay) of CC education.

educational achievements and included them in the mix of impacts generated by the college.

*Assuming state and local taxpayers represent the public, the public benefits of higher education can be gauged from two perspectives, 1) a broad perspective that tallies all benefits, and 2) a narrow perspective that considers only changes in the revenues and expenditures of state and local government.*

## Higher Earnings

**Broad Perspective:** Higher education begets higher earnings. The economy generates more income than it would absent the CC skills embodied in the labor force. From the broad taxpayer perspective, the total increase in regional earnings is counted as benefits of CC education, adjusted down by the benefits accruing to students covered by the alternative education variable in **Table 2.9** further below (50.0%)—these students would still attend college elsewhere even if the MHCC did not exist.

**Narrow Perspective:** Higher regional earnings translate into higher state and local *tax collections*. In the narrow taxpayer perspective we assume that the state and local authorities will collect 16.8% of the higher earnings in the form of taxes—the estimated composite of all taxes other than the federal income taxes.<sup>4</sup>

## Health Savings

The improved health of students generates savings in three measurable ways: 1) lower absenteeism from work, 2) reduced smoking and 3) reduced alcohol abuse (**Table 2.6**). These variables are based on softer (i.e., less-documented) data. In general, statistics show a positive correlation between higher education and improved health habits. The table shows the calculated reductions in the incidences of smoking and alcohol abuse as a function of adding the higher education, also linked to the gender and ethnicity profile of the MHCC student body. Recall from above, the health savings are reduced by 10% in recognition of causation variables not yet identified.

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<sup>4</sup> The tax data are obtained from the U.S. Census Bureau. See also **Appendix 2**.

**Broad Perspective:** The benefits from reduced absenteeism are equal to the average earnings per day multiplied by the number of days saved (less the students covered by the alternative education variable, as above). These are benefits that accrue largely to employers. Smoking- and alcohol-related savings accrue mostly to the individuals who will *not* have to incur the health-related costs. In the broad taxpayer perspective, however, these benefits accrued to employers and individuals are also public benefits.

**Narrow Perspective:** Taxpayers benefit from reduced absenteeism to the extent that state and local government is an employer. Accordingly, we assume a taxpayer's portion of absenteeism savings at 12.8%, equal to the estimated public portion of employment in the region.<sup>5</sup> As for smoking- and alcohol-related savings, the taxpayers benefit to the extent that state and local health subsidies (to hospitals, for example) are reduced. We assume that 6% of the total benefits can be counted as taxpayer savings.

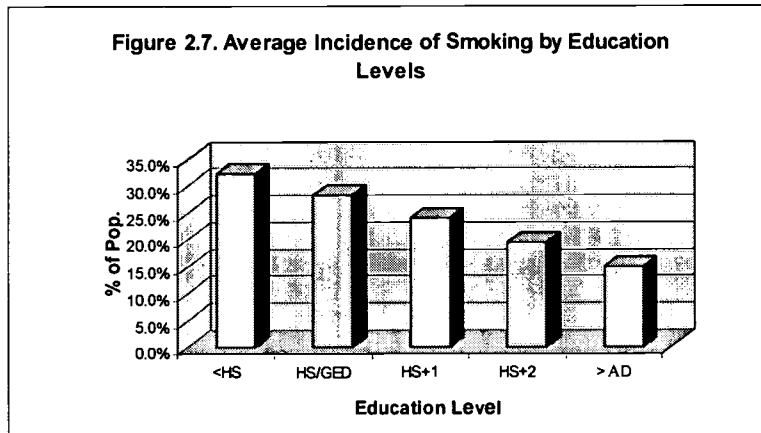
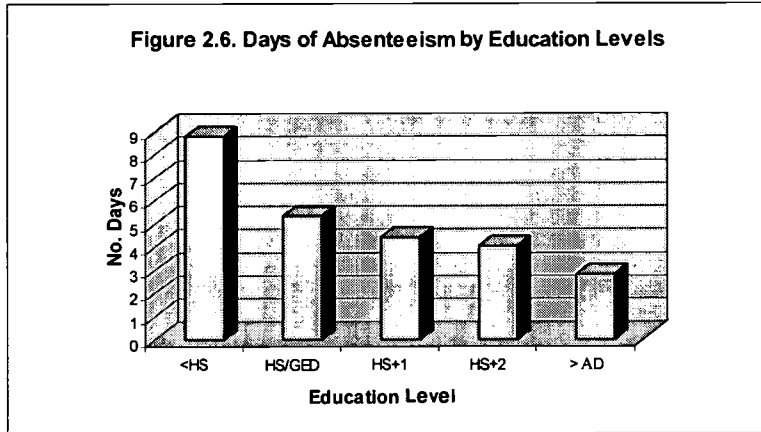
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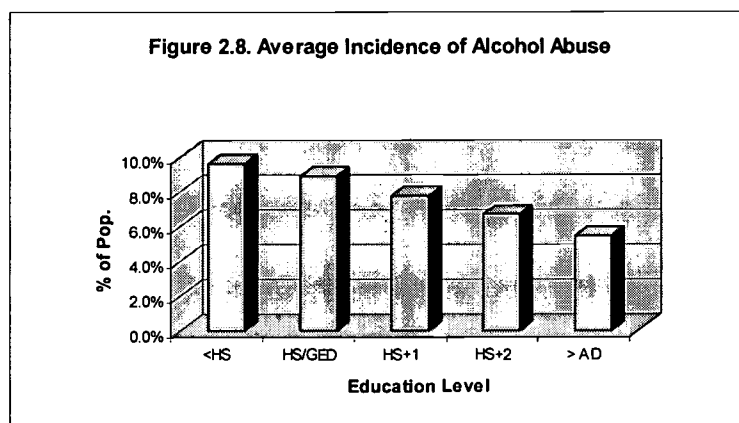
<sup>5</sup>The ratio of state and local earnings over total earnings in the US (Regional Economic Information System – REIS, Bureau of Economic Analysis, Dept. of Commerce, 1998)

Table 2.6. Reduced Absenteeism, Smoking and Alcohol Habits

Education Level	Absenteeism		Smoking		Alcohol Abuse	
	Days	%/Year	Average	Reduction	Average	Reduction
< HS/GED	9	3.4%	32.2%	NA	9.6%	NA
HS/GED equivalent	5	2.1%	28.4%	11.7%	8.9%	7.3%
1 year post HS or less	4	1.7%	24.1%	15.3%	7.8%	12.5%
2 years post HS or less	4	1.5%	19.6%	18.5%	6.7%	14.2%
> AD	3	1.1%	15.0%	23.4%	5.4%	18.7%

1. Absenteeism: U.S. Department of Labor, Bureau of Labor Statistics, Division of Labor Force Statistics, <ftp://ftp.bls.gov/pub/special.requests/lf/aat46.txt>
2. Smoking: *Health, United States, 2001*, Table 61: Centers for Disease Control and Prevention; National Center for Health Statistics; and *The Economic Costs of Smoking in the United States and the Benefits of Comprehensive Tobacco Legislation*, U.S. Treasury Department, <http://www.ustreas.gov/press/releases/docs/tobacco.pdf>
3. Alcoholism: *Health Promotion and Disease Questionnaire* of the 1990 National Health Interview Survey of the Center for Health Statistics; and National Institute on Drug Abuse and the National Institute on Alcohol Abuse and Alcoholism, <http://www.nida.nih.gov/EconomicCosts/Index.html>.





### Crime Reduction Benefits

The first column of **Table 2.7** relates the probabilities of incarceration to education levels – incarceration drops on a sliding scale as education levels rise (linked to the gender and ethnicity profile of the MHCC student body). The percentage reductions are based on total prison population relative to the population at large.<sup>6</sup> The implication is, as people achieve higher education levels, they are statistically less likely to commit crimes. The difference between before and after comprises the benefit attributable to education.

We identify three types of crime-related expenses, 1) the expense of prosecution, imprisonment, and reform, tracked as incarceration expense, 2) victim costs, and 3) productivity lost as a result of time spent in jail or prison rather than working. As with our other social statistics, crime-related expenses are reduced by 10% in recognition of other causation factors.

**Broad Perspective:** From the broad taxpayer perspective, all reductions in crime-related expenses are counted as a benefit (less the students covered by the alternative education variable, as above).

**Narrow Perspective:** We assume that nearly all (80%) of the incarceration savings accrue to the state and local taxpayers – federal funding covers the remainder. Crime victim savings are avoided costs to the potential victims,

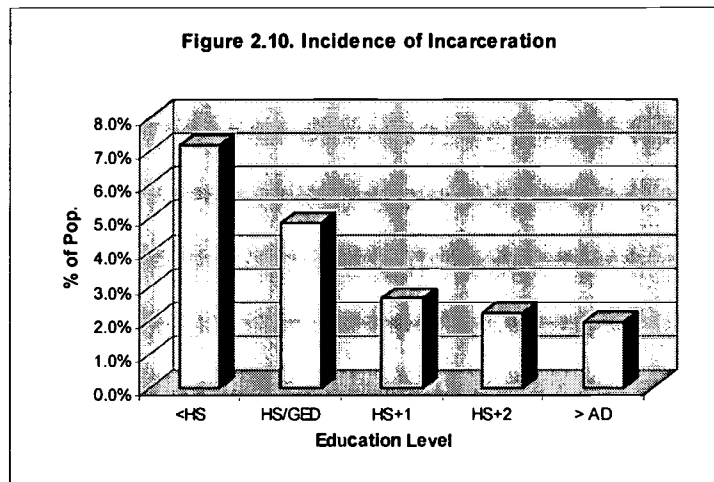


not to the taxpayers. As such, we claim none of these as taxpayer savings. Finally, we apply our “composite” state and local government average tax rate (16.8%) to the added productivity of persons *not* incarcerated to arrive at the taxpayer benefits.

Table 2.7. Incarceration Rates

Education Level	Average	Reduction
< HS/GED	7.2%	NA
HS/GED equivalent	4.9%	32.2%
1 year post HS or less	2.6%	45.7%
2 years post HS or less	2.2%	16.7%
> AD	2.0%	11.3%

1. *Literacy Behind Walls*, National Center for Education Statistics, Prison Literacy Programs, DIGEST No. 159 Literacy in Corrections, Correctional Educational Association,
2. T. P. Bonczar & Alan J. Beck; Lifetime likelihood of Going to State or Federal Prison, US Department of Justice, Office of Justice Programs, March 1997.
3. *Criminal Justice Expenditure and Employment*, Extracts Program (CJEE), author: Sidra Lea Gifford, askbjs@ojp.usdoj.gov (202) 307-0765, 12/14/00.



### Welfare and Unemployment Reduction Benefits

Higher education is statistically associated with lower welfare and unemployment. Table 2.8 relates the probabilities of individuals applying for welfare and/or unemployment assistance to education levels (linked to the

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<sup>6</sup> See also: <http://www.ojp.usdoj.gov/bjs/abstract/p00.htm>.

gender and ethnicity profile of the MHCC student body). As above, all welfare and unemployment savings are reduced by 10% in recognition of other causation factors.

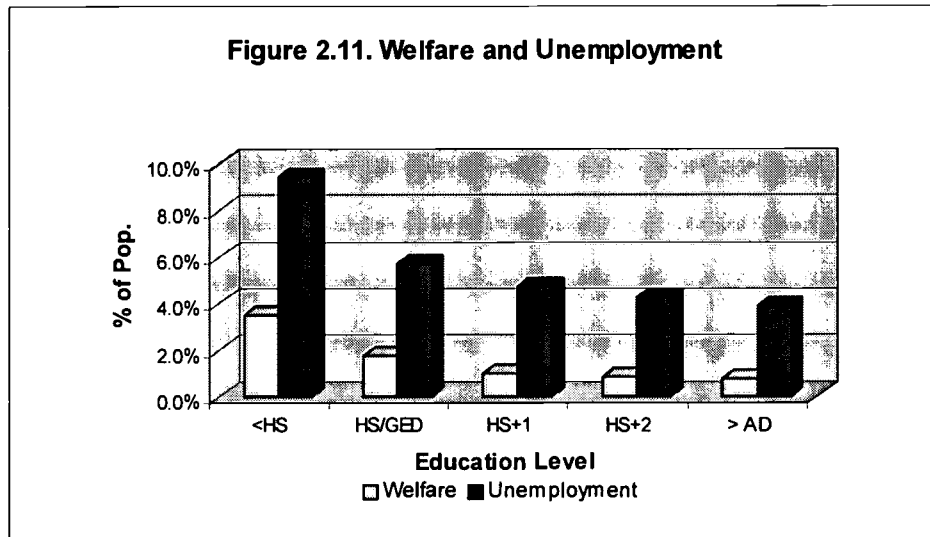
**Broad Perspective:** Reduced welfare and unemployment claims are counted in full as benefits in the broad taxpayer perspective (less the students covered by the alternative education variable, as above).

**Narrow Perspective:** Local taxpayer benefits from reduced welfare are limited to 16%--the extent to which the state and local taxpayers subsidize the welfare system. None is claimed for unemployment, because most of these costs are borne by the Federal Government.

Table 2.8. Welfare & Unemployment

Education Level	Welfare		Unemployment	
	Average	Reduction	Average	Reduction
< HS/GED	3.5%	NA	9.4%	NA
HS/GED equivalent	1.7%	50.1%	5.8%	39.1%
1 year post HS or less	1.0%	43.7%	4.7%	17.4%
2 years post HS or less	0.9%	9.3%	4.3%	9.4%
> AD	0.8%	11.5%	3.9%	9.2%

1. Temporary Assistance for Needy Families, TANF Program 3rd annual report to Congress, US Dept of Health and Human Resources, Table 10:12.
2. The Heritage Foundation, *Means-Tested Welfare Spending: Past and Future Growth*, Testimony by Robert Rector, (3/07/01).



## COSTS

There are two main cost components considered in the analytic framework: 1) the cost incurred by the student, including the opportunity cost of his or her time (represented by the earnings foregone while attending MHCC), and expenses for tuition and books, and 2) the cost incurred by state and local government taxpayers, part of the college's operating and capital costs (the budget – see Table 2.1). These are briefly discussed below.

### Opportunity Cost of Time

The opportunity cost of time is, by far, the largest cost. While attending MHCC, most students forego some earnings, because they are not employed or are employed only part-time. The assumptions are discussed in conjunction with Table 2.2 above. For the non-working students, the opportunity cost is the full measure of the incomes not earned during their CC attendance. For students working part-time, the opportunity cost is the difference between what they could make full-time less what they are making part-time. No opportunity cost of time is charged for the fully employed. The opportunity costs are derived from the earnings categories by education entry levels given in Table 2.5, although with some important modifications, as briefly described below:

- The earnings in Table 2.5 are averages based on trajectories of earnings for all ages, from 17 to 65 (roughly defining the time spent engaged in the workforce).
- The average earnings, therefore, define the mid-point of a working life trajectory that begins with low entry-level wages and culminates with a typical worker's highest wages around age 60.<sup>7</sup> The earnings data shown in Table 2.5 are specific to the state of Oregon, weighted, however, to reflect the specific gender and ethnicity makeup of the

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<sup>7</sup> This profile of lifetime earnings is well documented in labor economics literature. For example, see Willis (1986), supported by the well-respected theoretical and empirical work of Becker (1964) and Mincer (1958).

MHCC student body. Details on earnings and education sources are found in **Appendix 2**.

- The opportunity cost of time is then conditioned by the average age of the student (32.7 years, see **Table 2.4**). In particular, the average earnings at the midpoint (\$26,982 in **Table 3.5**) are adjusted downward to \$24,719 to reflect the average earnings at age 32.7.

## The Budget

Beyond the student perspective, our assessment of MHCC considers the benefits and costs from the state and local government taxpayer perspective. Accordingly, only the state and local government revenues in **Table 2.1** are included as costs in the investment and benefit-cost assessment. All else equal, the larger the other revenue sources in **Table 2.1** (federal grants, student tuition, and contract revenues) relative to state and local government revenues, the larger will be the relative economic payback to state and local taxpayers.

## OTHER ASSUMPTIONS

**Table 2.9** lists several other assumptions imbedded in the analytic model: a) the discount rate and time horizon, b) crime-related costs (incarceration costs are inclusive of the cost per prison year plus all costs associated with arrest, investigation, trial and finally incarceration), c) welfare and unemployment costs per year<sup>8</sup>, and d) health-related costs.<sup>9</sup> Annual real increases in costs are also included, although these are not used in the study. The alternative education opportunity assumption is discussed further below in association with the regional economic impacts.

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<sup>8</sup> As indicated in the table, we assume that the average duration on welfare and unemployment is 4.0 and 4.0 years, respectively. This means that, over the next 30 years or so, the cumulative incidence of welfare and/or unemployment will be spread evenly over the time horizon – it is not a consecutive period.

<sup>9</sup> The incarceration, health, welfare and unemployment probability and cost variables are internal to the analytic model.

Table 2.9. Miscellaneous Variables

	Variables
Discount rate	4.0%
Time horizon, years to retirement	32.3
Avg. cost/prison year (all incl.: arrest, trial, incarceration, rehab. etc.)	\$82,415
Avg. length of incarceration (total years over 30-year time horizon)	4.0
Real cost increase per prison year	0.0%
Average victim cost	\$ 60,219
Real victim cost increase per year	0.0%
Average cost per welfare year	\$ 75,138
Avg. duration on welfare (total years over 30-year time horizon)	4.0
Welfare/unemployment cost increase per year	0.0%
Average cost per unemployment year	\$ 36,249
Avg. duration on unempl. (total years over 30-year time horizon)	4.0
Smoking-related medical costs per year	\$ 2,962
Alcohol-related medical costs/year	\$ 7,946
Real medical cost increase per year	0.0%
Alternative education opportunities	50.0%
Assumptions adapted from:	
1. Bureau of Justice Statistics, Table #. 05 Total direct and intergovernmental expenditure, by activity and level of government, fiscal years 1980-97, Criminal Justice Expenditure and Employment Extracts Program, 12/14/00.	
2. OICJ The Extent and Costs of Victimization, Crime and Justice: The Americas, Dec-Jan 1995.	
3. The Heritage Foundation, <i>Means-Tested Welfare Spending: Past and Future Growth</i> , Testimony by Robert Rector, (3/07/01).	
4. U.S. Department of Labor, Bureau of Labor Statistics, <a href="http://www.bls.gov/news.release/annpay.t01.htm">http://www.bls.gov/news.release/annpay.t01.htm</a> .	
5. The Economic Costs of Smoking in the United States and the Benefits of Comprehensive Tobacco Legislation, <a href="http://www.ustreas.gov/press/releases/docs/tobacco.pdf">http://www.ustreas.gov/press/releases/docs/tobacco.pdf</a> .	
6. National Institute on Drug Abuse and the National Institute on Alcohol Abuse and Alcoholism, found at: <a href="http://www.nida.nih.gov/EconomicCosts/Index.html">http://www.nida.nih.gov/EconomicCosts/Index.html</a> .	

## REGIONAL ECONOMIC BENEFITS

In general, the regional economy is affected by the presence of MHCC in two ways: from its day-to-day operations (including capital spending), and from students who enter the workforce with increased skills and know-how. Day-to-day operations of the college provide the *direct* jobs and earnings of the faculty and staff, and additional *indirect* jobs and earnings through the action of regional multiplier effects. At the same time, students expand the skill-base of the local workforce, deepening the economy's stock of human capital, which attracts new industry and makes existing industry more productive.

Estimating these regional economic effects requires a number of interrelated models. Multiplier effects are obtained with an input-output (IO) model constructed for the Mt. Hood Community College economic region.<sup>10</sup>

<sup>10</sup> The Mt. Hood Community College model is constructed according to traditional practice using national model IO coefficients and secondary data. The models employ the IO accounting framework

Estimating CC operations effects requires an additional model that takes CC expenditures, deducts spending that leaks from the economy, and bridges what is left to the sectors of the IO model.

Several steps are involved in estimating the skill-enhancing effect of past students on the regional workforce, and in turn, the effect of these workforce changes on the regional economy. First, the number of past students still active in the regional workforce is estimated and converted to total workforce embodied CHEs. In the **Annual Private Benefits** section above an estimate was made of the incremental (per CHE) effect on student earnings of MHCC instruction. This estimate is applied to total embodied CHEs to arrive at an initial estimate of the past student regional income effect. In arriving at the final estimate, the initial value must first be reduced to account for a collection of substitution effects, and then expanded to capture a collection of demand and supply-side effects. The end result is an estimate of the impact of past student skills and increased productivity on the size of the regional economy.

This section is divided into two subsections. The first documents our estimation of day-to-day MHCC operations effects. The second documents our estimation of the effect of past student skills on the regional economy.

### **The Impact of MHCC Operations**

The first step in estimating the impact of MHCC operations is to assemble a profile of its combined operating and capital expenditures (see **Table 2.10**). These data are drawn from the college budget and collected into the categories of **Table 2.10**. Column 1 simply shows the total dollar amount of spending. Columns 2 through 5 apportion that spending to in-region, in-state and out-of-state vendors. The net local portion is derived in Column 6. The spending data shown in this column are fed into the regional IO model.<sup>11</sup>

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presented in Robison (1997) and are equipped with regional purchase coefficients adapted from Stevens et. al., 1983.

<sup>11</sup> **Table 2.10**, by itself, provides very important information to present to local audiences—Chambers of Commerce, local business establishments, Rotary clubs, and the like. The table demonstrates that the

The information on total spending required for column 1 is generally readily available, though sorting specific items to the categories of the table can take some time. Information in columns 2 through 5 is generally more problematic—hard data are scarce on the local/non-local split. In these cases, staff is asked to use their best judgment.

The first row in Table 2.10 shows salaries and wages. These *direct* earnings are part of the economic region's overall earnings, and appear as "Direct Earnings of Faculty and Staff" in the table of findings, Table 3.10. Dollar values in Table 2.10 column 6, "net local spending," are fed into the economic region IO model. The IO model provides an estimate of indirect effects, and these appear as "Indirect Earnings" in Table 3.10.

Table 2.10. Profile of College Spending in and out of Regional Economy (\$ Thousands)

Spending Categories	Tot. Dollar Amount (1)	Local % (2)	Non-Local, but in-state % (3)	% Local Manufact. (4)	% Non-Local Manufact. in-state % (5)	Net Local Spending (6)
Salaries and Wages	\$36,871	78%	15%			\$28,759
Travel	\$835	54%	12%			\$451
Electricity and natural gas	\$1,356	100%	0%			\$1,356
Telephone	\$321	3%	5%			\$10
Building Materials & Gardening Supplies	\$855	42%	24%	20%	40%	\$359
General Merchandise Stores	\$5,884	40%	20%	10%	30%	\$2,354
Eating & Drinking	\$108	47%	9%			\$51
Maintenance & Repair Construction	\$216	51%	29%			\$110
New Construction	\$1	100%	0%			\$1
Insurance	\$500	94%	6%			\$470
Legal Services	\$123	88%	10%			\$108
Credit Agencies	\$14	70%	20%			\$10
U.S. Postal Service	\$11	90%	0%			\$10
Accounting, Auditing & Bookkeeping	\$176	100%	0%			\$176
Marketing	\$169	65%	4%			\$110
Other Business Services	\$12,037	62%	29%			\$7,463
Water Supply & Sewerage Systems	\$257	99%	0%			\$254
Printing & Publishing	\$495	89%	8%			\$441
Rental Property	\$0	0%	0%			\$0
Services to Buildings	\$1,280	48%	23%			\$614
Unemployment Compensation	\$185	77%	15%			\$142
Honoraria + other payments to households	\$6,638	74%	25%			\$4,912
<b>Total</b>	<b>\$68,331</b>					<b>\$48,160</b>

Note: this table provides details for the summary of the college role in the regional economy (Table 3.10)

### The Direct Economic Development Effects of Students

In the next chapter we estimate that the average CHE of MHCC instruction is worth \$78 per year in increased employee earnings (see Table 3.3). This is the

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college is a "good neighbor" in the local community, evidenced by the fact that an estimated 70% of all college expenditures benefit local vendors ( $\$48,160 / \$68,331 = 70\%$ ).

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average value across the student's entire working life.<sup>12</sup> At any point in time, the local workforce will embody thousands of CHEs of past MHCC instruction. We obtain an initial estimate of the direct past student economic development effect by multiplying the total hours of embodied instruction by the \$78 value.

A separate model is constructed to estimate the CHEs of past MHCC instruction embodied in the regional workforce. **Table 2.11** indicates variables critical to the model, while **Table 2.12** shows the output of the model itself. Considering **Table 2.12** one column at a time conveys the logic of the model.

Column 1 provides an estimate of the enrollment history (unduplicated headcount) of MHCC students. Column 2 represents the non-retired students, in other words, the students who have the potential to go into the workforce. Column 3 is the same as column 2, but net of students who leave the region immediately upon leaving MHCC. As shown in the table, 60% of the students remain in the area upon leaving the CC, 40% leave.

Column 4 goes one step further—a comparison of columns 3 and 4 indicates that all past students have left MHCC except for the last three years (1997 – 2000) where students are still enrolled (the leaver assumptions are shown in column 9).

Column 5 further reduces leavers to focus only on those who have settled into a somewhat permanent occupation. As shown in column 10 (the "settling factor"), it is assumed that all students settle into permanent occupations by their fourth year out of school. Settling-in assumptions are specified in **Table 2.2** above.

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<sup>12</sup> In reality, the earnings increment due to MHCC skills might be expected to start low and grow over the course of a student's working life. MHCC-acquired skills open doors for the students, giving them a chance to excel and advance in their careers. Our earnings increment due to MHCC attendance is an average across all age levels (as also discussed above in relation to the opportunity cost of time variable). It would thus overstate earnings in the early years and understate them in later years. Our interest, however, is to arrive at an estimate of the lifetime accumulated earnings increment. Use of the average for the entire course of student working lives should provide the proper aggregate estimate.



Column 6 transitions further from leavers who have settled into jobs to leavers still active in the current workforce. Here we net off workers who, subsequent to leaving MHCC and settling into the local workforce, have out-migrated, retired, or died. As shown in **Table 2.11**, roughly one-third of the past students will out-migrate, retire or die over the course of the next 30 years. This "30-year attrition" follows an assumed logarithmic decay function shown in column 11 labeled "active in local workforce."

Column 7 shows the average CHEs generated per year back to 1971. These data were obtained by dividing total year-by-year CHEs by the corresponding headcount.<sup>13</sup> Column 8 shows the product of the year-by-year average CHEs, and the estimate of the number of past students active in the current workforce in column 6. Looking to the total in Column 8, we estimate that the current workforce of the Mt. Hood Community College economic region embodies some 4.1 million CHEs of past MHCC instruction.

### **From Embodied CHEs to Direct Income Effects**

An *upper-bound* estimate of the past student economic development effect is obtained by multiplying the total embodied CHEs (**Table 2.12**) by the estimated \$78 per-CHE value (**Table 3.2**). The result of this calculation is still an upper bound, for reasons pertaining to economic development theory. We constructed a model to capture this dynamic, and thereby reduced the upper bound to arrive at the estimate of the direct past student economic development effect. Our model hinges on two assumptions for two polar case scenarios (see **Box**).

Note that with polar case scenario 1, we would reduce our upper-bound estimate to zero - i.e., an enhanced workforce skill base has no economic development effect. In contrast, with polar case scenario 2 we would accept the full upper-bound amount as our past student economic development effect. Obviously the true measure is somewhere in between.

There is considerable empirical literature on the economic development effects of education, and from this research we are able to adapt a

documented adjustment factor. In particular, in a recent study Bils and Klenow (2000) survey past work on the economic development effects of education, and advance a model of their own. Based on their findings, we reduce the upper bound to 30% of the potential (upper bound) total to arrive at our final estimate: thus \$53.6 million of the upper bound value is counted as the direct past student economic development effect. These appear in Table 3.10 under the heading "Earnings Attributable to Past Student Economic Development Effects," "Direct Earnings."

**Box: Polar Cases**

**Polar Case Scenario 1.** Assumption #1 under this scenario is that the rate of technical substitution between local skilled and unskilled workers is infinitely elastic. This means that newly skilled past MHCC students are substituted for unskilled workers in a manner that creates no net additional regional earnings. Businesses simply replace lower productivity (and lower paid) unskilled workers with some smaller number of higher productivity (and higher paid) skilled workers, with no net change in overall output or earnings.

Assumption #2 is that the rate of technical substitution between local and non-local workers is infinitely elastic, and that the existence of a skilled workforce is not a factor in attracting new industry to the region. This means that existing industry can readily draw skilled workers from outside the region, and regional growth is driven by something other than skills in the local workforce. Skilled workers are easily imported without extraordinary inducements or wage premiums that would otherwise increase costs and reduce competitiveness.

**Polar Scenario 2.** Assumption #1 is that the rate of technical substitution between local skilled and unskilled workers is infinitely inelastic. Skilled workers are able to perform the same tasks at less expense than unskilled workers, and they are able to perform many tasks that unskilled workers cannot. Under this assumption, skilled workers increase efficiency, enable an expansion of the product line, and generally increase the competitiveness of existing industry. The result is an expansion of earnings as well as output.

Assumption #2 is that the rate of technical substitution between local and non-local workers is infinitely inelastic, and the existence of a skilled workforce is, therefore, a factor in attracting new industry to the region (there is a near stand-alone development theory based on the notion that skilled workers attract new industry – Borts and Stein, 1964).

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<sup>13</sup> We used the current year estimate of CHEs (see Table 2.4), adjusted for the retired students, as a proxy for the average achievement per student in all prior years before FY 2000-01.

## The Indirect Economic Development Effects of Students

The direct earnings attributed to the MHCC skills embodied in the current region workforce are not the only past student economic development effects. Associated with the increased output and earnings is an increased demand for both consumer goods and services, and goods and services purchased by businesses as inputs. These, in turn, produce a set of regional economic multiplier effects as increased employee and business spending ripples through the other parts of the economy.

We assume that the students will acquire jobs in the *higher-stage* sectors of the economy (e.g., technical services and advanced manufacturing sectors, see Parr, 1999). For demand-induced effects, we compute a weighted average demand-driven earnings multiplier from the IO model for the impact area. Higher-stage sectors receive greater weight than lower-stage sectors. Demand-side indirect effects are obtained in the usual manner by applying the multiplier to the direct effect estimate.

There is still more. Economic development theory describes an “agglomeration” effect whereby regional growth itself stimulates growth. A new plant (A) established in a region attracts other plants to the same region (B, C, and D) that use A’s outputs as inputs in their production processes. This in turn spawns another round of industry growth, and so on. To estimate agglomeration effects, we configure our economic region IO model to provide a set of so-called supply-driven multipliers (see for example Miller and Blair, 1985). We then compute a weighted average supply-driven earnings multiplier, again favoring higher-stage sectors. Agglomeration (or supply-side) effects are obtained by applying the multiplier to the direct effect estimate.

Finally, a third key element is accounted for – the *alternative education opportunity variable* (see Table 2.9). This is technically not a cost variable, but rather a “negative benefit,” one that recognizes the fact that, absent the MHCC, some portion of the aggregate student body would obtain an education elsewhere. The problem is determining what this portion is. Clearly, 100% would be incorrect because not everyone would be able to attend a technical college in a neighboring state. Indeed, an integral part of

the CC mission is to provide open educational access for those who cannot avail themselves of the alternatives. For the MHCC, the assumption for this variable is 50%; i.e., the statewide economic benefits are reduced across the board by this amount.

Table 2.11. Critical Variables

Assumptions	Values
Current headcount of students	31,072
Students remaining in the community after leaving CC	60%
30-year attrition	40%
Decay rate	1.7%
Overall average of credits earned per student this year	14.6

Table 2.12. Estimating Credit Hours of Instruction Embodied in the Workforce

Year	Student Enrollment Headcount	Subtract Retired Students	Subtract Students Migrating Immediately	Students who have left college (Leavers)	Leavers Who Have Settled Into Jobs	# Settled Into Jobs - Active in the Workforce	Average Credit Equivalents	Credits Embodied in the Workforce	Assumptions		
									% of Students in Workforce	"Settling" Factor	Active in Workforce
1	2	3	4	5	6	7	8	9	10	11	
1972	14,198	12,853	7,712	7,712	7,712	4,627	14.57	67,428	100%	100%	60.0%
1973	16,472	14,912	8,947	8,947	8,947	5,460	14.57	79,570	100%	100%	61.0%
1974	16,856	15,259	9,156	9,156	9,156	5,684	14.57	82,824	100%	100%	62.1%
1975	17,627	15,957	9,574	9,574	9,574	6,046	14.57	88,100	100%	100%	63.1%
1976	20,860	18,884	11,331	11,331	11,331	7,277	14.57	106,049	100%	100%	64.2%
1977	19,563	17,710	10,626	10,626	10,626	6,942	14.57	101,163	100%	100%	65.3%
1978	19,162	17,347	10,408	10,408	10,408	6,917	14.57	100,791	100%	100%	66.5%
1979	19,870	17,988	10,793	10,793	10,793	7,295	14.57	106,310	100%	100%	67.6%
1980	21,881	19,809	11,885	11,885	11,885	8,172	14.57	119,080	100%	100%	68.8%
1981	21,802	19,737	11,842	11,842	11,842	8,282	14.57	120,687	100%	100%	69.9%
1982	21,101	19,102	11,461	11,461	11,461	8,153	14.57	118,813	100%	100%	71.1%
1983	20,433	18,498	11,099	11,099	11,099	8,031	14.57	117,027	100%	100%	72.4%
1984	19,062	17,257	10,354	10,354	10,354	7,621	14.57	111,050	100%	100%	73.6%
1985	17,539	15,878	9,527	9,527	9,527	7,132	14.57	103,932	100%	100%	74.9%
1986	17,040	15,426	9,256	9,256	9,256	7,048	14.57	102,709	100%	100%	76.2%
1987	21,007	19,017	11,410	11,410	11,410	8,838	14.57	128,795	100%	100%	77.5%
1988	23,191	20,994	12,597	12,597	12,597	9,925	14.57	144,627	100%	100%	78.8%
1989	25,517	23,100	13,860	13,860	13,860	11,108	14.57	161,866	100%	100%	80.1%
1990	26,826	24,285	14,571	14,571	14,571	11,878	14.57	173,091	100%	100%	81.5%
1991	27,113	24,545	14,727	14,727	14,727	12,212	14.57	177,948	100%	100%	82.9%
1992	27,146	24,575	14,745	14,745	14,745	12,436	14.57	181,224	100%	100%	84.3%
1993	29,632	26,825	16,095	16,095	16,095	13,808	14.57	201,217	100%	100%	85.8%
1994	27,209	24,632	14,779	14,779	14,779	12,897	14.57	187,937	100%	100%	87.3%
1995	26,758	24,224	14,534	14,534	14,534	12,901	14.57	187,996	100%	100%	88.8%
1996	25,532	23,114	13,868	13,868	13,868	12,521	14.57	182,463	100%	100%	90.3%
1997	26,670	24,144	14,486	14,486	14,486	13,304	14.57	193,869	100%	100%	91.8%
1998	26,782	24,245	14,547	14,547	14,547	13,589	14.57	198,026	100%	100%	93.4%
1999	27,495	24,891	14,934	14,927	13,434	12,765	14.57	186,016	100%	90%	95.0%
2000	29,800	26,977	16,186	15,822	11,867	11,469	14.57	167,134	98%	75%	96.7%
2001	31,072	28,129	16,877	14,346	7,173	7,173	14.57	104,524	85%	50%	100.0%
<b>Embodied Total</b>								<b>4,102,263</b>			

## Chapter 3

# PRIVATE, PUBLIC AND REGIONAL ECONOMIC BENEFITS

### INTRODUCTION

**T**his chapter summarizes the main MHCC case study results in four sections: 1) the aggregate annual private and public benefits; 2) these same benefits measured per CHE and per student; 3) future benefits expressed in terms of NPV, RR, and B/C ratio, and 4) the regional economic benefits.

### ANNUAL BENEFITS

#### Higher Student Earnings

The annual benefits are summarized in **Tables 3.1** and **3.2**. We begin with earnings growth in **Table 3.1**. Last year, each student completed, on average, 14.6 CHEs at MHCC (see **Table 2.4**), only a fraction of one full year of study. This is because the majority of students attend for a variety of purposes as discussed in conjunction with **Table 2.4**; for some, to make progress towards an eventual degree, and for others, simply to acquire certain skills that will increase their productivity in the workforce. A total of 31,072 students will capture \$33.7million worth of higher annual earnings based on this average increase in educational attainment.

#### Social Savings

##### *Health-Related Savings*

Also in **Table 3.1**, we see that improved health, lower welfare and unemployment, and lower crime will result in annual dollar savings to the taxpayers of \$4.0, \$1.3, and \$2.0 million (rounded). In **Table 3.2**, these same results are presented in greater detail – health-related absenteeism will decline by 14,417 days per year, translating to a total of 55 years' worth of productivity gained per year (based on 260 workdays per year). Annual total

dollar savings from reduced absenteeism days equals \$1.5 million. There will be 502 fewer smokers and 129 fewer alcohol abusers, amounting to annual total dollar savings of \$1.49 and \$1.0 million, respectively, inclusive of insurance premiums, personal payments, and withholding for Medicare and Medicaid.

### *Crime-Related Savings*

There will be 131 fewer people incarcerated as a result of the higher education obtained, saving the taxpayers a grand total of some \$1,319,061 per year. The assumptions pertaining to these results are listed in Table 2.9 in the previous chapter. They are based on an average duration of 4.0 years incarcerated at an average cost of \$82,415 per year (inclusive of arrest, prosecution, incarceration, and rehabilitation).<sup>14</sup> Fewer people incarcerated means more people gainfully employed – this translates to \$448,960 in additional annual earnings for the local community. Victim costs will be reduced by \$277,016 per year.

### *Welfare and Unemployment Savings*

There will be 66 and 106 fewer people on welfare and unemployment, respectively, in the community. The corresponding total dollar savings for the local community amounts to \$1,286,293 (\$296,277 welfare + \$990,016 unemployment savings) for one year, assuming that the average time spent on welfare and unemployment is 4.0 years (see Table 2.9).

### *Total Public Benefits*

All told, there will be \$7.3 million in public savings per year in the community – the sum of all health, crime, and welfare/unemployment benefits in Table 3.2.

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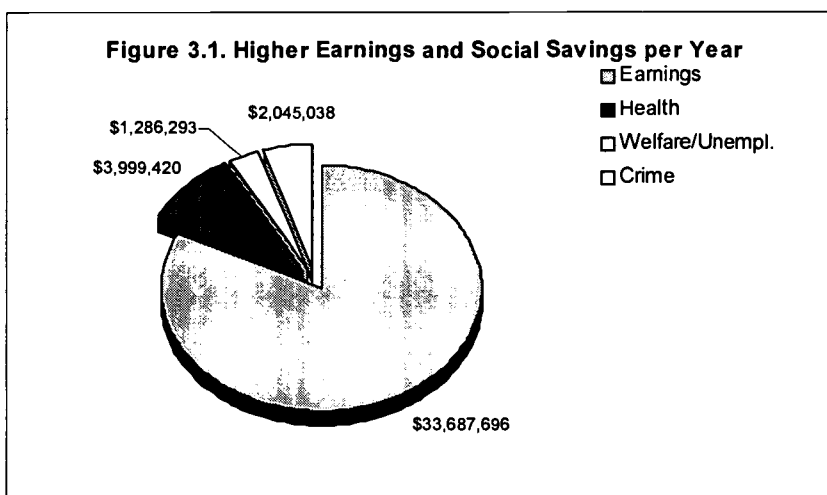
<sup>14</sup> The calculation is as follows: 131 not incarcerated x \$82,415 x 4.0 years / 32.3 years to retirement from Table 2.9 = \$83,368.

Table 3.1 Student Body Achievements, Higher Earnings

Level of Education	Social (External Benefits)				Total
	Higher Earnings	Improved Health	Lower Welfare Unemployment	Lower Crime	
< HS/GED	\$2,452,790	\$206,142	\$292,857	\$190,599	\$3,142,388
HS/GED equivalent	\$3,102,037	\$225,240	\$245,305	\$173,051	\$3,745,634
1 year post HS or less	\$11,516,304	\$1,329,898	\$519,997	\$1,449,730	\$14,815,930
2 years post HS or less	\$10,212,332	\$744,728	\$121,447	\$72,761	\$11,151,267
> Associate Degree	\$6,404,234	\$1,493,411	\$106,687	\$158,897	\$8,163,229
<b>Total</b>	<b>\$33,687,696</b>	<b>\$3,999,420</b>	<b>\$1,286,293</b>	<b>\$2,045,038</b>	<b>\$41,018,447</b>

Table 3.2. Summary of Annual Benefits

	Units	Earnings	Social Savings
Higher earnings	NA	\$33,687,696	
<b>Health benefits</b>			
Absenteeism savings (days)	14,417	NA	\$1,488,318
Fewer smokers, medical savings (# persons)	502	NA	\$1,485,768
Fewer alcohol abusers (# persons)	129	NA	\$1,025,334
<b>Crime benefits</b>			
Incarceration savings (# persons)	131	NA	\$1,319,061
Crime victim savings	NA	NA	\$277,016
Added productivity (fewer incarcerated)	NA	NA	\$448,960
<b>Welfare/unemployment benefits</b>			
Welfare savings (# persons)	66	NA	\$296,277
Unemployment savings (# persons)	106	NA	\$990,016
<b>Total</b>		<b>\$33,687,696</b>	<b>\$7,330,751</b>



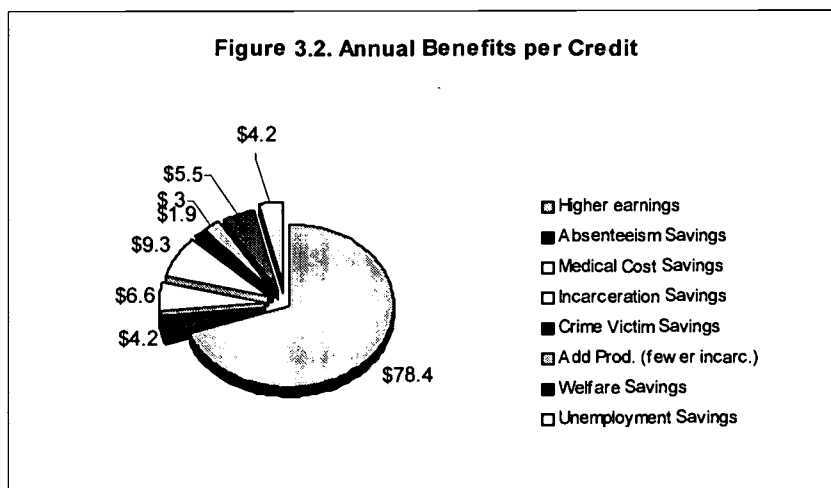
### ANNUAL BENEFITS PER CHE AND PER STUDENT

The aggregate benefits reported in Tables 3.1 and 3.2 above are expressed per CHE and per student in Table 3.3. On average, students capture: a) \$78 per

year in higher earnings per CHE,<sup>15</sup> and b) \$1,122 per year in higher earnings per student on the basis of the number of CHEs completed. **Converted to a full-year-equivalent (45 CHEs), the annual earnings would amount to \$3,463 per student.** On average, the social benefits per CHE range from a low of \$2 for Crime Victim Savings to a high of \$9 per CHE for Incarceration Savings. On a per student basis, they range from a low of \$26 per student for Crime Victim Savings to a high of \$122 for Incarceration Savings. On a full-year equivalent basis (45 CHEs), the social savings would amount to \$1,403 per student (the total of \$4,867 less \$3,463 of higher private earnings as indicated in Table 3.3).

Table 3.3. Annual \$ per Credit and Student

	Per Credit	Per Student	Annualized
Higher earnings	\$78	\$1,122	\$3,463
Absenteeism Savings	\$4	\$56	\$172
Medical Cost Savings	\$7	\$88	\$270
Incarceration Savings	\$9	\$122	\$377
Crime Victim Savings	\$2	\$26	\$79
Add Prod. (fewer incarceration.)	\$3	\$36	\$110
Welfare Savings	\$5	\$72	\$224
Unemployment Savings	\$4	\$55	\$171
<b>Total</b>	<b>\$113</b>	<b>\$1,576</b>	<b>\$4,867</b>



<sup>15</sup> Thus, a student attending for 10 CHEs will add \$784 per year to the lifetime earnings. A longer curriculum will add substantially more. The earnings expectations are portrayed as linear but with many computational steps involved (see Chapter 2). The extrapolation is based on the averages of low earnings additions for leavers completing few CHEs, plus higher additions for leavers completing more CHEs.



## THE INVESTMENT ANALYSIS: INCORPORATING FUTURE BENEFITS

The results in Tables 3.1 and 3.2 provide only a single-year snapshot of the benefits. As long as the students remain in the workforce, however, the CC-acquired skills continue to add productivity over time. In the investment analysis, the higher earnings and avoided costs are projected into the future over the working life of the student, discounted to the present, and then compared to the present costs of education. The investment is feasible if all discounted future benefits are greater than or equal to the costs.<sup>16</sup>

The investment analysis results are shown in Table 3.9 (in the aggregate, per CHE and per student). The end results sought are the **Net Present Value (NPV)**, **Rate of Return (RR)**, the **Benefit/Cost (B/C) ratio** and the **Payback Period**.<sup>17</sup> These are simply different ways of expressing the results. All of the present value results shown are intermediary steps that *ultimately generate* the NPVs, RRs and B/C ratios.

We begin with some definitions in Table 3.4. **Private benefits** are the higher earnings captured by the students themselves. **Broad taxpayer benefits** are the additions to regional earnings plus lower overall expenditures related to health, crime, welfare and unemployment. **Narrow taxpayer benefits** include increased state and local tax revenues (from increased regional income), and savings from reduced state and local government expenditures for incarceration, health and welfare.

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<sup>16</sup> Future benefits are worth less than present benefits. The present value of \$5,000 to be received 30 years from today is worth only \$1,603 given a 4% discount rate ( $\$5,000 / (1.04)^{30} = \$1,603$ ). If the same benefits occur each year for 30 years, each year's benefit must be discounted to the present, summed and collapsed into one value that represents the *cumulative* present value of all future benefits. Thus, the present value of 30-years' worth of \$5,000 per year is \$90,000.

<sup>17</sup> The criteria for feasibility: a) NPV must be positive or equal to zero; b) RR must be equal to or greater than the returns from other similar risk investments; c) the B/C ratio must be equal to or greater than 1; and d) the payback period is the number of years of benefits required to fully recover the investment made.

Table 3.4. Some Definitions

Definitions	
<b>Student Benefits</b>	Higher earnings, captured by the students
<b>Taxpayer Benefits: Broad</b>	Additions to earnings plus lower overall expenditures related to health, crime, welfare and unemployment
<b>Taxpayer Benefits: Narrow</b>	Increased state & local government tax collections plus lower state & local govt. exp. related to health, crime, welfare and unemployment
<b>Student Costs</b>	Tuition (Table 2.1) + opportunity cost of time
<b>Taxpayer Costs</b>	Taxes (state and local, see Table 2.1)
<b>Results:</b>	
<b>Student Perspective</b>	Student Benefits / Student Costs
<b>Taxpayer Perspective: Broad</b>	Taxpayer Benefits (Broad) / Taxpayer Costs
<b>Taxpayer Perspective: Narrow</b>	Taxpayer Benefits (Narrow) / Taxpayer Costs

On the cost side, **student costs** consist of the tuition paid by the students (15.5% of the total budget in Table 2.1) and, most importantly, the opportunity cost of time (the earnings foregone). Also included here are the other sources of institutional revenues from private sources (16.4% in the case of MHCC). The **taxpayer costs** consist of the state and local tax items in Table 2.1, or a total of 10.9% plus 35.7% = 46.6%.

The opportunity cost (earnings foregone) incurred by the student body in the aggregate is estimated in Table 3.5. The first number in the table is the overall average statistical annual income of the student body (given gender and ethnicity characteristics). This number, however, reflects the midpoint of the lifetime trajectory of earnings, while what is needed is the earnings of the students while enrolled (which is expected to be less than earnings at the midpoint). This is the second number in the table, or \$24,719 per year, assuming full-time employment. The adjustment from the first to the second number takes into account the average age of the student body and the relationship between earnings and age as specified by the well-known and tested "Mincer equation" (see, for example, Willis 1986, p 530).

We then deduct the retired student body (9.5%) to arrive at the net number of students subject to opportunity cost calculations— 28,129 students. The 7,032 students **not working** are charged the full opportunity cost of time, or \$56,290,208. The 21,097 **working** students are charged only a fraction of the full opportunity cost (65%), or \$59,104,718 as indicated in the table. Finally, we adjust the opportunity cost downward by the Pell and other student aid

grants and the estimated 10% adjustment for the restricted use of these grants for tuition and fees.

Table 3.5. Opportunity Costs (Earnings Foregone), \$ per Year

			Opp. Cost
Avg. statistical annual income of given gender and ethnicity profile			\$26,982
Annual income, given gender and ethnicity profile, at current age of students			\$24,719
CHEs per student (net of retired)	14.6		
Avg. term in residence and avg. income while in residence	32%		\$8,005
Total number of students			31,072
Less retired %	9.5%		2,943
Remaining students subject to opportunity cost computation			28,129
Students not working while attending college and opportunity cost	25%		7,032
			\$56,290,208
No. of working students			21,097
% working part time, earnings relative to stat. averages, and opp. cost	65%		\$2,802
			\$59,104,718
Total opportunity cost			\$115,394,926
Pell and other student aid			\$2,251,651
Restricted portion of student aid (tuition and fees)	10%		\$225,165
			(\$2,026,486)
<b>GRAND TOTAL STUDENT OPPORTUNITY COST</b>			<b>\$113,368,440</b>

We also present the results in different ways. **First**, the student perspective results indicate whether the MHCC education pays by comparing the private benefits (higher earnings) to the private costs. **Second** (as discussed in the previous chapter), we compare *all* private and public benefits to the public costs (the state and local taxpayer contributions in Table 2.1) in a **broad taxpayer perspective** in present value terms. **Third** and finally, in a **narrow taxpayer perspective**, we compare only a portion of the public benefits (taxpayer actual savings) to the public costs; i.e., do state and local taxpayer investments of \$29,941,619 (Table 2.1) pay off in terms of the public savings generated?

### The Student Perspective

The collective investment of the students (time and money) is assessed in Table 3.6. Column 1 tracks the increased earnings of the student body as they leave the CC, and follows them over the course of their working life ( $65 - 32.7 = 32.3$  years, see Table 2.4). The upward trend in earnings is calculated based on the Mincer equation (see Willis, 1986). It reflects both the growth in students' earnings over time and the spread in the increased earnings attributable to education.<sup>18</sup> Column 2 is simply column 1 reduced by the 10% discount value that accounts for causation factors affecting student earnings.

<sup>18</sup> We computed a Mincer equation based on the estimated coefficients presented in Willis, 1986, p. 545. These were adjusted to 2001 dollars in the usual fashion by applying the "GDP Implicit Price Deflator."

Column 3 shows the cost of the single year's education. Finally, Column 4 looks at the educational investment from a cash flow perspective, subtracting annual costs from the annual benefits.

Table 3.6. Student Earnings (\$ Thousands)

Year	1 Higher Earnings Gross	2 Higher Earnings Net	3 Cost	4 Net Cash Flow
1	\$20,239	\$18,215	\$133,839	(\$115,624)
2	\$22,108	\$19,897	\$0	\$19,897
3	\$34,536	\$31,082	\$0	\$31,082
4	\$37,431	\$33,688	\$0	\$33,688
5	\$40,416	\$36,375	\$0	\$36,375
6	\$43,481	\$39,133	\$0	\$39,133
7	\$46,611	\$41,949	\$0	\$41,949
8	\$49,791	\$44,812	\$0	\$44,812
9	\$53,006	\$47,706	\$0	\$47,706
10	\$56,240	\$50,616	\$0	\$50,616
11	\$59,473	\$53,526	\$0	\$53,526
12	\$62,688	\$56,419	\$0	\$56,419
13	\$65,865	\$59,278	\$0	\$59,278
14	\$68,984	\$62,086	\$0	\$62,086
15	\$72,026	\$64,823	\$0	\$64,823
16	\$74,970	\$67,473	\$0	\$67,473
17	\$77,796	\$70,016	\$0	\$70,016
18	\$80,486	\$72,437	\$0	\$72,437
19	\$83,020	\$74,718	\$0	\$74,718
20	\$85,380	\$76,842	\$0	\$76,842
21	\$87,550	\$78,795	\$0	\$78,795
22	\$89,514	\$80,563	\$0	\$80,563
23	\$91,258	\$82,133	\$0	\$82,133
24	\$92,770	\$83,493	\$0	\$83,493
25	\$94,038	\$84,634	\$0	\$84,634
26	\$95,054	\$85,549	\$0	\$85,549
27	\$95,811	\$86,230	\$0	\$86,230
28	\$96,305	\$86,674	\$0	\$86,674
29	\$96,531	\$86,878	\$0	\$86,878
30	\$96,491	\$86,842	\$0	\$86,842
31	\$96,186	\$86,568	\$0	\$86,568
32	\$95,620	\$86,058	\$0	\$86,058
0	\$0	\$0	\$0	\$0
0	\$0	\$0	\$0	\$0
0	\$0	\$0	\$0	\$0
0	\$0	\$0	\$0	\$0
0	\$0	\$0	\$0	\$0
0	\$0	\$0	\$0	\$0
0	\$0	\$0	\$0	\$0
0	\$0	\$0	\$0	\$0
NPV		\$1,001,923	\$128,692	\$873,231
IRR				30.5%
B/C ratio				7.8
Payback (years)				4.9

Does attending MHCC make economic sense for the students? The answer is a resounding yes. The future stream of benefits (higher earnings) accruing to the students has an NPV of \$873,231 (Table 3.6)—a positive NPV (greater than zero) indicates that the investments made are strongly feasible. The B/C ratio of 7.8 is strongly positive since the ratio is well above 1. The RR of 30.5% is also well above the long-term rates of return obtainable in the stock or

bond markets, and certainly above the 4.0% discount rate used in the analysis. In the long run, therefore, the average MHCC student will be substantially better off attending the college. The payback period for a student (tuition plus the earnings foregone) is 4.9 years – the higher earnings received beyond that period are pure economic rent – or a persistent earnings flow over and beyond the initial investments.

### The Broad Taxpayer Perspective

**Table 3.7** assesses one year's operation of MHCC from the broad taxpayer perspective. The taxpayers must weigh requests for MHCC funding against the myriad other public needs. As such, they need information to better allocate increasingly scarce resources between alternative and competing ends. Column 1 shows the stream of total benefits, including increased regional earnings, and social savings from reduced spending on incarceration, health, welfare and unemployment. Specifics on the estimation of values in column 1 are presented in **Volume 2: Detailed Results, Table 19**. Column 2 adjusts for the 50% alternative education opportunity assumption (the percent of the student body able to avail themselves of similar education elsewhere absent the Oregon community colleges). Column 3 is simply column 1 less column 2. Column 4 shows the single year state and local taxpayer cost, as reflected in state and local tax items in **Table 2.1**. Finally, Column 5 considers the broad perspective on the taxpayer's investment in a cash flow sense, subtracting annual costs from annual benefits.

The NPV given this broad perspective is \$429 million and the B/C ratio is 15.9. More succinctly, every dollar of tax monies spent on MHCC education will generate a total of \$15.89 worth of social savings.<sup>19</sup>

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<sup>19</sup> A word of caution – the RR approach sometimes generates percentage results that defy the imagination. Technically, the approach requires at least one negative cash flow (tuition plus opportunity cost of time) to offset all subsequent positive flows. A very high percentage return may be technically correct, but perhaps not consistent with conventional understanding of returns expressed as percentages. For purposes of the reports prepared for all colleges in the statewide system, therefore, we express all RR results as: "NA" (particularly for the broad taxpayer perspective where high returns are expected). Only the B/C ratio is reported for the broad taxpayer perspective.

## Chapter 3: Private, Public, and Regional Economic Benefits

Table 3.7. Taxpayer Perspective: Broad (\$ Thousands)

Year	1	2	3	4	5
	All Benefits	Benefits from Alt. Ed. Opportunities	Net Benefits	Total Taxpayer Costs	Less CC Income Cash Flow
1	\$80,400	\$10,805	\$69,595	\$29,942	\$39,653
2	\$22,737	\$11,369	\$11,369	\$0	\$11,369
3	\$31,151	\$15,576	\$15,576	\$0	\$15,576
4	\$32,868	\$16,434	\$16,434	\$0	\$16,434
5	\$34,611	\$17,305	\$17,305	\$0	\$17,305
6	\$36,372	\$18,186	\$18,186	\$0	\$18,186
7	\$38,140	\$19,070	\$19,070	\$0	\$19,070
8	\$39,905	\$19,952	\$19,952	\$0	\$19,952
9	\$41,656	\$20,828	\$20,828	\$0	\$20,828
10	\$43,383	\$21,691	\$21,691	\$0	\$21,691
11	\$45,074	\$22,537	\$22,537	\$0	\$22,537
12	\$46,717	\$23,358	\$23,358	\$0	\$23,358
13	\$48,302	\$24,151	\$24,151	\$0	\$24,151
14	\$49,816	\$24,908	\$24,908	\$0	\$24,908
15	\$51,250	\$25,625	\$25,625	\$0	\$25,625
16	\$52,593	\$26,297	\$26,297	\$0	\$26,297
17	\$53,836	\$26,918	\$26,918	\$0	\$26,918
18	\$54,967	\$27,484	\$27,484	\$0	\$27,484
19	\$55,981	\$27,990	\$27,990	\$0	\$27,990
20	\$56,868	\$28,434	\$28,434	\$0	\$28,434
21	\$57,622	\$28,811	\$28,811	\$0	\$28,811
22	\$58,239	\$29,119	\$29,119	\$0	\$29,119
23	\$58,712	\$29,356	\$29,356	\$0	\$29,356
24	\$59,040	\$29,520	\$29,520	\$0	\$29,520
25	\$59,219	\$29,609	\$29,609	\$0	\$29,609
26	\$59,249	\$29,625	\$29,625	\$0	\$29,625
27	\$59,131	\$29,566	\$29,566	\$0	\$29,566
28	\$58,866	\$29,433	\$29,433	\$0	\$29,433
29	\$58,456	\$29,228	\$29,228	\$0	\$29,228
30	\$57,906	\$28,953	\$28,953	\$0	\$28,953
31	\$57,220	\$28,610	\$28,610	\$0	\$28,610
32	\$56,405	\$28,202	\$28,202	\$0	\$28,202
0	\$0	\$0	\$0	\$0	\$0
0	\$0	\$0	\$0	\$0	\$0
0	\$0	\$0	\$0	\$0	\$0
0	\$0	\$0	\$0	\$0	\$0
0	\$0	\$0	\$0	\$0	\$0
0	\$0	\$0	\$0	\$0	\$0
0	\$0	\$0	\$0	\$0	\$0
0	\$0	\$0	\$0	\$0	\$0
NPV			\$457,350	\$28,790	\$428,560
IRR					NA
B/C ratio					15.9
Payback (years)					NA

### The Narrow Taxpayer Perspective

Table 3.8 provides an investment analysis of MHCC from the narrow taxpayer perspective. Recall from Chapter 2 that the narrow perspective considers only moneys that actually appear on the books of state and local governments: revenue items such as tax receipts, and expenditure items such as road, bridge and street maintenance, police, public libraries and hospitals, jails and prisons, welfare payments, and so on.

Table 3.8, column 1 shows additions to state and local government revenues stemming from the operation of MHCC during the single analysis year. The

values in column 1 are computed by applying average state and local government tax rates to the net increase in regional income attributed to MHCC.<sup>20</sup> Also included in column 1 are reductions (entered as negatives) in state and local government expenditures on crime, welfare, unemployment and health. Projected dollar amounts in column 1 are thus the sum of additional taxes collected, plus associated tax dollars saved as a result of the education provided by MHCC during the single analysis year. As in **Table 3.7**, column 2 reflects the adjustment attributable to the alternative education variable. Column 3 is simply column 1 less column 2.

Column 4 shows the state and local government expenditure in support of MHCC for the analysis year, a value obtained directly from **Table 2.1**. Finally, column 5 subtracts state and local government cost (column 4) from the net benefits (column 3), thereby providing the temporal cash flow needed for the investment analysis. As shown at the bottom of the table, MHCC provides state and local government with an annual return of \$51.0 million expressed as a net present value on its one year investment. Alternatively, the one year investment generates a 18.4% RR and a B/C ratio of 2.8, both indicating that the investment is attractive. The payback period is 7.1 years.

The returns shown in **Table 3.8** would be attractive even in the private sector, and they are very attractive in the public sector. Recall that the public sector generally undertakes those activities the private sector finds unprofitable, i.e., investments that generate book revenues insufficient to cover book costs, thus requiring taxpayer subsidy. For example, state governments fund the operation and maintenance of state parks at a substantial loss, collecting revenues in the form of camping and entrance fees that cover only a fraction of costs. Taxpayers are willing to subsidize parks because they perceive off-budget benefits, e.g., access to the outdoors, local development effects, environmental protection, and so on, that justify the budgetary losses. Note that this broader collection of off-budget benefits would normally be captured in the broad taxpayer perspective.

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<sup>20</sup> Increased regional income includes a portion of direct student earnings, salaries and wages at the college during the single analysis year, and an additional increment aimed at a collection of backward and forward multiplier effects.

Investments in public education are usually viewed in the same way as investments in parks and other publicly subsidized activities, i.e., activities that generate losses from a narrow investment perspective but are justified by net benefits from a broad investment perspective. As shown in Table 3.8, however, MHCC is a notable exception to this general net-subsidy rule. The narrow perspective rate of return is strongly positive, and thereby indicates that the taxpayers' investments in the college generate increased public revenues, and reduced expenditures, that actually exceed the subsidy by taxpayers. **The practical effect of this is the following: If the investments made in MHCC were reduced, taxes would actually have to be raised in order for state and local governments to continue their support of other activities at current levels. Because MHCC's operations generate the kinds of direct returns shown, the taxpayer investments of 47% of the MHCC budget community colleges in Table 2.1, in effect, subsidize other sectors of the economy that also receive taxpayer support. The simple bottom line from the narrow taxpayer perspective is that benefits accruing to the taxpayers far outweigh the relatively low investments they make in MHCC.**



Chapter 3: Private, Public, and Regional Economic Benefits

Table 3.8. Taxpayer Perspective: Narrow (\$ Thousands)

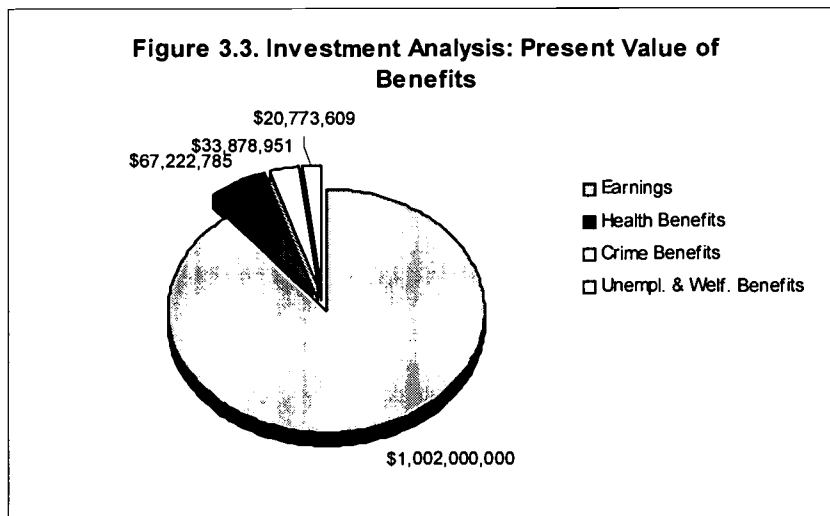
Year	1 Total Taxpayer Benefits	2 Benefits from Alt. Ed. Opportunities	3 Net Taxpayer Benefits	4 Total Taxpayer Costs	5 Net Cash Flow
1	\$13,769	\$1,345	\$12,424	\$29,942	(\$17,518)
2	\$4,101	\$2,050	\$2,050	\$0	\$2,050
3	\$5,510	\$2,755	\$2,755	\$0	\$2,755
4	\$5,797	\$2,899	\$2,899	\$0	\$2,899
5	\$6,088	\$3,044	\$3,044	\$0	\$3,044
6	\$6,383	\$3,191	\$3,191	\$0	\$3,191
7	\$6,678	\$3,339	\$3,339	\$0	\$3,339
8	\$6,973	\$3,486	\$3,486	\$0	\$3,486
9	\$7,266	\$3,633	\$3,633	\$0	\$3,633
10	\$7,554	\$3,777	\$3,777	\$0	\$3,777
11	\$7,837	\$3,918	\$3,918	\$0	\$3,918
12	\$8,111	\$4,056	\$4,056	\$0	\$4,056
13	\$8,376	\$4,188	\$4,188	\$0	\$4,188
14	\$8,629	\$4,314	\$4,314	\$0	\$4,314
15	\$8,868	\$4,434	\$4,434	\$0	\$4,434
16	\$9,092	\$4,546	\$4,546	\$0	\$4,546
17	\$9,300	\$4,650	\$4,650	\$0	\$4,650
18	\$9,488	\$4,744	\$4,744	\$0	\$4,744
19	\$9,657	\$4,829	\$4,829	\$0	\$4,829
20	\$9,805	\$4,902	\$4,902	\$0	\$4,902
21	\$9,930	\$4,965	\$4,965	\$0	\$4,965
22	\$10,033	\$5,016	\$5,016	\$0	\$5,016
23	\$10,111	\$5,056	\$5,056	\$0	\$5,056
24	\$10,165	\$5,083	\$5,083	\$0	\$5,083
25	\$10,194	\$5,097	\$5,097	\$0	\$5,097
26	\$10,198	\$5,099	\$5,099	\$0	\$5,099
27	\$10,177	\$5,089	\$5,089	\$0	\$5,089
28	\$10,132	\$5,066	\$5,066	\$0	\$5,066
29	\$10,062	\$5,031	\$5,031	\$0	\$5,031
30	\$9,969	\$4,985	\$4,985	\$0	\$4,985
31	\$9,853	\$4,927	\$4,927	\$0	\$4,927
32	\$9,715	\$4,858	\$4,858	\$0	\$4,858
0	\$0	\$0	\$0	\$0	\$0
0	\$0	\$0	\$0	\$0	\$0
0	\$0	\$0	\$0	\$0	\$0
0	\$0	\$0	\$0	\$0	\$0
0	\$0	\$0	\$0	\$0	\$0
0	\$0	\$0	\$0	\$0	\$0
0	\$0	\$0	\$0	\$0	\$0
0	\$0	\$0	\$0	\$0	\$0
0	\$0	\$0	\$0	\$0	\$0
NPV			\$79,744	\$28,790	\$50,954
IRR					18.4%
B/C ratio					2.8
Payback (years)					7.1

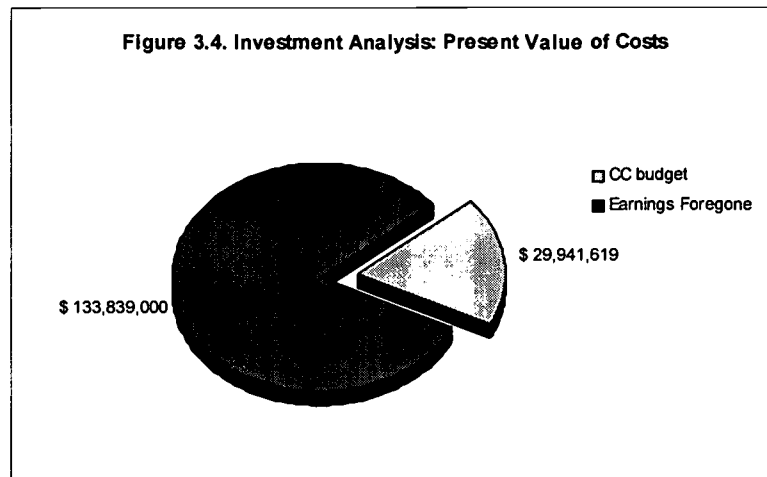
Summary

A summary of the investment analysis results (also reported in Tables 3.6 - 3.8 above) is provided in Table 3.9, on aggregate, per CHE, and per student bases.

Table 3.9. Benefit - Cost Summary

	Aggregate	Per Credit	Per Student
PV of student benefits, increased earnings	\$ 1,002,000,000	\$2,333	\$ 32,248
Health benefits, captured by society			
PV of absenteeism savings	\$ 25,205,523	\$59	\$ 811
PV of tobacco and alcohol abuse medical savings	\$ 42,017,262	\$98	\$ 1,352
Crime			
PV of reduced incarceration	\$ 22,071,324	\$51	\$ 710
PV of reduced victim costs	\$ 4,635,206	\$11	\$ 149
PV of earnings (opportunity gained)	\$ 7,172,421	\$17	\$ 231
Unemployment and welfare			
PV of reduced welfare rolls	\$ 4,957,484	\$12	\$ 160
PV of reduced unemployment	\$ 15,816,125	\$37	\$ 509
<b>Sum of all present values, benefits</b>	<b>\$ 1,123,875,345</b>	<b>\$ 2,617</b>	<b>\$ 36,170</b>
PV of all costs			
PV of state and local contribution to college budget	\$ 29,941,619	\$70	\$ 1,959
PV of opportunity cost of education + tuition	\$ 133,839,000	\$312	\$ 3,243
<b>Sum of all present values, costs</b>	<b>\$ 163,780,619</b>	<b>\$ 381</b>	<b>\$ 5,202</b>
NPV, Student Perspective		\$873,231	
RR, Student Perspective		31%	
B/C Ratio, Student Perspective		7.8	
Payback Period, Student Perspective		4.9	
NPV, Taxpayer Perspective: Broad		\$428,560	
RR, Taxpayer Perspective: Broad		NA	
B/C Ratio, Taxpayer Perspective: Broad		15.9	
Payback Period, Taxpayer Perspective: Broad		NA	
NPV, Taxpayer Perspective: Narrow		\$50,954	
RR, Taxpayer Perspective: Narrow		18.4%	
B/C Ratio, Taxpayer Perspective: Narrow		2.8	
Payback Period, Taxpayer Perspective: Narrow		7.1	



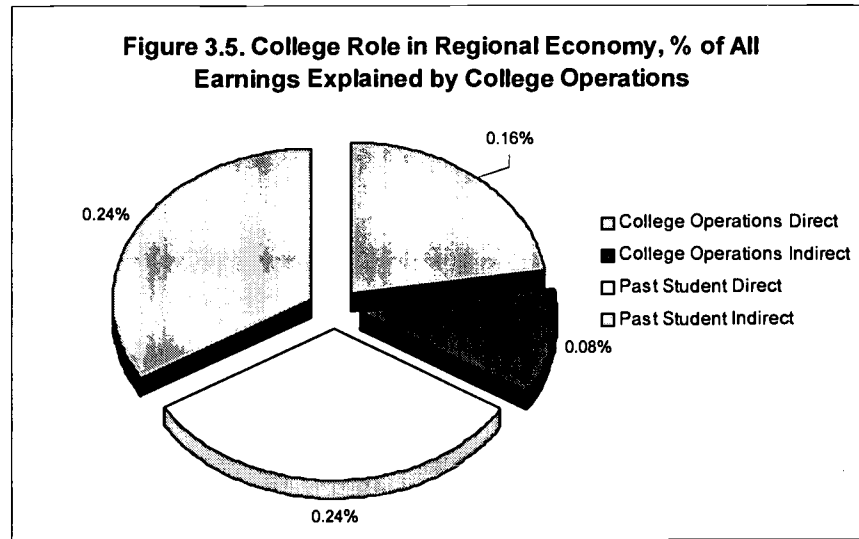


## REGIONAL ECONOMIC BENEFITS

Mt. Hood Community College plays an important role in the health, growth and development of the regional economy. This section estimates that role and expresses it as a gross share of region-wide earnings. As indicated in Table 3.10, region-wide earnings in the East County economic region amount to \$22.81 billion (Regional Information System, U.S. Department of Commerce).

**Table 3.10. Summary of College Role in the Regional Economy**

	Earnings (\$ Thousands)	% of Total
Total Earnings in College-Hosting Region	\$22,805,561	100%
<b>Earnings Attributable to College Operations</b>		
Direct Earnings of Faculty and Staff	\$36,871	0.2%
Indirect Earnings	\$18,878	0.1%
<b>TOTAL</b>	<b>\$55,749</b>	<b>0.2%</b>
<b>Earnings Attributable to Past Student Econ. Dev. Effects</b>		
Direct Earnings	\$53,627	0.2%
Indirect Earnings	\$55,411	0.2%
<b>TOTAL</b>	<b>\$109,038</b>	<b>0.5%</b>
<b>GRAND TOTAL</b>	<b>\$164,787</b>	<b>0.7%</b>



### MHCC Operations

As shown in **Table 3.10**, the direct earnings of faculty and staff are equal to \$36.9 million per year, and thus account for 0.2% of region-wide earnings. Multiplier effects, from the spending of faculty and staff salaries and from MHCC's purchase of local goods and services, account for another \$18.9 million, or 0.1% of region-wide earnings. Altogether, MHCC operations directly or indirectly account for \$55.7 million per year, or 0.2% of region-wide earnings.

### Past Student Economic Development Effects

Past students provide skills that attract new industry and make existing industry more competitive and productive. Accounting for retirement, out-migration and death, we estimate that the current Mt. Hood Community College workforce embodies 4.1 million CHEs of past instruction (see **Table 2.12**). As shown in **Table 3.10**, these directly account for \$53.6 million, or 0.2% of region-wide earnings.

Associated with the increased earnings of past MHCC students is a collection of *demand-induced* and *agglomeration-induced* indirect effects. As shown in

Table 3.10, these indirect effects account for \$55.4 million, or 0.2% of region-wide earnings.

### **Total Regional Economic Benefits**

Finally, the overall role of MHCC in the regional economy is equal to the sum of the direct and indirect effects. Accordingly, the college accounts for \$164.8 million, or 0.7% of region-wide earnings.

## Chapter 4

# SENSITIVITY ANALYSIS OF KEY VARIABLES

### INTRODUCTION

We conclude this study with a **base case** sensitivity analysis of some key variables on both the investment and regional economic development sides. The purpose of the sensitivity analysis is to set our approach apart from “advocacy” education impact analyses. Many of these may lack uniformity and use assumptions that will not stand up to rigorous peer scrutiny, and they often generate results that grossly overstate benefits. The approach taken here is to account for all relevant variables on both the benefit and cost sides as reflected in the conservatively estimated base case assumptions laid out in **Chapter 2**.

### INVESTMENT ANALYSIS: THE STUDENT PERSPECTIVE

The variables tested relate to the earnings foregone by the students—the opportunity cost of time. They include: 1) the % of the students employed, and 2) of those employed, the earnings received relative to the full earnings they would have received if not attending MHCC. These affect the investment analysis manifested in the results (NPV, RR, B/C, and payback period).

#### Percent of Students Employed

The students incur substantial expense by attending MHCC because of time spent not gainfully employed. Some of that cost is recaptured if the student remains partially (or fully) employed while attending MHCC. It is estimated that 75% of the current student body is employed. We test this variable in the sensitivity analysis by changing this assumption to 100%. The revised assumption would mean that *all* of the students are employed, thus the average opportunity cost of time would be reduced accordingly.

### Percent of Earnings Relative to Full Earnings

The second opportunity cost variable is more difficult to estimate. For MHCC it is estimated that for the students working while attending classes, their earnings amounted to only 65%, on average, of the earnings they would have statistically received if not attending the CC. This suggests that many of the students hold part-time jobs earning minimum wage (or less than their "statistical" wages). The model captures these differences and counts them as a part of the opportunity cost of time. As above, we test this variable in the sensitivity analysis by changing the assumption to 100%. This would mean that the students are fully employed, and the average opportunity cost of time would be reduced accordingly.

## RESULTS

The changed results are summarized in Table 4.1. Here, the base case assumptions are reflected in the two shaded rows for the variables tested – 75% for the portion of students employed, and 65% for their earnings relative to the statistical averages, taken from Table 2.2. These (base case) assumptions are held constant in the shaded rows for the student perspective. The sensitivity analysis results are shown in the non-shaded rows – the extent to which the investment analysis results would change if the two base case variables were increased to 100%, first separately, and second, together. Changing both assumptions to 100% (all students fully employed) would automatically increase the benefits because the opportunity cost of time would reduce to zero.

1. Increasing the students employed assumption from 75% to 100% first (holding all of the other assumptions constant), the RR, B/C, and payback period results would improve to 41.1%, 10.7, and 3.8 years, respectively, relative to the base case results. The improved results are attributable to a lower opportunity cost of time – all students would be employed in this case.
2. Increasing the earnings relative to the statistical averages from 65% to 100% second (holding the second employment assumption constant at the base case level), the RR, B/C, and payback period results would improve to

53.9%, 13.9, and 3.2 years, respectively, relative to the base case results—a strong improvement over the base case results, again attributable to a lower opportunity cost of time.

3. Finally, increasing both of the above assumptions to 100% simultaneously, the RR, B/C, and payback period results would improve yet further to >100%, 56.5, and 1.2 years, respectively, relative to the base case results. This scenario assumes that all students are fully employed and earning full salaries (equal to the statistical averages) while attending classes. These results are unrealistic, albeit not uncommon for advocacy analyses.

**Table 4.1 Sensitivity Analysis of Student Perspective**

Variables	Assumptions	RR	B/C	Payback
1. Percent Employed	75%	30.5%	7.8	4.9
	100%	41.1%	10.7	3.8
2. Percent of Earnings	65%	30.5%	7.8	4.9
	100%	53.9%	13.9	3.2
1 = 100%, 2 = 100%		>100%	56.5	1.2

**A final note to this student perspective sensitivity analysis—we strongly emphasize that the results, given the assumptions, are very attractive—the results are all well above their threshold levels and the payback periods are short.** As clearly demonstrated here, advocacy results appear much more attractive, although they would overstate the benefits. The results presented in Chapter 3 are realistic, indicating that investments in MHCC will generate excellent returns, well above the long-term average percent rates of return of roughly 7% in the stock and bond markets.

## REGIONAL ECONOMIC DEVELOPMENT

We estimated the regional economic impacts of MHCC in Chapter 3, Table 3.10 based on college operations and capital spending, and the increased productivity effects of past MHCC students in the regional workforce. The impacts were expressed in terms of regional earnings, i.e., area wages, salaries and proprietors' income, published by the U.S. Department of



Commerce.<sup>21</sup> In the present section we address two issues that occasionally arise in college economic impact studies: 1) the addition of **student spending** effects to impact estimates, and 2) the expression of economic impacts in terms of regional **gross sales** rather than earnings.

### The Economic Impact of Student Spending

Students spend money while attending college: they buy books and supplies, rent rooms, purchase food, pay for transportation, attend sports events and go to movies, and so on. These expenditures create jobs and incomes for local businesses, which, as argued by some, should be counted among the regional economic impacts attributable to the college.

In **Table 3.10**, however, we exclude student spending because most of the students already reside in the college region. Student expenditures, therefore, do not represent **new monies** in the region, but rather a redirection of monies that would have been spent anyway. The other side of the argument is that, even though the college-related spending of a resident student does not constitute new money, absent the college, some students will leave the region to obtain an education elsewhere. Thus, the region loses the spending and related jobs and incomes. Both cases have merit, although we believe the former has more than the latter. This is because only a few students will actually be able to avail themselves of education elsewhere (see **Table 2.9**). Our approach, therefore, is to exclude student spending, recognizing at the same time, that the regional impact estimates may err on the conservative side.

In **Table 4.2** we show the potential magnitude of student spending effects in the MHCC region economy. The table parallels **Table 3.10** in the previous chapter, but adds the section "Earnings Attributable to Student Spending,"<sup>22</sup>

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<sup>21</sup> U.S. Department of Commerce, Regional Economic Information System (REIS) data includes earnings estimates for counties and states, and is published annually in the *Department's Survey of Current Business*. It is also readily available in electronic form.

<sup>22</sup> We estimated student spending effects by borrowing average college student information from a study conducted for higher education economic impacts in Illinois (University of Illinois, 2000). Student spending by broad expenditure category was bridged to the sectors of the MHCC regional economy

creating some \$64.7 million in additional earnings for the local businesses patronized by students (the direct effects), plus another \$41.6 million in earnings stemming from related multiplier effects (indirect effects). Adding the student spending to the mix increases the MHCC total "explanatory power" of the regional earnings from 0.7% in Table 3.10 to 1.2% in Table 4.2.

Table 4.2. Summary of College Role in the Regional Economy

	Earnings (\$ Thousands)	% of Total
Total Earnings in College-Hosting Region	\$22,805,561	100%
<b>Earnings Attributable to Student Spending</b>		
Direct Earnings	\$64,684	0.3%
Indirect Earnings	\$41,595	0.2%
<b>TOTAL</b>	<b>\$106,279</b>	<b>0.5%</b>
<b>Earnings Attributable to College Operations</b>		
Direct Earnings of Faculty and Staff	\$36,871	0.2%
Indirect Earnings	\$18,878	0.1%
<b>TOTAL</b>	<b>\$55,749</b>	<b>0.2%</b>
<b>Earnings Attributable to Past Student Econ. Dev. Effects</b>		
Direct Earnings	\$53,627	0.2%
Indirect Earnings	\$55,411	0.2%
<b>TOTAL</b>	<b>\$109,038</b>	<b>0.5%</b>
<b>GRAND TOTAL</b>	<b>\$271,066</b>	<b>1.2%</b>

### Economic Impacts Reported as Gross Sales

Advocates sometimes favor gross sales over earnings as an impact measure, because sales are always larger than the earnings. But using gross sales as an impact measure has notable drawbacks. An immediate drawback is that, unlike earnings, there is generally no published total against which a sales impact can be measured. More importantly though, the most troublesome aspect of gross sales impact measures is captured in the following example:

Two visitors spend \$50,000 each in the economic region. One visits a local auto dealer and purchases a new luxury automobile. The other enters the county hospital for a medical procedure. In terms of direct economic impact, both have spent \$50,000. However, the expenditures will likely have very different meanings to the local economy. Of the \$50,000 spent for the luxury automobile, perhaps \$9,000 remains in the county as salesperson commissions and auto dealer income (part of the county's overall earnings), while the other \$41,000

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input-output model. Adjustments were made consistent with the model's regional accounts to allow for spending leakages.

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leaves the area for Detroit or somewhere else as wholesale payment for the new automobile. Contrast this to the hospital expenditure. Here perhaps \$40,000 appears as physician, nurse, and assorted hospital employee wages (part of the county's overall earnings), while only \$10,000 leaves the area, to pay for hospital supplies, or to help amortize building and equipment loans. In terms of sales, both have the same impact, while in terms of earnings, the former has less than one-fourth the impact of the latter.

**Table 4.3** expresses the MHCC impacts in terms of gross sales rather than earnings. Note that gross sales measures are everywhere larger than earnings. The economy-wide measure of total gross sales estimated by the economic model is \$61.7 billion.<sup>23</sup> Direct local spending by students reflects their total spending, reduced by the estimated portion that leaks out-of-region to purchase goods produced elsewhere.<sup>24</sup> In the usual fashion, indirect effects reflect the action of local economic multiplier effects, also estimated by the economic model.

Direct local expenditures include all spending by the college for consumer items and faculty and staff salaries. Both items are reduced to reflect purchases from outside the region. All told, the operation of MHCC is estimated to explain some \$509.6 million in regional gross sales, a number roughly twice the \$271.1 million explained by the college in regional gross earnings shown in **Table 4.2**.

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<sup>23</sup> Simply stated, economy-wide gross sales are obtained by multiplying sector-specific regional earnings by a national estimate of sales-to-earnings.

<sup>24</sup> Students purchase gasoline for their cars, for example, and while the trade margin stays in the area, in most cases the producer price of gasoline itself will leak out to the oil producing region.

Table 4.3. Summary of College Role in the Regional Economy

	Gross Sales (1,000)	% of Total
Total Gross Sales in College-Hosting Region	\$61,701,809	100%
<b>Gross Sales Attributable to Student Spending</b>		
Direct Local Spending by Students	\$114,182	0.2%
Indirect Spending Effect	\$60,543	0.1%
<b>TOTAL</b>	<b>\$174,725</b>	<b>0.3%</b>
<b>Gross Sales Attributable to College Operations</b>		
Direct Local Expenditures of CC	\$25,612	0.0%
Indirect Spending Effect	\$20,359	0.0%
<b>TOTAL</b>	<b>\$45,971</b>	<b>0.1%</b>
<b>Gross Sales Attributable to Past Student Econ. Dev. Effects</b>		
Direct Gross Sales	\$147,182	0.2%
Indirect Gross Sales	\$141,738	0.2%
<b>TOTAL</b>	<b>\$288,920</b>	<b>0.5%</b>
<b>GRAND TOTAL</b>	<b>\$509,616</b>	<b>0.8%</b>

While the gross sales impacts shown in Table 4.3 are not incorrect, we prefer to report college impacts in terms of earnings in Table 3.10 rather than gross sales because they reflect the economic realities in the local community much more accurately than the sales numbers. Advocacy studies, on the other hand, will often opt to express the results in terms of sales because the numbers are much more impressive. Such results, however, will likely not stand up to peer scrutiny in the economics profession.

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6000 Executive Boulevard - Willco Building  
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## Appendix 1: Explaining the Results – a Primer

The purpose of this appendix is to provide some context and meaning to 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 the associated investment analysis results.

Table 1. Costs and Benefits

	Tuition	Opportunity Cost	Total cost	Higher Earnings	NCF
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
NPV			\$20,673	\$35,747	\$15,074
IRR					18%
B/C ratio					1.7
Payback period					4.2 years

The assumptions are as follows:

- 1) The time horizon is 10 years—i.e., we project the benefits and costs out 10 years into the future (column 1). Once the higher education has been earned, the benefits of higher earnings remain with the student into the future. Our objective is to measure these future benefits and compare them to the costs of the education.
- 2) The student attends the CC for one year for which he or she pays a tuition of \$1,500 (column 2).
- 3) The opportunity cost of time (the earnings foregone while attending the CC 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, we assume that the student, having completed the one year of study, will earn \$5,000 more per year than 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) We assume a “going rate” of interest of 4%, the rate of return from alternative investment schemes, for the use of the \$21,500.

Now the “mechanics” – we express the results in standard investment analysis terms: the net present value (NPV), the internal rate of return (IRR— or, as referred to in the main report, simply the rate of return – 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.

## THE 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 we are tracking in Table 1 has choices: a) to attend the CC, or b) forget about higher education and hold on to the present employment. If he or she decides to enroll, certain economic implications unfold: the tuition must be paid and earnings will cease for one year. In exchange, the student calculates that, with the higher education, 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 we add up the 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—the benefits are far lower than \$45,000 because future money is worth less than present money. The costs (tuition plus foregone earnings) are felt immediately because they are incurred

today—in the present. The benefits (higher earnings), on the other hand, occur in the future. They are not yet available. We must discount all future benefits by the going rate of interest (referred to as the discount rate) to be able to express them in present value terms.<sup>25</sup> 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 10, the present value would reduce to \$3,377. Or 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 10 years. An “economically rational” person would, therefore, be equally satisfied receiving \$3,377 today or \$5,000 10 years from today given the going rate of interest of 4%. The process of discounting—finding the present value of future higher earnings—allows us express values on an equal basis in future or present value terms.

Our goal is to express all future higher earnings in present value terms so that we can compare them to the investments incurred today—the tuition and foregone earnings. As indicated in **Table 1**, the cumulative present value of the flow 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.

The measure we are looking for is the NPV result of \$15,074. It is simply the present value of the benefits less the present value of the costs, or \$35,747 - \$20,673 = \$15,074. In other words, the present value of benefits exceeds the present value of costs by as much as \$15,074. The criterion for an economically worthwhile investment is that the NPV 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 CC education is very strong.

## THE INTERNAL RATE OF RETURN (IRR)

The IRR is another way of measuring the worth of the investment in education using the same cash flows shown in **Table 1**. In technical terms—

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<sup>25</sup> 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 we reverse the process—determining the present value of future earnings.

the IRR is a measure of the average earning power of the money used over the life of the investment. It is simply the interest rate that makes the NPV equal to zero. In the NPV example above we applied the “going rate” of interest of 4% and computed a positive NPV of \$15,074. The question now is: what would the interest rate have to be in order to reduce the NPV to zero? Obviously it would have to be higher—18% in fact, as indicated in Table 1. Or, if we applied 18% to the NPV calculations instead of the 4%, then the NPV would reduce to zero.

What does this mean? The IRR of 18% defines a breakeven solution—the point where the present value of benefits just equals the present value of costs, or where the NPV equals zero. Or, at 18%, the higher incomes of \$5,000 per year for the next 9 years will earn back all the investments of \$21,500 made plus pay 18% for the use of that money (the \$21,500) in the meantime. Is this a good return? Indeed it is—first, if we compare it to the 4% “going rate” of interest we applied to the NPV calculations, 18% is far higher than 4%. We can conclude, therefore, that the investment in this case is solid. Alternatively, we can compare the rate to the long-term 7% rate or so obtained from investments in stocks and bonds. Again, the 18% is far higher, indicating that the investment in CC 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 (tuition plus opportunity cost of time) to offset all subsequent positive flows. For example, if the student works full time while attending college, the opportunity cost of time would be much lower—the only out-of-pocket cost would be the \$1,500 paid for tuition. In this case, it is still possible to compute the IRR, but it would be a staggering 333% because only a negative \$1,500 cash flow will be offsetting 9 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, we express all results in the main report exceeding 100% simply as: “> than 100%.”

## THE BENEFIT/COST RATIO (B/C)

The B/C ratio is simply the present value of benefits divided by present value of costs, or  $\$35,747 / \$21,500 = 1.7$  (based on the 4% discount rate). Of course, any change in the discount rate will also change the B/C ratio. If we applied the 18% IRR discussed above, the B/C ratio would reduce to 1.0—or the breakeven solution where benefits just equal the costs. Applying a discount rate higher than the 18 percent would reduce the ratio to less than one 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 10-year time period.

## THE PAYBACK PERIOD

This is the length of time from the beginning of the investment (consisting of the tuition plus the earnings foregone) before the higher future earnings return the investments made. In **Table 1**, it will take roughly 4.2 years of \$5,000 worth of higher earnings to recapture the student's investment of \$1,500 in tuition and the \$20,000 earnings he or she foregoes while attending the CC. The higher earnings occurring *beyond* the 4.2 years are the returns (the "gravy") that make the investment in education *in this example*, economically worthwhile. The payback period is a fairly rough, albeit common, means of choosing between investments. The shorter the payback period, the stronger the investment.

## Appendix 2: Methodology for Creating Income Gains by Levels of Education

The US Bureau of the Census reports income in two ways:

- 1) Mean income by race and Hispanic origin and by sex.
- 2) Mean income by educational attainment and sex.

The first and second data sets can be found at the following sources:

U.S. Census Bureau and U.S. Department of Commerce. Table P-3: Race and Hispanic Origin of People by Mean Income and Sex: 1947 to 2000, and Table P-18: Educational Attainment--People 25 Years Old and Over by Mean Income and Sex: 1991 to 2000. Also consult:

<http://www.census.gov/ftp/pub/hhes/income/histinc/histinctb.html>

Further contact information: a) Income Surveys Branch, b) Housing & Household Economic Statistics Division, c) U.S. Census Bureau, and d) U.S. Department of Commerce.

The data needed for this analysis is mean income by educational attainment reported by race/ethnic origin and by sex. A model was developed to translate these two data sets into the data needed for the analysis. This was accomplished in the following way:

1. Mean income by race and sex are calculated as a percent of all races.
2. This percent is then applied to mean income by educational attainment. For example, African-American males make an average income of \$28,392 versus \$40,293 for all males, or 70% of the average income of all males.

## Appendix 2: Methodology for Creating Income Gains by Levels of Education

3. This percent (70%) is then applied to the income levels by educational attainment for all males to estimate the income levels by educational attainment for African-American males.
4. To simplify the analysis, all nonwhite males are averaged together as are all nonwhite females. The same process is repeated for white males and white females.
5. The educational levels of attainment are aggregated together in some categories to model the educational system of community colleges. These numbers are then adjusted for inflation to 2001 dollars.
6. The final step is to adjust these income levels by state. The *Four Person Median Family Income by State* from the Bureau of the Census was used to make state level adjustments. Each state's median family income is taken as a percentage of the national average. These percentages are then applied to the income levels by educational attainment by race, ethnicity and sex calculated earlier.



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