Seidman Business Review

Seidman College of Business at Grand Valley State University, Grand Rapids, Michigan

SEIDMAN COLLEGE OF BUSINESS

GRAND VALLEY STATE UNIVERSITY

Vol. XIX
Winter 2013

What is in store for the West Michigan economy in 2013?

What are local purchasing managers doing about new orders, production, and prices?

What are the prospects for the region's commercial real estate?

Does LaughFest draw people—and money—to the local economy?

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Seidman Business Review is an annual publication of Grand Valley State University's Seidman College of Business, Grand Rapids, Michigan.

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SEIDMAN COLLEGE OF BUSINESS

From the Dean . . .

Now that the nation has begun another run toward the ominous "fiscal cliff"—by simply postponing the really difficult elements—we take stock of how we managed 2012 and what 2013 holds for us here in West Michigan. While 2012 proved even more positive than we hoped, at least in many respects, many challenges hold over to 2013, as we strive to continue a slow, but steady, recovery from the "Great Recession."

The following pages provide excellent analyses of critical aspects of the West Michigan economy, beginning with the 2013 economic forecast for Grand Rapids and the 2012–2013 review and forecast of West Michigan's commercial real estate and followed by significant economic retrospectives of 2012 for West Michigan's housing market and regional stocks, as well as a supply-management purchasing index review and projections. In addition, the commentators provide perspectives on serving customers at the "Base of the Pyramid," the impact of recent free-trade agreements on Michigan's exports, the economic impact of LaughFest, and the economic value of a college degree.

The College is proud of this publication's history of highlighting and reporting on the West Michigan economy and the companies, commerce, and activities that make it the wonderful community it is. For the past 17 years, Dr. Hari Singh, Professor of Economics and former Chairperson of the Economics Department, has served as the Editor and author of the lead article, addressing the Grand Rapids Economics Forecast. Dr. Singh has moved to a new role as Chairperson of the Business Department at Humboldt State University (in Arcata, California). We thank him for his many years of service to Grand Valley State University and to this Community! With this 2013 edition, the College begins a new chapter: Dr. Gerry Simons, Professor of Economics, assumes the role of Editor. Please help us welcome Dr. Simons to this new role. Ironically, he has also served as a faculty member in the Seidman College of Business for seventeen years, publishing more than 35 articles and proceedings and delivering more than 35 invited speeches, lectures, and presentations. He is an outstanding Economist and an even better person!

The Seidman College of Business strives to provide cutting-edge, relevant, and real-world commentary regarding existing and emerging business knowledge and innovations, in ways that are relevant and compelling for West Michigan businesses and other public and private organizations. We hope you agree that this edition of the *Seidman Business Review* achieves that vision!

H. James Williams
Dean, Seidman College of Business

Seidman Business Review
Winter 2013 Contents

Grand Rapids Economic Forecast 2013

Paul Isely, Ph.D., Department of Economics
Seidman College of Business

- Business confidence index in 2013 is poised to match the confidence in 2012 at 63%
- Employment is expected to grow by 1.7% to 2.3% in 2013
- Overall nominal sales are expected to increase by 2.4% for 2013
- Exports continue to be a bright spot; expected growth is 5.4% during 2013
- All indicators signal a continuous but slow improvement in 2013

Introduction

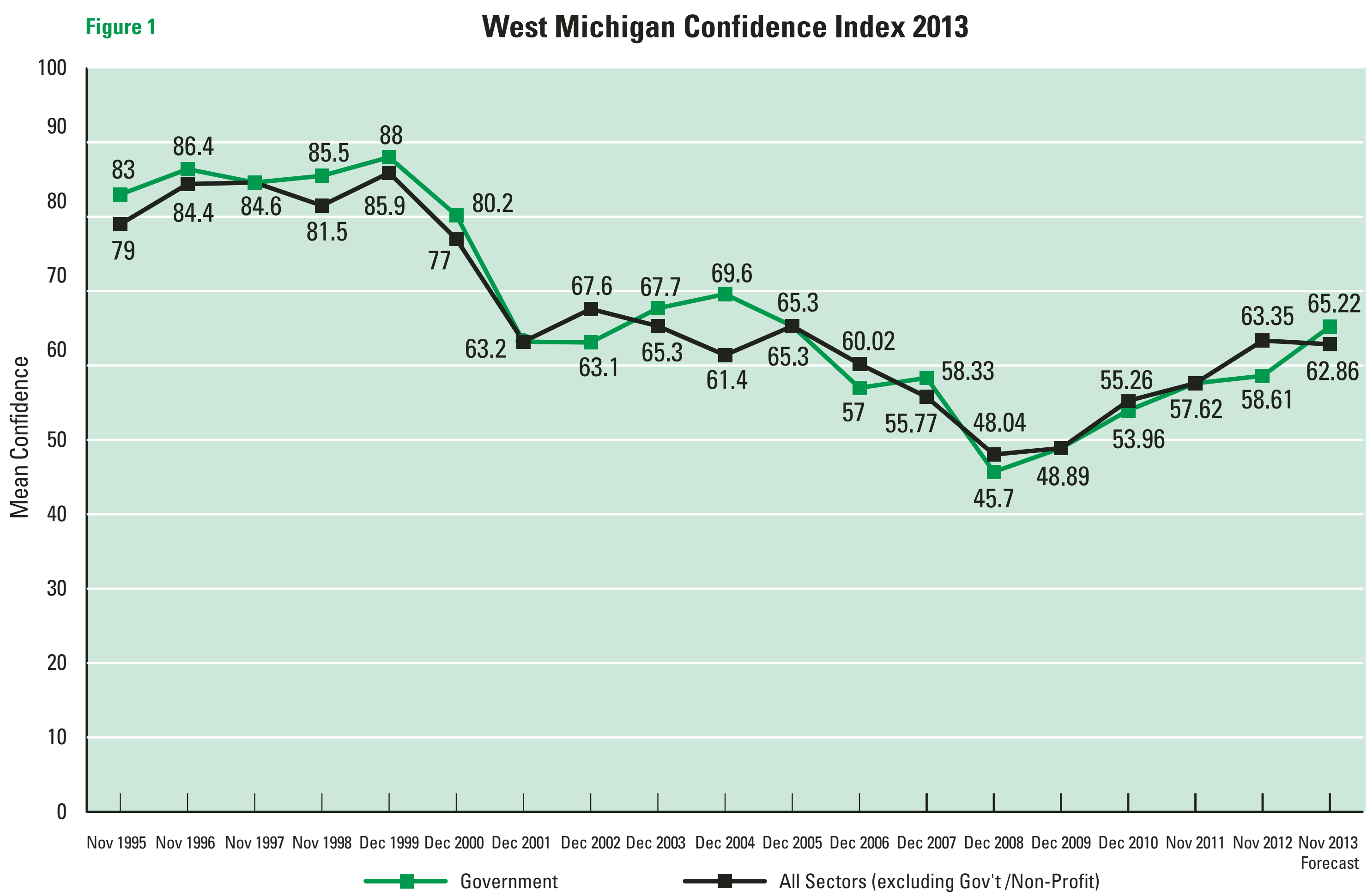
The survey for the greater Grand Rapids economy (Kent, Ottawa, Muskegon, and Allegan counties) was conducted in November 2012. A survey was mailed to the CEOs of nearly 1000 organizations based on a representative sample reflecting the different sectors and the geographical diversity of the regional economy. Responses came from 213 organizations, a response rate of 23%. Due to the small sample size, the survey should be interpreted with caution.

A few methodological considerations are in order. Although we discuss the survey results in terms of averages, the data are represented in a histogram format to show the entire distribution of responses. The employment, sales, and export numbers are more volatile as raw averages (when calculated without adjusting for outliers—responses beyond one standard deviation). Since the average of a small sample is significantly influenced by extreme numbers, we use the averages without the outliers to provide more reliable results. The histograms, however, depict all the available observations to show the broad picture. Note that the total numbers in the histogram figures do not add up to exactly 213 because a few respondents did not provide their employment or sales data.

Confidence Index

A continuing goal of our survey is to historically track the overall business confidence of the Grand Rapids area with a confidence index. The confidence index respondents use

Figure 1



a scale from 0% (no confidence at all) to 100% (complete confidence). The average responses for the private sector and the government/non-profit sector over the last 18 years to the question: *How confident are you in the regional economy?* are shown in Figure 1.

Last year, the private sector confidence index surpassed 60% for the first time since the recession that began in 2007. At this level it is consistent with the confidence levels expressed in the survey during 2001–2005. Prior to 2001, the confidence index was generally around 80% for the private sector. In November 2012, it increased to 63.4%, and it is expected to hold steady in 2013 at 63.1%. The government and nonprofit sector, however is expecting a better year in 2013, with the index increasing from 58.6% for 2012 to a projected 65.2% for 2013.

For the first time in the last five years, the projected confidence is remaining above the 60% benchmark. The regional economy is expected to continue the slow growth seen in 2012 during 2013, continuing the reverse of a long consolidation process.

Employment

Due to the restructuring in manufacturing, the regional labor market in West Michigan had been repairing at a very slow pace since the recent recession. For 2012, employment was projected to grow at an average of 1.5–2%. Actual employment growth was much faster. The numbers from the Local Area Unemployment Statistics (LUAS) survey indicate that employment in KOMA has grown by approximately 3.6%. It appears that our projection last year was less optimistic than what actually happened in 2012.

Expectations for 2013 were affected partially by the fact that 41% of the respondents returned their surveys within a day before the presidential election. In addition there continues to be a tight credit market for small businesses, a persistently high unemployment rate, fiscal uncertainty and higher debt at the federal level, and ongoing concerns about the Eurozone. We continue to see benefits in West Michigan from the resurgence of manufacturing.

The respondents answer the following question: *What percent change do you expect in employment for the four counties in 2012?*

In 2012 the distribution was clustered in the 0–2% range, but now it is clustered in the 0–3% range. In addition 43% of respondents expect to hire more than 2%. Only 13 respondents expect to reduce their work force. Average employment is expected to grow at 2% which is a strong improvement from the 2012 expectations. Given these expectations, regional employment should grow at or above 2% in 2013.

More than half of the respondents (58%) expect to hire next year. Of those persons being hired, about 70% are expected to be permanent workers. This continues to suggest hiring in West Michigan at a rate faster than the country as a whole.

Respondents' Anticipated Change in Employment for 2013
(All Sectors)

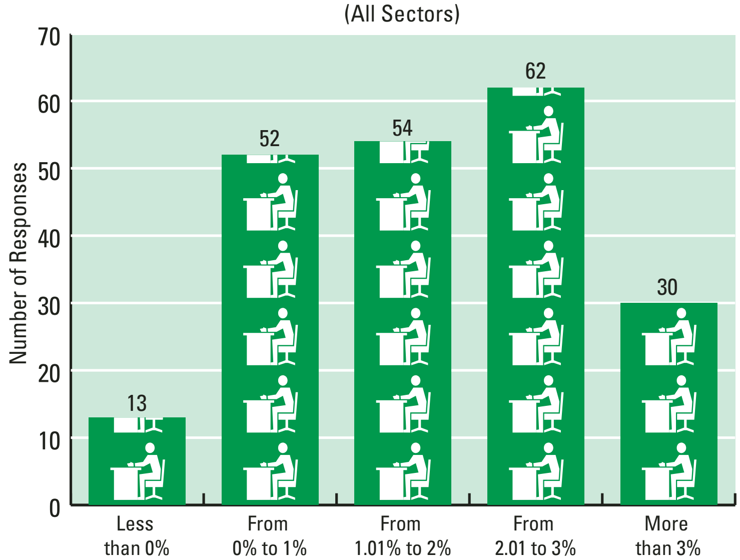


Figure 2

Respondents' Anticipated Change in Sales for 2013
(All Sectors)

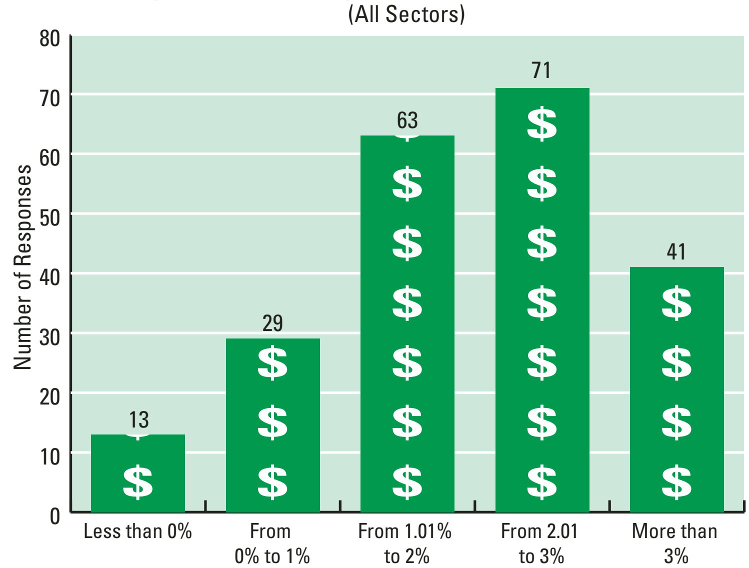


Figure 3

Sales

For sales, the respondents answer the following question: *What percent change in sales do you project for the four counties in 2013?* In times of robust economic growth, sales have grown at an annual rate of 5%. We can see in Figure 3 that respondents are clustered around 1–3% much as they were last year. We should expect sales to grow at a rate of 2.4% in 2013.

Note that our sales numbers are for the nominal sales of all goods/services produced in the West Michigan economy. Consequently, the increase could be in prices and/or quantities.

Export Growth

Exports have been a bright spot in the West Michigan economy the last few years. This year exports are expected to

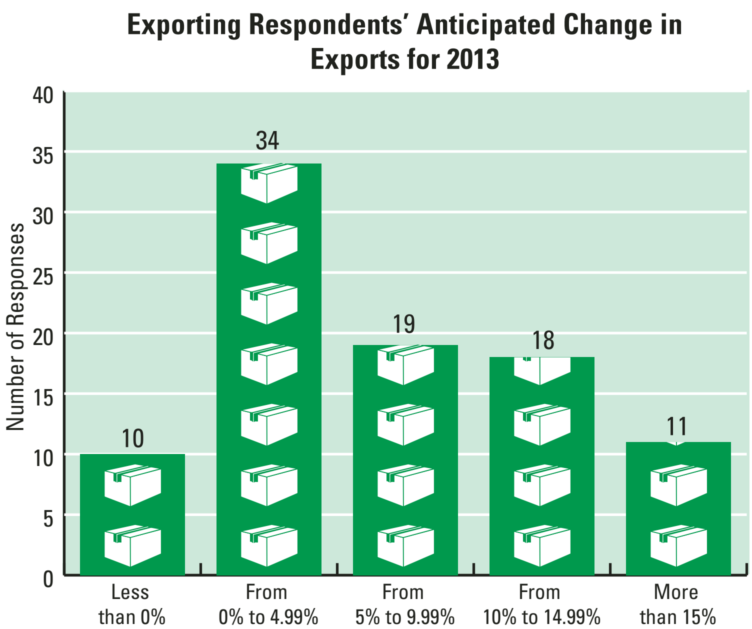


Figure 4

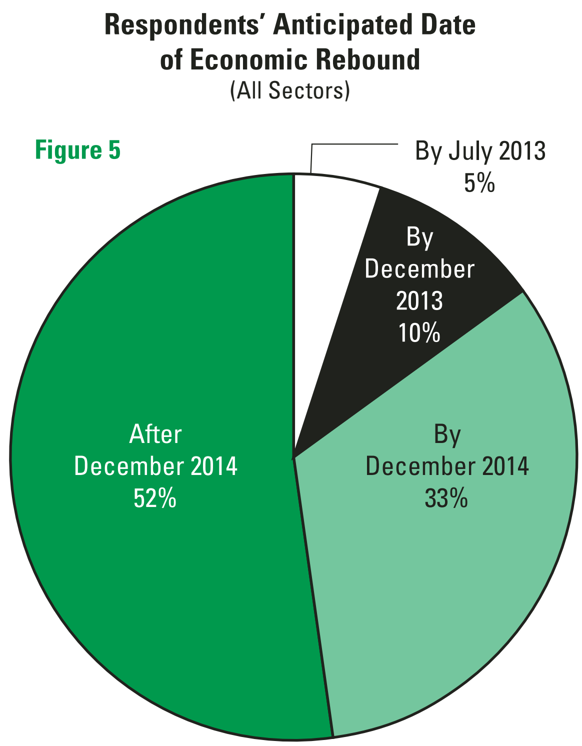


Figure 5

grow at a slower rate than the last few years at approximately 5.4% (without outliers) and 6.6% (with outliers). Actual growth will be 5.5–6.5% for 2013. However, since the expected growth of exports is based on a much smaller sample of only 92 respondents, it should be viewed with caution.

General Expectations

The slow improvement in employment, sales, and exports has also influenced the expectations for achieving a robust regional growth rate of 5% in the near future. (Figure 5). Approximately 48% expect a robust growth by December 2014. A significant majority (52%) expected a robust growth only after December 2014. These numbers are less pessimistic than last year; however, given the continued global uncertainty and the continuous bickering at the Federal level, this pessimism is understandable.

General Outlook

At the national level, expected growth will average 2–3% for 2013. The economy will continue to grow slowly, but also slowly accelerate from 2012. Nationwide employment will continue to improve in 2013. Full-time hiring will increase significantly as businesses become progressively more confident about the future. However, it is not likely that the employment situation will improve dramatically. By the end of 2013 the unemployment rate should still be above 7.0%.

At the regional level, the economy continues to improve slowly. Overall confidence is expected to remain above the 60% benchmark. Employment will grow by approximately 2%. Nominal sales will increase by 2.4%. In spite of its volatility, exports have always been a bright spot during the Great Recession and are projected to continue to grow next year by 5.4%.

The same possible pitfalls that existed last year remain for 2013. These include a significant meltdown in the Eurozone, further downgrading of U.S. debt, and/or some other external shock.

Acknowledgments

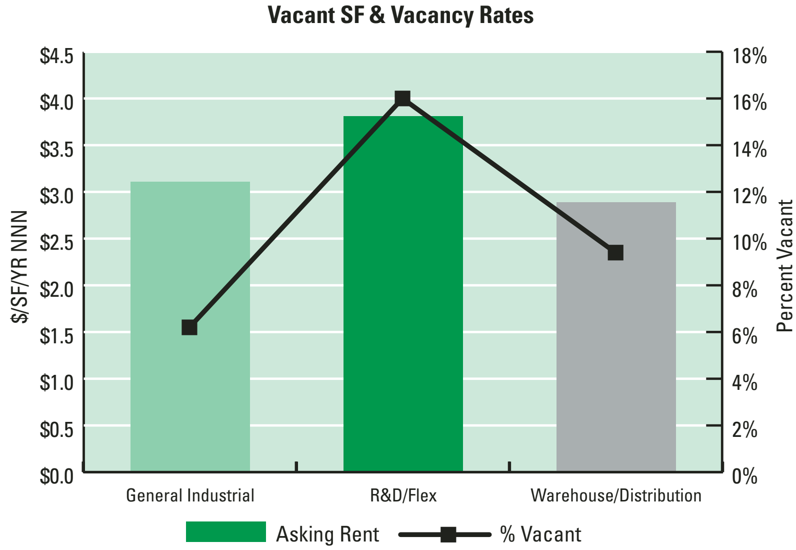
We are very grateful to all the organizations that participated in the survey.

West Michigan Commercial Real Estate Review and Forecast

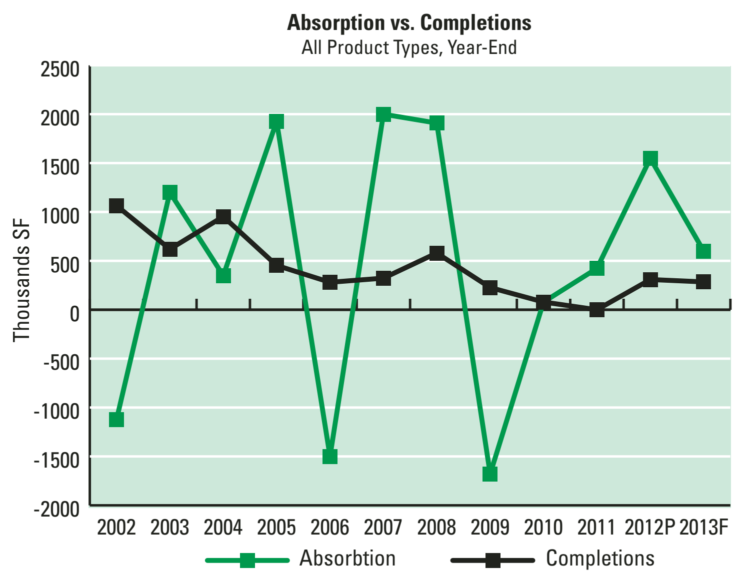
David Shafer and Logan Mentz, Research Analysts
Colliers International | West Michigan

Grand Rapids | Industrial Market

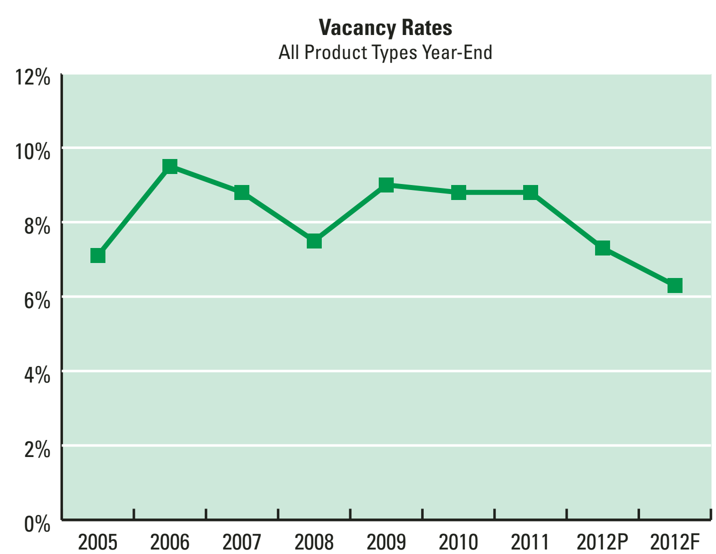
Manufacturing activity in 2012 has fueled the fire under the West Michigan economy, bringing forth positive change in the industrial real estate market. While interest in the market continued to escalate, prospective tenants were challenged by a diminishing inventory of upper-tier facilities. The popular perception that there is an abundance of high-quality, low-cost space quickly diminishes upon a close examination of available industrial properties. Finding imaginative alternatives to combat competition for the best space resulted in positive side effects, though. Most notably, West Michigan saw the ground breaking of its first build-to-suit industrial project after a five-year drought.



The driving force behind the West Michigan industrial activity is the Southeast quadrant. This area has a concentration of large, growing manufacturers that needed to consume space for increasing production demands. With few high-quality space options, companies began using alternative approaches to create more room like expanding their current sites or becoming more resourceful with the space that they currently occupy. Plans for speculative construction did not surface during 2012; however, the past year saw the onset of several new construction projects for West Michigan, including a new 85,000-square-foot site for CHEP USA in the Meadowbrook Business Park to be completed in the first quarter of 2013.

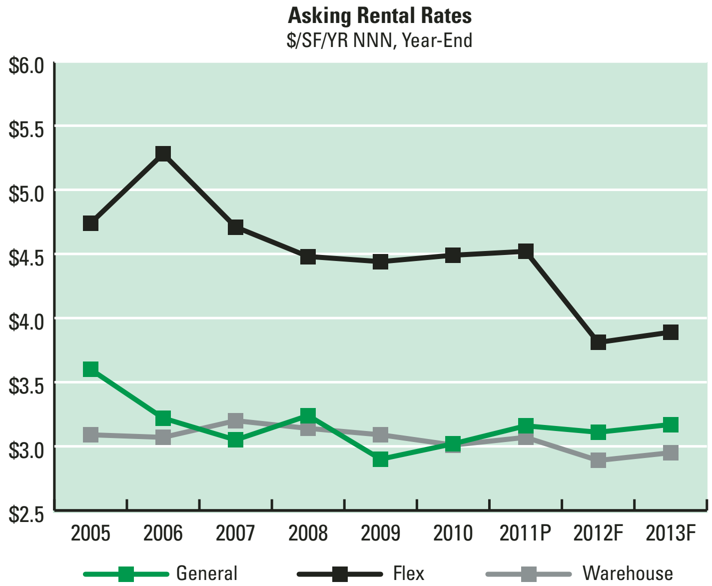


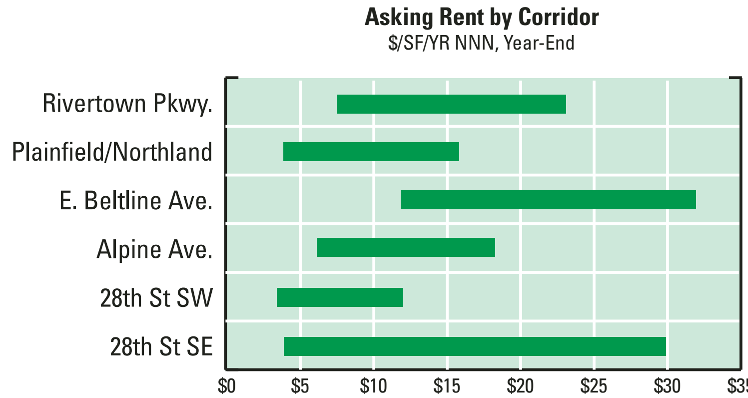
As 2013 begins, unresolved issues regarding the U.S. fiscal cliff along with volatile situations in foreign markets continue to leave the market with a fair amount of uncertainty. Eliminating this uncertainty will lead to accelerated growth in the industrial arena which will subsequently boost activity for warehouse facilities. Shrinking available inventory of superior space will make it necessary to get creative on deals for industrial space. Vacancy rates at the end of 2012 have left little room for improvement. However, look for the small amount of remaining coveted space to decrease the vacancy rate modestly.



Expect to see build-to-suit projects play a larger role as the West Michigan industrial market continues to distance itself from the recession. Users with unique and specific facility demands will have very few options aside from new construction.

Manufacturing growth will continue to pull West Michigan through the economic recovery. The industrial real estate climate is favorable stepping into 2013. Activity will slow considerably with the amount of available inventory shrinking. New construction, including speculative projects, will be the theme for manufacturing space throughout the next year.





Grand Rapids | Retail

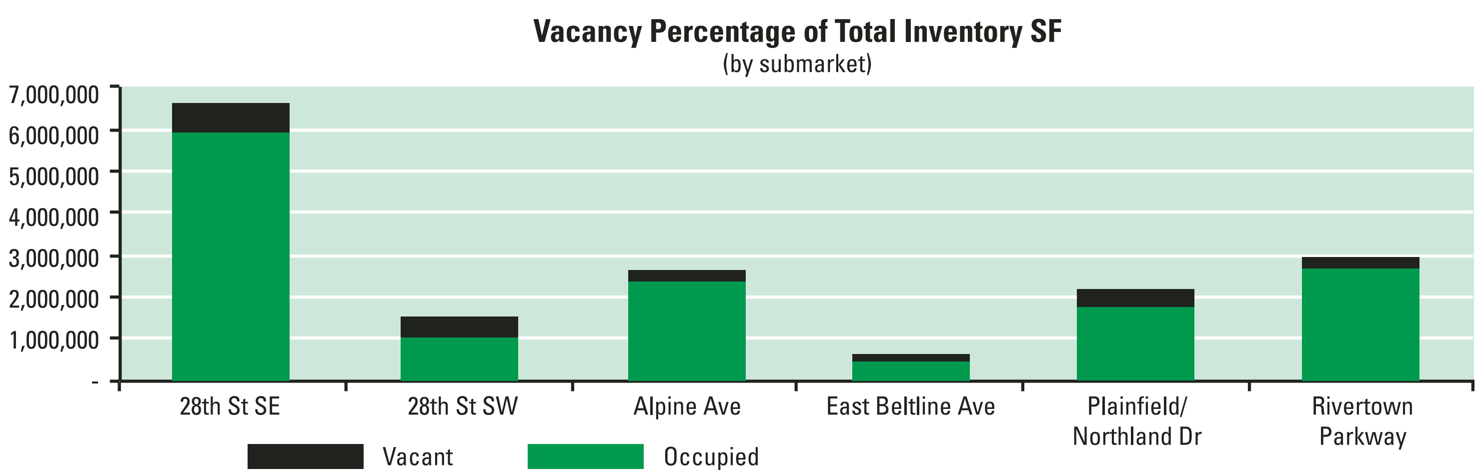
The overall tone of the retail market in 2012 was more upbeat and optimistic then it has been in years. Propelled by strong tenant activity, West Michigan is well on its way to recovery from the prior years of turmoil. As the market continues to stabilize, we are seeing positive trends and statistics for the upcoming year. Net absorption has increased each of the last three years, each year exceeding the previous. This trend, along with insight from our market experts, suggests that positive absorption will continue to escalate in 2013.

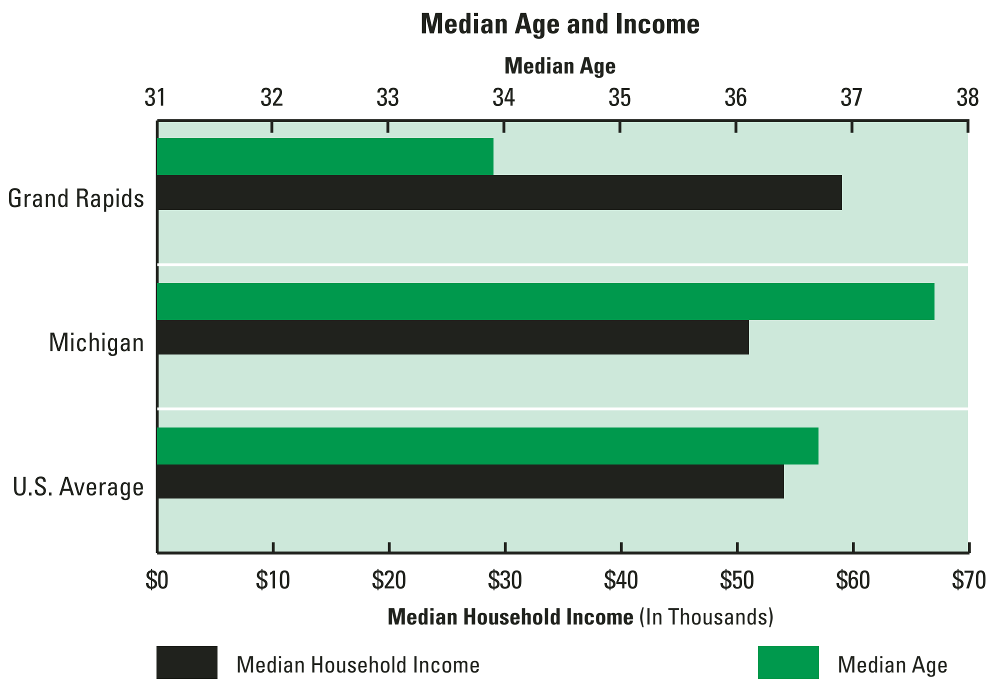
Developers in the downtown retail sector have been fostering growth by transforming outdated historic structures into new mixed-use buildings with loft, office, and retail space. A majority of these developments are a direct result of the various funding incentives that the Downtown Development Authority (DDA) and other organizations have been offering. As these types of tax credits and grants continue to ignite activity, we will see more and more renovations and redevelopments in 2013.

We are starting to see a slight shift in downtown activity with much of it moving south toward the Heartside District where many new apartment developments are in the planning stages. The completion of the “Downtown Urban Market” in 2013 near Wealthy Street will also contribute to absorption and the overall retail presence by reeling in a restaurant, brewery, and a variety of shops.

Over the last year we have noticed new construction starting to reappear in the retail market. Many of the developments that are currently underway are expected to reach completion in the upcoming year. These include Cabela’s new store in the Rivertown corridor, Centerpointe Mall’s transformation into more of a power center design in the 28th Street SE corridor, and a variety of downtown redevelopments into mixed-use space. With new tenants consistently entering the market and vacancy rates contracting, it is only a matter of time before we see supplementary speculative and build-to-suit construction in the retail market.

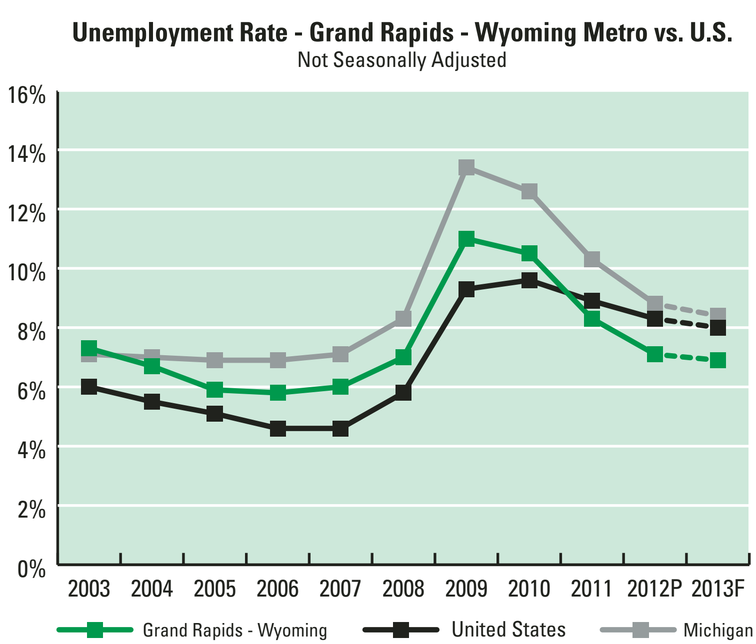
Compared to last year, the range of asking rents have widened in all of the major retail corridors. Landlords of low-grade, undesirable buildings are continuing to drop their rents as they struggle to find suitable tenants. “Under-demolished” has been an increasingly common term used to





describe these corridors with properties that have become physically outdated or functionally obsolete. As the economy improves we should expect even more investor interest in these areas, from investors who are willing to take advantage of the low price and redevelopment opportunity.

Overall, it has been a solid year and we expect more of the same moving forward. It is no longer a secret that Grand Rapids has become one of the most sought-after places in Michigan for its extremely successful Art Prize event to the endless amount of activity coming through DeVos Place and Van Andel Arena. The amount of positive activity we are seeing in the market coupled with steady retailer interest will ensure growth throughout 2013.

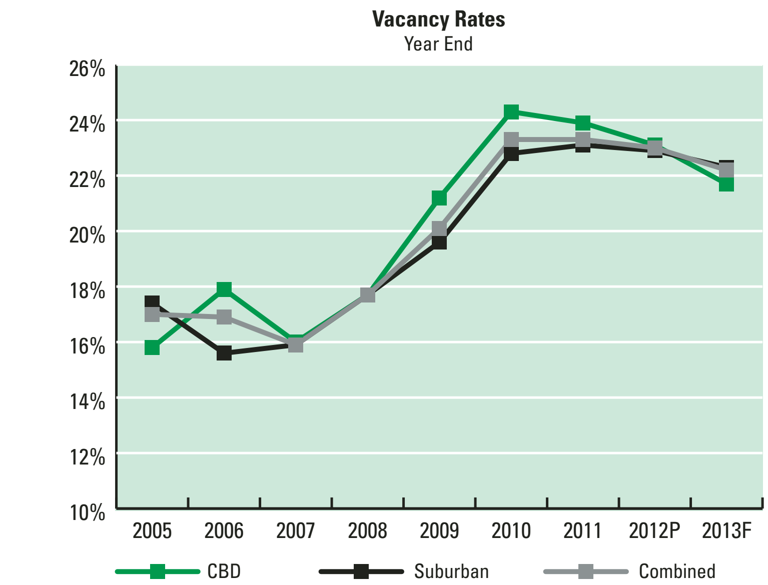


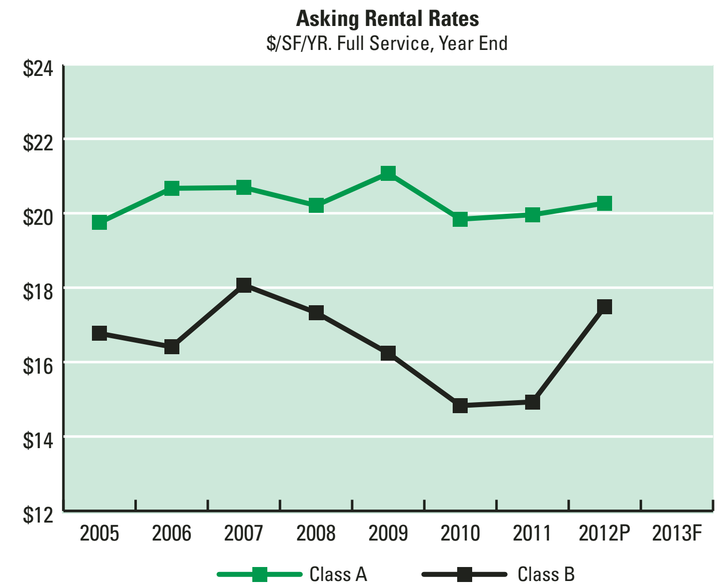
Grand Rapids | Office

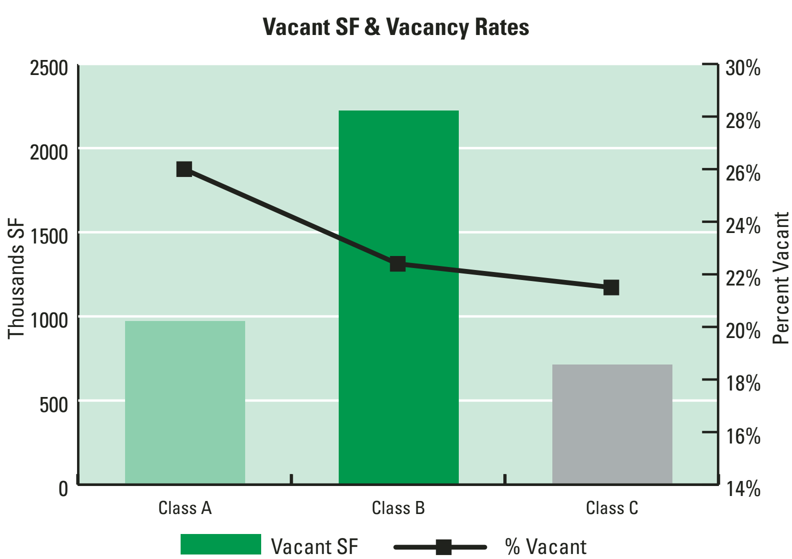
The Grand Rapids area has made healthy strides on the path to economic recovery over the course of 2012. According to The Brookings Institution, Grand Rapids metro area ranked eighth strongest-performing in recovery from the recession. The ranking is based on quarterly indicators including employment, unemployment rate, gross metropolitan product (GMP), and housing prices. This is a stark contrast to the same report in 2011 that labeled the market as one of the 20 weakest performing areas with respect to economic recovery. Additionally, the *Forbes Magazine* honor of "Best Metro Area to Raise a Family" was bestowed on Grand Rapids early in the year.

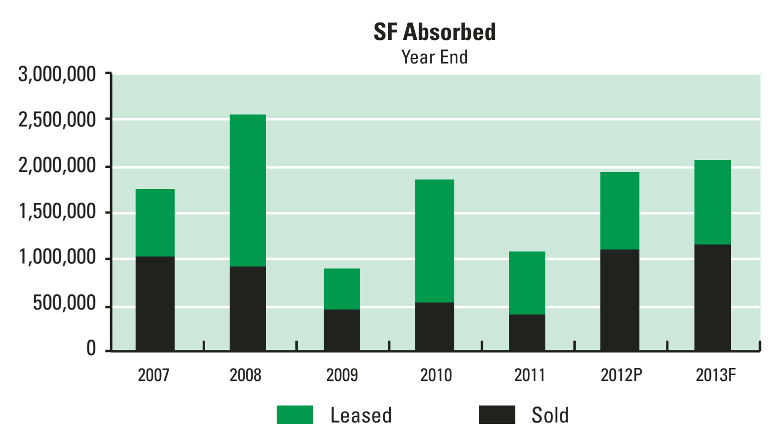
The past year saw the West Michigan office market firm up. While deals were not as luxurious as in the past, the Grand Rapids area was still able to offer space at a tremendous value to buyers and tenants. Tenant incentives are still on the table but have decreased through less available free rent and improvement allowances. Rental rates began to see a shift with slight increases as competition increased for premium space, especially in central business district properties. Tenants aware of these emerging trends reacted by shoring up longer-term deals to avoid larger increases in the future.

Sales activity for the year was highlighted by several major downtown assets changing hands. Most notably 50 Monroe Place, 99 Monroe Avenue, and McKay Tower were sold, totaling almost 700,000 square feet of office real estate. These transactions brought several ambitious ownership groups looking to revitalize previously less attractive tenant offerings. Many of these buildings are undergoing a facelift to both their internal structure and outside appearance to reinvent the office space.









Overall occupancy experienced a modest increase for 2012 and finished the year with an eighth straight quarter of positive absorption. The downtown and southeast submarkets garnered most of the attention of Grand Rapids office space users, keeping in line with historical trends. The suburban office scene benefited from improved growth but waned in comparison to the level of the CBD.

Medical use played a major role in lease activity. The Medical Mile had a strong year bringing occupancy to almost 100%. In addition, Spectrum Health continued to be active in the market, inking several major leases.

Construction over the next year should remain minimal. The downtown area will continue to see the majority of interest but development opportunities for new space are scarce in this area. Health care may be the anomaly of office users, with several big players positioned to tackle new projects. With an almost 20% vacancy rate, there is still plenty of usable space elsewhere that makes construction a less appealing option. With many renovation projects completing during the year, owners can anticipate slightly higher rates than similar unimproved properties in their vicinity.

New tenants to the market will see a quite different landscape than what was presented in the past few years. The options for high-quality inventory, especially downtown, have dramatically decreased compared to recent times. Also, lease terms will become less negotiable with respect to free rent and concessions, both of which were previously used to lure in occupants. From a landlord perspective, the trend of increasing rental rates will provide faster payback for improving office space and common areas.

The availability of distressed office properties will become less frequent as banks back away from their fire sale approach to offloading this inventory. Financial institutions are taking a more conservative and orderly approach to selling their foreclosed properties. Opportunities will still exist for investors that have done their homework and have no barriers to financing. The market will continue to offer great deals on these assets for those that are patient and willing to strike quickly.

Grand Rapids | Investment

In 2012, the market saw positive absorption and rising lease rates which contributed to lower cap rates (meaning higher values). This valuation improvement continues to be driven in large part by historically-low interest rates. Additionally, competition among local lenders remains strong, allowing well-funded investors the opportunity to finance at historic low levels. Cap rates have fallen approximately 100 basis points over the last year, resulting in higher value of many quality assets. There remain a larger proportion of distressed properties in the market; however, we are witnessing a decline of distressed inventory as banks continue to dispose of distressed assets and the pipeline of new distressed activity slows. The cumulative effect is that a significantly lower proportion of sales is of distressed nature, which is allowing prices to continue an upward trend.

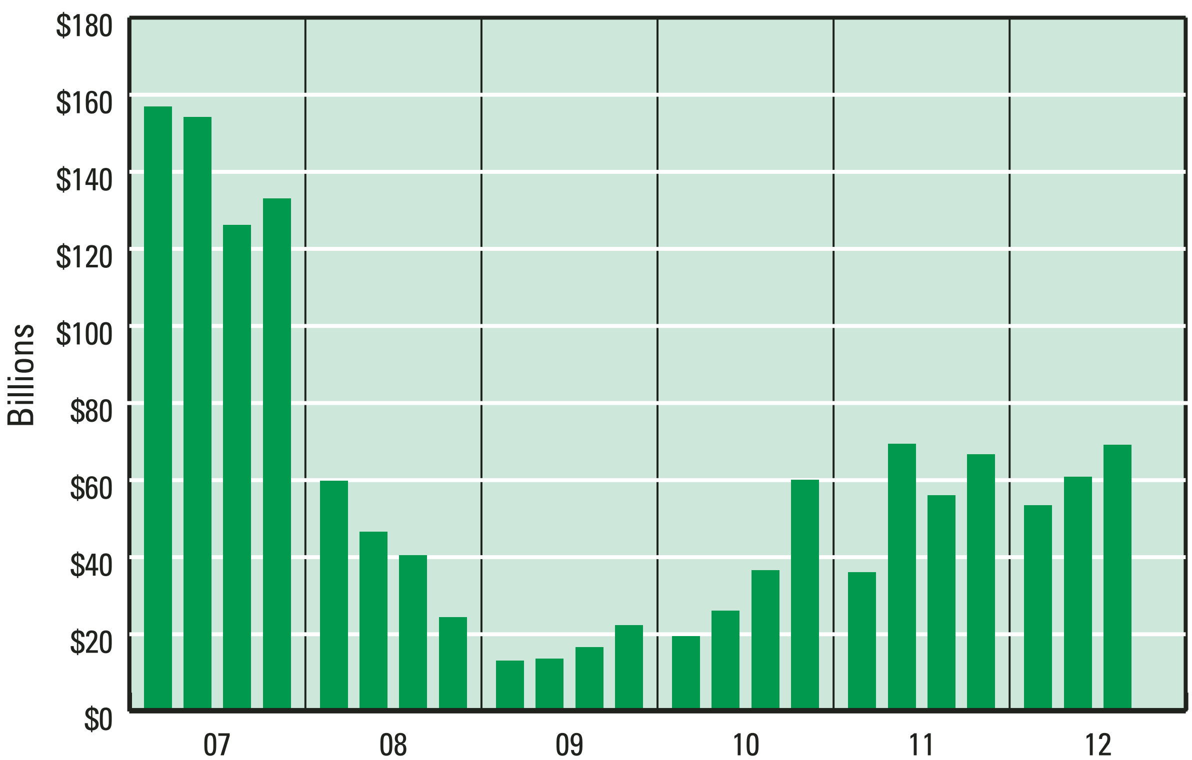
Similar to last year, the multi-family market continued to show the strongest increase in property values. This sector has shown the most consistency and improvement with increasing rental rates, increasing occupancy rates, and high buyer interest. There is currently a shortage of multi-family inventory as demand outweighs quality supply. With low interest rates and favorable financing conditions, investors are actively seeking opportunities to purchase; however, there have been few opportunities offered to the market.

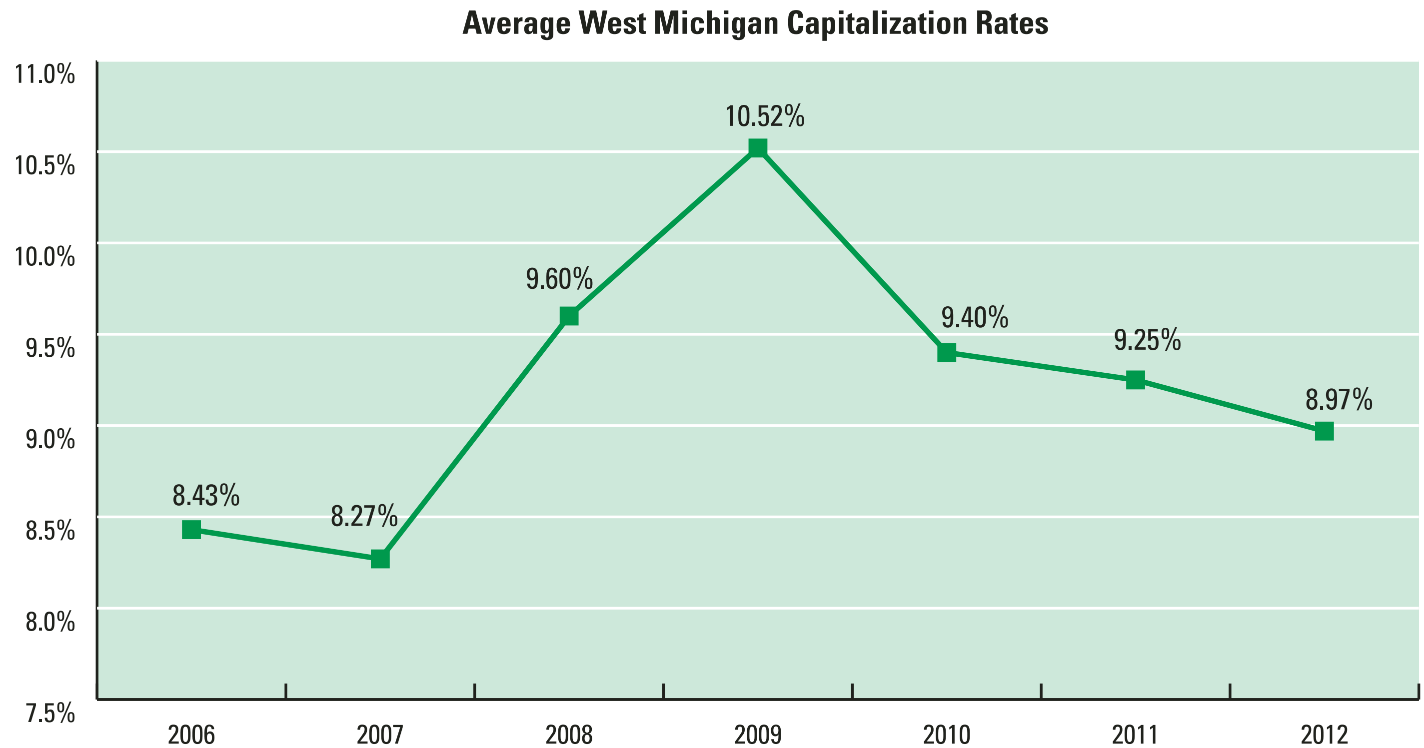
In 2012, the suburb office market has been relatively quiet with a tremendous amount of activity occurring instead in the downtown marketplace. The office market saw several key assets trade hands in the Central Business District (CBD) over the past year. These include 99 Monroe (Former Campau Square Plaza), 50 Monroe (Huntington/TGIF), 146 Monroe Center (McKay Tower), 125 Ottawa (Ledyard Building), and 50 Louis (Trade Center Building), and soon to be followed by Bridgewater Place. We anticipate these purchases to be long-term holds, which are driven by both the stability of our urban core and the ability to achieve very attractive long-term financing. The current interest rate environment is allowing investors to pursue projects that may be in need of significant updating and rehabilitation. Many recent transactions in the CBD are being closely followed by significant property improvements. By giving a new look and upgrading amenities at some of these properties, owners are beginning to drive rent growth as well as appeal to new tenants which otherwise may have overlooked these opportunities.

The fundamentals of the retail market, such as vacancy rates and rents have steadily improved in major retail areas. Despite this improvement, there has not been a great deal of investment activity. There were less than a dozen arms-length retail investment transactions and only a handful of retail strip center transactions. Due to the lack of activity in retail investments we anticipate that this segment will see the greatest increase in activity over the next couple years.

The industrial market was very healthy in 2012 with significant interest exhibited by out-of-market investors.

Total U.S. Investment Volume





Reflects average cap rates for all investment property sales completed by Colliers International in West Michigan

A number of quality assets with long-term leases in place traded to out-of-market investors. Interest is expected to remain steady into 2013 as the local industrial market continues to exhibit strength. Investors remain focused on quality buildings, strong tenants and longer term leases. The demand from investors in this segment has seen steadily rising prices. In 2013 we expect to see several build-to-suit "new construction" projects surface in the market.

In 2013, we anticipate an increase in arms-length transactions, as distressed opportunities continue to decline. Transaction volume should continue to increase in all sectors, with retail and multi-family experiencing the biggest upswing. Net leased single tenant properties demonstrating stable and predictable cash flows will remain the focus of many investors. The buyers of the high-profile downtown transactions will conclude their renovations and upgrades resulting in elevated rents. Buyer activity will remain strong as buyers seek to take advantage of low interest rates that will allow them to pursue properties with a long-term hold in mind. Overall activity should escalate as long as the economic conditions cooperate, interest rates remain at historic lows, and sufficient financing options are available.

Kalamazoo | Office

The Kalamazoo office market can be summarized by slow, but steady, growth. Contributing to the overall growth of the area is the anticipated completion of the Western Michigan University School of Medicine. This downtown project is a $68-million renovation of a 320,000-square-foot former Pfizer building donated by MPI Research, with a 30,000-square-foot building addition. The development promises to attract new retail and service uses, while creating new jobs.

The purchase of the 130,000-square-foot former Kalamazoo Gazette building by a local development group is anticipated to create new multi-use options in the downtown area. In addition, the approximately 46,500-square-foot PNC Bank building in the 100 block of W. Michigan Avenue will be 100% vacant by 2013 due to the relocation of the retail branch to the newly renovated Kalamazoo Metropolitan Center across the street, and the relocation of corporate offices to the Varnum Building on N. Rose Street. PNC's move creates a unique opportunity for a large user in the downtown office market.

The overall office market in Kalamazoo continues its uphill climb at a modest rate, with the demand for suburban office space remaining flat. However, continued redevelopment activity in the downtown area is expected to have owners looking to acquire new assets, encourage corporate expansions, create longer-term deals for tenants, and increase the demand for downtown residential properties in 2013.

Kalamazoo | Industrial

Kalamazoo's industrial economy continues to focus on attracting high-technology, life science and research-intensive industrial applications, including pharmaceuticals. This initiative is supported by the community's strong partnership between public and private entities.

Although the Kalamazoo area experienced the closure of International Paper in mid-September, displacing seventy-seven workers, new tenants entered the market and existing tenants showed signs of growth by upgrading space, expanding and signing longer-term deals.

Janesville Acoustics opted to relocate to a 308,000-square-foot facility in Battle Creek after its former Ohio location was destroyed by fire late last year, and Mueller Industries recently announced its plan to invest $26.5 million in its Portage facility/equipment as a result of a 2011 fire at an Arkansas site. In addition, Hark Orchids, a German company that cultivates orchids, broke ground on a new $5 million facility in Midlink Business Park, and Imperial Beverage Company absorbed over 500,000 square feet with its relocation from Manchester Road to the former American Greetings/DesignWare building on Emerald Drive.

Reinventing the area as a destination for high-tech and life science users will prove to be the path to industrial strength in the Kalamazoo market. This, coupled with core manufacturing companies, will ensure the longevity of industrial real estate use in the area.

Kalamazoo | Retail

Retail activity in Kalamazoo has been driven by a tight market and limited availability in the primary retail corridors. While there is a growing number of national retailers seeking entry into the main retail corridors, adequate sites are at a premium. Expect interest in this area to continue to be strong as we enter 2013. Landlords are benefitting from this piqued interest by upgrading tenants and improving rental rates.

The main retail corridors of W. Main Street, S. Westnedge Avenue and Gull Road continue to see positive absorption. This last year saw the introduction of many new retailers to the S. Westnedge Avenue corridor, including Tim Horton's, Dunkin' Donuts, Five Guys Burgers & Fries, Five Below, Planet Fitness, and while the coming year will bring several new tenants to this much sought-after corridor, including Dick's Sporting Goods and Hobby Lobby, which will absorb 100,000 square feet in the former Kmart Plaza.

The W. Main Street corridor gained several new tenants in 2012, including Chipotle, Let's Swirl Frozen Yogurt, Niskers Char-Grill, Lumber Liquidators, Wild Bill's Tobacco, Taste of Heaven, Tim Horton's and Huntington Bank. In addition, Maple Hill Pavilion is currently constructing 20,000 square feet of new retail space for occupancy in the first quarter of 2013.

The Gull Road corridor remained steady in 2012. The coming year will bring the addition of a new AutoZone in front of Walmart, as well as the ground-up construction of the area's third Menards store at the former Kmart site.

Moving into 2013, the Kalamazoo retail market is poised to continue the trend of decreasing vacancies. Competition for quality locations will remain high, especially along S. Westnedge Avenue, while new retail space opportunities are also expected to emerge in downtown Kalamazoo as development of the new medical school campus nears completion. ■

West Michigan Supply Management: A Year in Review

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Onward and upward. As we wrap up 2012, the year can be characterized as yet another twelve months of recovery from the 2007–2009 economic downturn that will always be referred to as the "Great Recession." Resembling the situation of 2010 and 2011, the pace of the recovery continues to be very slow by historical standards, and now shows signs of topping out.

At the onset of 2012, we read warnings in trade publications that office furniture, one of our region's largest industries, would probably experience a modest decline of about 2% as the year unfolded. Fortunately, the forecasters were wrong, and the office furniture industry will finish the year with a small gain. Part of this progress can be attributed to a slight recovery in commercial construction and the desire of new tenants to furnish new office space with equally new furniture. This year, as in 2011, industry analysts noted that the industry's growing diversification into the medical furniture business has become as a growing component of the industry's success. It is no secret that the cash positions of many firms enabled many firms to decide that now is the time to invest in long-promised new office furniture.

A slow but steady increase in the sales of new motor vehicles in North America has been one of the major catalysts in creating the demand for the production of automotive parts, our second largest industry in West Michigan. Indeed, the industry ended the calendar year with sales about 13% higher than last year. Despite the high price of gas, the miles driven throughout our nation remain very high. In addition, the average age of vehicles on the road continues to grow. Industry analysts refer to "pent up demand" finally being unleashed. Now that standards for auto loans have loosened by the financial institutions, customers are drawn to the automobile showrooms. The price of a good used car remains fairly high, so considering a new car could well be a better financial choice than repairing old ones. Lucrative rebates and other incentives by the major manufacturers have also been a draw. The bottom line is simple: The recovery of the automotive industry has been the primary driver of the economic recovery in the state of Michigan, and to a lesser degree, West Michigan as well.

In July of 2012, for the first time since the local recovery began in April of 2009, the industrial economy in the Greater Grand Rapids area slid into the minus column. A trend is never determined by a single month, and the next three reports turned flat, but not declining. As other industries were showing signs of topping out, the West Michigan area was simultaneously blessed with an upturn in both the residential and commercial housing markets.

As the year drew to a close, the Michigan legislature passed a landmark piece of legislation known as "Right to Work." For the first time since the labor movement amassed power in Michigan, workers in private firms and public institutions will no longer be required to join a union and pay union dues if they choose not to. Michigan now joins 23 other states that have enacted similar measures. Despite the bitter protests from almost all of the unions in the state, the advantages will not be as pronounced as either side may suggest. In many states that have passed "Right to Work" legislation, large numbers of workers have not elected to leave the union. Although the measure is easily recognized as pro-growth by the business community, it is only one factor in a decision by a firm to relocate. Of course, the measure can also be repealed at some future time, so it will be necessary for Michigan to now deliver the promised growth if "Right to Work" is to survive.

About the Survey

The monthly survey of business conditions, published under the title of "Current Business Trends," first debuted in Kalamazoo in February of 1979, and was expanded to Grand Rapids in 1988. At present, the survey encompasses 56 purchasing managers from ISM-Greater Grand Rapids, and 20 from N.A.P.M. Southwestern Michigan. For both surveys, the respondents are purchasing managers from the region's major industrial manufacturers, distributors, and industrial service organizations.

Patterned after the nationwide survey conducted by the Institute for Supply Management, the strength of the survey is its simplicity. Each month, the respondents are asked to rate eight factors as "SAME" or stable, "UP" or improving/rising, or "DOWN" as in declining/falling.

New Orders

This index is designed to focus on business improvement or decline by assessing new business coming into the firm. When this index is positive for an extended period of time, it implies that the firm or organization will soon need to purchase more raw materials and services, hire more people, or possibly expand facilities. Consequently, an increase results in billions of dollars being added to the economy. Conversely, billions of dollars are pulled from the economy when the index turns negative. Depending on the firm, a significant portion of this money ends up being spent in the local community.

Figure 1: 2010–2012 New Orders
Percent "Up" vs. "Down"

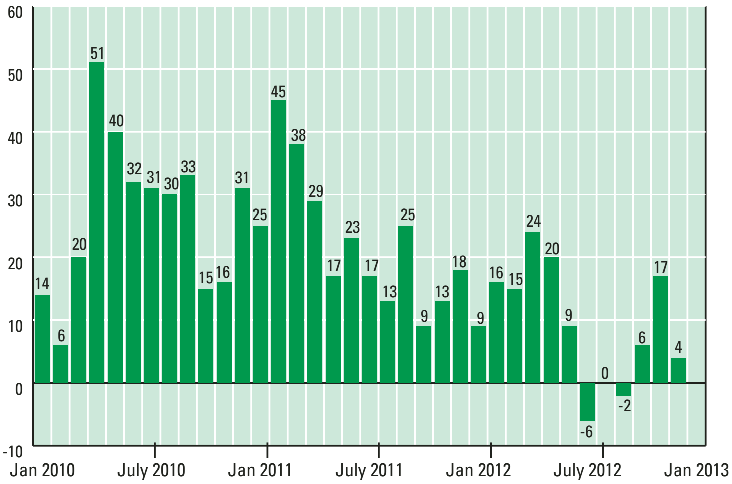
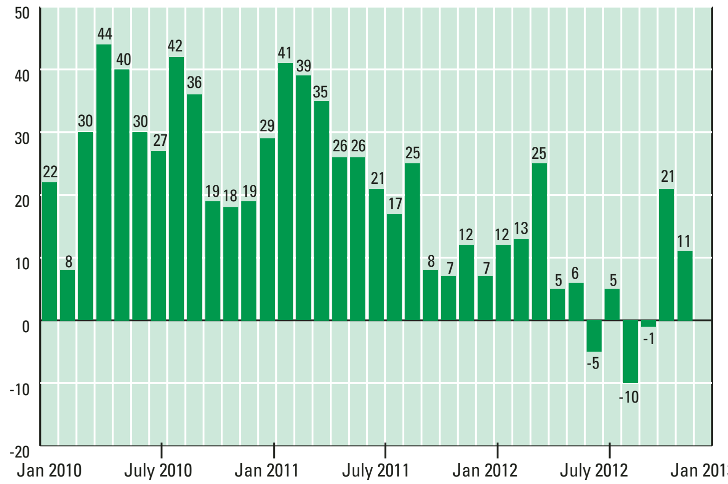


Figure 2: 2010–2012 Production
Percent "Up" vs. "Down"



As the 2012 year began in the Greater Grand Rapids area, the index of New Orders for January came in at a rather modest +9. From here, business conditions picked up in response to improved business conditions for the nation as a whole. The relentless monthly growth in auto sales continued to keep many of our local auto parts producers at full capacity. In the case of many foreign nameplates, the recovery from the 2011 tsunami resulted in an equal recovery for their Michigan suppliers. However, at +24, our best month for the New Orders index was April. While still very positive, this reading came in far below the +51 index we recorded two years earlier in the recovery cycle.

In mid-summer, the index fell to +8 in June. In the month ended July 31, we recorded -6, our first negative reading in three years. The recovery was starting to look like it may have run its course. At the national level, New Orders index from the Institute for Supply Management declined to -9, further confirming our suspicions. Fortunately, the statistical dip did not continue, and our local index of New Orders ended the year with a slight bounce.

Production

As many firms approached full capacity in 2012, it was not surprising to see our Production index become more subdued. Although the production schedules varied widely between different types of manufacturing firms, modernization of production methods and computer software have removed much of the seasonality experienced in years gone by. In the auto industry, the annual "model changeover," becomes less pronounced with each passing year.

Beyond factory output, the Production index is a limited forecaster for increases and decreases in the Employment index. The strength of our survey is that of being a "real time" report. Hence, an increase in production will result in an increase in hiring activity, but it will take several months before these statistics are finally reflected in the government statistics. Since we ended 2012 with a slight bounce in Production, we can hope that it will carry through to generate more jobs in 2013.

Industrial Inflation

In the middle of 2011, the index of Prices escalated to its highest level in the 24 year history of the survey. To make matters worse, the inflation centered on "big ticket" commodities like steel, aluminum, magnesium, corrugated, plastic resins, and all oil-related products. Industrial buyers scramble to find better pricing for these commodities, but most were unable to hold back the tide. Unfortunately, much of the problem was caused by speculation.

For industrial inflation, 2012 was a different kind of year. It is obvious that excessive industrial inflation is a problem for most firms, given that rising costs in today's competitive world are very difficult to pass along and often cut into profitability. However, FALLING prices can foreshadow an economic downturn. At the international level, the J.P. Morgan international index for Prices fell to its lowest level in 37 months. In our local report, the list of commodities falling in price grew considerably and included most of the big ticket items such as copper, corrugated, steel, plastic resins, aluminum, nickel, and even freight. With worldwide demand for most commodities still weak, industrial inflation is unlikely to be a problem in 2013, unless there is another financial crisis that manifests itself in another round of commodity speculation.

Employment

In 2011, our survey's index of Employment hit a 20 year high and was very positive for the entire year. In 2012, our index of Employment remained positive, but the results were not as strong as in 2011. The automotive parts producers were among the firms to begin reaching capacity, and as a result, stopped hiring at the rate of previous months. According to some employers, the main reason for the slower job growth continues to be the lack of qualified

Figure 3: 2010–2012 PRICES

Percent Reporting "Up" vs. "Down"

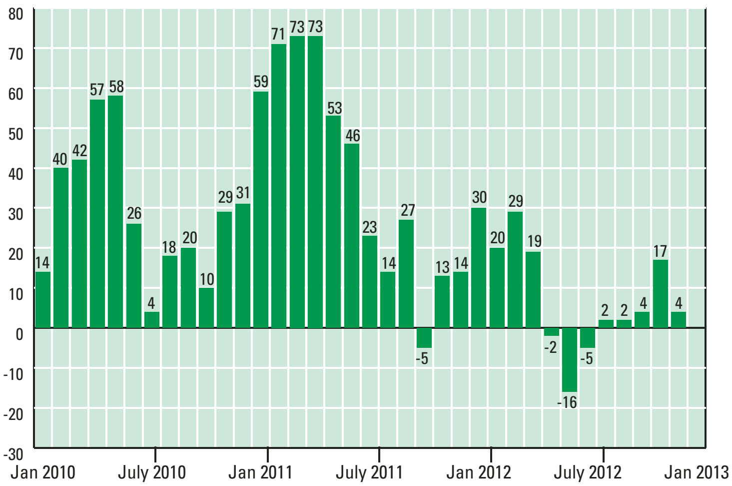
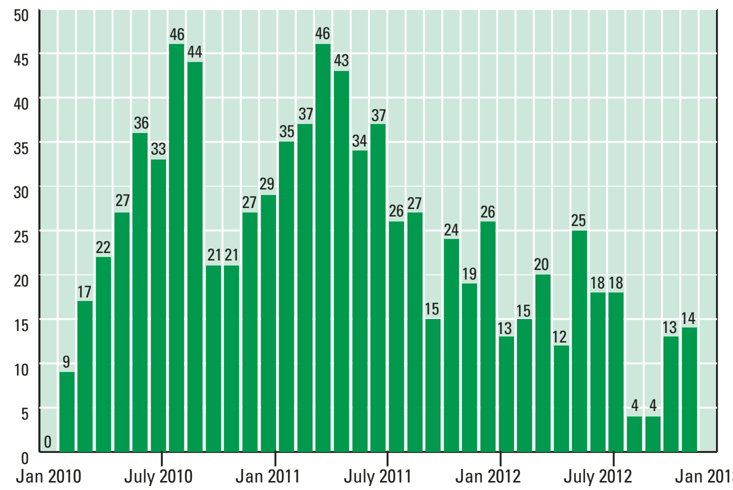


Figure 4: 2010–2012 EMPLOYMENT

Percent Reporting "Up" vs. "Down"



candidates. The fact remains that almost all of the new hires require some kind of skill, and firms are unwilling to run their own training programs like they did in the past. Smaller firms are even more reluctant to hire, and view the future with much more caution.

However, all of our months of positive reports have finally spilled over into the official unemployment statistics for the Greater Grand Rapids area. For instance, the local SMSA began the year at a 7.5% unemployment rate and ended the year close to a rate of 5.6%. Granted, at least some of this improvement was the result of people dropping out of the workforce and others accepting jobs below their trading and experience.

In 2013, the employment situation in the Greater Grand Rapids area will probably continue to improve, but at a slower rate. Our September and October Employment reports slowed to single digits for the first time in many months, probably foreshadowing slower growth for the first quarter of 2013.

Looking Ahead to 2013

Overall, barring the collapse of the Euro, we still expect to see the current pattern of slow growth to continue in West Michigan for 2013. Looking at the big picture, the largest obstacle facing us right now is the realization that our local, state, and national governments have overcommitted on retirement benefits, both in the form of pensions and health care. At this stage, the problem is still fixable, but it won't be easy. If, however, it becomes apparent that the problem is mired in political wrangling and is therefore not fixable, then we could be in for trouble.

We had hoped that the November 2012 election would clarify the business picture for the next few years. Instead, it left most questions still unanswered. Little has happened to resolve the differences in fiscal ideology, largely because almost none of the people have changed. The Republicans still control the House, and the Democrats still control the Senate and the White House. The statistics remain the same, most of the people in decision-making positions hold the same views, and so, of course, the rhetoric remains the same. The hotly debated list of solutions, such as they are, still claim that each is THE best tonic. Some pundits on both sides of the isle are already looking ahead two years to the mid-term elections to be the next juncture of change.

Another major uncertainty remains the implementation of the Affordable Care Act. This legislation imposes numerous new regulations and numerous new taxes on the business community, and the reaction to all of this new legislation is very difficult to assess.

In 2013, the recovery of the beleaguered housing industry will continue to be good news for the economy at both the local and national levels. For the past few months, the S&P/Case-Shiller index of property values has posted significant gains because of several factors. First, there is pent-up demand. Some buyers who have been waiting many months for the market to finally bottom out have decided that now is the time to buy. This long wait has allowed the buyers to accumulate a larger down payment, which also pleases the lending institutions. This trend has been augmented by less stringent lending requirements, including the lowering of minimum credit scores and more reasonable and more optimistic appraisals by the lenders. In that same context, buyers have gotten better at shopping around for better mortgage deals, and traditional competition is coming back to the lending markets. Also, there is a tightening of residential units available for sale. From a practical standpoint, higher rents have caused some people to rethink the idea of owning rather than renting. As headlines spread the news of a housing market revival, properties are beginning to be listed now that sellers feel they can expect a fair price rather than be hammered by a one-sided buyer's market. However, the recovery is not uniform across the national, state, and local geographies wherein abnormal levels of foreclosures will still be a problem for many more years.

For the industrial sector, we enter 2013 with at least some degree of uncertainty. Locally, our statistics have ended the year on a high note. However, the national statistics from the Institute for Supply Management and the international statistics from the J. P. Morgan Global Manufacturing reports remain modestly negative. We remain mired in a world-wide economic slowdown, which still threatens to spill over into the United States.

Just like last year and the year before, the financial situation in Europe remains one of the greatest threats to the world economy, as well as to our national, state, and local economies. In 2012, at least some progress was made toward solving the crisis in countries like Italy and Ireland, but then there is Greece. The Greek government will probably continue to meet the targets of the bailout programs, but financial managers around the world are always watching the situation. Over the last half of 2012, money was flowing out of the Greek banks at an alarming rate. New investment, from both inside and outside the country, is virtually nonexistent. A large portion of the population still believes that simply raising taxes on rich will solve the problem, but "the rich" are the people who are moving their money out of the country and out of reach of any taxes for Greece. In short, the Greek bailouts from the Europeans will have to continue in 2013, and the current estimates for future growth are far too "Keynesian" and far too optimistic. We also cannot forget that Spain is the next country to follow in the Greek footsteps, and that the 2013 news will probably be filled with various bail-out proposals to keep this country afloat. ■

West Michigan Stock Returns

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West Michigan Stocks Gain 13.2% in 2012

The West Michigan Stock Index rose 13.2% in 2012. That's a great return, and most investors likely are delighted with those results given the Dow Jones Industrial Index's single digit gain of 7.3% and the negligible returns paid on bank deposits. Both the S&P 500 Index and the NASDAQ Composite Index, however, outperformed the West Michigan Index as shown below in Table 1, Stock Market Returns.

Table 1: Stock Market Returns[1]

	2012	2011	2010
West Michigan Index	13.2%	- 3.7%	41.9%
Dow Jones Industrial Average	7.3	5.5	11.0
S&P 500 Index	13.4	0.0	12.8
NASDAQ Composite Index	15.9	- 1.8	16.9

[1]The West Michigan Index consists of 14 publicly-traded companies headquartered in West Michigan. Each company's return is weighted by the number of shares of common stock outstanding, the same procedure used in the S&P 500 Index and the NASDAQ Composite Index. In contrast, the DJIA Index uses a simple unweighted average return.

The news is even better for investors in publicly-traded corporations headquartered in West Michigan when 3-year cumulative returns are considered. The West Michigan Index far outperformed the three other indexes during the years 2010 through 2012 as shown below:

Index	3-Year Cumulative Returns
West Michigan Index	54.7%
Dow Jones Industrial Average	25.7
S&P 500 Index	27.9
NASDAQ Composite Index	33.0

Prices of the area's two smallest banks—Community Shores Bank Corp and Independent Bank—more than doubled in 2012, making both the best performing stocks in the Index. The price of Community Shores Bank rose from 5 cents to 21 cents, generating a 320% return, while Independent Bank's stock rose from $1.33 to $3.50, equivalent to a 163% return. As great as that sounds, only the boldest investors earned these returns. You may recall the severe uncertainty surrounding both banks during the past four years. Many investors were concerned about Community Shores Bank's ability to remain a going concern, and in fact, the bank's latest quarterly earnings report still warns that the outcome remains in doubt even though the bank eked out a small profit in each of the past two quarters.

Independent Bank's outlook is much better. Through the first three quarters of 2012, the bank generated $11 million of net income compared with a loss of $14.6 million during the same period in 2011. The bank also reached an agreement December 10 to sell 21 of its NE Michigan and Battle Creek branches to Chemical Bank, a deal that will generate cash needed to help repay the Federal Government's TARP money.

Table 2, West MI Company 2012 Returns, shows how each stock in the West Michigan Index performed in 2012. In contrast to most years, the stocks of only two companies—Spartan Stores and Gentex—declined during the year.

Table 2: West Michigan Company 2012 Returns

	2012 PRICES		
	Closing	Opening	Percent Change
Community Shores Bank	0.21	0.05	+320.0
Independent Bank	3.50	1.33	+163.2
Steelcase	12.74	7.46	+ 70.8
Mercantile Bank	16.50	9.75	+ 69.2
Meritage Hospitality Group	2.55	1.71	+ 49.1
Macatawa Bank	2.89	2.28	+ 26.8
Universal Forest Products	38.04	30.87	+ 23.2
ChoiceOne Financial Services	14.44	12.25	+ 17.9
Herman Miller, Inc.	21.46	18.45	+ 16.3
Wolverine World Wide	40.98	35.64	+ 15.0
Stryker	54.82	49.71	+ 10.3
Perrigo	104.03	97.30	+ 6.9
Spartan Stores Inc.	15.36	18.50	- 17.0
Gentex Corporation	18.85	29.59	- 36.3

The performance of each of the above companies is described below.

Other West Michigan Banks

While none of the five West Michigan banks in the Index has completely recovered from the real estate bubble and the resulting deep recession, provisions for loan losses are falling significantly, residential mortgage financing is strong, and profitability is improving.

As was the case in 2011, Mercantile is recovering the quickest. Its stock price rose 69% in 2012. Nonperforming loans have decreased 69% since peaking in early 2010. There are virtually no delinquent loans in the 30–89 day category, and best of all, the bank repaid all of its TARP funds during the year, and then reinstated a common stock dividend of 9 cents per quarter.

Macatawa Bank also had a great year. Net income through the first three quarters of 2012 was $14.3 million versus $1.7 million in the 2011 comparable period.

Like other area banks, the outlook for Choice One Financial Services, a Sparta-based bank holding company, has improved significantly. The bank's financial health wasn't hurt as badly by the recession as were other area banks, however. It didn't miss a regular common stock dividend as a result of the recession, something no other West Michigan bank can say.

If profitability of area banks has increased so drastically, why aren't bank stocks selling for much higher prices? It's because a good portion of the return to profitability is attributable to the release of reserves held for non-performing loans. As a bank's portfolio of bad loans is reduced—either because some of the bad loans are repaid, or they are foreclosed and the resulting property pledged as collateral is sold—the reserves held in case of a complete loss are transferred to earnings, goosing reported profits. But those profits are a one-time event, and don't reflect a bank's ability to compete with other banks for business. Even with the higher reported earnings, therefore, there is still uncertainty over longer-term financial health. It will take at least another year or two before investors can be sure of the true profitability of area banks.

Gentex

Gentex finds itself in the unusual position of having had the worst stock price performance of any stock in the Index during 2012. Two major factors are affecting Gentex's stock price: Concerns about slowing sales of luxury light vehicles in Europe, and further delay in the anticipated announcement from the U.S. Department of Transportation requiring rear camera displays on all light vehicles. That announcement seemed imminent at this time last year, but now there is doubt about if and when the rule will come. As a result, Gentex is predicting flat sales growth, and investors have lost some of their optimism about the company's future.

Herman Miller and Steelcase

In the quarter ended December 1, Herman Miller announced it had failed to meet its earnings expectations but also reported increased order activity in each of its product segments. Similarly, Steelcase reported three weeks later that it was optimistic about growth in the Americas, and that announcement pushed up its stock price 12% the next day. Sales and profits of both office systems manufacturers follow the economy closely, and indications from both companies are that 2013 will be a better year than 2012.

Meritage Hospitality Group

Meritage Hospitality Group operates 92 restaurants in the Americas. At the end of the third quarter, Meritage reported its 9-month sales had increased 8.8%, and its net income was up 117%. Its stock price increased steadily beginning in May, ending the year with a nearly 50% gain.

Perrigo

Perrigo's net income was in line with investor expectations in the latest quarter ending November 7, but sales were $50 million less than expected. The bad news about sales knocked about $10 per share off the company's stock price and caused Perrigo's stock return to increase only 6.9% in 2012.

Spartan Stores

Spartan operates 97 corporate-owned grocery stores and distributes 45,000 items to 475 independent grocery stores. It experienced a slight decrease in same-store sales, and that was enough to make the company's stock fall 17% in 2012.

Stryker Corp.

Stryker's common stock price meandered between $51 and $56 per share throughout most of 2012. Net sales grew 3.7% through the first 9 months of 2012, while net income increased 11.2%. Stryker's stock price likely is lower than otherwise because of uncertainties about how fully-implemented ObamaCare regulations and taxes will affect medical device producers.

Universal Forest Products

Universal's stock price rose steadily during the year, reflecting the strengthening housing market. As the housing market strengthens further, the company's sales and profits will continue to increase, and that should be reflected in a higher stock price in 2013.

Wolverine Worldwide

The company's long string of consecutive quarters of increasing sales and record earnings ended in 2012 as weak economies in Europe and slow sales in Canada hurt shoe sales and company profits. Still, a 15% stock price increase is a good return, no doubt spurred on by Wolverine's purchase of PLG on October 9. PLG makes Keds, Stride Rite, Sperry Top-Sider, and Saucony brand shoes. This is a major acquisition, and should strengthen Wolverine's market strength, sales, and income.

Here are a few facts about stocks in the West Michigan Index:

- The company whose stock is most responsive to stock market changes is Macatawa Bank. For every 1% change in the stock market, Macatawa's stock changes 2.2%.
- The most defensive stock is Community Shores Bank. For every 1% drop in the stock market, its stock rises 1.9%.
- Stryker has the greatest number of outstanding shares: 380 million.
- Community Shores Bank has the fewest number of outstanding shares: 1.5 million.
- Dividends added another 1.4% to the Index's 13.2% return in 2012, giving a total return of 14.6%.
- X-Rite dropped out of the West Michigan Index after being acquired by out-of-state Danaher on April 12. ■

Housing Prices in 2012

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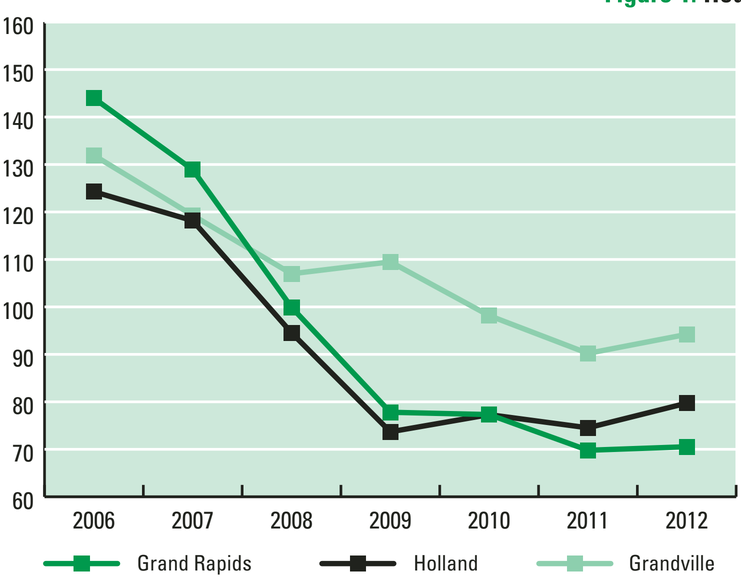
Recently, there have been many signs that the U.S. housing market is finally recovering. Since prices started to decline in mid-2006, the national housing price index reached a bottom in the first quarter of 2012 and since then rose 4% until August (based on the seasonally adjusted S&P/Case-Shiller 20-city; Federal Reserve Bank of St Louis). Private housing starts have been in an uptrend since 2011, rising from around 550,000 to almost 900,000 in September 2012 (U.S. Census Bureau). These positive changes in the housing market have been credited to the economic recovery (unemployment rates were down to 7.9% in October 2012 after reaching a peak of 10% three years ago) and historically low mortgage rates (30-year mortgage rates reached 3.4% in October 2012), although credit requirements are still very restrictive compared to the previous boom years.

In West Michigan, our latest estimations of a quality adjusted housing price index for several cities in the region show prices rising in 2012 (based on data available up to mid-November). We estimated price indices for Grand Rapids, Grandville, and Cascade Township in Kent County, and Holland and Georgetown Township in Ottawa County. Figure 1 depicts these indices since 2006, when prices started to decline. The index is set at 100 in 2000, so it can be interpreted as the amount of money needed to buy a house for every $100 that was needed to buy the same house in 2000. The index is computed by comparing the sales prices of the same houses over time, which means that only houses sold more than once are taken into account. Although the estimation does not include the sale prices of all houses and disregards the impact of renovation or deterioration, the index is considered to be a good measure of the average changes in local market conditions. For this work, we computed the indices using home sales from 2000 and 2012, with sale prices as low as $10,000. For Grand Rapids, we also computed an alternative index that excludes houses with sale prices below $50,000 (which are likely more affected by the foreclosure crisis). In Figure 1, the alternative measure is called non-distressed index.

As seen in Figure 1, housing prices in richer suburban areas like Cascade and Georgetown townships are still above the 2000 levels, but central areas have seen deeper price declines (Grand Rapids price index is 51% below the 2006 level). This difference is likely due to the foreclosures crisis, which affected lower income homeowners in particular. Indeed, the non-distressed home price index for Grand Rapids suggests a much smaller drop in prices (a 24% decline since 2006, which is more in line with the decrease in suburban areas). Higher household income and better employment conditions (see Table 1) have helped soften the impact of the economic recession and slow growth in recent years, leading to smaller declines in housing prices.

To understand the recent rise in home prices in Kent and Ottawa counties, we analyze how market conditions have evolved in the past year. Higher housing prices are typically a result of higher demand and/or lower supply. Demand for housing increases when there is growth in the population of households, growth in the income needed to buy a house, or better credit market conditions (lower mortgage rates and looser credit requirements). Higher expectations on future prices and income also help stimulate current demand. On the other hand, the supply of available housing increases when new houses are built or more people choose to sell or face foreclosure.

Figure 1: Housing Price Index



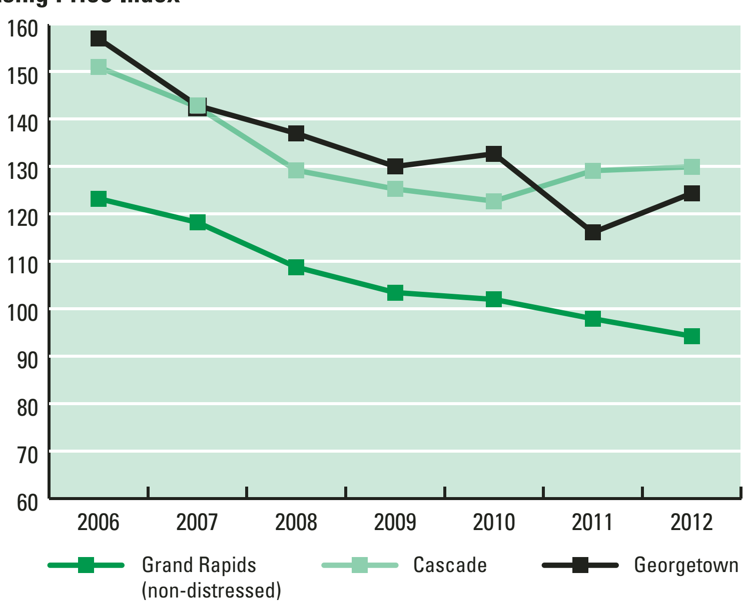


Table 1: Local housing demand factors

Area	Population growth from 2000 to 2010	Population growth from 2010 to 2011	Median household income (2006–2010)	Unemployment rate (2006–2010)	Employment change from 2005 to 2010
Grand Rapids	-4.9%	0.9%	38,344	11.7%	-14.6%
Grandville	-5.4%	0.9%	50,984	5.7%	-10.1%
Cascade	+13.4%	0.9%	94,313	6.8%	+3.3%
Holland	-5.7%	0.6%	44,001	8.2%	-12.5%
Georgetown	+12.8%	0.9%	62,723	5.6%	-11.2%

Median household income and unemployment rate data are from the American Community Survey 2006–2010 (U.S. Census Bureau). Employment change in Cascade is based on zip code 49301; in Georgetown, it is based on zip code 49428 (Source: U.S. Census LEHD).

Both Kent and Ottawa counties had a 0.9% population growth in 2011, according to estimates of the U.S. Census Bureau. This increase in population follows the positive growth trend seen in the last half of the 2000s in most of the region. Labor market conditions have also improved recently. In the January-September 2012 period, employment in Kent County was 2.9% higher than in the same period in 2011. In Ottawa County, employment increased by 5.2% in that period (Michigan DTMB). Improved expectations for employment and future market conditions helped stimulate housing demand. The historically low mortgage rates also stimulated demand. Together, these factors explain the recent increase in housing prices in the region. However, home purchases are still hindered by mortgage requirements that became strict during the foreclosure crisis and have not yet loosened significantly, as recently reported by the Federal Reserve System's Chairman Ben S. Bernanke.

Housing prices are also influenced by the supply of houses in the region. As the supply of houses increases relative to the demand, downward pressure is exerted on the price of available housing as buyers have more choices. Two important recent supply drivers have been foreclosures and new house construction.

As the foreclosure crisis expanded in the second half of the last decade, it added a large number of houses to the market, putting downward pressure on prices. The percent of bank-owned houses in Kent County reached 1.2% in 2010. Over the last three years, the foreclosure crisis has steadily abated. Prior to the crisis, in 2005, 0.3% of all houses in Kent County were bank owned. Ottawa County fared better over this timeframe with 0.1% bank owned in 2005, rising to 0.6% bank owned in 2010. By November 2012, only one of the locations listed in Table 2, Holland, showed a bank owned rate above the 2010 Kent county average. The suburban areas of Cascade and Georgetown Townships had rates at or below the 2005 Kent County average. This shows that the stock of houses available via foreclosure has been decreasing and in some cases might be back to normal, reducing the downward pressure on housing prices.

The second supply side driver, new homes, has remained in check. The cities of Grand Rapids, Grandville, and Holland have limited ability to increase the number of new homes. As such, these areas show almost no new building over the last few years. However, Cascade, which started to show pricing strength last year, is now building houses at a faster rate than it did during the housing boom in 2005. The cities that have the highest bank owned rates and the lowest income levels are showing no building pressure. However, in places where bank owned rates are normalized and income is high, there has been a return of housing construction.

As the slow economic recovery continues, employment should keep growing and credit standards should start loosening up. Mortgage rates might start rising, but they will likely stay low

Table 2: Local housing supply factors

Area	Bank Owned Rate November 15 2012	Annual House Construction per 10,000 Houses 2005	Annual House Construction per 10,000 Houses 2010–2011
Grand Rapids	1.2%	21.1	2.3
Grandville	0.7%	117.9	2.4
Cascade	0.1%	253.9	280.5
Holland	2.5%	41.6	3.8
Georgetown	0.4%	183.8	51.9

Bank owned rate from Realty Trac and house construction from U.S. Census. Cascade data is based on zip code 49301; in Georgetown, it is based on zip code 49428.

as long as the Federal Reserve System continues its stimulus program through the purchase of long-term assets (as it has promised to do for the foreseeable future). Decreasing foreclosure rates and rising price expectations should induce greater construction activity. However, while most experts are optimistic that the housing recovery can continue from now on, there are still risks that the rising demand for housing will stall or revert if the economy faces another downturn. This could happen due to the looming fiscal crisis, the repercussions of the European recession, or another major negative event. About 20% of homeowners are still underwater (they owe more than what their homes are worth), which can cause another wave of foreclosures if economic conditions deteriorate. ■

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Serving Customers at the Base of the Pyramid: Two West Michigan Case Studies

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The Base of the Pyramid (BoP) refers to more than 4 billion low-income people who tend to live in emerging market countries and earn less than $2/day. Although people living at the BoP have limited economic resources, the global BoP market is worth about U.S.$5 trillion, and many businesses want to sell products to this important and large market segment. In this paper, we discuss projects from two West Michigan organizations that produce and sell products to people at the BoP in Honduras and Kenya. We use a concept called the relational view of strategy to explain the projects' sustainable success.

The market at the BoP is large and untapped, and many companies that try to serve it fail. Many products that sell successfully to middle- or upper-income customers sell poorly at the BoP because products are too expensive, too large, too hard to transport, or are inappropriate to buyers' needs. For example, consumer product companies discovered they could sell more shampoo and laundry detergent to BoP customers when they packaged it in single-use sachets. Customers often lacked either the funds or the space at home to purchase more expensive, larger bottles. So, companies that intend to succeed at the BoP usually try to create or adapt products specifically to these customers' needs, making them more affordable, likely to create local savings, and helping to alleviate symptoms of poverty.

But how do we know if BoP projects are successful? One of the pioneers of the BoP concept, the late Dr. C.K. Prahalad (2012), suggests that four criteria may determine BoP project success for companies that sell products and customers who buy them:

1. Companies must *tailor* products to solve the problems of BoP customers and create *scalability* so that thousands or millions can be sold.
2. Companies must make BoP customers *aware* of what the product is and does, and that the product is *accessible, affordable, and available.*
3. Companies must *modify* the value chain to produce a product adapted to BoP customers' needs and opportunities.
4. Companies must build *partnerships* with other organizations that may design, build, test, sell, and educate people about the product.

While these criteria may help us determine if BoP projects are successful, how do we know if they are sustainable? Prahalad's fourth point, about *partnerships,* is especially important. Organizations wanting to sell to the BoP learn they must partner with local non-governmental or community groups to reach their customers and sustain their success. For example, Unilever learned that to sell Lifebuoy soap in India, it had to launch community education campaigns along with an affordable bar of soap, because many people were unfamiliar with the health benefits of hand washing. It *partnered* with a local NGO to train community health workers to spread this message and sold more bars of soap over time as a result. Based on this idea, we use the relational view of strategy and competitive advantage (Dyer & Singh, 1998) to build a stronger set of criteria for measuring the sustainable success of BoP projects. Our view is that the sustainable success of BoP projects depends on *partner relationships* among organizations engaged in BoP projects, and the *resources* they create. In short, successful BoP projects demonstrate:

1. Assets created specifically by the partnerships, that lead to tailored and scalable solutions,
2. Sharing of knowledge among producers and users, increasing user awareness, affordability, availability and accessibility,
3. Shared resources and capabilities that lead to changes to the value chain, and
4. Good governance, created by strong partnerships.

Two organizations in West Michigan, Aqua Clara International (ACI) and Triple Quest, design, sell, and produce water purification systems that use biologically treated sand filtration technology for BoP customers in Kenya and Honduras. We interviewed principals of both organizations about their work and used relational view criteria to evaluate how sustainable and successful the projects are.

Aqua Clara International (ACI) is a non-profit organization based in Holland, Michigan. ACI designed the Aqua Clara International water filter and sells it to BoP customers in several countries, including Kenya. The filter consists of a bucket-sized plastic container that holds sand and gravel used to biologically filter water and a PVC plumbing tube that dispenses up to 40 liters of purified water daily (Aqua Clara, 2012). The filter's size and functionality is tailored to the needs of Kenyans in the target communities. ACI *reconfigured its value chain* by moving several activities to Kenya, which keeps product costs low. Plastic containers are manufactured, components are sourced, and final assembly takes place in Kenya. The filter is *scalable* in part because by 2012, over 2,300 water filters were sold. Local public schools are ACI's principal local *partners,* and their role is to store components and assemble, demonstrate, and distribute filters from this key community location. Other *partners* are community development entrepreneurs who buy parts, assemble, and sell the product to their neighbors, and community health promoters who give pre- and post-sale education on how to use the filters. The local knowledge and control of these *partners* lets ACI focus on technology transfer and training, and increases product sales with limited additional investment. These community *partners* know best how to raise *awareness,* create *access,* and make the product *available* to their neighbors. The filter is *affordable* to BoP consumers who earn less than $2 per day, because its average cost of goods sold (COGS) is U.S.$9 and its average retail price is $12, which includes a U.S.$3 commission. ACI and its *partners* have created strong *governance systems and relationships,* including thorough due diligence, a sophisticated partner selection process, and metrics to track product activities, sales, usage, problems, successes, and customer feedback (Aqua Clara, 2012; Personal communication, 2012). Based on the criteria in our relational view model, the ACI Kenya water filter project has had significant, sustainable success.

Triple Quest is a business venture between Cascade Engineering, a Grand Rapids, Michigan manufacturing company, and a West Michigan private investment fund. Triple Quest purchased intellectual property rights and tooling equipment to manufacture the HydrAid© Filter, consisting of a 30-inch tall plastic container holding biologically treated sand that filters water, a PVC tube, and a valve that channels purified water into a receptacle. The filter's large size is not specifically *tailored* to local users' needs: it may better serve a typical school or a very large family's drinking and washing needs. Annually, Triple Quest's Michigan plant can manufacture 250,000 plastic containers, which are shipped to its warehouse in Honduras. Initially, Triple Quest sourced sand for filtering in the U.S. and shipped it to Honduras as well, but it *reconfigured part of the value chain* and now sources sand locally. While Triple Quest achieves manufacturing *scalability,* it achieves distribution *scalability* only if a full ocean container of filters is shipped. Ocean freight costs are high, and volume is necessary to lower the per unit price to consumers. Occasionally and space permitting, the U.S. Navy subsidizes ocean freight and duty-free entry of the plastic containers from the U.S. port to Honduras, but the subsidy masks the true cost of goods sold.

Triple Quest does market research in Michigan and Honduras. Triple Quest hired one Honduran representative who manages the warehouse, sources sand, identifies new markets, and delivers components to installers. He creates *governance mechanisms* by *partnering* with local NGOs who can reach filter customers in remote communities, and with potential water filter installers and distributors. This dual distribution method, using NGOs and local installers, creates *user awareness* and *access.* The delivery of filter kits to Honduran rural areas has been costly and difficult, challenging the product's *availability,* in part because secondary roads in provincial Honduras are poor and inefficient. The HydrAid© filter is less *affordable,* because the retail price is U.S.$34 if ocean freight is subsidized (Triple Quest, 2012; Personal communication, 2012). Based on the criteria in our relational view model, this project has had moderate, sustainable success.

Discussion

The relational view tells us that BoP projects will be more successful and sustainable if they connect partners who create unique, relation-specific capabilities, effectively govern their relationships, and include BoP customers as co-producers, suppliers, and agents. The cases we highlighted support this argument. While the two West Michigan organizations use similar, non-proprietary water filtering technology to serve a similar BoP customer demographic, their business models, and their approaches to materials sourcing, manufacturing, promotion, training, sales, channel management, distribution, and after-sales service differ. Each uses resources and capabilities differently and creates different relational resources, resulting in significantly different price points, different sales results, and variance in their potential success.

Conclusion

We applied a concept called the relational view of strategy to explain the sustainable success of two Base of the Pyramid (BoP) projects, implemented by two West Michigan organizations. We found that *partnerships,* which are critical to the relational view, matter significantly to the success of BoP projects, because such projects often occur in places and cultures where mutual trust, reciprocity between partners, and personal relationships are important. These relationships often spur innovations that lead to critical *value chain modifications,* reducing the cost and the price of products to BoP customers. In many emerging market countries trust may substitute contract law and market infrastructure to reduce transaction costs and uncertainty. Consistent and repeated interaction between potential partners can build and nurture trust, leading to relation-specific assets, innovations to the value chain, and more successful project results.

Indeed, many innovations to a BoP project's value chain emerge because the projects are targeted to the BoP market. Such innovations occur because the BoP market demands them to reduce cost and increase *affordability and accessibility.* Another famous BoP project, Aravind Eye Care System in India, worked with suppliers and customers to significantly reduce the cost and price of cataract surgery to reach thousands of price-sensitive patients (Rangan, 2009). If customers were not so price sensitive, such radical cost reduction might not have occurred.

Finally, we found that establishing formal and informal *governance mechanisms* helps increase trust and relationships among BoP project partners. It is often necessary to hold many meetings with local partners to find the best mechanisms for reporting, accountability, and rewards. But once partners understand and agree to the rules of the game, their desire to protect their reputations discourages partners from behaving opportunistically, and project outcomes tend to be more successful. ■

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Have Recent Free Trade Agreements Boosted Michigan's Exports?

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On January 1, 2004, a free trade agreement (FTA) between the U.S. and Chile went into effect. In 2011, Michigan's merchandise exports to Chile were 316% greater than in 2003. That is impressive growth, perhaps convincing observers that this is clear evidence that FTAs are vital to Michigan's exports and economy. But would that opinion change upon learning that Michigan's annual merchandise exports to Chile's neighbor, Bolivia—with whom the U.S. has no FTA—have increased by over 1500% during the same period? This paper presents a straightforward comparison of the state's export growth for both recent FTA and non-FTA partners to see if FTAs have significantly benefited Michigan exports.

One legacy of former President George W. Bush's two terms in office is the substantial increase in the number of FTAs that the U.S. has with various countries. At the time of his inauguration, the U.S. had FTAs in force with just three countries—Israel, Canada, and Mexico (the latter two under NAFTA). At present, the U.S. has FTAs with an additional 17 countries: Australia, Bahrain, the CAFTA-DR countries (Costa Rica, The Dominican Republic, El Salvador, Guatemala, Honduras, and Nicaragua), Chile, Colombia, Jordan, Morocco, Oman, Panama, Peru, Singapore, and South Korea. All of these were either signed into law by President Bush or were negotiated during his time in office and signed into law by President Obama.

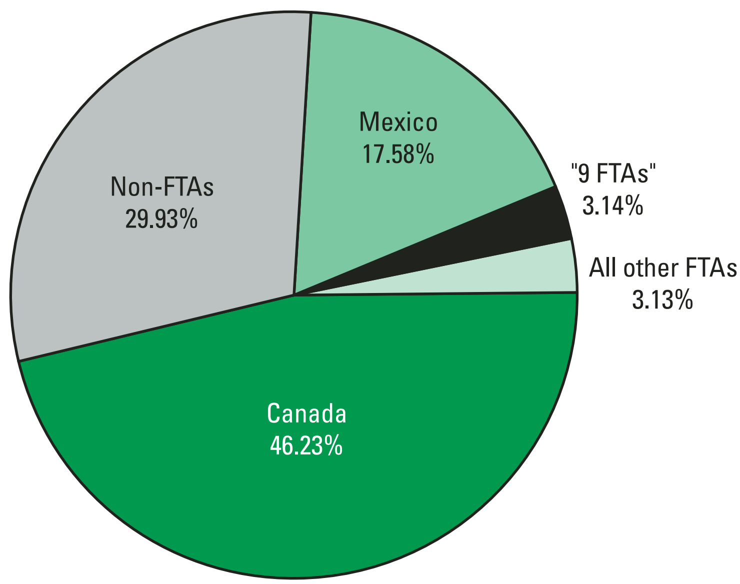
There are strong opinions on both sides of the debate over FTAs, with opponents arguing that they cost sales, jobs, and worker pay for domestic businesses that compete with imports, and proponents arguing that they result in greater sales, jobs, and pay for domestic exporters as well as lower production costs for businesses who use the cheaper, imported inputs.

Economists as a rule, however, favor free trade, concluding that the benefits outweigh the costs, at least in the long term. But it must be noted that FTAs are *not* what economists call free trade—FTAs only involve trade between specific countries, not between *all* countries and, despite the name, FTAs never eliminate all trade barriers between the partners. As a result, a complete economic analysis of FTAs is an extremely complex issue and beyond the scope of this paper. Instead, the intent of this paper is to focus on the impact on merchandise exports alone, and to ascertain if there is a clear difference in the pattern of exports to FTA partners and to non-FTA partners.

To draw meaningful conclusions about the impact of FTAs on Michigan exports, I restrict the analysis to countries with at least five full years' worth of data both before and after the FTA with them went into effect. All data used here come from the U.S. International Trade Administration's TradeStats Express database (http://tse.export.gov). This database provides information on merchandise exports from any U.S. state ("merchandise exports" refers to all exports of goods, but not services). Unfortunately, comprehensive state data is only available from 1999 on. This then excludes from the study the FTA with Jordan (and the pre-G.W. Bush FTAs with Israel, Canada, and Mexico) as there is too little data *before* it went into force, and the FTAs with Oman, Peru, The Dominican Republic, Costa Rica, Panama, Colombia, and South Korea, as there is too little data *after* those FTAs went into force.

This leaves the following nine countries: Australia, Bahrain, Chile, El Salvador, Guatemala, Honduras, Morocco, Nicaragua, and Singapore. Hereafter, I refer to this group as the "9 FTAs".

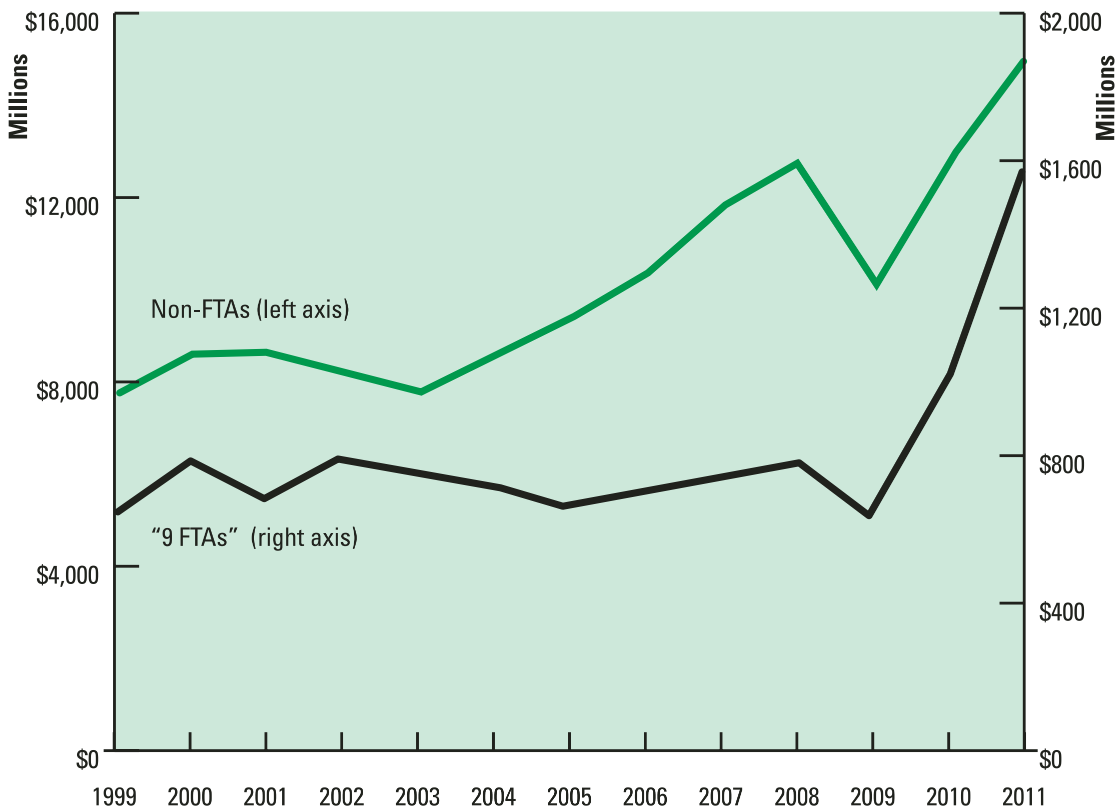
Figure 1: Michigan Exports, 2011



First, some perspective. Figure 1 shows Michigan's merchandise export markets for 2011, by percentage. About 64% of the state's $51 billion in merchandise exports went to Canada and Mexico. The "9 FTAs" group accounted for just over 3% of Michigan's exports, as did exports to the remaining FTA countries. About 30% of exports went to countries with which the U.S. has no FTA.

Figure 2 shows Michigan's annual merchandise exports in millions of current dollars, for 1999–2011, to the 9 FTAs and to all the countries with which the U.S. has no FTA at the present time. This shows that, broadly speaking, exports to these two groups of countries follow the same basic path, including the substantial drop in exports during the recent "Great Recession." The similarity in the pattern makes it difficult to discern any consistent difference in the behavior of exports between

Figure 2: **Michigan Exports to Selected Markets**
1999–2011



the two groups. However, the problem is compounded by differences in the timing of the implementation of the FTAs. To more easily visualize the changes in exports over time, I separate the 9 FTAs into two groups: Australia, Chile, and Singapore, whose FTAs all went into effect in 2004, and Bahrain, El Salvador, Guatemala, Honduras, Morocco, and Nicaragua, whose FTAs all went into effect in 2006. Figures 3 and 4 illustrate how the volume of Michigan's merchandise exports to each of the nine FTA countries varies in the years before and after their FTAs went into effect. Columns for the group of non-FTA countries are shown for comparison.

Figure 3 shows that annual exports to non-FTA countries grew on average by 0.3% during 1999–2003 and by 9.7% during 2004–2011. In contrast, annual exports to Chile grew on average by about 12% during 1999–2003, but after the Chile-U.S. FTA went into effect on January 1st 2004, exports grew on average by about 30%. Annual exports to Singapore fell by over 3% on average during the five years prior to the Singapore-U.S. FTA, but rose by over 24% on average during the 8 years after. Figure 3 clearly shows that Michigan's merchandise exports to Australia, Chile and Singapore grew more rapidly after 2004—but so did exports to non-FTA countries. More importantly, Figure 3 shows that the growth of exports to Chile and Singapore far exceeded that to non-FTA countries after 2004, while exports to Australia kept pace with the group of non-FTA countries. Interestingly, these three FTA countries were all in the top 20 largest export markets for Michigan in 2011.

Figure 4 tells a different story. Michigan exports to all six of the countries shown experienced greater average growth during 1999–2005 than to the group of non-FTA countries. For five of them (the exception being El Salvador), Michigan exports also had greater average growth than the non-FTA group during 2006–2011. However, the interesting distinction is between the pre- and post-FTA period. Exports to non-FTA countries as a whole averaged *greater* growth from 2006 on than before, but exports to four of the six FTA countries averaged *weaker* growth from 2006 on. In comparison to the countries in Figure 3, all six of these FTA countries ranked in the 50-80 range of Michigan's largest merchandise export markets in 2011.

To conclude, although this analysis focuses only on one aspect of the impact of FTAs on Michigan—exports—and is not an attempt to provide a comprehensive analysis of the effect on the state's economy, it nevertheless provides some interesting information. State exports to five of the nine FTA partners in this study have grown more rapidly after the FTAs went into effect, but for only four of these (Bahrain, Chile, Guatemala, and Singapore) was this post-FTA improvement greater than for non-FTA partners on average. The growth in exports to some of the countries post-FTA has been impressive (eg. 49.9% annual average growth for exports to Nicaragua). However, the comparison with the pre-FTA time period and with the pattern for exports to non-FTA countries, shows that such strong average export growth cannot be clearly attributed to the FTAs themselves.

One difficulty, though, is that the timeframes used here are short, and a different pattern might emerge given a longer adjustment period after an FTA goes into effect. Additionally, the post-FTA time period includes the recent Great Recession, and the accompanying drop in Michigan's exports across the board. Although this would be reflected in the data for FTA and non-FTA partners alike, it could be argued that these FTA partners are likely to be hurt more by a recession in the U.S. *because* of the closer connections to the U.S. that the FTA brought about. This could help explain their drop in performance post-FTA.

Nevertheless, the evidence that FTAs enhance Michigan's overall exports to a country is mixed, and it would be best to avoid generalizations concerning their impact. ■

Figure 3: Annual Michigan Exports
average% change, 1999–2003 vs 2004–2011

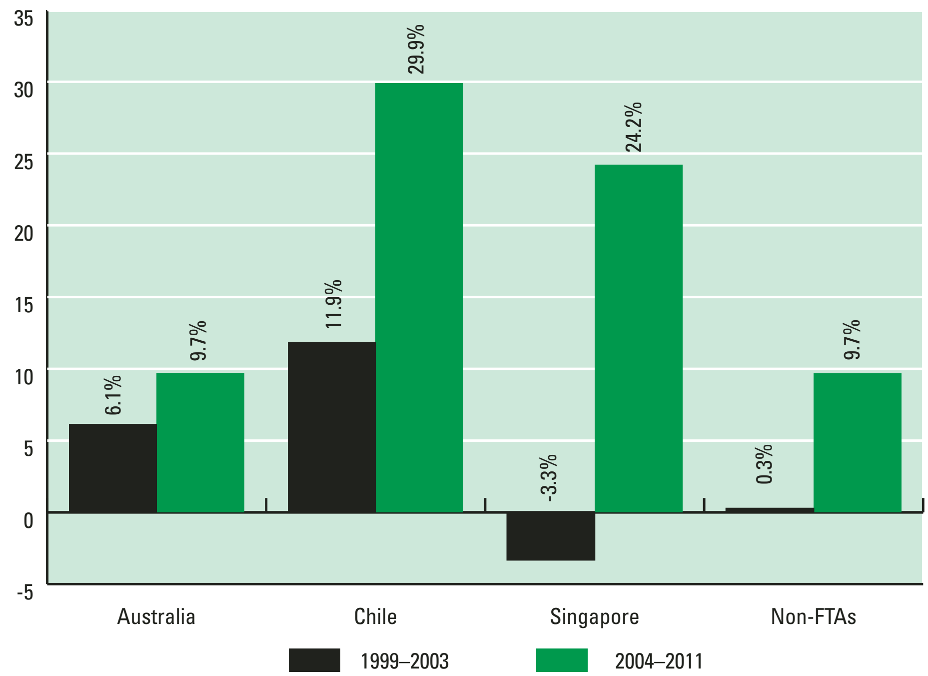
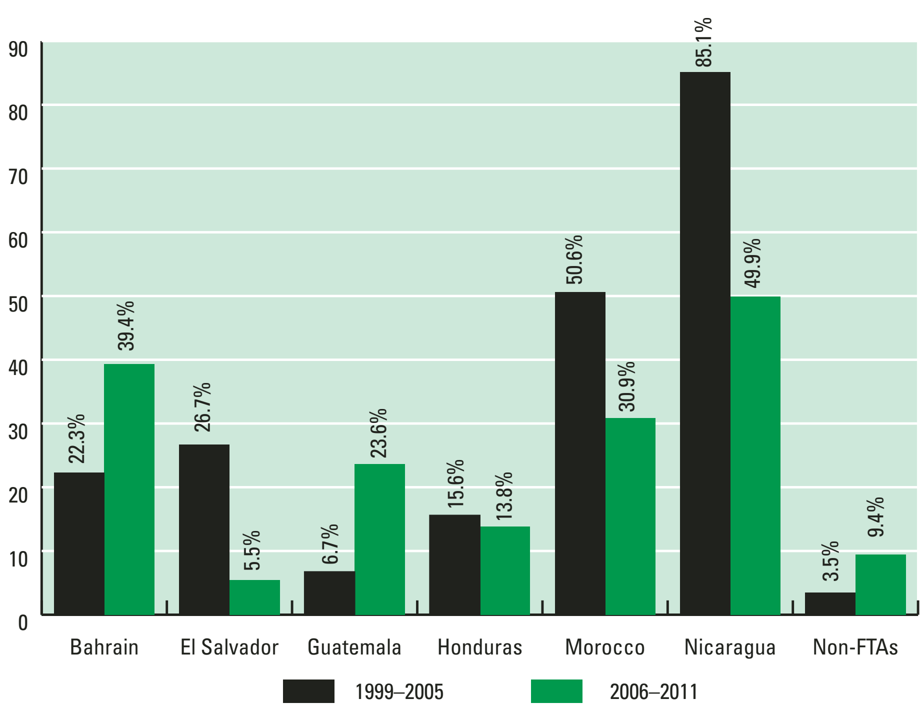


Figure 4: Annual Michigan Exports
average% change, 1999–2005 vs 2006–2011



Economic Impact of LaughFest and Re-Branding of Grand Rapids

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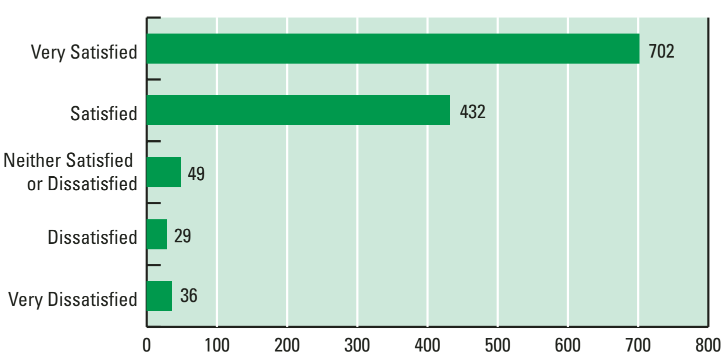
Gilda Radner was part of the first ground-breaking cast of Saturday Night Live. During her career, she also appeared in several movies and on Broadway. She was all about "celebrating the good, the great and the funny." In 1986 she was diagnosed with Ovarian Cancer, which ultimately took her life in 1989. During her cancer journey, she was part of a cancer support group and expressed that she wished that everyone going through this journey could have the same support. In 1991, Gilda's cancer psychotherapist, Joanna Bull, with the help of Gilda's husband and friends, founded Gilda's Club in memory of Gilda and her wish. The first Gilda's Club opened its doors in New York in 1995.

Gilda's Club Grand Rapids opened its doors in 2001, started by local philanthropist and cancer survivor, Twink Frey, along with two other cancer survivors, Deb Bailey and Susan Smith. The club quickly grew into the largest and busiest of the 52 affiliates in North America. Ten years after it first opened its doors, Gilda's Club Grand Rapids introduced its new major fundraising event LaughFest, a ten-day comedy festival focusing on the health benefits of laughter. The idea evolved from an effort to celebrate the ten-year anniversary of the club, and grew from a simple luncheon to a ten-day festival in downtown Grand Rapids. The main idea behind the festival was to raise not only money but awareness of the need for emotional healthcare. The festival was designed to reach across all ages and demographics with laughter in many forms. In the two years of its existence, LaughFest has netted over one-half million dollars for Gilda's Club Grand Rapids, helping them continue to fund their programs for cancer patients and their families (Gilda's Club Grand Rapids).

A survey taken in LaughFest's second year (2012) found that it was successfully reaching people from many different ages and demographics. Furthermore, most attendees were satisfied or highly satisfied with their experience, suggesting that LaughFest was accomplishing its goal (see Chart 1).

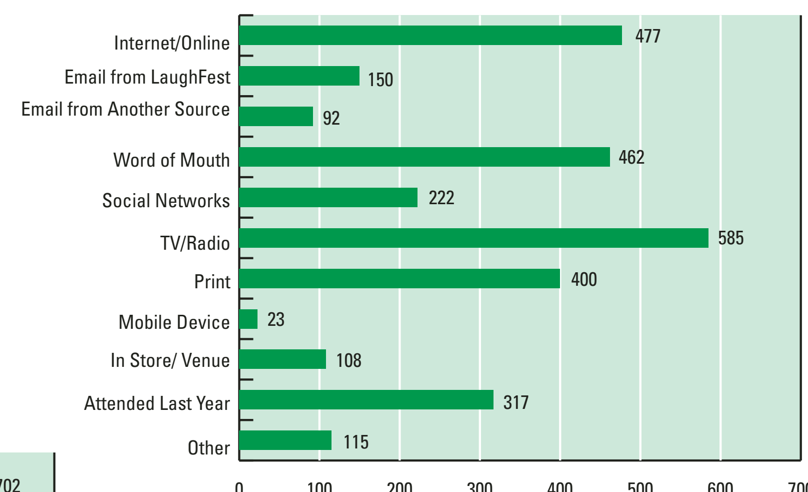
Chart 1: Level of Attendee Satisfaction



The majority of people heard about LaughFest through regular media sources. TV, Radio, and the Internet were the most often cited sources of information about LaughFest, followed closely by Word of Mouth and Print (See Chart 2). Almost half of the respondents (46.3%) cited only one source, and another 47.6% got information from as many as five different sources. An extensive search found that LaughFest was mentioned at least 70 times in media outlets such as newspapers and news internet sites before the event even began, and that with TV and radio coverage as well, the festival was well covered by the local media. This coverage started in May 2011, 10 months before the event took place, and there was a significant increase in mentions of the event in November 2011. During the event the coverage, was just as extensive, with a similar number of hits as before the event. However, there was almost no mention of LaughFest in news media outside of Michigan, suggesting that most of the people who came in from out of state were either here for another reason or came for a specific artist.

Interestingly, word of mouth proved to be a very valuable marketing tool which, best of all, is free. The caveat is that word of mouth is outside the organization's control and can work against LaughFest as much as it can help it.

Chart 2: How did people hear about LaughFest 2012?



The media attention resulted in over 56,000 people attending the event. More importantly 22,500 of these people came to Grand Rapids primarily for LaughFest, drawing new people into the area and adding to the economy—an estimated 40–50% of the attendees came from more than 10 miles away. In addition, nearly 14% of these visitors came from far enough away that they stayed overnight in a local hotel, adding even more to the local economy. So an event that is very important to the organization has also become important to the region.

By surveying people as they attended the events, it is possible to more completely analyze the effect on the local economy. These surveys showed that an average individual spent money primarily on food and beverages as can be seen in Chart 3.

Chart 3: How much did people spend at LaughFest 2012?

	Per Person Spending:
Lodging	$7.95
Meals	$17.25
Transportation	$5.03
Other	$8.72
Total	$38.95

Although the spending patterns were different, the total effect for an average individual is very close to those seen in Artprize, as previously described in the *Seidman Business Review.* Students at GVSU (Brittany DeVries, Patrick Karabon, Zachary Koopman, and Casey VerStrate) used this data to show the total impact on the area. The result is $1.7–$2.2 million dollars in additional spending in Kent County as a result of LaughFest.

Spending by visitors supported jobs for many workers in the Grand Rapids area. However, the bigger effect on the region is that the event helps Grand Rapids re-brand itself. In order to draw in new business to the area, it is important that Grand Rapids differentiate itself from Detroit and the rest of Michigan. Events like this that generate national media attention go a long way to support this differentiation. LaughFest has been and should continue to be a successful event that people anticipate well in advance. The announcement of the 2013 lineup drew considerable media attention. The increasing media attention and success of LaughFest has not only helped Gilda's Club continue its mission, but is helping make Grand Rapids a destination location and not one that people simply pass through on their way to somewhere else. ■

The Economic Value of a College Degree: Evidence from Michigan and the Nation

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Introduction

Many people are questioning the value of a college education. Several recent news stories have highlighted rates of unemployment and "underemployment" for recent graduates, while rising college tuition rates are a concern for families and government policy-makers alike. The value of degrees in the "liberal arts," in particular, is questioned because of the belief that these degrees do not lead to gainful employment. Since Michigan is a manufacturing-based economy with a relatively unionized workforce (in 2011, 17.5 percent of the Michigan workers—public and private—were union members, the 5th highest percentage in the country[1]), one might think that the economic returns to a college education would be smaller in Michigan as compared to the nation.

This paper looks at the evidence concerning these claims and finds that a college education remains a good investment. While there are significant differences in earnings by college major, all college degrees offer the potential for life-time earnings significantly greater than the life-time earnings possible with only a high school education. Moreover, the evidence indicates that a college education offers several types of non-economic benefits that mean a higher quality of life for those who undertake the investment.

Costs of a College Education

The President's Council, State Universities of Michigan, provides information on tuition and fees for Michigan public universities.[2] Undergraduate tuition and fees for 2012–2013 ranged from $12,994 (University of Michigan) to $8,120 (Saginaw Valley State University). Tuition and fees for West Michigan universities include $10,780 at Grand Valley State University, $10,710 at Ferris State University and $10,282 at Western Michigan University. These costs compare to a national median tuition and fees of $16,488 for in-state public institutions (The College Board, 2011).

These "sticker prices," however, overstate average costs faced by many students because of the availability of financial aid. In 2011–2012 undergraduate students received on average $6,539 in grant aid and an additional $1,009 in tax credits, deductions and Work-Study aid (The College Board 2011). In addition to these grants, the average federal student loan was $4,907. Because of such aid, the net tuition at Michigan public universities in recent years is less than 50 percent of the tuition and fees listed above (Farrell, et al., 2011).

Earnings and Educational Attainment in Michigan

While a college education is expensive, earnings differences by education are large. Table 1 presents median annual earnings for Michigan and for the nation by educational attainment for full-time workers in 2011.[4] Median high school earnings in Michigan are only 56.7 percent of median college earnings.

Table 1: Median Annual Earning By Education, 2011

	Michigan	Nation
College	$59,999.00	$54,227.00
High School	$34,000.00	$33,000.00

Source: Author's calculations using March 2012 CPS

Human Capital Theory offers an explanation for these wage differentials. Basic economic models of labor markets suggest that earnings are determined by worker productivity. Individuals can increase their productivity by investing in "human capital" in much the same way a business can invest in physical capital. Formal education is one way to build human capital.

Figure 1 presents a three-year moving average of the national college-to high school earnings ratio from 1976 to 2011, which shows that the college earnings premium has grown significantly over the past 30 years. Michigan earnings shows a similar pattern, although, the college premium for men has fallen from its peak in 2007 more in Michigan than for the nation overall. These annual earnings differences translate to life-time earnings premia for college-educated workers that swamp the costs of college. In fact, over their career, college-educated workers will, on average, earn well over $1,000,000 more than high school workers.

What of the belief that certain college majors—the traditional liberal arts and humanities degrees—are not worth the cost? The college earnings premium may be driven, for example, by Technology and Engineering majors. Figure 2 shows life-time earnings by a variety of majors. These statistics are derived from the 2009 and 2010 American Community Surveys (ACS).

[1] Source: www.unionstats.com
[2] "Report On Tuition And Fees 2012–2013." http://www.pcsum.org/Portals/0/docs/Tuition%20and%20Fees%202012-2013.pdf
[3] I don't include room and board costs as these costs exist for non-college individuals and well as for those attending college.
[4] For information on the CPS, see http://www.bls.gov/cps/. Individuals were considered to be working full time if they worked 50 or more weeks in the year and 38 or more hours per week. Median earnings are for workers between the ages of 22 and 70. CPS data retrieved from http://www.ipums.org.

Figure 1: **College to High School Annual Earnings Ratio**
Men and Women between the Ages 22 and 70

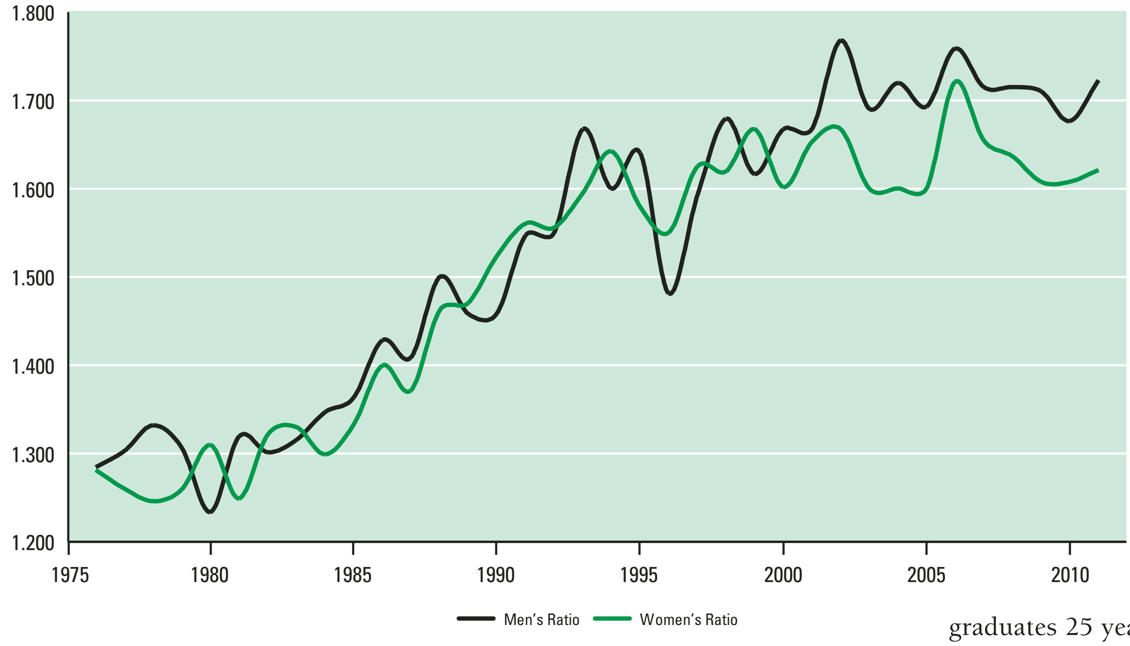
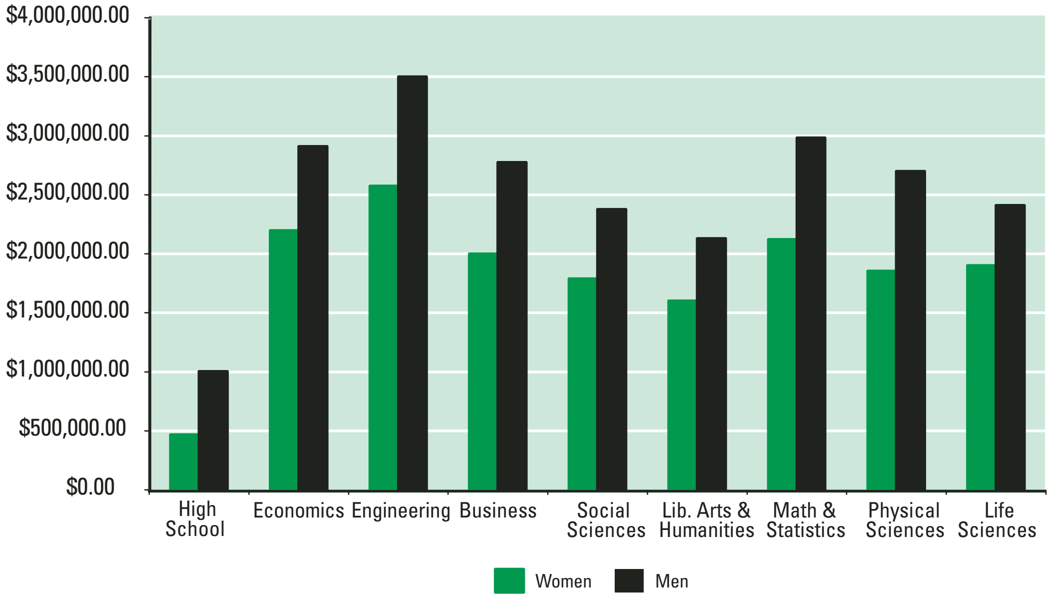


Figure 2: **Life Time Earnings for Men and Women by Education and Major**



As many suspect, liberal arts and humanities majors have the lowest earnings, yet even men and women with these majors have life-time earnings in excess of $1,000,000 more than men and women with a high school education.

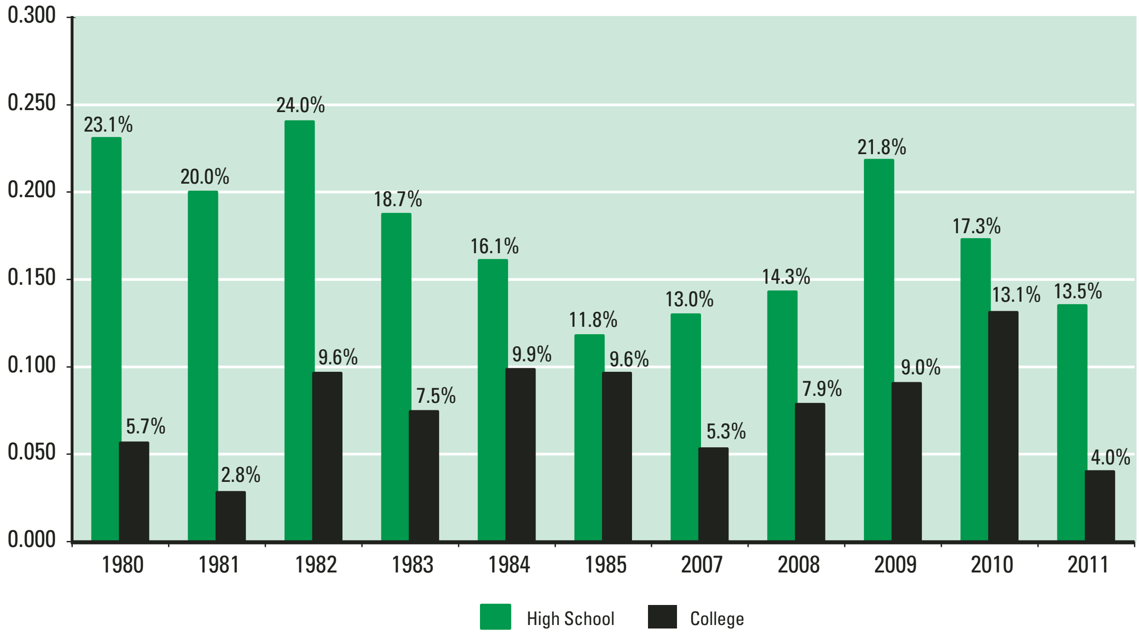
Unemployment and Education in Michigan

Historically, college graduates have experienced significantly lower rates of unemployment compared to those with a high school education (between 1992 and 2012, the average national unemployment rate for high school graduates 25 years and over was 5.2 percent as compared to 2.8 percent for college graduates). Nonetheless, there is concern that recent college graduates suffer from high unemployment or "underemployment"— that is, they are in jobs that do not require college-level skills.

It is a mistake to focus only on short-run outcomes, particularly at a time when the labor market is in arguably the worst condition since the Great Depression. One could ask if the current unemployment rate of recent graduates is temporary—a standard business cycle phenomenon—or if the labor market has fundamentally changed for the worse for college graduates. While this cannot be answered with certainty, one way to shed light on this question is to consider the experiences of young college graduates during previous recessions. In particular, the double recession of the early 1980s was, at that time, the worst recession since the Great Depression. Figure 3 presents unemployment rates in Michigan for recent college graduates (individuals with a college degree between the ages of 22 and 26) derived from the March CPS for the years 1980–1985 and 2007–2012. This allows us to see how the unemployment rate evolved

[5] Since 1984, the unemployment rate for college graduates older than 26 averaged 2.95 percent. Thus, those who graduated from college during the early 1980s recession, have experienced very low unemployment rates for most of their careers, despite graduating into a deep recession. The average unemployment rate for high school graduates over 26 years old over this same period was 6 percent.

Figure 3: Michigan Unemployment Rates over Two Recessions
Young Workers



before and after the 1980s recession and to compare the pattern to the recent changes in unemployment rates. Two things stand out. First, the variation in the unemployment rate over the most recent recession is similar to that from the early 1980s.[5] Second, the unemployment rate for young workers with only a high school education has been as much as three times the unemployment rate for young college-educated workers. Apparently, then, a college degree is "needed" for many jobs.

The unemployment rate can be misleading as it can fall either because more people are finding employment or because more people are dropping out of the labor force. For young workers in Michigan, it is a combination of both things—labor force participation rates for young college graduates fell from 89 percent in 2007 to only 78 percent in 2011. Young high school graduates exhibited a smaller decline-from 78 percent in 2007 to 74 percent in 2011. Still, by 2011 the unemployment rate had dropped significantly and there is no reason to expect that unemployment rates for college-educated workers in Michigan will not return to their historically low values, even with increasing labor force participation rates as the economy improves.

In addition to the economic benefits of college, there are other important "returns" to education. For example, research finds that maternal education improves birth outcomes (Currie and Moretti 2003). Also recent trends show that college-educated couples are more apt to get and stay married (Isen and Stevenson 2010). Research even finds that life expectancy is greater for more educated individuals and that the "education gap" in life expectancy is growing (Meara, et al., 2008).

Conclusion

It is certainly true that college is expensive and that the costs are rising quickly. Nonetheless, the notion that a college education is not worth the cost is misguided. This paper has demonstrated that college graduates in Michigan as well as in the rest of the country enjoy large financial and non-financial benefits relative to those with a high school education—large enough to easily offset the costs of college. ■

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