Report
to the
Stockholders
of the
State of Washington

Governor Daniel J. Evans
January, 1976
"Why don't you run government more like a business?"

In the past 11 years I have heard that question more than any other. Of course, people never specify whether we should run government like Boeing or Weyerhaeuser, or like Penn Central or Lockheed. The following report will enable you -- the stockholders of Washington State government -- to decide just how well your state government performs.

First, let's examine the organizational structure of state government. More than 25 department heads report to the Governor, not by choice but by statute. Few corporations, even of major size, have that many who report directly to a chief executive officer. In addition, there are at least six major departments whose executives report not to the Governor, but to citizen commissions or, in some cases, full-time commissions appointed by the Governor. Eight separately elected officials -- roughly equivalent to independent corporate vice presidents -- not only do not report to a chief executive officer but may have policies in direct competition with that chief executive. Twenty-eight institutions of higher education function as separate departments of this major corporation with boards of trustees holding considerable independent authority.

Next, let's compare the budget of the State of Washington with that of a major corporation. We deal with 245 appropriated funds and more than 120 additional non-appropriated funds ranking in size from the state general fund of $4 billion to some with as little as $13.95.

The options of the chief executive officer or the board of directors (the legislature) of a governmental corporation are not quite as unlimited as they are for most businesses. When sales (revenues) go down, the state can't always cut the product line to fit. In fact, when sales go down it is not because the state can't sell its product. Rather, government often is confronted with the unhappy prospect of revenues decreasing during a period of economic downturn while at the same time products, the services of state government, are under immense pressure. The pressure comes in the form of increased demand for public assistance, unemployment compensation, and for education -- particularly the community colleges which always face increased enrollment pressures when the economy is down and people seek better educations in order to be more competitive in the job market.
This year is a bicentennial year. During this year I hope we will see a radical shift in the feelings of people toward their government, their institutions, and each other. The years immediately preceding 1976 were times of strident complaints, of bitter strife which must be overcome if we are to have any happiness in celebrating our bicentennial or hope of facing a reasonable future.

Too often we hear the following complaints about government:
"There are too many bums drawing welfare who just won't work ... The schools don't teach basic education ... Environmental regulations stifle industry."

But we also hear complaints about businesses: automobiles that have to be recalled, sales clerks who are surly to their customers, skyrocketing utility rates, newspapers that go up and up in price but have less news and even then mostly bad news, East Coast financial institutions which misappropriate trust fund monies for food stamps ... the list goes on.

But it is important that we realize that this obsession about the evils of public or private enterprise does none of us much good. Yes, we do have problems. But we also have many successes.

This is the first time, to my knowledge, that a balance sheet of the State of Washington in corporate terms has been presented. It is a balance sheet in which we can take some deep sense of pride.

The current assets are fairly self-explanatory. Long-term investments represent primarily those assets in retirement systems. The state has major reserves in public retirement systems, about $1.5 billion of investments representing the trust funds for the three major retirement systems and the several smaller ones for state employees, teachers, and law enforcement and fire fighter employees. Industrial insurance funds, again on a trust fund basis, represent most of the remainder of those long-term investments which are listed at cost.

| WASHINGTON STATE GOVERNMENT BALANCE SHEET, ALL BUDGETED FUNDS AT JUNE 30, 1975 AND 1974 |
|------------------------------------------|-------------------|-------------------|
| ASSETS                                  | 1975   | 1974   |
| Current Assets:                          |        |        |
| Cash                                    | $83.4  | $65.3  |
| Short-Term Investments, at Cost          | 368.8  | 319.2  |
| Accounts Receivable                     | 20.4   | 22.6   |
| Taxes Receivable                        | 148.1  | 139.9  |
| Inventories, at Cost                    | 30.7   | 23.4   |
| Total Current Assets                    | 650.4  | 654.4  |
| Long-Term Investments, at Cost          |        |        |
| (Retirement Systems, Industrial Insurance, and Restricted Funds) | 2,120.6 | 1,890.4 |
| Fixed Assets:                           |        |        |
| Land, Tidelands & Timber                | 290.8  | 262.2  |
| Buildings & Facilities                  | 1,255.1| 1,143.1|
| State Highway System (Net of Depreciation at 1975, $678.5; 1974, $619.4) | 1,874.7 | 1,727.3 |
| Equipment                               | 291.7  | 258.4  |
| Total Assets                            | $6,493.3| $6,031.3|

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Fixed assets deserve some additional explanation. Major accounting firms and corporations were consulted in this area to insure that the corporate balance sheet of the State of Washington was done in conformity with reasonable accounting practices.

Therefore the fixed assets of lands, tidelands, and timber are listed at cost or near cost. Many of those lands came to us at statehood. To compute their worth, the figure of $79 an acre, was chosen -- the average figure of the major corporations of this state in terms of their large land holdings. The total value for land listed in the balance sheet is $290 million. Current value of those same timber lands, tidelands, and other lands of the state is in excess of $4.4 billion, which is not shown on the balance sheet.

Buildings and facilities are listed at original cost. It was too difficult to apply depreciation to them, because so many of them have gone through remodeling and changes during intervening periods. Some 75 percent of this investment has been made in the last 15 years. The replacement value of those buildings is substantially higher than that initial cost. The state highway system is based on a 30-year depreciation schedule and the undepreciated value is listed in the balance sheet.

On the liability side, current liabilities are self-explanatory. Long-term debts, the bonds payable in more than a one-year period, are about a billion dollars. The retirement system liabilities are subject to some considerable misunderstanding. The funded amounts, of course, are essentially a trade-off with the long-term investments listed on the asset side. But the unfunded amounts listed as $1.5 billion are composed of two rather separate elements. The first is the unfunded amount represented by people who came into the system at the beginning for whom there were no payments made. They are being funded on a 40-year basis. In addition, however, there is a potential liability based on expectations of salary increases and employment increases in future years. In other words, if state government were to close its doors today, the money necessary to pay off all of

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<th>LIABILITIES AND CITIZEN'S EQUITY:</th>
<th>MILLIONS</th>
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<tr>
<td></td>
<td>1975</td>
</tr>
<tr>
<td><strong>Current Liabilities:</strong></td>
<td></td>
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<tr>
<td>Accounts and Warrants Payable</td>
<td>134.7</td>
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<tr>
<td>Employer Taxes Payable Clearing and Suspense Items Deposits and Deferred Revenue</td>
<td>39.3</td>
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<tr>
<td>Bonds Payable Current Portion</td>
<td>50.5</td>
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<tr>
<td>Total Current Liabilities</td>
<td>224.5</td>
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<td><strong>Long-Term Debt and Liabilities:</strong></td>
<td></td>
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<tr>
<td>Bonds Payable (more than one year)</td>
<td>1,028.6</td>
</tr>
<tr>
<td>Retirement Systems Liabilities</td>
<td></td>
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<tr>
<td>Funded amounts in Investments</td>
<td>1,583.6</td>
</tr>
<tr>
<td>Unfunded Amounts</td>
<td>1,555.2</td>
</tr>
<tr>
<td>Industrial Insurance—Amounts are funded by employers and held in investments above</td>
<td>361.1</td>
</tr>
<tr>
<td>Citizen's Equity (increase in 1975 was $177.6)</td>
<td>1,830.3</td>
</tr>
<tr>
<td>Total Liabilities and Citizen's Equity</td>
<td>$6,483.3</td>
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those who would have benefits coming under a retirement system would be
the total of the funded amounts of our retirement systems plus something
less than half of what is now listed as the unfunded amount.

It is important for people to understand that, because it is too
easy to say that these systems are monumentally unfunded when in fact
they are funded to a fair degree. It doesn't mean that changes are not
desirable or necessary in those retirement systems. As the figures
show, much of the so-called unfunded liability comes from future events,
salary increases and potential increases in the membership of the
retirement system which simply have not yet happened. Industrial
insurance amounts again are a trade-off against long-term investments.

The citizens equity in this state, $1.8 billion, translates into a
substantial amount for each individual citizen—something over $500 per
citizen. Based on current values of assets, the equity is six billion
dollars or almost $1,800 per citizen.

What has happened to
the budget during the
course of the last dozen
years? As you see on the
chart, inflationary costs
over the last eight years
have been responsible for
nearly all of the in-
creased spending of state
government.

Also, during that
same period between 1969
to 1977 there has been
virtually no increase
in total state employ-
ment. There was sub-
stantial increase during
the mid-1960's in re-
ponse to the rapid changes and the growth in our educational system and
the federal Great Society programs. However, the last eight years have
brought almost no employment increase and little constant dollar in-
crease in expenditures, although in current dollars the figure is up
substantially.
Where does the state get its money? One illustration represents all funds in terms of state revenue. Taxes are 53 percent, Federal Aid

25 percent and the remainder is from a series of charges, liquor profits, earnings on investments, and proceeds from bonding. The other chart depicts expenditures. The biggest single expenditure is education at 43 percent; human resources is the second largest at 25 percent; transportation is a little over 10 percent; and the remainder, in descending order, are natural resources, general government, and aid to cities and counties.

But the fund we all understand is the state's general fund. It is responsible for about two-thirds of all of our spending. Taxes comprise 71 percent of the revenue in the state's general fund for the current biennium. The important thing is the distribution of those taxes: the retail sales—about half of the total intake; the business and occupation tax—11 percent of the total or about one-seventh of the tax intake; property taxes—now collected especially for schools at the state level for redistribution to those schools—another 8 1/2 percent; and other smaller taxes.
The second largest source is federal revenue, which makes up 25 percent of the state's general fund. Almost all of that federal revenue goes to specific programs under rather detailed requirements and with little flexibility for state government. The remainder comes from a variety of other smaller sources.

In examining how we spend the general fund, we get to that question raised so often, "Why don't you cut governmental spending?" Well, education accounts for just over half of the total expenditures of our state's general fund. And human resources, including public assistance, developmental disabilities, mental health, mental retardation, corrections, and a variety of other smaller social and human services, accounts for most of the remainder. Those two comprise just under 90 percent of general fund spending. All of the other many departments of state government, all of the other services, all of the judiciary, all of the legislative expense, all of general government, make up that last 10 percent. If you are going to cut spending very much, it has to come out of either human resources or education, or both.

Let's turn to a question that is perhaps the most fundamental of all: Why do expenditures grow at a faster rate than the population or why do expenditures grow at a greater rate than inflation? Too few in either public or private life understand the influence of population age shift—not just total population growth but the population age shift—on spending. It affects private businesses markedly and, believe me, it affects governmental spending monumentally.
The charts show, in 10-year intervals, the shift of the population by age groups between 1950 and 2000. In 1950 there was a bulge or wave of young adults in the work force who were born shortly after World War I. But off to the left was the immense happen ing which was to affect governmental spending for the next quarter of a century and which will continue to affect governmental spending for the next quarter of a century. That large group from zero to five represents the war babies born after World War II. Returning veterans started families and they initiated the crest of a population wave which has dramatically influenced events ever since.

The 1950's were the time of school construction and demands for school spending. They were demands created not by chance, but by youngsters. School bond issues were voted every two years during the 1960's in order to build school buildings to house those youngsters. Then in the 1970's the wave was beginning to approach the college years and we began to build and spend for the high cost of college and university education.
We also saw the beginning of a crime wave which affects us to this day. There is no question why there is so much crime today. It is because we have so many more young adults than we had a few years ago. That coupled with some of the other changes in our society, has produced more violent crime.

Note the beginning in 1970 of the trough following the wave, the trough of lower birth rates and reduced pressures in early school years. In 1980, the wave moves into the work force years and in the next few years we face the problems of family formation and increased job pressures. We also face the beginning of another wave with more babies being born simply because there are more young women having children. The wave of World War I babies is now approaching retirement age.
In 1990, the population wave is clearly into the job force. The retirement numbers are growing rapidly. Colleges and universities are in the population trough and will face declining enrollments. But the crest of the new wave is moving into the common schools.

Finally, in the year 2000, the World War II wave moves into the highest earning years of the work force. By that time we will have long since either resolved the problem of more work for a higher percentage of our population, which will be in the labor force, or we will have faced some enormous problems.

From 1950 to 1980, the population of the state has grown by a little over 50 percent. In the same period of time the numbers of young adults, those from 20 to 25, have more than doubled. The impact on college and university expenditures, on violent crime, on aid to dependent children will soon peak.
We are also faced with the planning for that wave which is about to reach retirement age. Again, although population in those 30 years has gone up 50 percent, the number of retirees has already risen by more than 75 percent and will soon double.

The two problems just ahead of us are those of the retirees and economic opportunity for our young adults.

Let's turn then to the pressures of population and what it does to the service requirements in government. The second line from the bottom shows the population over the past decade with its 12 percent increase. The next line up represents the impact of inflation on the purchasing power of state and local government dollars. Above that are the demands we must face in terms of services: park visitations, which increased 120 percent in the last ten years; the highest line, community college growth, which is almost off the chart, shows a 250 percent increase. Also, burglaries are up 235 percent; aid to dependent children recipients is up 128 percent; and potential unemployment beneficiaries are up 33 percent.

To assess the real cost impact one must multiply the numbers to be served times the inflation index. The number of community college students is up 250 percent and inflation is up 74 percent. Coupled together, the figures mean if we were to serve each community college student to the same degree we did 10 years ago we would require funding 400 percent higher than it was then. Actual increases were far less.

In the last dozen years we have experienced local booms to an extent we had never seen. Local economic disaster immediately followed. In response this state and its people cut more than $65 million from a
budget during the 1969-71 Biennium. The lower spending rate has been used as a base ever since. We suffered along with the rest of the country a national recession and massive inflation in 1974.

The last major state tax increase for the support of state government in this state occurred in 1967. During the last decade tax growth was slower than in any other state in the nation. State and local tax burden per $1,000 of income, the percentage of your income that you spend on state and local taxes, has diminished for each of the past two years; we are today below the national average. In the most recent bond sale which the State of Washington presented, both Standard and Poor's and Moody's, who have long rated Washington's bonds, upgraded the AA rating which we had enjoyed to AA plus. I am convinced that we would have had a triple A rating if it had not been for the chaotic condition of municipal financing in New York City.

I hope this presentation -- particularly the charts showing the monumental changes which have occurred in our population and their past and future effects on government and private industry -- gives you a better understanding of the problems with which state government must grapple.

How does Washington compare to other states of the union? Recently, the Midwest Research Institute looked at all 50 states and measured the quality of life in each. Washington ranked third and was within a fraction of a point of first among the 50 states.

So, I believe this corporation is in excellent condition. But the future is murky, indeed. In this bicentennial year we have the choice of bold and courageous action, or of indecision and failure which will haunt us for a generation yet to come. Investors ought to watch closely to see if there is the boldness of action necessary to prove that Washington is worth retaining as an investment.