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Illinois Stops Paying Its Bills, but Can't Stop Digging Hole

By MICHAEL POWELL

CHICAGO — Even by the standards of this deficit-ridden state, Illinois's comptroller, Daniel W. Hynes, faces an ugly balance sheet. Precisely how ugly becomes clear when he beckons you into his office to examine his daily briefing memo.

He picks the papers off his desk and points to a figure in red: $5.01 billion.

"This is what the state owes right now to schools, rehabilitation centers, child care, the state university — and it's getting worse every single day," he says in his downtown office.

Mr. Hynes shakes his head. "This is not some esoteric budget issue; we are not paying bills for absolutely essential services," he says. "That is obscene."

For the last few years, California stood more or less unchallenged as a symbol of the fiscal collapse of states during the recession. Now Illinois has shouldered to the fore, as its dysfunctional political class refuses to pay the state's bills and refuses to take the painful steps — cuts and tax increases — to close a deficit of at least $12 billion, equal to nearly half the state's budget.

Then there is the spectacularly mismanaged pension system, which is at least 50 percent underfunded and, analysts warn, could push Illinois into insolvency if the economy fails to pick up.

States cannot go bankrupt, technically, but signs of fiscal crackup are easy to see. Legislators left the capital this month without deciding how to pay 26 percent of the state budget. The governor proposes to borrow $3.5 billion to cover a year's worth of pension payments, a step that would cost about $1 billion in interest. And every major rating agency has downgraded the state; Illinois now pays millions of dollars more to insure its debt than any other state in

the nation.

“Their pension is the most underfunded in the nation,” said Karen S. Krop, a senior director at Fitch Ratings. “They have not made significant cuts or raised revenues. There’s no state out there like this. They can’t grow their way out of this.”

As the recession has swept over states and cities, it has laid bare economic weakness and shoddy fiscal practices. Only an infusion of federal stimulus money allowed many states to avert deep layoffs last year.

Cuts in Work Forces

The federal dollars are nearly spent. Last month, local governments nationwide shed more than 20,000 jobs. Should the largest struggling states — like California, New York or Illinois — lay off tens of thousands more in coming months, or default on payments, the reverberations could badly damage a weakened economy and push housing prices down still further.

“You’re not seeing these states bounce back, and that could be a big drag on the national economy,” said Susan K. Urahn of the Pew Center on the States. “It could be a very tough decade.”

In Illinois, the fiscal pain is radiating downward.

From suburban Elgin to Chicago to Rockford to Peoria, school districts have fired thousands of teachers, curtailed kindergarten and electives, drained pools and cut after-school clubs. Drug, family and mental health counseling centers have slashed their work forces and borrowed money to stave off insolvency.

In Beardstown, a small city deep in the western marshes, Ann Johnson plans to shut her century-old pharmacy. Because of late state payments, she could not afford to keep a 10-day supply of drugs. In Chicago, a funeral home owner wonders whether he can afford to bury the impoverished, as the state has fallen six months behind on its charity payments, $1,103 a funeral.

In Peoria — where the city faced a $14.5 million gap this year and could face an additional $10 million budget hole next year — Virginia Holwell, a trainer of child welfare caseworkers, lost her job when the state cut payments to her agency. She sits in her living room high above the Illinois River and calculates the months of savings left before the bank forecloses

on her house.

“I’ve got enough to last until the end of August,” she says, matter-of-factly. “I’m 58 and I’m pretty good at what I do, and I got to tell you, I’m pretty devastated.”

Public colleges and universities occupy a fiscal sickbed all their own. This year they muddled through without $668 million expected from the state; the University of Illinois has yet to receive 45 percent of its state appropriation. Legislators made no pretense of promising to pay this bill soon. Instead they authorized colleges to borrow against the expected state payments.

“The big fear is that next year we’ll be down twice as much,” said Randy Kangas, an associate vice president of the university. “No one knows how to make the cash flow work.”

Illinois legislators tend to plead victim to economic circumstance, and the state’s maladies are considerable. In 2006, the Illinois unemployment rate stood below 5 percent; now it is near 11 percent, and the percentage of long-term unemployed exceeds the national average. Major manufacturers have eliminated thousands of jobs, and the state ranks in the top 10 nationally in foreclosures.

Five years ago, the Chicago suburb of Tinley Park issued about 650 home building permits; last year it processed one. The city of Rockford plans to close fire stations and lay off firefighters, and in Decatur, 180 impoverished seniors have lost their delivered meals. The lakeshore condo towers in Chicago bespeak affluence, but there are so many foreclosures on the bungalow blocks of southern and western Chicago that “for sale” signs sprout like sunflowers.

Few budget analysts are surprised to see Illinois, with a limping economy and broken political culture, edge close to the abyss. Two of the last six governors have served jail terms, and a third is on trial.

“We are a fiscal poster child for what not to do,” said Ralph Martire of the Center for Tax and Budget Accountability, a liberal-leaning policy group in Illinois. “We make California look as if it’s run by penurious accountants who sit in rooms trying to put together an honest budget all day.”

Stopgap Solutions

The Community Counseling Centers of Chicago is another of those workaday groups that are

like the stitches on a baseball, holding together poor and working-class neighborhoods. With an annual budget of $16 million, the agency tends to families torn by crime and violence as well as people who are psychologically stressed and abusing drugs.

On any given Monday morning, the agency's chief administrative officer, John J. Troy, 61, has no idea how he is going to keep its doors open until Friday. He said the state had not come through with an expected $2.2 million, which is about six months of arrears. He has laid off and recalled employees three times in the last two years.

"Two weeks ago, I had days to meet my $420,000 payroll and all I was looking at was a $200,000 line of credit from a bank," recalled Mr. Troy. "I drove down to Springfield and said, 'Hey, you owe us $3 million.' They said: 'Oh, that's nothing. We owe another agency $10 million.' "

"The fact of the matter is," he added, "I don't sleep much these days."

Illinois's fiscal practices are thoroughly fractured. Large agencies survive from one payday to the next. Small agencies seek high-interest loans from out-of-state finance companies.

The state pension system is a money sinkhole and the most immediate threat. The governor and legislature have shortchanged the pensions since the mid-1990s, taking payment "holidays" with alarming regularity.

The state's last elected governor, Rod R. Blagojevich, is on trial for racketeering and extortion. But in 2003, he persuaded the legislature to let him float $10 billion in 30-year bonds and use the proceeds for two years of pension payments.

That gamble backfired and wound up costing the state many billions of dollars. Illinois reports that it has $62.4 billion in unfunded pension liabilities, although many experts place that liability tens of billions of dollars higher.

Legislators this year raised the retirement age and slashed benefits. Though changes apply only to future employees, the legislature claimed immediate savings.

"Savings upfront and reforms down the road," said Mr. Hynes, the state comptroller. "It's just bad habits and bad practices."

More broadly, Illinois is caught between blue state convictions about social safety nets and a red state aversion to taxes. For years, the Democratic-controlled legislature has passed

budgets that are, in effect, in deficit. Lawmakers routinely skip around the state's balanced-budget law, with few consequences. (Republicans are near monolithic in voting against any tax increases and borrowings. When one broke ranks to try to keep the pension solvent, he was stripped of a committee position, reducing his pay and pension.)

"The pension move was Enron-esque," said Mike Lawrence, a press secretary to the former Republican governor Jim Edgar, who was the last governor to sign an income tax increase. "Blagojevich was not a tax-and-spend governor; he was a spend-and-borrow governor."

The state's income tax burden is not terribly high — Illinois ranks in the bottom half of states — and its government is not terribly large. (The budgets in New York and California, per capita, are much larger). Even if the state cut out all family and human services spending, more than half of the budget deficit would remain.

As comptroller, Mr. Hynes has trained his attention on the public and nonprofit agencies that rely on state money; he tends to roll his eyes at the notion that slashing alone is a solution.

"Only the most delusional people think you can solve this without raising taxes," he said.

The legislature has a different instinct: to borrow. In good times, that leads to unsightly imbalances. In bad times, it becomes catastrophic. This year, leaders gave the governor authority to move money around and left town to campaign.

"Each budget has gotten historically worse during this recession," said Laurence Msall, president of the Civic Federation, a policy research organization. "We've borrowed more and pushed larger unpaid bills into the future."

'Everything Is Triage'

So where is the exit door from this crisis? In Illinois, it depends on whom you ask. The state representative Barbara Flynn Currie, one of the Democratic leaders in the statehouse, sees salvation in the economic cycle. "In the long run, we'll muddle our way through," she said.

Perhaps, but many analysts, liberal and conservative, warn of a potentially far grimmer reckoning — Greece by Lake Michigan. Borrowing costs are rising, nonprofits that depend on taxpayer money are dropping contracts, and the state's pension costs and unpaid bills balloon each month.

Newspaper reports offer stories of hundreds of young teachers moving out of state. Sounding as if she had been punched in the stomach, Ms. Johnson, 53, the pharmacist in Beardstown, said she was going to work at Wal-Mart. Mr. Troy keeps logging on to the comptroller's Web site to see whether money might soon flow to his counseling centers.

And Ms. Holwell has joined Illinois People's Action, which challenges banks and foreclosures. With a raspy voice, she talks of her irritation with "the people who just yammer."

"We've helped save four houses," she said. "Now I wonder: can I save my own?"

For now, Illinois spends a minor fortune papering over its budget holes. Last year, the comptroller's office paid $55.3 million just in interest on two short-term borrowings to pay the state's bills.

Mr. Hynes walked into his child's elementary school recently and learned that kindergarten hours were being cut because of the state budget.

"Everything is triage now," he said. "We work to avoid outright disaster."

In past years, when nonprofits needed credit lines to see themselves through tough budget times, the comptroller issued letters assuring banks that vendors would be paid. Not anymore.

"I don't feel comfortable doing that," he said, adding with a shrug, "I mean, who knows, right?"