

Illinois Still Faces Significant Challenge with Its Debt

Written by Rich Miller

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As we are all too painfully aware, the past several weeks have been beyond crazy.

Congress and the president took the nation to the brink of default. Standard & Poor's lowered the federal government's credit rating by a notch. The markets devolved into a swooning bipolar frenzy. And the political rancor emanating from Washington, DC, showed no signs of abating.

I focus on state politics, however, so I've been trying to keep a close eye on how all this insanity would impact Illinois. S&P lowered the federal credit rating, but bond interest rates actually dropped in response. That wouldn't be the case for a state such as Illinois, which is far more sensitive to ratings changes than the feds apparently are. If Illinois is downgraded yet again, then the interest rates the state pays would undoubtedly rise, costing taxpayers hundreds of millions of dollars that they don't have.

On August 8, S&P issued a report that said state bond ratings weren't necessarily tied to the U.S. debt rating. "This means a downgrade is unlikely" was how a spokesperson for the state's budget office responded.

Ironically enough, one of the very few "advantages" that Illinois has right now in comparison to DC is the absence of a government bitterly divided along partisan lines. There's one-party rule here, which means things can get done.

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If you read S&P's full statement from August 5 and its comments since then, you'll see that the bone-crushingly partisan federal gridlock during the debt-ceiling debacle was as important to the agency's federal downgrade as the nation's mid- and long-term debt problems – or even more important.

Unlike DC, Illinois showed it could act by raising its income-tax rates earlier this year, which has mitigated some of its near-term problems. That action (and other things such as pension reform last year and some budget cuts this year) did prove that the state, unlike the federal government, can move itself when necessary.

But while our state government is more “stable” than the federal government in that one, single, very narrow partisan aspect, it is still severely hobbled by an undeniably huge debt load, particularly when \$80 billion of future pension obligations are included in the mix.

And if federal payments suddenly stop during a budget-related shutdown, for instance, or are reduced via a federal budget deal that drastically or even significantly cuts aid to states, then Illinois would have almost zero room to maneuver. The same is true if the economy tanks again.

That was essentially the message another ratings agency delivered to Illinois last Thursday night.

Moody's whacked Illinois for its billions of dollars in past-due bills and its failure to control pension and retiree-health-care costs, which it claimed are on an “unsustainable ascent.”

The ratings agency also worried that the state will allow its income-tax increase to expire on schedule in 2013 without first shoring up the underlying budget problems.

The ratings agency may have been so pessimistic about Illinois' future because it wasn't exactly impressed with this year's budgetary effort. “The state may be able to use increased tax revenue to chip away at its large balance of past-due budgetary payment obligations, but it has not adopted a comprehensive plan to do so,” Moody's rightly claimed.

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The revenue from January's income-tax hike is about equal to the state's annual pension payments, which the state earlier couldn't afford to pay without borrowing. If the problems with pensions and the rest of the budget aren't addressed, then there's no way the state can get rid of the "temporary" income-tax hike without causing yet another serious crisis.

Earlier this year, Governor Pat Quinn promised the CEO of Caterpillar that the tax hike would expire on schedule in 2013. The company is the state's largest private employer, and it was getting really nervous about Illinois' negative business climate.

But last week, Quinn toned down his prediction. "We'll have to take it year by year," Quinn told reporters. "Hopefully, we'll have a much stronger economy"

Hope is not a plan, of course, and bond-ratings agencies very often have more influence over state governments than any big business. Quinn has even admitted that the tax hike was all but forced on the state in the face of a major credit downgrade.

Somehow, some way, this state has to finally get its act together.

Rich Miller also publishes Capitol Fax (a daily political newsletter) and CapitolFax.com .