This statement is submitted by R. Eden Martin, one of the members appointed by Governor Quinn from the "business community," to the Pension Modernization Task Force.

On September 16, 2009, Mr. David Vaught, Senior Advisor to Governor Pat Quinn, submitted a proposal to the Pension Modernization Task Force with respect to the funding of the State's unfunded pension obligations. The Governor's office recognizes the importance of "consistent and increased funding" of pensions. However, instead of making the necessary funding contributions out of operating revenues, the Governor would issue more "pension obligation bonds … to re-finance a portion of the existing unfunded liability. Bonding about 20% of the unfunded liability would provide a down-payment to supplement regular annual payments …."

The State's present unfunded pension obligations amount to approximately $79 Billion as of the end of the last fiscal year, June 30, 2009. The Governor is thus proposing to issue new State of Illinois "pension bonds" in the range of 20% of $79 Billion – or $16 Billion.

The main reason we have such an enormous unfunded pension liability in Illinois today is that the State has in the past shifted pension costs from the present to the future through underfunding and also through borrowing in the form of "pension bonds" and "pension notes." The State's total pension obligation – both the unfunded obligation and the remaining pension debt – has jumped in the last 10 years from $15 Billion at the end of FY1999 to $89 Billion at the end of FY2009. Governor Quinn's proposal would radically increase this reliance on borrowing, thereby shifting huge risk – as well as an enormous additional burden – to future budgets and future taxpayers.

The purpose of this statement is to address this recent proposal of Governor Quinn's representative.

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The fiscal situation in which the State of Illinois finds itself may be summarized as follows:

1) The State has for years been heading toward financial implosion. It has run larger annual budget deficits; and it has increased dramatically its unfunded obligations.

2) How? Instead of balancing budgets and making hard choices, the State – under both Republicans and Democrats – has *borrowed to cover current costs*. In particular, we have failed to cover the costs of public pensions on a current basis. We have "back-end loaded" these costs – shifting them to tomorrow's taxpayers. Similarly, we have ignored the increasing liability for retiree health care for State employees – thus back-end loading these costs as well. Governor Blagojevich added a huge measure of such back-end loading when his administration in 2003 issued $10 Billion in "pension

obligation bonds" and used those bonds as a justification for failing to fund pensions out of current revenues.

3) *Such shifting of current costs to the future is damaging and risky to the future of Illinois*. The State is now nearing a "tipping point" beyond which it will not be able to balance its budgets without service cuts so large, or tax increases so extreme, that they would drive businesses, jobs and people out of the State.

4) Governor Quinn did not create this problem. But he is Governor; and he has a responsibility to deal with it. Unfortunately, instead of reforming pensions and retiree health, and cutting other costly programs and grants, the Quinn administration continues to "balance" our State's budget through more borrowing. In addition, Governor Quinn's Senior Advisor, David Vaught, has now submitted to the Pension Modernization Task Force a proposal that the State *should bond about 20% of the unfunded liability*. (Based on the $79 Billion unfunded liability at the end of FY2009, this would amount to around $16 Billion in new pension bonds.) Authorization of this "pension bond" borrowing would represent the ultimate avoidance of responsibility for managing our State's finances.

If the Quinn administration's proposal to issue new pension bonds in order to finance the State's pension deficits is approved by the Legislature, Illinois will soon become a zombie state. It will appear alive – opening its doors for business, issuing increasing payroll checks to its employees, spending more money on capital projects, and paying out expensive pension benefits to public-service retirees – all without cutting costs or raising revenues to cover the escalating pension costs.

But in reality the State will be headed toward bankruptcy. Although states have no right under federal law to seek bankruptcy protection, Illinois' liabilities will exceed its assets; and not many years will pass before it will become unable to pay its pensions and its debts as they come due. State government will continue to function for a while by virtue of the massive transfusion of borrowed money. But any possibility of comprehensive budget reform – or of dealing with the State's burgeoning pension and retiree health obligations – will have been lost.

I. Heading Toward Implosion

In December 2006, well before the market crash and recession of 2008, the Civic Committee of the Commercial Club released its task force report on the state of the State's finances. We concluded then that "Illinois is headed toward financial implosion."

At that time, we estimated that the annual budget gap – between own-source revenues and budgeted expenditures and increasing commitments – was in the range of $5.9 Billion. (This gap was about 20% of the State's budgeted expenditures of $29 Billion.) By the end of that fiscal year (FY2007), Illinois had unfunded pension obligations of around $42 Billion, and an additional $10 Billion in "pension obligation bonds" issued during the Blagojevich administration.

Almost three years later we are now in the middle of the predicted fiscal implosion – though the Governor, the legislative leadership of both parties, and most of the members of the Legislature operate on the basis that it is "life as usual" in Springfield. The unfunded pension obligation has mushroomed **from $42 Billion to about $79 Billion** (at the end of FY2009).

The annual operating budget gap, without taking into account borrowing or federal stimulus dollars, has grown to something in the range of $8 Billion on a cash basis. On an accrual basis, taking into account the State's increasing commitments for pensions and retiree health care, the real gap is much larger.

For FY2010, the Governor and the Legislature plan to borrow $3.2 Billion from suppliers and $3.5 Billion in "pension notes" to plug the hole in the current fiscal year's operating budget. And the Governor now proposes more Blagojevich-style pension bonds for FY2010 as well.

The amount of our pension obligations to retirees and public employees has sharply increased. The value of the assets in the State's five pension funds has declined as a result of the 2008 market collapse. And with the recession, the State's revenues from various sources – income tax, sales tax, gasoline tax – are down sharply.

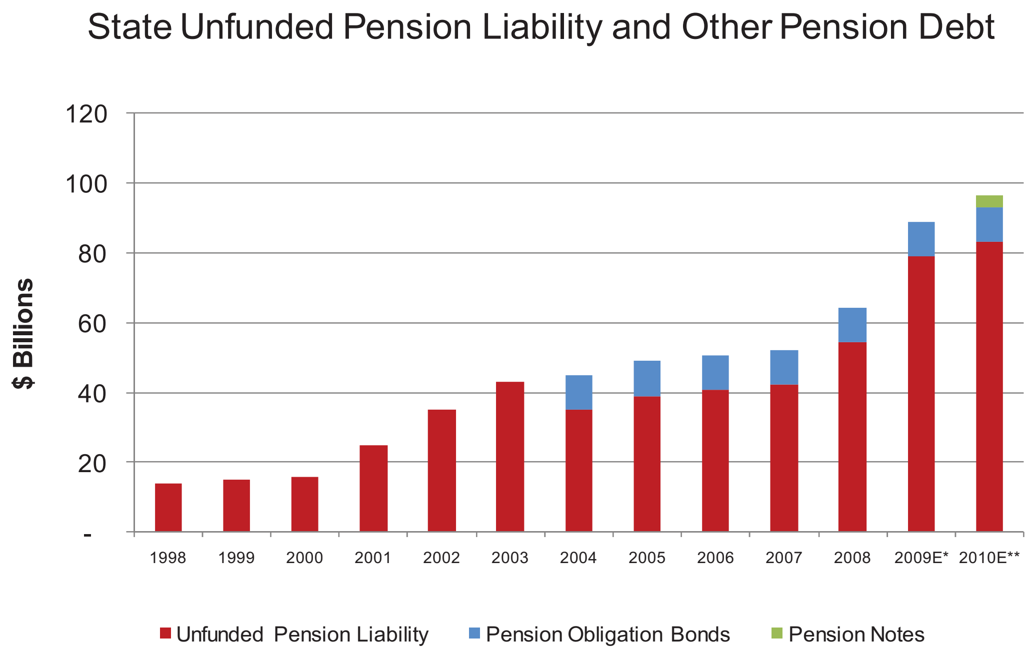
The private sector has experienced these same economic events, and most companies have taken steps to avoid collapse. Private-sector employers have cut costs: trimmed payroll, frozen pension plans, cut back on retiree health costs, reduced spending and purchases, and otherwise hunkered down to survive the recession.

State government in Illinois has done none of these things. Cutting costs or grants would make someone unhappy – the contractors who live off public expenditures, the employees who work for them, the unions that represent public employees, and other recipients of the State's largesse. Increasing taxes would also make someone unhappy – the taxpayers, first and foremost. Also, legislators who have to run for re-election and don't want to explain why they voted for a tax increase.

II. Borrowing To Cover Pension Costs

There are four ways we can shift to the future our growing pension and related retiree health obligations by borrowing: (1) ignore them, (2) miscalculate them, (3) underfund them, or (4) fund them with borrowed money. Illinois uses all these ways.

Figure 1



*Estimate is based on COGFA April 2009 Pension Briefing projection of $78.9 B unfunded liability at the end of FY2009.
**Estimate is based on COGFA April 2009 Pension Briefing projection of $83 B unfunded liability at the end of FY2010 and $3.5 B in pension notes issued in FY2010. The Governor's proposed $16 B in new pension bonds would not change the total amount of pension debt, but would convert approximately $16 B (minus transaction costs) of unfunded liability into pension obligation bonds.

Source: "2008 Bonded Indebtedness Report of the State of Illinois," January 2009, Commission on Government Forecasting and Accountability; Commission on Government Forecasting and Accountability Monthly Briefing, April 2009; "Report on the Financial Condition of the State Retirement Systems," February 2009, Commission on Government Forecasting and Accountability; Commission on Government Forecasting and Accountability Monthly Briefing, February 2009; "Report on the Financial Condition of the State Retirement Systems," February 2008, Commission on Government Forecasting and Accountability; "Report on the Financial Condition of the State Retirement Systems," July 2007, Commission on Government Forecasting and Accountability; Historical unfunded liability data from Senate GOP staff.

Figure 1 shows that ten years ago the State's *unfunded pension obligation* was $15 Billion (end of FY1999). Only two years ago (end of FY2007), the amount of the State's unfunded pension liability (the red part of the bar) was $42 Billion. At the end of FY2009, it was about $79 Billion (reflecting the decline in the value of the assets in the State's pension funds). By the end of FY2010, the unfunded pension liability is expected to grow to around $83 Billion.

Moreover, the State has pension-related obligations apart from its unfunded pension liability – and these obligations have escalated in recent years as the State has used bonds or notes to cover its pension costs. Figure 1 shows the $10 Billion in *pension bonds* that were issued in 2003 (and deposited into the pension funds in 2004). A portion of these bonds was deposited into the pension funds – initially reducing the unfunded liability (although not by the full amount of the borrowing, because part of the bond proceeds were used to make the State's annual pension contributions in 2003 and 2004). However, as the State continued to take "pension holidays" and underfund its annual contributions, the unfunded liability grew and grew – by 2008 it had surpassed its level in 2003 before the issuance of the bonds. Most of the $10 Billion in pension bond principal remains outstanding today.

In addition, for FY2010 the Governor sought and the Legislature granted authorization of $3.5 Billion in *pension notes* to cover most of this year's pension contribution. These notes are a new addition to our pension debt, which as of the end of FY2010 would approach $100 Billion.

Also, Illinois has obligations to pay the *health care costs of its retirees* in the range of $24 Billion or more. These are completely unfunded.

Governor Quinn's response to this mountain of pension debt is to propose still more debt in the form of $16 Billion of new pension bonds. While the infusion of these funds would initially reduce the unfunded liability (after taking into account fees and other transaction costs), history suggests that the State will use these bonds as an excuse not to fund the pensions out of current revenues in future years. Sometime in the not-to-distant future we will be right back where we started in terms of the unfunded liability – but *with additional pension bond debt*.

The State's massively underfunded pension and retiree health plans are the source of most of the State's fiscal distress. If our pension plans and retiree medical obligations were properly funded, Illinois would not have a fiscal crisis.

Two questions: (1) What does that $79 Billion of unfunded pension obligation at the end of FY2009 really represent? (2) And how did it get to be so huge? Let's take these one at a time.

First, the State of Illinois maintains five separate pension funds. Several of these are for retired employees of the State – members of the Legislature, judges, people who work in State offices (white collar workers) or facilities (e.g., prison guards). The State also maintains a pension plan for retired downstate and suburban public school teachers of K-12 grades. But all public schools are not covered. Chicago Public Schools have their own pension fund. Finally, the State maintains a pension plan for people who teach and work in our State universities.

Someone might ask: "I can see why the State would have a pension plan for its own employees. But why does it maintain plans for folks who never worked for State government – folks like elementary school teachers in Decatur, or professors at Southern Illinois University in Carbondale? Why don't their employers maintain their own separate funds, so that the State would have no responsibility to fund those pensions? Answer: local entities like school districts did maintain their own school districts once upon a time; but they had trouble coming up with the money to fund their own pensions. The teachers were unionized; and their unions persuaded the State to take on the responsibility of funding those pensions. Why wasn't Chicago included? CPS's pension fund at the time of the take-over was in pretty good shape, so the State didn't need to take it over. As a result Chicago taxpayers are responsible for the costs of CPS's pensions through their local taxes; *and* they also share in the responsibility for the costs of other school districts throughout the State through their State taxes.

Back to the State's five pension plans. The total of these plan obligations is not $79 Billion. It is far more than that. The pension plans owe money to retirees this year … and next year… and the year after that … out 35 years or so. If you added up the sum of all those obligations (as estimated by actuaries), the resulting sum would be closer to $200 Billion. But dollars due to be paid in one year cannot simply be added to dollars due to be paid in another year. One gets the "present value" of all these pension obligations by discounting the stream of payments to their value today using a discount rate. The State uses 8.5% as a discount rate (which is higher than many economists would say is proper). Using that discount rate, the present value (PV) of all the obligations is about $125 Billion, today. (A lower and more realistic discount rate would result in an even higher present value of these obligations.) The assets in the pension plans are worth about $46 Billion. The "unfunded" amount is thus about $79 Billion (as of June 30, 2009).

The key point to keep in mind is this: because the "present value" of the $125 Billion total liability was estimated using an 8.5% discount rate, this means that the liability will go up by 8.5% each year as the discount is "reversed." Some people casually refer to this as "interest." Actually, it is something else. It is due to the fact that next year, the obligations will be discounted by one less year – one less clipping off of 8.5% of the total. Other things happen each year too: current *retirees* are paid out one year's worth of pension benefits, current *employees* earn an additional year's worth of pension benefits for the future, etc. Thus, the total obligation changes each year for many reasons. But the biggest reason is that this year's estimated present value of the obligations will go up by 8.5% simply because we're one year closer to paying off those obligations.

The addition of another year's worth of pension benefits is also a key factor in pension obligation increases from year-to-year. Assume that the present pension liability was completely funded. There would still be the so-called "normal" increase in the pension liability due to the fact that folks now employed would have worked an additional year – and thus earned one additional year's accrual of pension benefits. This "normal" pension expense (independent of the unfunded liability) is about $1.6 Billion.

Thus, each year Illinois should be setting aside, in the pension funds, amounts which would do two things: (1) cover the "normal" pension expense of $1.6 Billion; and (2) keep the unfunded amount from getting bigger – essentially add 8.5% of the unfunded balance of $79 Billion – roughly $6.7 Billion. (This assumes that the assets in the funds will also grow, over the long run, at a rate of about 8.5%.)

Illinois should thus this year be setting aside, in the pension funds, the sum of $1.6 Billion and $6.7 Billion – or *$8.3 Billion. Just to keep the unfunded pension obligation from growing.* If we did what underfunded private sector firms are required to do – i.e., amortize the unfunded amount ($79 Billion) – we would have to contribute additional amounts.

Second, how did Illinois' pension problem get to be so huge? Again, there are several reasons.

The Civic Committee study three years ago, its update report from last February, and its recent testimony submitted to the Governor's Commission to Modernize Pensions, all show that public sector pensions in Illinois are *more generous* than private sector pensions. Employees can retire earlier, well before the retirement age allowed under Social Security. They accrue more benefits each year along the way, and they have greater protection against inflation after they retire.

In addition, public sector pensions have been subjected to *enormous abuse*. The *Chicago Sun-Times* recently reported that nearly 4,000 retired government workers now have pensions that pay them at least $100,000 per year; and more than half have collected more than $1 million each since they retired. A few have topped $2 million, and five have received more than $3 million each. (*Sun-Times*, September 11, 2009.)

One way to abuse the system is to "double up" – arrange to get more than one pension from the funds. The *Sun-Times* reported that the former chair of anesthesiology at Cook County Hospital and the University of Illinois has two pensions totaling $447,233 per year.

Another way is to retire from one job and take another – thus earning both a pension and a salary. This can happen because the State's pension plans permit retirement long before normal retirement age. The *Sun-Times* reported the case of a Chicago city worker who retired from one job at age 49 and took a new job with the City – and now receives a pension and salary totaling $246,721 per year. (*Sun-Times*, September 13, 2009.) Another 62-year old worker was reportedly drawing three pensions – totaling over $280,000 – and drawing a salary of over $246,000

Another way is to manipulate the career-end compensation number. The amount which public pension beneficiaries receive is dependent on the amount of their salary at career end. A sharp escalation of salary at career end – either in the final year, or some number of years used as the base for pension calculations – can dramatically increase pension benefits. It has been particularly tempting for local school districts to play this game at career end since the State – rather than the local school district – bears the increased pension costs generated by such manipulation.

Still another form of abuse, as recently described by the *Chicago Sun-Times,* is to permit career-end salary hikes to increase pension rights, even when the employee is no longer working for State government or the schools. One of the cases cited by the newspaper is that of a senior union official who formerly worked as a steamroller for Chicago's Department of Streets and Sanitation. After 21 years, he left in 1994 to go to work for a local union as business agent, and never returned to the city payroll. He then became president of the Chicago Federation of Labor, representing more than 300 unions affiliated with the AFL-CIO. Under State law he was permitted to base his taxpayer-supported pension on the much larger salary he earned with the labor organization. The enhanced City pension paid over $153,000 per year. Moreover, even after he began collecting the City pension at the age of 50, he was able to earn his $215,000-plus salary as union chief. The *Sun-Times* found "more than five dozen" retired government workers whose pensions are based not on their public salaries, but rather on what they were paid by labor unions, lobbying groups and other non-governmental organizations.

These abuses rightly irritate taxpayers. They add to the build-up of the State's pension liabilities. But the principal cause of the build-up is not the abuses. It has been the *failure of the State to fund* the pension costs on a current basis.

Unlike employers in the private sector, the State has never been required – or required itself – to fund on a current basis all of the costs being incurred each year. The State has instead funded what it thought at the time it could afford. The formula adopted by the State in 1995 deliberately back-end loaded pension costs in order to shift them from the present to future taxpayers. Structured into the pension formula was a "ramp up" which further shifted costs off to the future. During the past decade and a half, the State has several times taken "pension holidays" which enabled it to avoid altogether – or reduce below the formula level – the amounts contributed to the State pension funds. These "holidays" or partial holidays occurred in fiscal years 2005, 2006, and 2007. In addition, the State used proceeds from the 2003 pension obligation bonds to pay a part of or the entire amount of the required pension contribution in fiscal years 2003 and 2004.

Each year that the State funds less than the actuarially-correct amount, the shortfall is added to the mountain of unfunded liability, and then increases at 8.5% per year as the present value discount is reversed.

This year (FY2010), instead of covering its costs (including its pension obligations to the extent of $8.3 Billion) out of operating revenues, Illinois is borrowing. It entered the year by declaring it would borrow $6.7 Billion – by issuing $3.5 Billion in "pension notes" and also deferring payments to creditors in the amount of $3.2 Billion. The notes will have to be paid over the next five years. The creditors will have to be paid in the next fiscal year. So we haven't pushed the costs off for very long.

We are also borrowing – in effect – by failing adequately to fund this year's growth in pension liabilities. The $4.0 Billion contribution made to the pension funds in FY2010 (funded largely by the $3.5 Billion in pension notes) is far short of what is needed to keep the pension obligations from growing. To do that, an *additional $4.3 Billion* payment would be required.

This is how, along with the 2008-9 market decline, the unfunded pension obligation has now risen to a mountainous $79 Billion. The Blagojevich-era pension bonds add another $10 Billion, pension notes add another $3.5 Billion, and the retiree health obligation adds another $24+ Billion.

III. Such Cost-Shifting Is Dangerous and Risky

Unless the Governor and legislative leaders realize the enormity of the State's fiscal distress and bring to a halt the practice of funding State government through borrowing, Illinois will soon reach a "tipping point" beyond which it will be impossible to reverse the fiscal slide into bankruptcy. This is because the radical cost cutting and huge tax increases needed to pay all the deferred costs from the past would become so large that many businesses and individuals would be driven out of the State, thereby magnifying the vicious cycle of contracting State services, increasing taxes, and loss of the State's tax base.

Is it possible for the State still to manage its way out of this mess? We believe so. But Illinois cannot continue to put off funding its pensions out of current operating revenues. The annual funding requirement now should be at least $8.3 Billion just to keep the mountain of obligations from growing. If the borrowing continues, these obligations will increase. Also, just as private sector firms with unfunded pensions are required to amortize their unfunded amounts, the State should do so as well. And it should also start to recognize and fund retiree health care.

One may ask: cannot these painful measures be avoided by reforming the current system? Or selling assets? Or taking on more borrowing? Or increasing taxes?

1. Take first the possibility of pension "reform." Can't we reduce the enormity of the $79 Billion iceberg of unfunded liability by creating a second and less-costly new pension system for new employees?

The answer is no. We can – and should – stop the abuses; and we should reduce future additions to the pension liability by creating such a second-tier pension plan for new employees. Although a new second-tier plan with less costly benefits would help *reduce additions* to the present iceberg, it would *do nothing to reduce* that iceberg – or change the fact that it is growing at the rate of 8.5% per year. That debt is owed to existing retirees and current employees for their past services. The cost-saving benefits of a new plan for new employees would be recognized only gradually as new employees enter the system.

Also, in addition to reducing benefits prospectively for new employees, we can and should increase contributions made by both current and new employees.

2. People sometimes ask: why don't you sell a State asset? Or, why don't you borrow the money and put it in the funds?

Assets generate money in the future. If the State sells a revenue-generating asset, like a toll road or an office building, it gives up the future revenue. This is one way to shift today's costs to future taxpayers.

Alternatively, if the State borrows money today – through a pension bond or note – that borrowed money will have to be repaid in the future. This is another way to shift today's costs to future taxpayers.

3. How about increasing taxes? Governor Quinn is proposing to raise the State income tax from 3% to 4.5%. He also proposes to tax retirement benefits – pensions. But how much can be raised this way?

Experts differ, but the consensus seems to be that a 1 percentage point increase (with increased exemptions proposed by Governor Quinn) might raise about $3 Billion. Governor Quinn's proposed increase of 1.5 percentage points (from 3% to 4.5%) thus would not begin to cover the current annual budget hole.

How about 2 percentage points? How about *doubling* the income tax – from 3% to 6%? Dan Hynes, Governor Quinn's opponent in the Democratic primary race, wants to amend the State Constitution and take the top rate to 7.5%.

Even if Governor Quinn and his legislative colleagues could force through a multi-billion dollar income tax increase, this would not by itself deal with the State's fiscal emergency. The emergency stems from the unfunded pension funds, which just keep growing. But the members of the Legislature do not – generally – seem to care much about unfunded pensions. These are old debts. They are history. There is no fun in funding or paying off old debts. There is no ribbon-cutting ceremony – no new spending program to celebrate – no headline in the local newspaper. The impression of Springfield-watchers is that even if billions of new dollars were somehow made available, the Legislature would never allow those dollars to be used to improve pension funding. They would largely be spent on new programs that are popular with the strongest Springfield constituencies – principally the unions and the construction lobby. Jobs – jobs – jobs. Which is another way of saying: money – money – money. So the mountain of pension obligations would continue to grow.

But – and this is the key point – no Governor can force businesses and people to remain in Illinois. When people who care about their own economics realize that the slide cannot be reversed, the prospect of radical service cuts and increased taxes will drive existing businesses and the jobs they provide out of the State. New investment will be diverted elsewhere. Individuals will leave. They will leave quietly. Many have left already.

The loss of economic activity and the reduction in property values will reduce State tax collections and magnify its budget woes. Illinois will be compelled to cut costs and grants to local governments and school districts. The cycle of budget cuts, tax increases, and outflow of business and jobs will intensify. Whether the State will collapse with a bang or a whimper remains to be seen.

The "tipping point" will have been passed.

IV. Governor Quinn's Recent Proposal to Issue $16 Billion of New Pension Bonds is a Terrible Idea

Within the past few months, the Quinn administration has borrowed or committed to borrow more money than any previous Governor in the history of Illinois. Specifically, it has:

1. Committed to borrow more than $10 Billion to finance a new $31 Billion capital campaign.

2. Obtained legislative approval of an operating budget for our current fiscal year (FY2010) based on borrowing another $6.7 Billion from creditors and in the form of "pension notes."

3. Borrowed – in effect – a total of $6 Billion by underfunding current increases in obligations for public pensions (underfunded by about $4.3 Billion) and retiree health (unfunded by about $1.7 Billion).

Now Governor Quinn proposes *more* borrowing in the form of Blagojevich-style "pension bonds" – a risky "arbitrage" tactic designed to satisfy the State's unions by converting a "soft obligation" (of the pension funds) into a "hard obligation" (of the State), and to serve as a further excuse to postpone facing the State's fiscal realities. This is the Blagojevich solution with a vengeance.

The objections to pension bonds are numerous and enormous:

a. Pension bonds would create an additional "full faith and credit" obligation on the part of the State. The State already has to pay off the $10 Billion in bonds issued under Blagojevich. It will also have to pay off the $3.5 Billion in "pension notes" which Governor Quinn and the Legislature approved earlier this year. It must pay not only the principal of these obligations, but interest as well.

b. The State has recognized the dangers of too much debt by setting a limit on the amount of general obligation bonds it may issue (based on the amount of debt service on all outstanding bonds as a percentage of general fund appropriations – currently set at 7%). With the additional borrowing necessary to fund the new capital plan, the addition of more pension obligation bonds would likely put the State's debt over this limit.

c. Such borrowing not only does not solve the problem – the budget imbalance – but would be used (as Blagojevich used it) as an excuse for continuing not to fund pension costs out of current revenues. And the mountain of debt will just keep getting bigger.

d. Such borrowing is enormously risky. In the private sector it is called "arbitrage." One borrows at a lower rate of interest in order to invest the borrowed money in an investment that may draw a higher return. Private-sector arbitrageurs pursue such strategies with their own money subject to careful controls and limitations. Does anyone believe that State pension plan managers and their money managers operate – with other people's money – subject to these same controls and limitations? Moreover, the reason such arbitrage may work is that the arbitrageur takes on a greater risk. But the strategy may *not* work. Risky investments can go bump in the night. Anyone who doubts the risk inherent in pension bonds should look at the history of New Jersey's experiment with such bonds. (After the state issued $2.7 Billion in pension obligation bonds in 1997, the equity markets into which these monies had been invested plummeted between 2000 and 2002 – leading to "negative arbitrage.")[1]

e. Such borrowing is also costly. Lawyers and investment bankers charge for their services incurred in issuing the bonds. The risk of "pay to play" is increased.

f. What happens when the $16 Billion of borrowed money runs out? Would we issue still more bonds? And pile up even more costs to be paid by future taxpayers?

Perhaps because states have no right under the federal bankruptcy code to declare bankruptcy, the rating agencies and the buyers of bonds may assume that states can always raise taxes to cover the principal and interest payments. They may be radically disappointed.

Business groups like the Civic Committee have strongly opposed any effort to solve the budget crisis with a revenue-only solution or with more borrowing. Except for minor whittling

[1] For a few years after the issuance of the POBs, New Jersey's pension funds generated returns in the double-digits. But with the market bust of 2000, returns fell dramatically. Overall, from 1997-2005, the pension funds averaged an annual return well below the 7.6% that New Jersey promised in interest on the bonds, thus leading to "negative arbitrage" (this does not take into account the transaction costs associated with issuing the bonds). (*BusinessWeek*, June 13, 2005)

at the budgets of the State's social service agencies – perhaps in the range of $1.5 Billion – the Quinn administration has done nothing serious to reduce State costs or grants. None of the cost-cutting suggestions made by the Civic Committee in its 2006 or 2009 "Facing Facts" reports has been seriously pursued. Medicaid costs haven't been touched. Nor have retiree health-care costs.

The focus of this statement is on the *State's* unfunded pension obligations. But the City of Chicago has major budget and unfunded pension problems of its own. They just aren't as well publicized. So does CPS. So do many other municipalities throughout Illinois. And they all depend on the State budget for major chunks of their funding.

If Governor Quinn proceeds with this massive new borrowing – his proposed $16 Billion of new pension bonds – then the last opportunity for serious fiscal reform may well have been lost. If so, we will simply be transfusing blood into a corpse.