# EXECUTIVE SUMMARY

Illinois is headed toward financial implosion.

The State's liabilities and unfunded commitments exceed its assets by over $100 billion. The State has failed to set aside the amounts necessary to pay employee/retiree pensions and health benefits and to pay amounts currently owed to healthcare providers under Medicaid. The State has also failed to fund K-12 education at the "foundation" level. These liabilities and unfunded commitments are growing rapidly. Yet the State continues to spend or commit to spend billions more than it takes in each year.

In the current fiscal year, FY 2007, the State has discretion over approximately $28.8 billion of revenue. To fully fund its true costs -- including its increasing obligations -- as well as its unmet commitment to fund K-12 education at the "foundation level," approximately $5.9 billion more would be required. This annual gap will grow as the cost of pensions and health care rises faster than tax revenues.

Illinois' debt and unrecognized obligations have grown at an enormous rate. In FY 2002, Illinois had about $8.4 billion in general obligation bonds outstanding. In FY 2003, the State took on an additional $10 billion in pension debt. Moreover, the State now has $46 billion of unfunded pension liability. Also, unfunded commitments to cover the health care costs of its employees and retirees are estimated to be in the range of $48 billion. In addition, the State owes about $1.7 billion in unpaid Medicaid bills to health care providers.

The total of these debts and unfunded obligations (apart from general obligation bonds) is about $106 billion – roughly $8,800 per person for the 12 million residents of the State.

Illinois cannot solve its problems by printing money. Our Executive and Legislative branch leaders in Springfield must (a) cut costs, or (b) increase revenues, or (c) both. If they do not, commitments to State employees will become a huge burden to future generations or will not be kept at all. Illinois may be forced to implement radical service cut-backs; and its ability to refinance its debt may be adversely affected by deteriorating ratings.

Significant cost savings are possible. Retirement and healthcare benefits for State employees are more generous and expensive than those of most of the taxpayers asked to pay for those benefits. By bringing State plans into line with reasonable private and public benchmarks, total State-level costs can be reduced by approximately $1 billion per year. Substantial savings also can be achieved through more widespread outsourcing and restructuring of State services. The cost of many programs can be reduced through tightening of the rules governing campaign contributions, hiring and contracting.

Although such reforms can and should be undertaken, the resulting savings will not be enough to cover the State's annual costs, including the obligations that are being accumulated. To avoid collapse, a tax increase may be inevitable. The State could increase its income tax rates and expand its sales tax base without jeopardizing its competitive status compared to other Midwestern or urban-industrial states.

But to do nothing more than raise taxes would be disastrous. In particular:

Taxes should *not* be raised unless – simultaneously – the State reduces its costs dramatically. Specifically, it should trim its pension benefits, shift to Defined Contribution Plans for future employees, and align health care benefits of State employees and retirees with relevant private and public sector benchmarks. Other suggested economies are set forth in this Report.

Taxes should *not* be raised for K-12 education unless – simultaneously – major reforms are made to improve school accountability, operations, results and transparency. In Chicago the legislative cap on charter schools should be eliminated. To spend more money on K-12 education without these reforms would waste the money.

Taxes should *not* be raised state-wide to pay for a property tax "swap." Revenues used to pay for such a "swap" are needed to meet existing commitments. Effective property tax rates in Chicago have declined over the last few years to a level close to the national average. Property taxes provide a more stable, less fluctuating source of funds to support schools than statewide income or sales taxes, which vary with the level of economic activity. Reducing taxes on property – and making up for it by increasing income and sales taxes– would accomplish little of substance. Moreover, the proposed tax "swaps" would shift funding and control of local K-12 education away from local districts and local citizens in the direction of centralized State decision-making.

Taxes should *not* be raised unless the proceeds are used to meet the State's commitments. It would make no sense to launch expensive new programs with new tax dollars, while leaving existing commitments to pensions, health care costs and K-12 education underfunded.

Good government in a democracy involves making hard choices. Citizens who live in Illinois and pay taxes here, and the businesses located here, make hard choices. Their government should do no less.