State can run out of money, but can't file for bankruptcy

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SPRINGFIELD - Facing an ever-growing pile of bills, crushing debt and less tax money flowing into the state treasury, Illinois is broke. But could the state climb out of its nearly $9 billion budget hole by declaring bankruptcy?

No, say tax and budget experts.

Federal law permits individuals, businesses and local governments to file for bankruptcy reorganization and sometimes debt forgiveness. States are not covered by the law. No U.S. state has ever declared bankruptcy.

"A state is not going to just shut down," said Elizabeth McNichol, a state budget specialist at the Center on Budget and Policy Priorities, a nonpartisan Washington, D.C., think tank.

"As bad as things are, no state is going to have zero revenue coming in," McNichol said. "It's really just a matter of choices."

So, rather than having a court restructure its finances as in a bankruptcy filing, a state would have to reorganize its spending and debt on its own. That's the current challenge for Gov. Pat Quinn and lawmakers.

Illinois has long balanced the stack of bills on the comptroller's desk very carefully. Certain payments must be made on certain days, so other bills sometimes get pushed back a few days - or longer - to make sure there is enough cash on hand, said a spokeswoman for Comptroller Dan Hynes.

But should state finances became especially dire, Illinois could keep going by not paying back money it has borrowed. Such a move is unlikely and the consequences of default would make the state's financial situation worse.

That's because it would greatly hinder the state's ability to borrow in the future. Plus, the people Illinois owes money to could go to court to force the state to pay.

"It's not something you want to do because when you want to borrow in the future you'll have to pay a lot more interest because you're a higher risk," explained Beverly Bunch, an associate professor of public administration at the University of Illinois at Springfield.

But if the state manages to muddle through, the future could get pretty bleak. California's current $41 billion budget crisis is a preview of what Illinois might have to do to stay solvent.

California has been borrowing to pay its everyday bills. But facing a $346 million shortfall just for February, California Controller John Chaing this week stopped writing checks for nearly everything other than education and debt payments.

That means spending on state agencies, including public safety, payments for state purchases and tax refunds will be delayed until at least March.

The Illinois Constitution says state pensions cannot be "diminished or impaired." But money for schools, public safety, and payments to cities and counties are offered no such protection and could all be delayed.

The trickle-down effect of stopped payments in the Golden State is busting the budgets of cities and counties across California. Riverside County, located between Los Angeles and San Diego, is going to court for permission to stop providing state mandated services if the county does not receive state funding.

Starting today, California's 238,000 state workers begin "Furlough Fridays" - unpaid days off on the first and third Friday of every month through June 2010. The furloughs will save the state $1.3 billion over the next 17 months, but will also end up costing the state revenue as those workers pay less tax on smaller incomes.