Connecticut's Fiscal Guardrails: A Data-Driven Analysis

The Impact of the Caps

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DECEMBER 2024

A joint research effort between The Tobin Center for Economic Policy and The Connecticut Project

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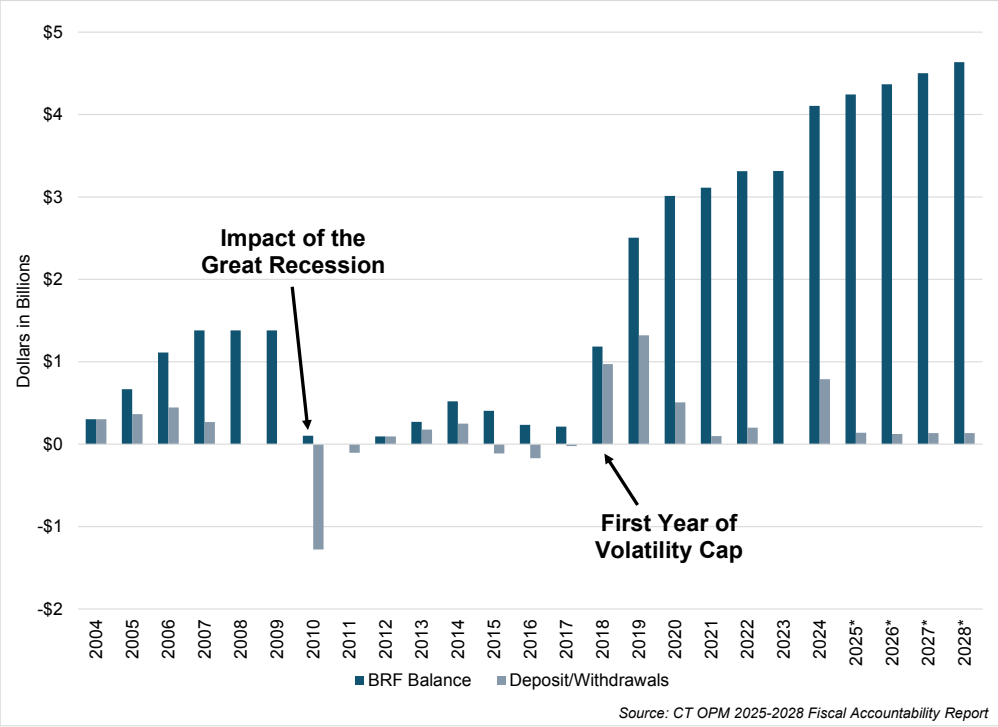
IMPROVING CONNECTICUT'S LONG-TERM FISCAL STRENGTH

Over the past seven years, Connecticut's fiscal guardrails have contributed to a substantial increase to the state's readiness to absorb a fiscal shock. The state's Budget Reserve Fund (BRF), or "rainy day fund," has grown from zero and near-zero during the years following the Great Recession to $4.1 billion in FY25 (see Figure VI.A), representing approximately 18 percent of the current budget.[1]

Figure VI.A: Overall balance and changes in the Budget Reserve Fund, 2004–2028



The impact of the guardrails on long-term liabilities also has been significant. As a result of the fiscal guardrails, more than $8.6 billion in surplus funds has been paid into the pension funds since FY20, on top of the annual actuarially required contributions.[2]

1 "October Comptroller Letter," Jeffrey R. Beckham, Office of Policy and Management, https://portal.ct.gov/-/media/opm/budget/comptrollerletter/fy-2025/fy-25_october_2025_comptroller_-letter.pdf?rev=f97b38a50671458abcb3e8db2ee91bef&hash=1A8AAB1514C5CEC3078EC8F7A928B9D5, Statement 1.

2 "Fiscal Accountability Report Fiscal Years 2025–2028," Jeffrey R. Beckham, Office of Policy and Management, https://portal.ct.gov/-/media/opm/budget/fiscalaccountability/opm-2024-fiscal-accountability-report-final.pdf?rev=62b1ee2e4449447aae844475a9a500c7&hash=C76D46300CDD088FFD55F6A05E6CA60C%20%20,%2052, 50.

As of FY23, Connecticut's two largest pension funds were 56 percent funded, a meaningful improvement over the 46 percent funding ratio in 2016 (see Figure VI.B).[3] That said, it is important to note that the state's debt-to-GDP ratio remains the third highest in the country as of 2022[4] and total unfunded liabilities have grown in absolute terms, though this growth can be attributed, in part, to the adoption of more conservative rate of return assumptions.

Figure VI.B: Changes in assets and actuarially estimated liabilities for the Connecticut State Employees and Teachers Retirement Systems, 2016–2023 (dollars in millions)

	Assets		Est. Liability		Funding Ratio	
Retirement System	*2016*	*2023*	*2016*	*2023*	*2016*	*2023*
State	$11,923	$21,847	$32,310	$41,981	0.37	0.52
Teachers	$16,712	$24,455	$29,860	$40,877	0.56	0.60
Total	**$28,635**	**$46,302**	**$62,171**	**$82,858**	**0.46**	**0.56**

Source: CT Employees Retirement System Report of the Actuary 6/30/23, CT Teachers' Retirement System Actuarial Valuation 6/30/23

Bond Ratings

The progress toward fiscal sustainability has been affirmed by the major credit rating agencies. The three major credit rating agencies followed a similar pattern, downgrading Connecticut's ratings beginning in 2016 and 2017 in response to the state's sustained fiscal challenges and each upgrading the state's ratings between 2021 and 2024. Today, Connecticut is rated Aa3, AA-, and AA- by Moody's, Fitch, and S&P, respectively, leaving room for further improvement (see Figure VI.C).[5]

Improved credit ratings have a tangible fiscal impact, lowering the relative cost of borrowing. In Connecticut's competitive bond sale in July 2024, the state treasurer attributed $23.4 million in reduced borrowing costs for Connecticut residents over the next ten years to improved credit ratings.[6] These savings would be larger if Connecticut were to achieve still higher credit ratings.

3 For a complete picture of Connecticut's long-term liabilities, it is also important to consider Other Post-Employment Benefits (OPEBs), which primarily consist of covering a share of health care costs for retirees. The most recent estimate of the outstanding unfunded OPEB liability facing Connecticut is $15.5 billion, as of June 2022. See, "State of Connecticut State Employee OPEB Plan," Governmental Accounting Standards Board, Segal, 2023, https://osc.ct.gov/wp-content/uploads/2024/09/State-of-Connecticut-OPEB-GASB-75-for-June-30-2023-OSC.pdf, 7. This figure also represents an overall improvement in position. In 2015, the estimated unfunded liability was $18.9 billion. See, "State of Connecticut Other Post-Employment Benefits Program," Governmental Accounting Standards Board, Segal, 2015, https://osc.ct.gov/empret/OPEBActuarialReports/OPEBreport2016.pdf.

4 Chris Edwards, Marc Joffe, and Krit Chanwong, "Government Debt Varies Widely by State," *CATO At Liberty*, July 19, 2024, https://www.cato.org/blog/government-debt-varies-widely-state.

5 "Treasurer Russell Announces Successful $450 Million General Obligation Bond Sale Following Positive Rating Outlooks from Moody's and Fitch," The Office of Treasurer Erick Russell, State of Connecticut's Treasurer's Office, 2024, https://portal.ct.gov/ott/newsroom/news/news-releases/bondsale_june2024.

6 "Treasurer Russell Announces Competitive Bond Refunding Sale Produces Savings of $23.4 Million over Ten Years," The Office of Treasurer Erick Russell, State of Connecticut's Treasurer's Office, 2024, https://portal.ct.gov/ott/newsroom/news/news-releases/competitivebondsale2024.

Figure VI.C: Connecticut general obligation (GO) bond ratings, 2004–2024

Year	Moody's	Fitch	S&P
2004	Aa3	AA	AA
2005	Aa3	AA	AA
2006	Aa3	AA	AA
2007	Aa3	AAA	AA
2008	Aa3	AA	AA
2009	Aa3	AA	AA
2010	Aa3	AA	AA
2011	Aa2	AA	AA
2012	Aa3	AA	AA
2013	Aa3	AA	AA
2014	Aa3	AA	AA
2015	Aa3	AA	AA
2016	Aa3	AA-	AA-
2017	Aa3	A+	A+
2018	A1	A+	A
2019	A1	A+	A
2020	A1	A+	A
2021	A1	AA-	A+
2022	Aa3	AA-	A+
2023	Aa3	AA-	AA-
2024	Aa3	AA-	AA-

Source: S&P Global, Fitch, Moody's, CT School + State Finance Project

REDUCING AVAILABLE FUNDS FOR CURRENT NEEDS

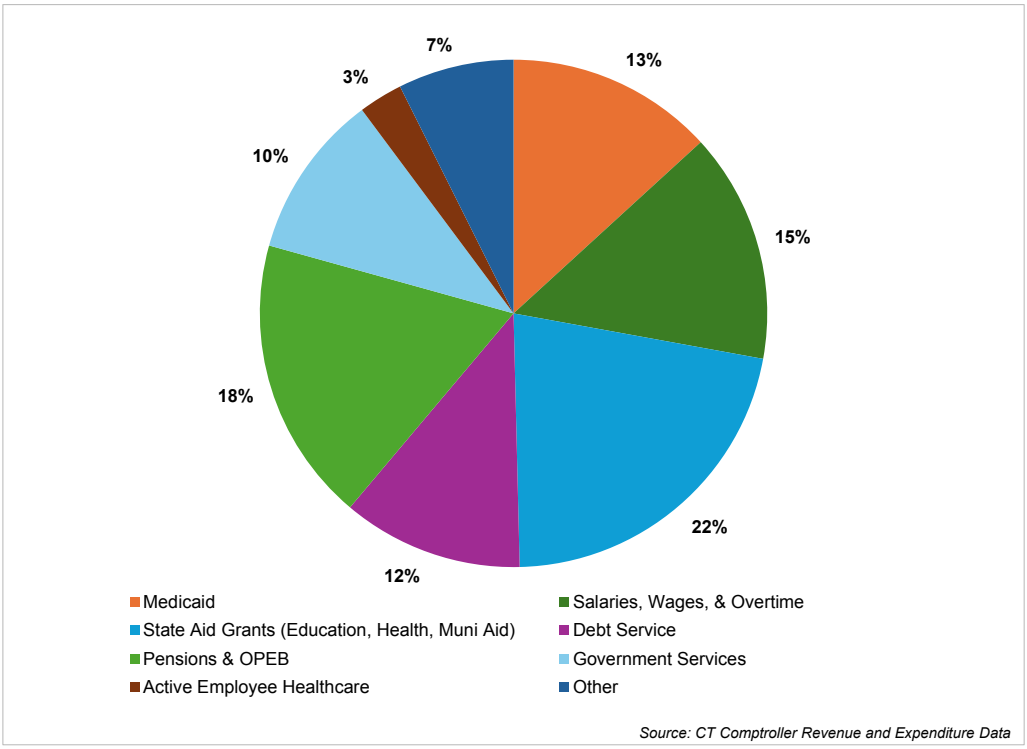
At the same time, the guardrails have constrained the state's flexibility in funding current needs and making other future-oriented investments. Over the same seven-year period examined in Figure VI.B (2016–2023), spending on priorities other than pensions has decreased both in real terms and as a share of state expenditures.[7]

To provide additional context, it is worth providing detail on Connecticut's expenditures, both currently and over time. The largest share of Connecticut's budget, close to a quarter of expenditures in 2023, is distributed in the form of state grants in aid and intergovernmental transfers to local governments. In the same year, 15 percent of the state's expenditures paid the salaries of current employees and 3 percent covered the costs of employee healthcare. Medicaid made up another 13 percent of state spending, and government services—a broad category that included aging and disability services, community supports and services, mental health, higher education, substance abuse, and early childhood education—made up another 10 percent of state general fund expenditures (see Figure VI.D).

7 In 2016, Connecticut spent $15.2 billion on all but pensions and OPEB, 85% of total spending in 2016, and $2.7 billion on Pensions and OPEB. In 2023, Connecticut spent $18.2 billion on all but pensions and OPEB, 82% of total spending in 2023, and $4.0 billion on pensions and OPEB. When 2016 spending figures are adjusted to 2023 dollars (using the Bureau of Economic Analysis' GDP deflator), Connecticut spending on pensions and OPEB grew 20.3% from 2016 to 2023, while non-pensions and OPEB spending fell by 2.5%. See, Connecticut Comptroller Revenue and Expenditure Data; "Table 1.1.9. Implicit Price Deflators for Gross Domestic Product," U.S. Bureau of Economic Analysis, last revised on September 26, 2024, https://www.bea.gov/itable/national-gdp-and-personal-income.

The next largest share, approximately 30 percent of expenditures, were commitments that the state made in prior years. This spending included 12 percent for debt service and 18 percent for retiree pensions and health benefits or Other Post-Employment Benefits (OPEB) (see Figure VI.D).

Figure VI.D: Total General Fund spending in Connecticut, 2023



Note: Categories in figure developed based on Connecticut Comptroller Revenue and Expenditure Data in order to best illustrate relevant expenditures.

The composition of state spending has changed over time. For example, the relative share of funding allocated for pension payments and the retirement system has increased. In 2014, pensions and OPEB categories accounted for 14.3 percent of expenditures. In 2023, that percentage was 18 percent. Illustrated along a different timeframe, when 2016 spending figures are adjusted to 2023 dollars (using the Bureau of Economic Analysis' GDP deflator), Connecticut spending on pensions and OPEB grew 20.3 percent from 2016 to 2023, while non-pensions and OPEB spending fell by 2.5 percent.[8]

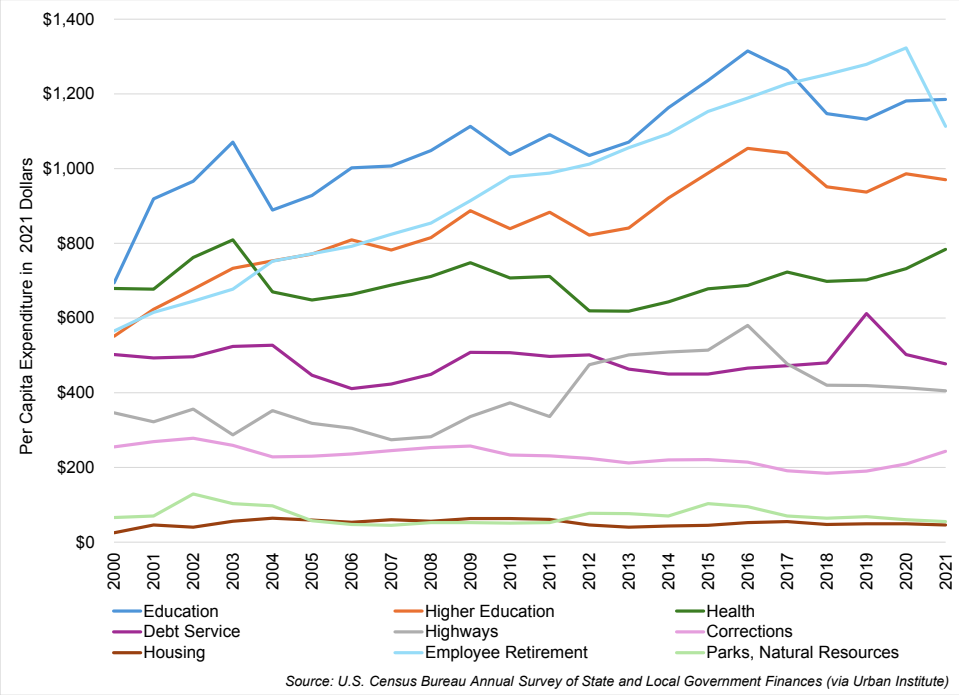
Moreover, since 2018, the appropriations budget has significantly understated the overall share of state funding of pensions. Incorporating annual deposits of volatile revenues, which was $1.87 billion in FY23, spending on pensions and OPEB would account for almost a quarter (24.5 percent) of General Fund expenditures in 2023.[9]

8 Connecticut Comptroller Revenue and Expenditure Data; "Table 1.1.9. Implicit Price Deflators for Gross Domestic Product."
9 "Fiscal Accountability Report Fiscal Years 2024–2028," Jeffrey R. Beckham, Office of Policy and Management, 2023, https://portal.ct.gov/-/media/opm/budget/fiscalaccountability/opm-2023-fiscal-accountability-report-final.pdf, 31–32.

Debt service also grew from 9.7 percent to 11.5 percent over the period of 2014 to 2023 as a percentage of General Fund expenditures. In contrast, the share of spending on grants to local governments and nonprofits declined from 23.4 percent to 21.8 percent, and that of salaries paid to state employees declined from 16.3 percent to 14.7 percent over the same period.[10]

For a more detailed breakdown of expenditure trends over time, the Bureau of the Census Annual Survey of State and Local Governments offers another look—albeit from an imperfect source, as consistent data across categories are difficult to obtain.[11]

Figure VI.E: Real per capita Connecticut spending on selected functions, 2000–2021



Note: Figure does not include the Public Welfare function, which includes Medicaid spending. It is also important to note that although the chart above depicts a decrease in per capita expenditure on employee retirement, this chart does not include the surplus payments captured by the volatility cap and directed into the state pension funds, and therefore understates the amount dedicated to employee retirement costs since 2018.

Over the entire period, spending on employee retirement (pensions) has grown the fastest of the categories in the figures, increasing more than 3 percent per year in real growth, even before accounting for the additional surplus payments captured by the volatility cap. The trends that can be observed in the brief post-cap window (2017 to 2021) are also notable, though certainly

10 Connecticut Comptroller Revenue and Expenditure Data.

11 Note that this data was pulled from the Urban Institute's State and Local Finance Data tool. See, "State and Local Finance Data Exploring the Census of Governments," State and Local Finance Initiative, Urban-Brookings Tax Policy Center, https://state-local-finance-data.taxpolicycenter.org/pages.cfm.

impacted by the infusion of COVID-related federal funds that supplemented state spending starting in 2020. Here, spending on education, higher education, highways, housing, and employee retirement (pensions) all fell in real terms, while debt service and spending on corrections and health grew.

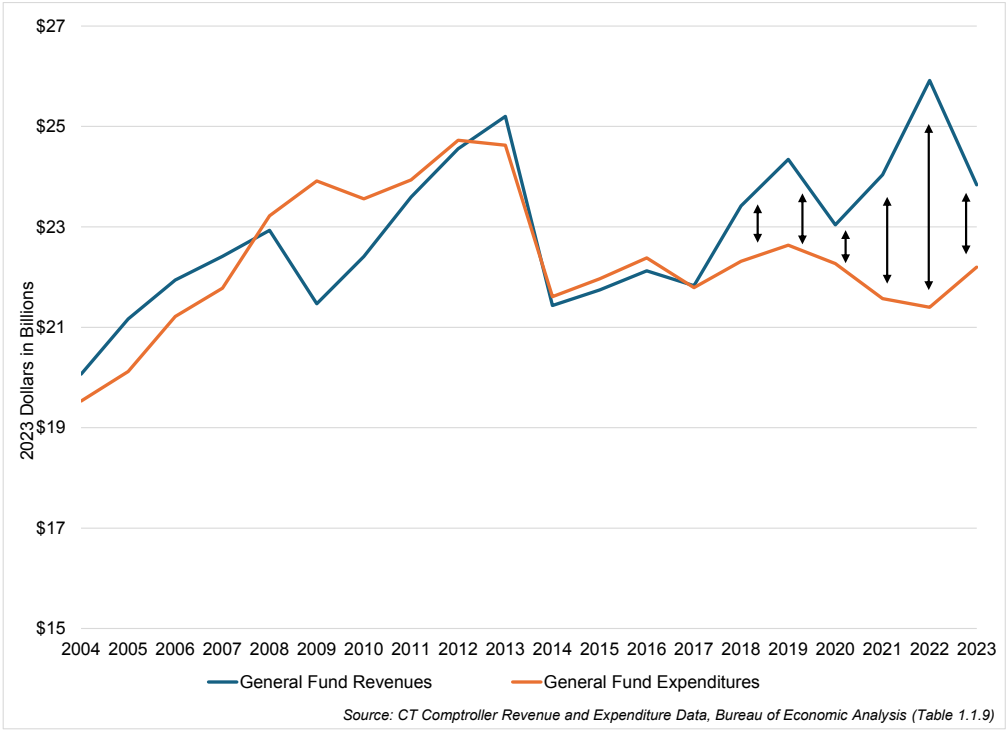
In sum, a growing portion of state spending has been used to fund fiscal decisions made in the past (debt service and pensions), leaving less available to address the problems of the present. As discussed in our "Stakes of the Debate" paper, without modification of the guardrails, Connecticut may be forced to make difficult cuts to core programs and services despite projecting sizable surpluses in the years ahead. Connecticut currently faces a gap of $331 million to $1.05 billion between anticipated FY26 spendable General Fund revenues and expenditures (see Figure III.A in "Stakes of the Debate").

THE ROLE OF THE GUARDRAILS IN CONSTRAINING SPENDING

It is difficult to make precise spending comparisons over time due to changes in the accounting treatment of different categories. Nevertheless, it is worth trying to determine whether Connecticut's fiscal guardrails are responsible, at least in part, for the trends in spending. To do so, we first examine differences before and after the imposition of the caps. We then investigate Connecticut's spending compared to states in the region, where policymakers do not have to contend with such budget restrictions.

Adjusting for inflation, we compare revenues and expenditures over a twenty-year period (see Figure VI.F).

Figure VI.F: Connecticut General Fund real revenues and expenditures, 2004–2023

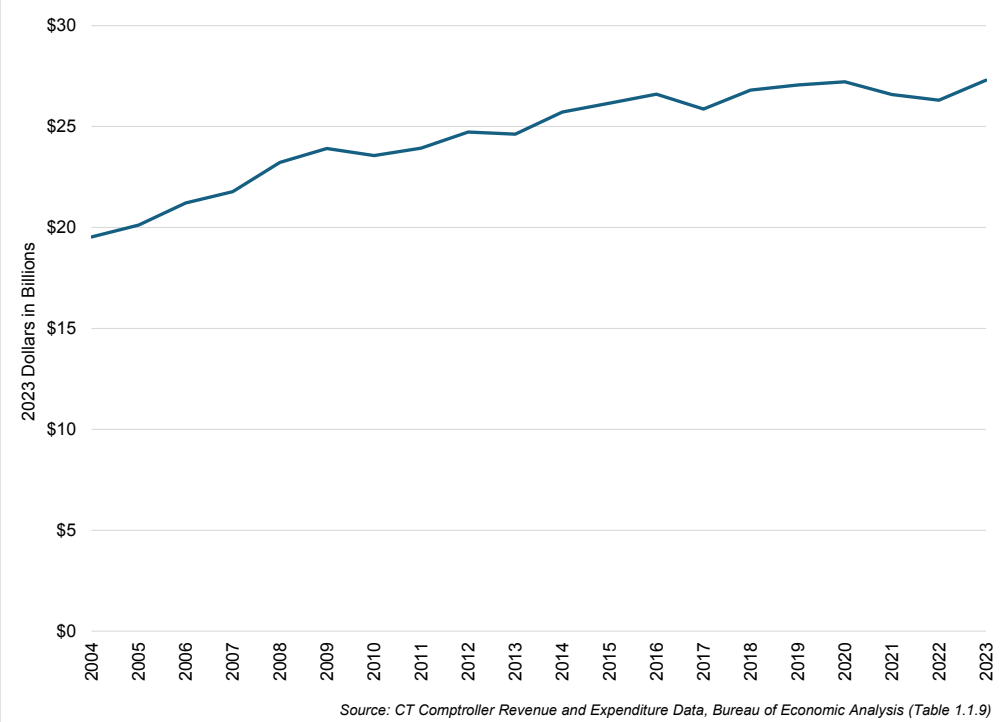


Source: CT Comptroller Revenue and Expenditure Data, Bureau of Economic Analysis (Table 1.1.9)

This simple look at state revenues and expenditures in 2023 dollars shows the change in state spending behavior in 2018 and on with the implementation of the guardrails.

We then compare the rate of growth in total spending 14 years before the start of the revenue and volatility caps (2004–2017) against the period following their implementation (2018–2023).

Figure VI.G: Connecticut General Fund real expenditures, 2004–2023



Note: Starting in 2014, federal matching dollars to state expenditures on Medicaid were excluded from total reported state spending figures.[12] In order to display spending consistently over time, expenditures have been adjusted to include that matching spending from 2014 on. From 2014 to 2023, we calculate federal matching spending by applying the federal proportion of "Total Net Expenditures" to Connecticut's state Medicaid spending, as reported by Centers for Medicare and Medicaid Services.[13]

With the spending cap present but not the volatility or revenue caps, real total expenditures (including the federal share of Medicaid spending, which is estimated in 2014 and after) grew at an annual rate of 1.33 percent from 2012 to 2017.[14] In contrast, from 2018 to 2023, with the revenue cap, the volatility cap, and an intact spending cap, total expenditures grew at an

12 "Connecticut State Budget FY 14 & FY 15 Budget," Office of Fiscal Analysis, https://www.cga.ct.gov/ofa/Documents/year/BB/2014BB-20130926_FY%2014%20and%20FY%2015%20Connecticut%20Budget.pdf, 5.

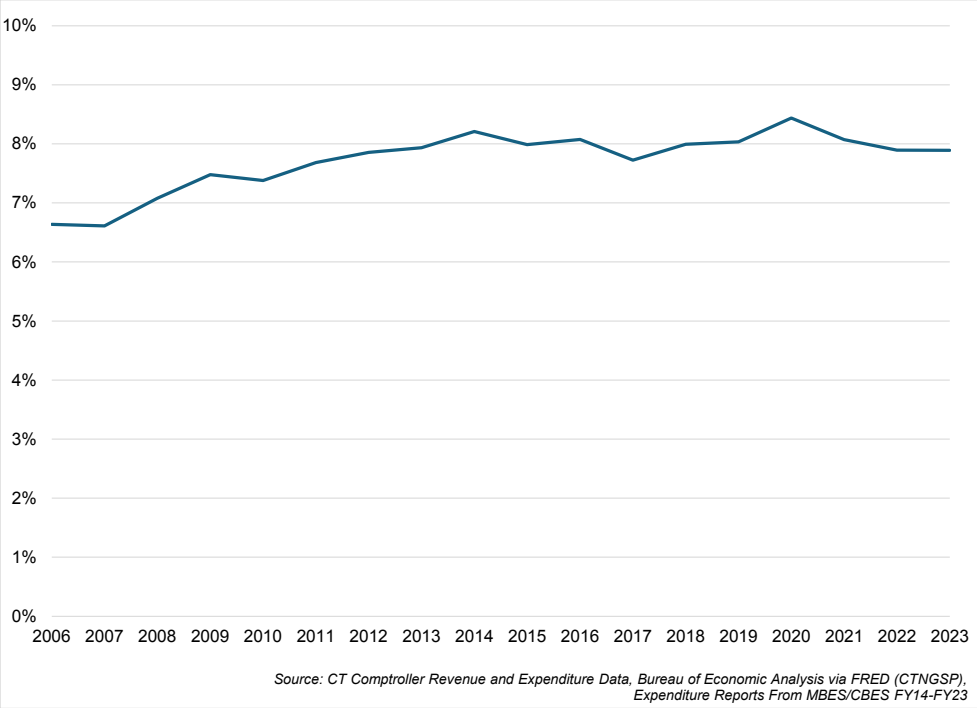
13 "Expenditure Reports from MBES/CBES," Centers for Medicare & Medicaid Services, https://www.medicaid.gov/medicaid/financial-management/state-expenditure-reporting-for-medicaid-chip/expenditure-reports-mbescbes/index.html.

14 In order to maintain a consistent, six-year comparison in the before and after periods, we use 2012–2017 and 2018–2023 as our comparison periods. If we compare all years in the chart before 2018 (2004–2017) to 2018–2023, the valence of the conclusion remains: spending grew at an annual rate of 2.22% from 2004–2017, meaning average annual growth 2018–2023 was less than half of growth from 2004–2017.

average annual rate of 0.92 percent, or less than three-quarters the speed of the prior period. It is worth noting that, during the latter part of this period, COVID-19 federal relief funds allowed the state to devote additional resources to current programs and services without relying on state funds.

To determine whether the slower rate of spending is merely a function of the rate of economic growth, we examine the trend in spending as a share of state GDP.

Figure VI.H: Connecticut General Fund spending as a percentage of GDP, 2006–2023



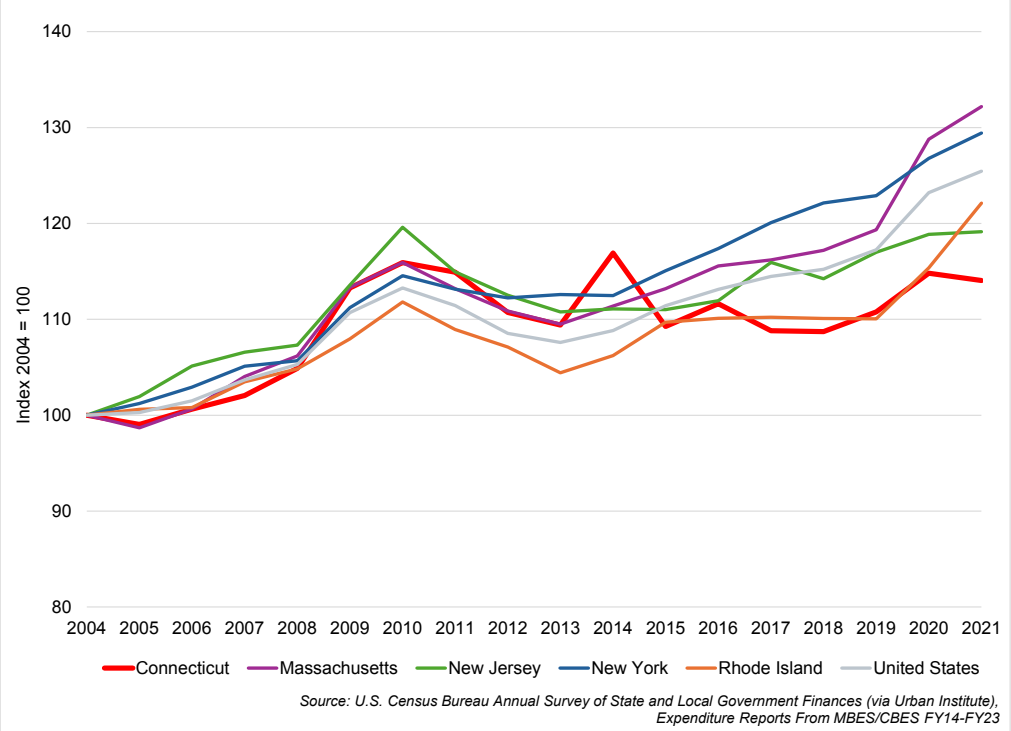
Here we see a relatively stable relationship with General Fund spending hovering between 6.6 percent and 8.4 percent of state GDP. There does appear to be a local peak of almost 8.4 percent in 2020 before decreasing in subsequent years to approximately 7.9 percent.

Another way to explore the impact of the caps is to examine Connecticut relative to neighboring states. Once again, it is difficult to make precise comparisons between states because of differences in how budgets are structured and how responsibilities are allocated between state and local governments. As a consequence, to draw a more meaningful comparison, we examine total state and local spending. Figure VI.I draws upon the Bureau of the Census Annual Survey of State and Local Government series to compare state and local spending in Connecticut relative to neighboring states as well as the U.S. as a whole.[15]

15 Note that this data was pulled from the Urban Institute's State and Local Finance Data tool. See, "State and Local Finance Data Exploring the Census of Governments," State and Local Finance Initiative, Urban-Brookings Tax Policy Center, https://state-local-finance-data.taxpolicycenter.org/pages.cfm.

Some adjustments are made to ensure that the comparison is meaningful. The calculation starts with total current expenditures (excluding such things as capital accounts), adjusts for population size and inflation, and indexes the dollars to 2004.

Figure VI.I: Real per capita state and local expenditure growth in Connecticut and other states, 2004–2021



Note: Starting in 2014, federal matching dollars to state expenditures on Medicaid were excluded from total reported state spending figures.[16] In order to display spending consistently over time, expenditures have been adjusted to include that matching spending from 2014 on. From 2014 to 2023, we calculate federal matching spending by applying the federal proportion of "Total Net Expenditures" to Connecticut's state Medicaid spending, as reported by Centers for Medicare and Medicaid Services.[17]

Using this measure, state and local spending in Connecticut roughly kept pace with the group prior to 2014, the period leading up to the point at which the federal share of Medicaid was removed from the reporting and before the imposition of the other guardrails in 2017.[18] Total inflation-adjusted expenditures per capita have grown extremely slowly in Connecticut from 2015 to 2021 (an average of 0.74 percent annually in real terms). By contrast, state spending in New Jersey grew at 1.20 percent annually and the other states grew at a rate at least twice that of Connecticut. The national average growth rate was 2.01 percent over the period, with Massachusetts demonstrating an average annual rate of growth of 2.65 percent.

16 "Connecticut State Budget FY 14 & FY 15 Budget," 5.
17 "Expenditure Reports from MBES/CBES."
18 "Connecticut State Budget FY 14 & FY 15 Budget," 5.

Even without the indexing, Connecticut lags behind the comparison group. In 2021, the most recent year with comparable data, total state and local expenditures per capita in Connecticut were $12,347. That figure was roughly in line with the U.S per capita spending in 2021 ($12,276) despite Connecticut's rank of third wealthiest state in the country, as measured by personal income per capita, behind the District of Columbia and Massachusetts.[19] Connecticut's 2021 total state and local expenditures per capita also lagged well below the comparison states listed, which ranged roughly from $13,000 to $19,000 per capita.

These comparisons do not establish a causal link between the guardrails and state spending. A number of different factors contribute to the creation of a state budget. For example, Connecticut has recently had slow GDP growth—though it remains one of the richest states in country. At a minimum, however, the comparisons demonstrate that spending in Connecticut has grown at a far slower pace relative to neighboring states and that there is an observable difference in the pace of growth in spending before and after imposition of the caps.

CONCLUSION

It is impossible to say, with certainty, what Connecticut's fiscal picture would look like in the absence of the guardrails. After a long period of economic stagnation, Connecticut's revenue growth increased beginning in 2018. The adoption of the fiscal guardrails compelled policy-makers to use much of that additional revenue to make substantial contributions to the Budget Reserve Fund and substantial supplemental payments into state pension funds. Over the past seven years, those contributions have brought the Budget Reserve Fund to the statutory maximum of 18 percent of budget and have resulted in $8.6 billion in additional payments to the pension funds. Ratings agencies have improved their outlook.

At the same time, it is important to recognize that Connecticut's spending on many priorities other than pensions has decreased in recent years, and spending on current needs and other future-focused priorities has begun to lag peer states. Even prior to the imposition of the guardrails, the composition of state spending has shifted, with a greater share going to fund commitments from prior years. To the extent that the fiscal guardrails extend these trends, Connecticut may find itself falling behind in the provision of current services or growth-promoting investments, relative to peer states.

19 "SAINC1 State annual personal income summary: personal income, population, per capita personal income," U.S. Bureau of Economic Analysis, last revised on September 27, 2024, https://www.bea.gov/data/gdp/gdp-state.