INTRODUCTION

Investments over the last few budgets reflect California's values and priorities. Together with the Legislature, the Administration is making healthcare affordable and accessible to all, regardless of immigration status; expanding child care and universal transitional kindergarten for all 4-year-olds; and enabling more people to graduate from college without crippling debt. The state has also made historic investments to protect Californians against the impacts of climate change and keep them safe during the COVID-19 Pandemic. These investments over the past four years are continuing to improve both the quality of life and the long-term outlook for all Californians.

At the same time, California has recognized the importance of being able to withstand annual fluctuations in state revenues. As 2023 begins, risks to the state's economic and revenue outlook highlighted in the 2022 Budget have been realized—continued high inflation, multiple federal reserve bank interest rate increases, and further stock market declines. This last risk is particularly important to California, as market-based compensation—including stock options and bonus payments—greatly influences the incomes of high-income Californians. Combined with a progressive income tax structure, this can have an outsized effect, both good and bad, on state revenues.

Given these developments, the revenue outlook is substantially different than seen in the last two years. Prior to accounting for solutions, the Governor's Budget forecasts General Fund revenues will be $29.5 billion lower than at the 2022 Budget Act projections, and California now faces an estimated budget gap of $22.5 billion in the 2023-24 fiscal year.

Fortunately, through prudent planning and budget resilience built into previous budgets, the state is in its best fiscal position in recent memory to address this slowdown. By using the bulk of the recent surplus to boost the state's budget reserves and pay down prior debts, by focusing on one-time and near-term spending instead of costly long-term obligations, and by tying or "triggering" a handful of new ongoing programs to sufficient revenue availability in 2024-25, the state does not have to propose the kind of deep reductions to priority programs that marked the budget shortfalls over the past two decades. It will, however, require the state to delay or forego some spending in the near term.

Part of the state's planning has included building up the state's budget reserves. To offset the significant swings in revenue caused in large part by market volatility, voters in 2014 passed Proposition 2, which created new requirements for deposits into the Budget Stabilization Account or "Rainy Day Fund." In order to make a withdrawal from this account, the Governor must first declare a fiscal emergency, and no more than 50 percent of the balance can be withdrawn in any single fiscal year.

The Budget reflects $35.6 billion in total budgetary reserves. These reserves include $22.4 billion in the Budget Stabilization Account, which fulfills the constitutional maximum mandatory deposit limit of 10 percent of General Fund tax proceeds. The reserve total also includes:

- $8.5 billion in the Public School System Stabilization Account,
- $900 million in the Safety Net Reserve, and
- $3.8 billion in the state's operating reserve – the Special Fund for Economic Uncertainties.

As the Budget Stabilization Account balance is at its constitutional maximum amount, a total of $951 million is required to be dedicated for infrastructure investments in 2023-24.

The Budget accelerates the paydown of state retirement liabilities as required by Proposition 2, with $1.9 billion in additional payments in 2023-24 and approximately $5.3 billion projected to be paid over the next three years.

A BALANCED PLAN TO CLOSE THE BUDGET GAP

Because of the multiple uncertainties regarding the overall economic and revenue outlook in the near term, the Governor's Budget reflects a balanced plan of funding delays, reductions and pullbacks, fund shifts, trigger reductions, and limited revenue generation and borrowing to address the budget problem. To preserve the state's ability to respond to any potentially significant negative changes to the outlook in early 2023, the Governor's Budget does not propose to draw from the state's reserve accounts to close the budget gap.

The Governor's Budget economic forecast does not project a recession. If economic and revenue conditions deteriorate in the spring, then the Administration may propose withdrawals from reserve accounts, as well as additional program reductions. Conversely, if conditions improve, then the Administration would not have to propose reserve withdrawals, and would also reconsider proposed spending delays and reductions.

The balanced plan reflected in the Governor's Budget to close the projected shortfall includes:

- ***Funding Delays—$7.4 billion.*** The Budget delays funding for multiple items across the 2021-22 through 2023-24 fiscal years, and spreads it across the multi-year without reducing the total amount of funding through the multi-year.
- ***Reductions/Pullbacks—$5.7 billion.*** The Budget reduces spending for various items across the 2021-22 through 2023-24 fiscal years, and pulls back certain items that were included in the 2022 Budget Act to provide additional budget resilience. Significant items in this category include the $3 billion included in the 2022 Budget as an inflationary adjustment, and a $750 million Unemployment Trust Fund payment in the 2023-24 fiscal year.
- ***Fund Shifts—$4.3 billion.*** The Budget shifts certain expenditures in the 2022-23 and 2023-24 fiscal years from the General Fund to other funds. These include (1) shifting various California State University (CSU) capital outlay projects to CSU issued debt with the state providing support for the underlying debt service, (2) reverting certain bonds to cash projects from the 2022 Budget Act back to bonds, and (3) shifting certain Zero Emission Vehicle commitments to the Greenhouse Gas Reduction Fund.
- ***Trigger Reductions—$3.9 billion***. The Budget reduces funding for certain items in the 2020-21 through 2023-24 fiscal years and places them in a "trigger" that would restore the reductions at the 2024 Governor's Budget if it is determined that sufficient funds will be available to cover certain commitments. These commitments include: baseline adjustments, enrollment, caseload, and population adjustments, constitutional obligations, as well as the cost of funding all of the items included in the trigger. These items are primarily in the areas of Climate and Transportation

($3.1 billion), Housing ($600 million), Parks ($106 million) and Workforce Training ($55 million).

- ***Limited Revenue Generation and Borrowing—$1.2 billion.*** The Budget augments General Fund resources in the 2023-24 fiscal year. The majority of the funds in this category are derived from loans from special funds and from the renewal of the Managed Care Organization Tax.

In addition to solving the $22.5 billion shortfall, the Budget utilizes a number of the resiliency measures in the 2022 Budget Act to close shortfalls projected in the coming years. These include:

- ***Future Inflationary Adjustments Withdrawn***—In addition to the $3 billion referenced above for the 2023-24 fiscal year, $7 billion to address inflationary adjustments, which were scheduled over 2024-25 and 2025-26, are now withdrawn.
- ***General Obligation Bond Liability***—$1.7 billion in General Fund, which had been scheduled in 2024-25 to reduce General Obligation bond liability through the redemption of callable bonds, is now withdrawn.
- ***Lease Revenue Bonds Liability***—$2.1 billion in General Fund had been scheduled to reduce lease revenue bond liability in 2022-23 through 2025-26. This amount is reverted back to lease revenue bond funds to pay for capital projects.
- ***Supplemental Deposits to Budget Stabilization Account***—$4 billion in supplemental deposits to this reserve account had been scheduled over 2024-25 and 2025-26. These are now withdrawn.
- ***Additional Safety Net Reserve Deposits***—$4 billion in additional deposits to the Safety Net Reserve had been scheduled in 2024-25 and 2025-26. These are now withdrawn.

SUSTAINING KEY INVESTMENTS WHILE CLOSING THE BUDGET GAP

Even with the decisions necessary to close the budget gap in 2023-24, the Governor's Budget sustains key investments in recent budgets to advance the shared priorities of the Governor and the Legislature.

- ***Implementing Transitional Kindergarten***—The 2022 Budget Act included funds for the first year of expanded eligibility for transitional kindergarten, which covers the shift from all children turning five-years-old between September 2 and December 2 to all children turning five-years-old between September 2 and February 2. Building upon these first-year investments, the Budget includes $690 million to implement the second year of transitional kindergarten expansion, which will increase access to the program to all children turning five-years-old between September 2 and April 2 (approximately 46,000 children) and $165 million to support the addition of one additional certificated or classified staff person in transitional kindergarten classrooms serving these students. Full implementation of universal transitional kindergarten is expected in 2025-26.

- ***Child Care Availability and Affordability***—The Budget sustains over $2 billion annualized to expand subsidized child care slot availability.
- ***Universal School Meals***—In 2020, the U.S. Department of Agriculture allowed states to apply for a waiver of certain requirements connected to the National School Lunch Program and School Breakfast Program. The Budget protects the funding for universal access to subsidized school meals and the additional enhanced meal rate. California will spend over $1.4 billion to reimburse school meals and ensure all students who want a meal will have access to two free meals each day.
- ***Maintaining Higher Education Compacts and Roadmap***—The Budget sustains the second year of the multi-year compacts with the University of California (UC) and the California State University (CSU), and a multi-year roadmap with the California Community Colleges (CCCs). Despite the state's fiscal climate, the Administration remains committed to the shared goals of increasing access to the UC and CSU, improving student success while advancing equity, increasing the affordability of higher education, increasing intersegmental collaboration to benefit students, and supporting workforce preparedness and high-demand career pipelines.
- ***Advancing the Climate Agenda***—The 2021 and 2022 Budget Acts allocated approximately $54 billion over five years to advance the state's climate agenda. The Budget maintains 89 percent of these investments (approximately $48 billion) and continues to prioritize equity and investments in populations facing disproportionate harm from pollution and the climate crisis. Given the projected decline in General Fund revenues, the Budget includes reductions across several climate programs, which are partially offset by shifts to other fund sources. Additionally, the state will pursue additional federal funding through the Inflation Reduction Act and the Infrastructure Investment and Jobs Act. Most of the climate reductions are included in the trigger so if there is sufficient General Fund in January 2024, these reductions will be restored.
- ***Expanding Health Care Access and Health Care Delivery Transformation***—The Budget maintains continued funding to expand full-scope Medi-Cal eligibility to all

income-eligible Californians, regardless of immigration status. Additionally, the Budget sustains approximately $10 billion in total funds commitment to continue transforming the state's health care delivery system through California Advancing and innovating Medi-Cal.

- ***Greater Assistance For California's Most Vulnerable***—The Budget includes over $1 billion General Fund annually to provide increased cash assistance to individuals with disabilities and older adults in the Supplemental Security Income/State Supplementary Payment program, and low-income children and families in the CalWORKs program.
- ***Expanding the Behavioral Health Continuum***—The Budget sustains over $8 billion total funds across various multiple Health and Human Services departments to expand the continuum of behavioral health treatment and infrastructure capacity and transform the system for providing behavioral health services to children and youth.
- ***Improving Services for the Developmentally Disabled***—The Budget sustains an estimated annual $1.2 billion General Fund by 2024-25 to fully implement service provider rate reform with a focus on improving outcomes and quality of services.
- ***Reproductive Health Services***—The Budget maintains the over $200 million investments to protect the right to safe and accessible reproductive health care, including grants to health care providers to offset the cost of care to uninsured or underinsured individuals, for clinical infrastructure, and to provide scholarships and loan repayments to providers that commit to providing reproductive health care services. Further, the Budget adds $200 million ($15 million General Fund) in 2024-25 for a grant program focused on supporting access to family planning and related services, system transformation, capacity, and sustainability of California's safety net.
- ***Investments in Infrastructure***—The Budget sustains a multi-year commitment of $44 billion in state funds for various statewide infrastructure investments. This includes funding to accelerate the transition to zero-emission vehicles, modernize the state's transportation system, promote energy innovation and reliability, provide greater access to broadband connectivity, advance the state's housing goals, reduce wildfire risk to communities, and to support drought resiliency and response.
- ***Investments in Housing***—Given the scale of California's housing backlog and need, the state has invested billions in the past two years for housing production incentives, with 2021 and 2022 Budget Act housing packages totaling $21.5 billion combined. Importantly, the state has continued to deploy a comprehensive set of

strategies, including improving existing state financing programs, targeting housing investments, providing technical assistance to rural, tribal, and urban areas, and leveraging land use tools. The Budget includes $350 million in General Fund reductions related to housing programs that were included as part of the 2022 Budget Act. Even with these reductions, funding for these housing programs would remain at approximately 88 percent of the allocations made in 2022-23 and 2023-24 ($2.85 billion). These reductions are included in the trigger, so if there is sufficient General Fund in January 2024, these reductions will be restored.

- ***Investments in Homelessness***—The 2022 Budget Act allocated $10.2 billion, in addition to the $7.3 billion provided in 2021, signifying a continued priority in providing investments to support the state's comprehensive homelessness strategy, including resources to provide long-term permanent housing options, services, and supports for individuals experiencing homelessness, or who are at risk of experiencing homelessness. The Budget maintains these investments.
- ***Continuing Workforce Development***—The 2022 Budget invested approximately $2.2 billion General Fund to create additional apprenticeships; provide training to mitigate the effects of climate change; provide job training and other assistance to the justice-involved population; and create more innovative and accessible opportunities to recruit, train, hire, and advance an ethnically and culturally inclusive health and human services workforce. The Budget reduces $55 million of these investments. However, these reductions are included in the trigger, so if there is sufficient General Fund in January 2024, they will be restored.
- ***Combatting Organized Retail Theft and Other Crimes***—The Budget sustains $564.4 million General Fund over three years to bolster local law enforcement efforts to address retail theft and other crimes. These investments help local law enforcement agencies implement anti-theft task forces, improve prosecution, expand Department of Justice and California Highway Patrol anti-crime and retail theft taskforces, expand drug interdiction and combat fentanyl prevalence, improve emergency response times, combat human trafficking and child sexual exploitation, support programs to remove and dispose of firearms and provides resources to research to inform policies that address the ever-evolving firearms market.

Conclusion

Through strong fiscal planning, California's Budget can protect core programs and still build a California for today and the future. Due to the work that the Governor and the Legislature have done to plan for a revenue shortfall such as this one, the Budget is able to maintain the majority of recent commitments, including continuing to build upon programs and services that the most vulnerable populations rely even more heavily upon during economic downturns.

However, considerable risks to the economy remain. In particular, if the economy slips into a recession in the coming months, there will be more difficult decisions ahead. The Administration has taken steps in this Budget, such as not using the state's reserves, to ensure there is additional capacity to protect the programs and services that California residents rely upon, AND build a California for the future that continues to be a national and world leader in combating the effects of climate change, elevating diversity and inclusion, improving innovation, and protecting the rights of all of our residents. That is the California way.