INTRODUCTION

California has led the nation in recent years by making transformative investments that will continue to benefit the state well into the future. Progress is demonstrable—by providing universal access to transitional kindergarten, universal school meals, ensuring all students in kindergarten through second grade are screened for reading difficulties, allowing more college students access to financial aid, providing historic increases to the California State University and the University of California, making unprecedented investments to combat climate change, address housing needs, prevent homelessness, enhance safety net programs, and improve public safety. The future of California is brighter, cleaner, and safer because of the investments made in California, thanks to the work by this Administration and the Legislature.

It is upon this foundation of progress that California begins a new year with a Governor's Budget that reflects a benefit, a cost, and a challenge:

- The benefit of a welcome surge in state revenues in 2025 that reflects a boost in the overall revenue outlook.
- The additional near-term costs imposed on California by federal tax legislation as well as unknown future costs to the state's economy from higher tariffs and restrictive immigration policy.
- The challenge and imperative of balancing the budget not only for the coming fiscal year but for the following year as well.

The Budget forecast reflects General Fund revenues that are higher by more than $42 billion over the budget window, from 2024-25 through 2026-27, than projected at the 2025 Budget Act—an increase driven by higher cash receipts, higher stock market levels, and an improved economic outlook. At the same time, however, constitutional funding requirements, the need for an adequate discretionary budget reserve, and higher program costs are additional commitments that exceed the level of increased revenues, resulting in a modest projected shortfall of $2.9 billion. As a result, the Budget does not include new significant spending proposals. Instead, the Budget focuses on the continued implementation of previous investments.

BALANCING FOR TWO BUDGET YEARS

Both during and after the COVID-19 Pandemic, California experienced significant revenue volatility. For example, in 2021, capital gains as a percent of personal income spiked to an all-time high of 11.6 percent, contributing to a surge in General Fund revenues. The following two years saw a significant revenue decline, as capital gains as a percent of personal income dropped to 4.1 percent by 2023. At the same time, this volatility was compounded in 2023 by the disaster-driven delay in income tax filings to November, affecting over 99 percent of California taxpayers.

Coming out of that period, even as revenues increased and approximately $12 billion in ongoing expenditure reductions were included in the 2025 Budget Act, the state continues to be confronted with structural operating deficits. Given the actions required to address the revenue declines experienced in 2022 and 2023, and the budget pressures and uncertainty caused by the current federal government, the state must take meaningful steps to address the structural imbalance in the budget.

While the Budget is balanced in the 2026-27 fiscal year, with a discretionary reserve of $4.5 billion, it projects a deficit of roughly $22 billion in the 2027-28 fiscal year and shortfalls in the two years following. The Administration intends to build on this budget proposal in May with a revised plan—reflecting updated revenue and spending data—that balances the Budget in both the 2026-27 and 2027-28 fiscal years with adequate budget reserves.

RISKS TO THE BUDGET

While the significant revenue increase since the 2025 Budget Act is encouraging, it is important to recognize that much of this surge is attributable to a relatively small

number of technology companies that have experienced a substantial increase in their share prices due to investor enthusiasm in artificial intelligence. Given the outsized effect that technology companies' stocks have on personal income tax revenues, history indicates that these surges cannot be sustained indefinitely at such high levels. As such, the dominant risk to the Budget is stock market and asset price declines—shocks that disproportionately impact high-income earners. Unpredictable federal policies, including continued uncertainty regarding tariffs and immigration, as well as their impact on inflation, the labor market, investment, and overall demand, are another risk to the budget.

FEDERAL POLICY CHANGES

House of Representatives (H.R.) 1 of 2025 included significant federal policy changes for Health and Human Services programs that are projected to result in costs of $1.4 billion General Fund in 2026-27. Of this amount, $1.1 billion in additional costs are in Medi-Cal—California's Medicaid program that provides health care services for more than 14 million low-income Californians. In addition, H.R. 1 will add nearly $300 million in costs to CalFresh—the state's Supplemental Nutrition Assistance Program providing food purchase assistance for adequate nutrition to more than 3 million California households. These costs are in addition to the natural growth in program cost and caseload since the 2025 Budget Act. see the Health and Human Services Chapter for more information.

A BALANCED 2026-27 BUDGET THAT MAINTAINS RESERVES

Since the approval of Proposition 2 in 2014, the Budget Stabilization Account (BSA) has been a key component of budget resiliency, a buffer against revenue volatility, and an insurance policy that has protected core state programs. Also known as the "Rainy Day Fund," it annually receives a deposit of 1.5 percent of General Fund tax revenue as well as a portion of General Fund revenues that result from capital gains.

Over the last two fiscal years, the state has withdrawn approximately $12.2 billion from the BSA and suspended deposits into the BSA for the 2024-25 and 2025-26 fiscal years. These actions have allowed the state to take a balanced approach by using a portion of these reserves as one component in closing prior budget shortfalls.

Consistent with these actions, the Budget suspends a $2.8 billion "true-up" deposit into the BSA in 2025-26. However, the Budget reflects a BSA deposit in 2026-27 of approximately $3 billion and a minor "true-up" for fiscal year 2024-25. After accounting

for these actions, the BSA balance in 2026-27 is $14.4 billion—an increase compared to the 2025 Budget Act level of $11.2 billion.

In addition to this reserve amount, the Budget includes $4.5 billion in the Special Fund for Economic Uncertainties and $4.1 billion in the Public School System Stabilization Account—bringing the combined amount of reserves in 2026-27 to roughly $23 billion.

MAJOR ACCOMPLISHMENTS AND HISTORIC PROGRESS

Over the past seven years, the state has made unprecedented investments and enacted transformational policies through various Budget Acts that will benefit Californians for generations to come. These budget investments and accomplishments are included in the following chapters. Highlights include:

- **Child Care Slot Expansion**—Since 2020-21, the state has invested over $3.6 billion in additional General Fund to increase access to child care and development services, improve affordability for families, support the child care workforce, and strengthen capacity, including funding approximately 125,000 new subsidized child care slots.
- **Pre-K for All**—California has created universal access to free transitional kindergarten for all four-year-olds (over 400,000 children, 300,000 more than in 2021-22), with increased access to the California State Preschool Program for two-, three-, and four-year-olds.
- **Higher Education Compacts**—In spring 2022, the Administration entered into multi-year agreements known as Compacts with the University of California (UC) and the California State University (CSU) and the Roadmap with the CCC. These agreements focus on shared student-focused priorities, especially for resident students, such as increasing access to the UC and CSU, enhancing student success and advancing equity, making higher education more affordable, increasing intersegmental collaboration to benefit students, and supporting workforce preparedness and high-demand career pathways.
- **College Affordability**—Since 2018-19, CSU has increased the number of students graduating without any student loan debt from 53 percent to 65 percent, and UC has increased the number of students graduating without any student loan debt from 54 percent to 65 percent. The number of students receiving state financial aid increased from 429,306 in 2018-19 to 871,292 projected in 2025-26.

- **Climate Change**—$39.1 billion ($23.9 billion General Fund) has been dedicated to a portfolio of climate investments that reduce greenhouse gas emissions, including clean energy and transportation projects, and strengthen the state's resilience to the impacts of climate change, such as wildfires, floods, and droughts.
- **Wildfire Surge Capacity**—$1.5 billion General Fund ongoing has been dedicated and 5,237 positions have been created to expand the state's ability to respond to catastrophic wildfires, including $770.4 million and 2,457 positions for full implementation of the 66-hour work week in 2028-29.
- **Behavioral Health Continuum**—The state has invested over $10 billion total funds across various 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.
- **Developmental Services Rate Reform**—The 2021 Budget Act initiated the phased-in developmental services provider rate reform, with a focus on improving quality of service outcomes and addressing disparities within the system. At full implementation, the Budget is estimated to include approximately $3.5 billion ($2.1 billion General Fund) annually.
- **Housing and Homelessness Agency**—The Governor's Reorganization Plan established a dedicated state housing and homelessness agency to institutionalize the state's progress both now and over the long term. The new Agency will integrate housing programs, advance and protect civil rights, and simplify the administration of affordable housing programs.
- **Improving Public Safety**—California has invested approximately $2.1 billion ($1.8 billion General Fund and $300 million special funds) in various public safety efforts since 2021-22—including $194.6 million in 2026-27—in recognition of the importance of keeping Californians safe.
- **Clean California**—The Clean California program began in July 2021 with $1.2 billion in one-time funding as a transformative initiative to remove litter, create jobs, and beautify California. Since its implementation, along with clearing more than 3.4 million cubic yards of litter, Clean California has supported local art installations, new or ungraded recreational venues, and aesthetic improvements to shared public spaces.
- **Technology Modernization**—California has invested over $10 billion to accelerate the digital transformation of services, including Broadband for All, Technology Modernization and Stabilization, Cybersecurity, Generative AI and large scale IT

Project Implementation at the Franchise Tax Board, Department of Motor Vehicles, and Employment Development Department, making government operations more efficient, accessible, and effective for all Californians.

- **California Jobs First**—A total of $450 million General Fund has been allocated for California Jobs First. This initiative has produced the first statewide economic development strategy in 20 years, supported the development of 13 regional economic development strategies, driven investments into 260 early stage projects, and funded 11 ready-to-go projects that are expected to create upwards of 23,000 well-paying jobs.
- **Support for Small Businesses**—Over $4.8 billion General Fund has gone to the California Office of the Small Business Advocate (CalOSBA) since January 2019 to support California's 4.3 million small businesses and nonprofit entities.
- **California Earned Income Tax Credit (CalEITC) Expansion and Creation of the Young Child Tax Credit and the Foster Youth Tax Credit**—This Administration significantly expanded the CalEITC program from $400 million in 2019 and additionally created the Young Child Tax Credit and the Foster Youth Tax Credit to provide over $1.4 billion in relief by 2024 across the three programs to low-income families, families with young children, and former foster youth.