INTRODUCTION

The Governor's Budget was developed against the backdrop of an extraordinarily strong economy. As 2020 begins, California's economy is the strongest in the nation, with a gross domestic product (GDP) of nearly $3 trillion, representing the fifth largest economy in the world.

California's economic growth has fueled the nation's economy, which has been growing for a record 126 months. The state's unemployment rate is now at 3.9 percent, down from a peak of 12.2 percent during the Great Recession. The state's average annual real GDP growth of 3.8 percent has beaten that of Texas and Florida, and California is first in the nation in new business starts, venture capital, and manufacturing.

Even with California's strong economy, continued growth is uncertain due to the instability in global economic markets and the nation's political climate. Further, the state's strong economy has not lifted all Californians. Economic inequality persists between regions of the state and for many living within the state's more prosperous regions.

Building on the 2019 Budget Act, the Budget continues to build reserves and promotes a more effective government that can withstand a downturn in the economy, as well as emergencies and disasters. It squarely addresses the affordability crisis that too many Californians experience and continues unprecedented investments in promoting opportunity. The Budget continues to reflect the principle that maintaining a balanced budget and strong budget resiliency is non-negotiable and a necessary predicate for expanding programs, especially with the growing risks facing the state.

Last year, the Budget took steps to reduce the cost of prescription drugs, made a major investment to lower housing costs by spurring more housing development, and expanded the Earned Income Tax Credit (EITC) to provide an economic boost to working families and reduce childhood poverty. The Budget builds on these efforts by adding new proposals to address the affordability of health care and housing, support the increase in the state's minimum wage to $13 per hour, and make bold steps to promote opportunity from cradle to career.

The Budget continues to tackle two persistent problems facing California: risks caused by climate change, including wildfires, and providing safe, reliable, affordable, and clean energy given the climate change impacts on utilities; and the increase in people living on the streets that affects communities throughout the state. Building on an investment of $1 billion last year, the Budget tackles the root causes of homelessness with new approaches to expand affordable and supportive housing and to improve the state’s behavioral health system.

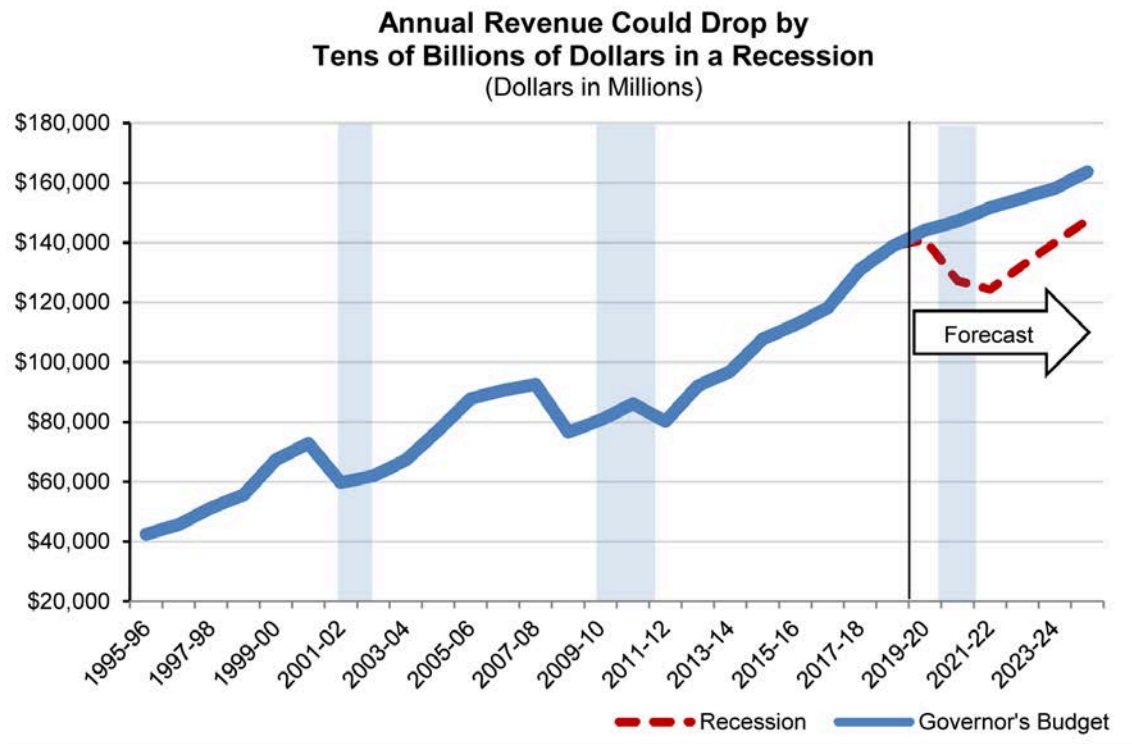
The Budget also promotes effective government by enhancing California’s ability to prevent and respond to emergencies, and continues critical work to bring government services into the digital age, including enhancing California’s ability to prevent and respond to cyber threats.

STRONG FOUNDATION, BUT INTENSIFIED RISKS

Now in its eleventh year, the nation's economic expansion marks the longest period of sustained growth since World War II. However, this expansion is occurring in the context of slowing global growth and growing uncertainty regarding the political climate and federal policies. State revenue growth is projected to be slower in each of the next four years compared to 2019-20, constraining new spending commitments.

In 2019, the state enacted a budget that committed the bulk of available resources to build reserves and pay down budgetary debts and unfunded liabilities. As a result, California is in a stronger fiscal position, with robust reserves.

The state is prepared for an economic downturn with reserves of $21 billion. Even with these reserves, managing a recession will be challenging, as even a moderate recession could result in revenue declines of nearly $70 billion and a budget deficit of over $40 billion over three years.



To promote a more effective government that is able to withstand a slowing economy, the 2019 Budget Act was structurally balanced in each fiscal year through 2022-23. This was accomplished in part with statutory provisions to suspend nearly $2 billion in programmatic expansions on December 31, 2021.

While the state is currently projected to have reserves to cover the suspended programs through 2023-24, significant risks to the forecast remain. To maintain structural balance through 2023-24, the Budget proposes to continue the suspensions added by the 2019 Budget Act, but delays them by 18 months until July 1, 2023.

The forecast assumes federal approval of the Managed Care Organization tax authorized in Chapter 348, Statutes of 2019 (AB 115) with revenues beginning to accrue in 2021-22. With these revenues, the Budget is projected to remain structurally balanced through 2023-24.

In this Budget, as with last year’s, the majority of the surplus is devoted to one-time spending. This approach enables the state to make significant investments in critical areas while also maintaining reserves.

ADDRESSING THE AFFORDABILITY CRISIS

HEALTH CARE COST CONTAINMENT

California continues to be a national leader in health care, but more needs to be done to advance health care affordability and universal access to health care for all Californians. The 2019 Budget Act reduced health care costs for individuals and families by stabilizing the individual insurance market, saving money on prescription drugs, and adding subsidies for more middle-class Californians. This year, the Administration will pursue new initiatives to increase price transparency, address hospital cost trends by region with a particular focus on increases driven by consolidation, and reduce unnecessary administrative costs by increasing the use of technology and value-based reimbursements. In these efforts, the Administration will focus on returning cost savings to consumers and employers. The Administration will also strengthen California's existing public option for health insurance to promote choice and affordability.

The Budget continues work to reduce prescription drug costs for taxpayers, employers, and consumers by expanding the state's ability to consider the best prices offered by manufacturers internationally, negotiate additional supplemental rebates, and increase the state's purchasing program to further consolidate the state's purchasing power. This spring the Administration will propose to establish a single market for drug pricing within the state, as well as the state's own generic drug label.

The Budget also expands full-scope Medi-Cal coverage to low-income undocumented Californians aged 65 and above. This investment moves the state towards universal coverage, which will further the state's cost containment goals.

HEALTHIER CALIFORNIA FOR ALL

The Budget proposes to transform Medi-Cal to achieve a healthier California with the Medi-Cal Healthier California for All initiative. It is designed to move Medi-Cal to a more consistent and seamless system by reducing complexity and increasing flexibility, identifying and managing member risk and needs through enhanced care, and addressing social determinants of health.

In its last federal demonstration waiver, the state piloted a whole person care approach to better integrate services and treatment, and more effectively address social determinants of health. Medi-Cal Healthier California for All will build on that progress by pursuing structural changes to the state’s behavioral health delivery system and expanding statewide wraparound services, such as housing and social services. The initiative will also make additional investments in prevention through incentives to provide a broader range of services including preventive dental care. These steps will position the state's Medi-Cal system to better connect individuals—including children and youth in foster care, individuals experiencing homelessness, individuals with substance use disorders, and individuals involved in the justice system—to the services they need.

The Budget also includes funding to support counties in implementing the changes necessary for transformation of the county-run behavioral health and substance use disorder systems.

HOUSING

After decades of underproduction, Californians continue to face a staggering housing crisis. The 2019 Budget Act included $1.75 billion to increase housing supply, including funding to local governments for planning and infrastructure, an investment in the state's housing loan program, and an expansion of state housing tax credits. The Administration also launched an effort to reuse excess state properties for innovative housing projects and worked to leverage additional capital from the private sector to build more housing.

The Budget authorizes $500 million annually for the state's housing tax credit program. It continues to support the Administration's efforts to spur housing development by significantly increasing the number of excess state properties used for housing development, pursuing additional capital from the private sector for housing development, and revamping the state's regional housing goals. In addition, the Administration is streamlining state processes to accelerate housing production. The Administration is also committed to working with the Legislature on additional actions to expedite housing production, including changes to local zoning and permitting processes, as well as adding predictability and reducing the costs of development fees.

Last year, the state passed the strongest renter protections in the nation, which addresses two key causes of the housing crisis: price gouging and evictions. Beginning January 1, 2020, annual rent increases may not exceed 5 percent, plus inflation, and renters are protected from discriminatory and retaliatory evictions without cause.

Finally, the Administration continues work in accordance with Chapter 669, Statutes of 2019 (SB 113) to establish a trust with $331 million that will provide borrower relief and support housing counselors or other legal aid agencies in representing homeowners and renters in housing-related matters.

PROMOTING OPPORTUNITY

EARLY CHILDHOOD

Over the long term, the Administration is committed to building a universal preschool system and a comprehensive, quality, and affordable child care system for California. To this end, the Administration is continuing development of a Master Plan for Early Learning and Care that will provide a roadmap for implementing this commitment. The Plan will be completed by October 1, 2020. The Budget builds on the historic investments made last year to expand access to child care, preschool and full-day kindergarten, with funding for 10,000 additional full day/full year preschool slots, moving the state closer to its goal of universal preschool for all income-eligible four-year-olds.

Reducing childhood poverty and health disparities is critical to improving outcomes for children. The Budget builds on major investments made last year to expand the EITC and increase California Work Opportunity and Responsibility to Kids (CalWORKs) grants by increasing the amount of child support payments retained by families on CalWORKs. The Budget also proposes to develop a new adverse childhood experiences cross-sector training program with the goal of reducing adverse childhood experiences and toxic stress by half in a generation.

The 2019 Budget Act expanded the Paid Family Leave benefit duration from six to eight weeks—moving two-thirds towards the goal of six months of paid family leave for two parents to bond with a new child. The Budget builds on this expansion by proposing to extend job protections to more employees, thereby expanding the number of families that can take advantage of this benefit.

Finally, the Administration is proposing to establish a new Department of Early Childhood Development under the Health and Human Services Agency effective July 1, 2021. This new department will better position the state to implement recommendations from the Master Plan for Early Learning and Care, and allow for better integration of services and outcomes for children in child care and other health and human services programs.

K-12 EDUCATION

The Budget proposes a historic level of funding for K-12 schools. Per pupil funding has grown by more than $7,200 since its low point in 2011-12 and achievement gaps are closing for many students. Since the implementation of the Local Control Funding Formula, new standards, and the new accountability system, the state has seen some of the nation's steepest gains in reading and math, and achievement gaps are starting to close for low-income children and children who enter school as English learners. However, achievement gaps are not closing broadly for students with disabilities and African American students.

To further strengthen the state's accountability system, the Administration is proposing additional changes to the Local Control Accountability Plan to improve transparency of how funds are expended for high-need student groups, and to require local educational agencies to identify actions and spending that did not occur as planned.

The state has a well documented, long-term, statewide teacher shortage in the areas of special education, science, and math. Certain regions of the state, including rural and high cost-of-living areas, have been more heavily impacted than others and report difficulty hiring fully credentialed teachers regardless of subject matter area. Recent studies link poor student outcomes directly to a high proportion of un-credentialed and underprepared teachers, especially in high-poverty schools. Most African American students are concentrated in only 23 districts and are in the highest poverty schools where there are fewer experienced teachers. To improve the number of prepared teachers in the state's high-poverty schools, the Budget proposes an investment of approximately $900 million in teacher training, including professional development, educator service awards, and teacher residency programs. These investments will increase and improve the teacher workforce, which is foundational to improving student outcomes.

The 2019 Budget Act began a multi-year effort to reform the special education system to improve outcomes and incentivize inclusive models, prevention, and early intervention. The Budget builds on the new base rate funding provided last year with an additional $250 million ongoing focused on early intervention. The teacher training investments will also focus on training for special education teachers, including early diagnosis of dyslexia.

The Budget also includes $300 million one-time for grants and technical assistance to prepare and implement improvement plans at the state's lowest-performing schools, and includes $300 million one-time for grants to develop community school models with innovative partnerships that support mental health and the whole child.

To better prepare California students for high-technology careers, the Budget makes critical investments in computer science instruction, including teacher training.

School nutrition programs play a critical role in supporting health outcomes for children. The Budget includes a 40-percent increase in state funding for school nutrition programs to boost the quality of meals provided and to expand access. The Budget also includes $10 million for grants to foster innovative farm-to-school linkages that support sustainable agriculture and make more healthy foods available to school children.

Local educational agencies will also continue to benefit from the massive $3.15 billion non-Proposition 98 General Fund payment made on their behalf to the California State Teachers' Retirement System (CalSTRS) and the California Public Employees' Retirement System (CalPERS) Schools Pool. An estimated $850 million is buying down the employer contribution rates in 2019-20 and 2020-21 and the remaining $2.3 billion is being paid toward long-term unfunded liabilities. Overall, these payments are expected to save schools $6.9 billion over the next three decades.

HIGHER EDUCATION

Higher education continues to be a driving force of innovation in California's economy. However, the state's colleges and universities must continue to evolve and adapt to the changing needs of the state's economy. Further innovation and integration is needed across the state's higher education system to strengthen occupational pathways that also improve students' social and economic mobility.

The 2019 Budget Act included major investments in higher education that provided two years of tuition-free community college and increased enrollment and investments to improve student success across all segments. The Budget further expands enrollment, increases student supports, and encourages degree completion through innovative delivery methods, including University Extension centers.

JOBS, THE ECONOMY, AND PROTECTING THE ENVIRONMENT

More businesses start in California than anywhere in the United States, including many green technology businesses. Many of California's businesses become industry leaders. This is a direct result of the state's world-class colleges and universities, state-of-the-art laboratories, talented workforce, and commitment to combatting climate change. Further, the state continues to move towards a $15 per hour minimum wage by 2023. The Budget reflects the next $1 increase in the state's minimum wage, bringing it to $13 per hour for most employees on January 1, 2020.

Income inequality persists and prosperity is not shared by all regions of the state. Last year, the Governor established the Future of Work Commission to create inclusive, long-term economic growth so that workers and their families share in the state's prosperity. The Commission is examining ways to broaden opportunity, better prepare the state's workforce, modernize worker safety net protections, and preserve good jobs. The Commission will bring forward a set of recommendations later this spring.

Rapid advancements in technology, automation, and artificial intelligence are reshaping the economy and the nature of work, and the state needs to better align data, policy, and program analysis for the state's workforce training programs. The Budget includes funding to establish a new Department of Better Jobs and Higher Wages to consolidate the workforce functions currently dispersed across the Labor and Workforce Development Agency.

In recognition of the important role that small businesses play in the creation of jobs and regional economic development, the Budget also proposes to reduce the minimum franchise tax for small businesses, removing a barrier to entrepreneurship and job creation.

The Budget proposes major investments in Inland California communities that face higher unemployment and create fewer jobs in high-wage sectors. The Budget allocates additional ongoing funding to expand enrollment and increase operational support for the UC Riverside School of Medicine and to expand the UC San Francisco School of Medicine Fresno Branch Campus in partnership with UC Merced. The Budget also includes funding for a major new food innovation corridor in the Central Valley. This collaboration between academic institutions and industry will spur economic development in a region of the state that for decades has faced nearly double the unemployment rate of the entire state.

The Budget proposes a comprehensive approach to California's investments to protect the state's environment, address the effects of climate change, and promote resiliency. This Climate Budget includes $12 billion over the next five years. Three key areas of the Climate Budget are a proposed climate resilience bond, Cap and Trade expenditures to continue the transition to a carbon-neutral economy, and a new Climate Catalyst Fund to promote the deployment of new technologies, especially by small businesses and emerging industries.

The Climate Catalyst Fund, which will be administered by the Infrastructure and Economic Development Bank, will finance investments in low-carbon transportation, sustainable agriculture, and waste diversion through low-interest loans. The Budget proposes to capitalize the Fund with $1 billion General Fund over the next four years. The Fund will have a revolving loan structure that will leverage private capital and will support projects well into the future. It will be designed to support good jobs and a just transition to achieving California's climate goals.

Finally, the Budget allocates $53 billion to the state's infrastructure over the next five years, focusing on investments that underpin economic activity and create a sustainable and resilient California.

CRIMINAL JUSTICE

The Budget continues recent significant progress in creating a more effective, rational, and equitable criminal justice system. As a result of Public Safety Realignment in 2011, Propositions 47 and 57, and other efforts, California has significantly reduced its prison population. At the same time, it has created more incentives for inmates to participate in rehabilitation programs. If population trends hold, the Administration plans to end private prison contracts for male inmates this year, to phase out public prison contracts thereafter, and to close a state-operated prison within five years.

The Budget builds on important steps taken last year, including shifting juvenile justice to focus on rehabilitation and reentry, investing in restorative justice, community-based violence prevention, substance use disorder treatment, prison literacy, and pretrial diversion.

The Budget proposes to continue expansion of opportunities for rehabilitation and treatment—starting with the youngest offenders in state prison. The Budget proposes to cluster the 5,800 young offenders (under age 26) into campus-style environments within existing facilities, with specialized programming and educational opportunities. The Budget also includes a major investment in technology for inmates participating in academic programs and expanded access to higher education programming through partnerships with the California State University system.

A critical component of a well-functioning correctional system is a professional, well-trained workforce. Correctional officers and counselors play an especially important role in the rehabilitation efforts of inmates. The Budget includes a major proposal to enhance staff development through a new training facility and training program for correctional officers and counselors.

The Budget also proposes evidence-based reform of the probation system that will include reducing probation terms to a two-year maximum and increasing supervision for specified misdemeanors. These changes will improve public safety and reduce further incarceration.

Recognizing the financial hardship certain fines and fees have created for low-income individuals, the Budget includes resources to establish a statewide ability to pay program within the trial courts for both traffic and non-traffic infractions.

EMERGENCY RESPONSE AND EFFECTIVE GOVERNMENT

EMERGENCY RESPONSE

The 2019 Budget Act included nearly $1 billion to enhance the state's emergency response capabilities. The Budget builds on this foundation with investments that further strengthen California’s ability to prevent and respond to fires, and that provide the state’s first responders with additional capabilities and support.

The Budget enhances the Department of Forestry and Fire Protection’s operational capabilities by adding firefighter surge capacity during peak fire season, increasing the number of year-round engines, and providing further relief coverage to support state firefighter health and wellness. The Budget also increases the use of technology by obtaining Light Detection and Ranging (LiDAR) data to better inform resources management and hazard assessment decisions, and establishes a new Wildfire Forecast and Threat Intelligence Integration Center to analyze data on wildfire risk.

The Budget also devotes significant new resources to further improve cyber security. Building on recent initiatives, the Budget expands the California Cyber Security Integration Center and supports a full-time Joint Incident Response team for cyber threats. These investments offer additional protection in a time of growing cyber risks and enhance the state’s emergency capabilities across all areas.

HOMELESSNESS CRISIS

Homelessness is an issue that impacts both urban and rural communities throughout the state, and puts stress on public resources from emergency rooms to jails and public works departments. It is a complex social services problem and must be combatted at its root causes, which is why the Budget introduces several new strategies to build on the $1.15 billion provided to local governments in the last two budgets.

The Budget proposes a radical shift in the state's involvement to house the many unsheltered persons living in California, by launching the California Access to Housing and Services Fund with a $750 million initial investment. This Fund will create a structure for developing affordable housing units, supplementing and augmenting rental subsidies, and stabilizing board and care homes. Funds will flow through contracts between the state and regional administrators and will be subject to a 10-percent administrative cap. These efforts will be coordinated with county services and designed to align to community needs. To the extent feasible, state funding will be coupled with the use of excess state properties to expedite availability of homelessness housing capacity. The Administration is asking the Legislature to take early action to establish this Fund so investments can be deployed this summer.

The changes proposed in the Medi-Cal Healthier California for All initiative will also contribute to addressing the homelessness crisis by transforming the Medi-Cal system to better serve individuals experiencing mental illness and homelessness. The Administration will also work to reform the state's behavioral health system, including changes to the Mental Health Services Act (Proposition 63) to better focus it on early intervention and people with mental illness who are also experiencing homelessness, or are involved in the criminal justice system, as well as strategies to strengthen enforcement of behavioral health parity laws.

SAFE, RELIABLE, AFFORDABLE, AND CLEAN ENERGY

Addressing the destabilizing effects of catastrophic wildfires on the state's electric utilities has been a primary focus of the Administration, which took decisive action in 2019 to more effectively prevent and fight fires, partnered with the Legislature to enact Chapter 79, Statutes of 2019 (AB 1054)—wildfire safety and utility transformation legislation—and assumed a leadership role in the resolution of the Pacific Gas & Electric (PG&E) bankruptcy. These efforts have paid off, stabilizing Southern California Edison and San Diego Gas & Electric, supporting investments in hardening electricity transmission at a lower cost to ratepayers, and making California safer and more resilient.

The state's goals are clear. Californians must have access to safe, reliable, affordable, and clean energy. California must continue to make progress on the state's climate change goals. And any resolution of the pending bankruptcy proceeding must fairly compensate victims, protect the workforce, and on average must be ratepayer neutral.

After PG&E's decades of mismanagement and neglect of its critical infrastructure, failed efforts to improve its safety culture, and its disruptive implementation of public safety power shutoffs, the company that emerges from bankruptcy must be poised for transformation as required by AB 1054. The Budget reflects necessary support for the Administration's efforts to achieve the required transformation of PG&E within the bankruptcy process. However, if protecting Californians' interests and ensuring the necessary transformation requires further intervention, including a state takeover of the utility, the Administration will work with the Legislature to secure necessary statutory changes, appropriations to support transactional and planning costs, and liquidity measures. Consistent with the Administration's commitment to maintain a balanced budget and strong fiscal resiliency, any such action would be carefully structured in a manner that safeguards the state's General Fund.

EFFECTIVE GOVERNMENT

The state continues to improve the way it delivers services and invests in technology. The 2019 Budget Act included a major investment in a new Office of Digital Innovation that is charged with revamping the way government delivers service to Californians. This includes driving a customer-focused culture and providing additional information technology training across state government.

The Administration also continues major improvements at the Department of Motor Vehicles, including additional staffing and operational improvements to develop more mobile and online transaction capabilities and to make critical information technology improvements.

The Budget also expands the Department of Business Oversight's authority and capacity to protect consumers and foster the responsible development of new financial products. It establishes a new California Consumer Financial Protection Law, modeled on the activities of the federal Consumer Financial Protection Bureau, to provide consumers with more protection against unfair, deceptive, and abusive practices when accessing financial services and products.

BUILDING RESERVES AND REDUCING LIABILITIES

BUDGETARY RESERVES

The Budget continues to build additional reserves in the Budget Stabilization Account (commonly called the Rainy Day Fund). The Budget assumes an additional transfer of nearly $2 billion in 2020-21 and an additional $1.4 billion over the remainder of the three-year forecast period. The Rainy Day Fund balance is projected to be $18 billion in 2020-21 and $19.4 billion by 2023-24.

The Budget maintains $900 million in the Safety Net Reserve, and also sets aside $110 million more in the Public School System Stabilization Account, bringing its total balance to $487 million.

Finally, the Budget reserves $1.6 billion in the Special Fund for Economic Uncertainties to address emergencies and other unforeseen events.

Overall, the Budget has $21 billion set aside in reserves.

PAYING DOWN UNFUNDED RETIREMENT LIABILITIES

Maintaining the fiscal health of the state's retirement systems is critical to ensuring the long-term security of the state's retirement benefits. The Budget dedicates all constitutionally required Proposition 2 debt payments to pay down the state's retirement liabilities. Proposition 2, passed by the voters in 2014, requires minimum annual payments toward eligible debts until 2029-30 and annual deposits into the state's rainy day fund.

Last year, the Budget set aside an additional $6 billion to pay down the state's share of unfunded liabilities within CalPERS and CalSTRS. This included an additional $3 billion General Fund above required Proposition 2 debt payments.

These supplemental payments to CalPERS and CalSTRS are each expected to generate savings to the state of $7.4 billion over the next three decades.

Even with these commitments, California continues to have considerable unfunded retirement liabilities.

Retirement Liabilities

(Dollars in Millions)

	Outstanding Amount at Start of 2020-21 [2/]
Retirement Liabilities	
State Retiree Health	$85,595
State Employee Pensions	59,714
Teachers' Pensions [1/]	101,992
Judges' Pensions	3,299
Total	**$250,600**

[1/] The state portion of the unfunded liability for teachers' pensions is $33.4 billion.

[2/] For retiree health and pensions, the amounts reflect latest actuarial report available.

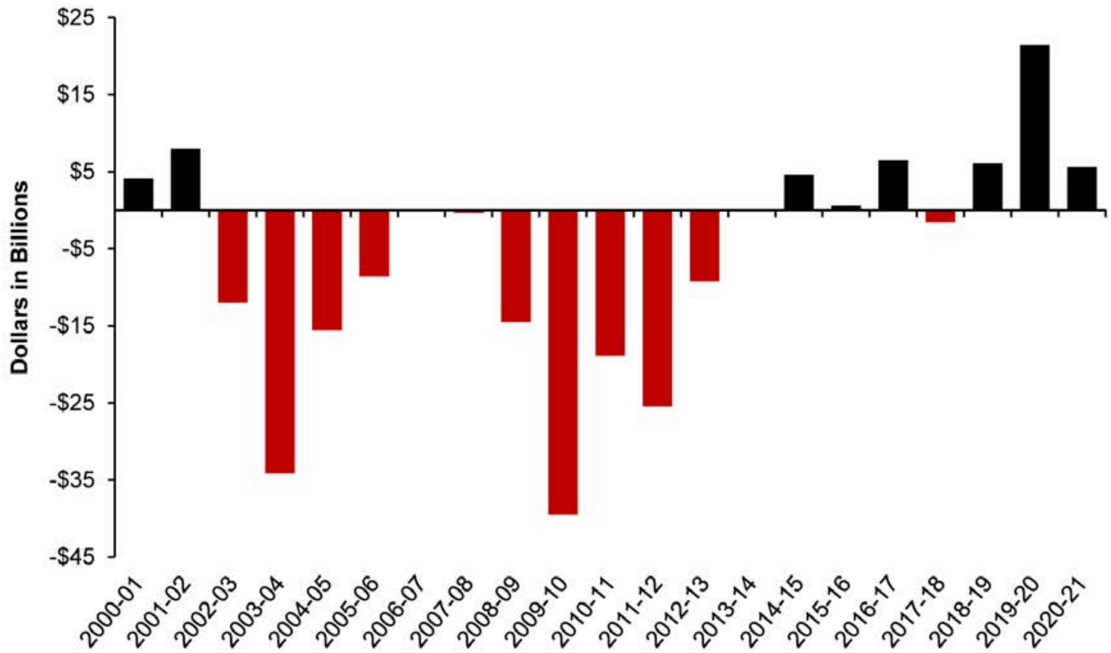
The Budget allocates the remaining required Proposition 2 debt payments to further reduce unfunded retirement liabilities, including $340 million towards retiree health and $817 million to repay the loan from the state's Surplus Money Investment Fund used to make a $6 billion supplemental payment to CalPERS authorized in 2017.

Finally, under Proposition 2, an additional supplemental payment of $1.1 billion will be made to CalPERS in 2023-24. This additional payment to CalPERS will generate $2.3 billion in additional savings over the next three decades.

A STRONG FOUNDATION IS FUNDAMENTAL TO A CALIFORNIA FOR ALL

Maintaining California's fiscal health is an ongoing challenge, particularly given the state's volatile revenue base and limited spending flexibility. As shown in the figure, balanced budgets have been followed quickly by huge deficits. The Budget demands constant attention to stay in balance—especially in light of the record length of the economic expansion and ongoing federal uncertainty.

Balanced Budgets Have Been Quickly Followed by Huge Deficits[1/]



[1/] Budget shortfalls or surplus, measured by the annual Governor's Budget.

The Budget continues to prepare the state for an economic slowdown by building reserves. The Budget also makes strategic investments—mainly one-time—to expand opportunity, address affordability, and strengthen emergency preparedness and effective government. Building a strong fiscal foundation now is the best way the state can prepare for the future and continue to build a California for all.