

INTRODUCTION

The Budget closes a \$54.3 billion gap in 2020-21 and significantly reduces the state's ongoing structural deficit. Despite the global economic crisis caused by the COVID-19 pandemic, the state's prudent fiscal management, including its structurally balanced budgets and record reserves, puts it in a much better position to contend with these challenges.

The COVID-19 pandemic has impacted every sector of the state's economy and has caused record high unemployment—almost 1 in 5 Californians who were employed in February were out of work in May—and further action from the federal government is needed given the magnitude of the crisis. The Governor continues his efforts to secure \$1 trillion in flexible federal aid to state and local governments across the country. This additional support is critical to mitigate the worst effects of the public health crisis, encourage recovery, and support Californians in need.

The Budget makes critical investments to save lives and promote economic recovery by continuing critical purchases of personal protective equipment and other safeguards necessary to safely reopen the economy during the COVID-19 pandemic. It protects public education and supports Californians facing the greatest hardships. This is important since the pandemic is having a disproportionate impact on lower-wage workers and is further exacerbating income inequality. Finally, the Budget supports job creation, economic recovery and opportunity by recognizing and supporting the role small businesses play in job creation in the state.

BUDGET POSITIONS THE STATE FOR THE FUTURE

At the Governor's Budget in January, the state was projecting a surplus of \$5.6 billion. At the May Revision, the state confronted a budget deficit of \$54.3 billion—a four-month swing of \$60 billion caused by the COVID-19 Recession. The Budget closes this gap and brings the state's resources and spending into balance while preserving reserves for future years.

The Budget significantly reduces the structural deficit over the next several years, but there is still more work to do to eliminate it. To reduce the structural deficit in the coming years, the Budget sustains the January 1, 2022 suspension of several ongoing programmatic expansions that were made in the 2019 Budget Act. In addition, the Budget accelerates the suspension of most Proposition 56 rate increases to July 1, 2021. Despite these measures, the Administration forecasts an operating deficit of \$8.7 billion in 2021-22, after accounting for reserves.

BALANCED APPROACH TO CLOSING THE BUDGET GAP

The Budget takes a balanced approach to closing the \$54.3 billion budget deficit and sets aside \$2.6 billion in the Special Fund for Economic Uncertainties, including \$716 million for the state to respond quickly to the changing conditions of the COVID-19 pandemic. The Budget is balanced as follows:

- **Reserves**—The Budget draws down \$8.8 billion in reserves from the Rainy Day Fund (\$7.8 billion), the Safety Net Reserve (\$450 million), and all of the funds in the Public School System Stabilization Account.
- **Triggers**—The Budget includes \$11.1 billion in reductions and deferrals that will be restored if at least \$14 billion in federal funds are received by October 15, 2020. If the state receives a lesser amount between \$2 billion and \$14 billion, the reductions and deferrals will be partially restored. The trigger includes \$6.6 billion in deferred spending on schools, approximately \$970 million in funding for the University of California and the California State University, \$2.8 billion for state employee compensation, \$150 million for courts, and funding for child support administration, teacher training, moderate-income housing, and infrastructure to support infill housing. The trigger would also fund an additional \$250 million for county programs to backfill revenue losses.
- **Federal Funds**—The Budget relies on \$10.1 billion in federal funds that provide General Fund relief, including \$8.1 billion already received. This includes the

enhanced Federal Medical Assistance Percentage (FMAP), a portion of the state's Coronavirus Relief Fund allocation and funds provided for childcare programs.

- **Revenues**—The Budget temporarily suspends the use of net operating losses for medium and large businesses and temporarily limits to \$5 million the amount of business incentive credits a taxpayer can use in any given tax year. These short-term limitations will generate \$4.4 billion in new revenues in the 2020-21 fiscal year.
- **Borrowing/Transfers/Deferrals**—The Budget relies on \$9.3 billion in special fund borrowing and transfers, as well as other deferrals for K-14 schools. (Approximately \$900 million in additional special fund borrowing is associated with the reductions to employee compensation and is contained in the trigger.)
- **Cancelled Expansions, Updated Assumptions and Other Solutions**—The remaining \$10.6 billion of solutions includes:
 - Cancelling multiple program expansions and anticipating increased government efficiencies.
 - Higher ongoing revenues above the May Revision forecast.
 - Lower health and human services caseload costs than the May Revision estimate.

Summary of Solutions

(Dollars in Billions)

Category	2020 Budget Act
1 Reserves	\$8.8
2 Borrowing/Transfers/Deferrals	9.3
3 Revenues	4.4
4 Federal Funds	10.1
5 Cancelled Expansions, Updated Assumptions, and Other	10.6
6 Trigger Reductions/Additional Deferrals	11.1
Total	\$54.3

STRENGTHENING EMERGENCY RESPONSE AND PROTECTING PUBLIC HEALTH

The Budget reflects estimated spending of \$5.7 billion to respond directly to the COVID-19 pandemic. Expenditures include the necessary personal protective equipment to reopen the economy, hospital surge preparation, and other expenditures to support populations at greater risk of contracting COVID-19. Under federal law, at least 75 percent of these expenditures will be reimbursed by the federal government. The Budget also includes a \$716 million reserve within the Special Fund for Economic

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Uncertainties so the state can respond to the changing conditions of the COVID-19 pandemic.

The Budget also strengthens the state's emergency preparedness in other areas. It makes new investments in wildfire prevention and mitigation, including \$85.6 million to CAL FIRE for firefighting resources and surge capacity and \$50 million for community power resiliency. The Budget also supports the new state Earthquake Early Warning Program, integrates the Seismic Safety Commission into the California Office of Emergency Services, and significantly expands efforts to address cybersecurity threats.

The Budget also includes support for counties that are on the front lines of addressing the public health impacts of the pandemic. Of the \$9.5 billion in Coronavirus Relief Fund received by the state, \$4.5 billion is allocated to local school districts, \$1.3 billion is allocated to counties, and \$500 million to cities. The Budget also includes \$750 million General Fund to provide support for counties experiencing revenue losses due to the pandemic. Funds are available for all local governments in compliance with federal guidance and state health requirements on COVID-19 response. If sufficient federal funds are made available by October 15, 2020, the Budget provides an additional \$250 million in support to counties in protecting programs serving vulnerable populations.

PROTECTING PUBLIC EDUCATION

Due to declining revenue, the constitutional Proposition 98 guarantee level of \$70.9 billion is more than \$10 billion below the minimum guarantee at the 2019 Budget Act. However, the Budget offsets this loss in several ways and defers \$12.9 billion in payments into the next fiscal year to preserve programs and give K-12 schools and California Community Colleges the resources needed to safely reopen. The state has also committed to purchasing personal protective equipment and other supplies needed to reopen schools safely.

Furthermore, the Budget allocates \$5.3 billion (\$4.8 billion federal funds) to mitigate learning loss and support the immediate needs of students and schools, with a focus on students disproportionately impacted by the pandemic. The Budget also redirects \$2.3 billion designated for long-term unfunded pension liabilities to reduce school (district and community college district) employer contribution rates in the next two years. Finally, the Budget commits to making supplemental appropriations above the Proposition 98 guarantee for several years starting in 2021-22, which will accelerate General Fund support for schools over the multi-year forecast period.

In addition to these funding changes, the Budget also increases support for students in special education programs by raising per-pupil base rates, and initiates a process to inform future changes in school policing.

SUPPORTING CALIFORNIANS FACING THE GREATEST HARDSHIPS

The Budget takes several steps to support Californians who are facing the greatest hardships. It maintains eligibility for the Medi-Cal program, including the expanded senior eligibility enacted in the 2019 Budget Act, and preserves optional benefits and Proposition 56 provider rate increases in the budget year. The Budget also maintains In-Home Supportive Services (IHSS) service hours and developmental services rates at current levels for the budget year. It includes an increase in the overall maximum Supplemental Security Income/State Supplemental Payment grant by passing the federal cost-of-living adjustment onto recipients. In CalWORKs, the Budget maintains eligibility and grant levels and extends the time limit for aid to adult recipients from 48 months to 60 months, the maximum under federal law. These steps will reduce childhood poverty and provide vital support for families in need during the current economic crisis.

The Budget also protects programs for working families and students. It preserves last year's expansion of the state Earned Income Tax Credit, including the Young Child Tax Credit, and expands eligibility to include undocumented filers with a child age five and under. It also preserves the Covered California health insurance subsidies for middle-income households enacted in the 2019 Budget Act, and it protects Cal Grants at current levels of eligibility, including the recently established supplemental Cal Grant access award for students with dependent children. These steps will enable more workers and families to cope with the impact of the pandemic.

The Budget also prioritizes funds to mitigate homelessness and takes a new approach by allocating \$600 million to the Department of Housing and Community Development for HomeKey to acquire permanent housing through the purchase and renovation of motel properties throughout the state. The Budget also includes \$300 million General Fund to cities, counties, and continuums of care to support efforts to reduce homelessness.

ENHANCING GOVERNMENT EFFICIENCY

Historically, state government has been slow to adopt modernizations in the workplace. But the COVID-19 pandemic has forced a massive experiment in telework and allowed

state managers, led by the Government Operations Agency, to rethink business processes.

This transformation will allow for expanded long-term telework strategies, increased modernization and delivery of government services online, reconfigured office space, reduced leased space, and when possible, flexible work schedules for employees.

Nearly all state operations will be reduced by approximately 5 percent over the next two years. Nonessential contracts, purchases, and travel are suspended and departments have been directed to fill only the most essential vacant positions.

PROMOTING ECONOMIC RECOVERY

Small businesses will play a critical role in California's economic recovery. For this reason, the Budget provides an additional \$75 million for loan loss mitigation and reducing the cost of capital for small businesses to address gaps in available federal assistance. These funds will be administered by the California Infrastructure and Economic Development Bank. The Budget also expands the \$800 Minimum Franchise Tax exemption for first-year corporations to all businesses, removing a barrier to small business creation for all types of small businesses.

A strong recovery must lift people and small businesses up in all parts of the state. For this reason, the Budget includes funding for additional staff at the Governor's Office of Business & Economic Development to connect businesses with opportunities to create jobs in regions of the state that have historically experienced less economic growth. The Budget also includes funding to expand University of California medical training in Fresno and Riverside and supports an economic development effort in the Fresno region.

The Administration is committed to creating the necessary conditions for a more equitable recovery; to this end, the Budget reflects an increase of the statewide minimum wage to \$15 per hour by 2022. The increases over the next few years will affect roughly 60 percent of Californians who earn the minimum wage. The Budget also maintains last year's historic expansion of the Earned Income Tax Credit, providing a tax credit to households making up to \$30,000 annually (full-time at minimum wage), and provides a credit of \$1,000 for every family that otherwise qualifies for a credit and has at least one child age 5 and under.

The Governor has convened a Task Force on Business and Jobs Recovery—a diverse group of leaders from business, government, labor, and the non-profit sector—to

develop actionable recommendations and advise the state on how economic recovery can be expedited and address the effects of wage disparity exacerbated by COVID-19. The Administration will work with the Legislature as well as the Task Force, the Governor's Council of Economic Advisors, and other stakeholders to develop further actions that support a safe, swift, and equitable economic recovery.

DEFINING THE PATH FORWARD

California's history has been marked by periods of great challenge—brought on by global conflict and change, natural disasters, and economic crises. California's history has also been one of innovation, ingenuity, resiliency and resurgence. The COVID-19 pandemic and the recession that has accompanied it pose a new challenge for the state. The Budget takes steps to reduce spending commitments and address long-term structural deficits, but deficits remain and further actions will be needed especially if the federal government does not act.

California will overcome this challenge as it has overcome challenges in the past. The state, its businesses and its families will recover and will emerge stronger and more resilient. However, the size and scale of this crisis has not been seen in recent times and the federal government must do more to prevent exacerbating income inequality that existed before the pandemic.