INTRODUCTION

The COVID-19 pandemic has caused enormous hardship for families, businesses and governments across the world, the United States and California. It has endangered health, stressed the health care system and caused devastating losses in family and business income.

COVID-19 has caused a global economic crisis which has had a profound impact on California. It has caused business closures, job losses and has driven millions of Californians to seek unemployment and other assistance. Necessary efforts to contain the virus and to address its effects have increased costs for state and local governments across the country.

California's prudent fiscal management, including its structurally balanced budget and record reserves, puts it in a much better position than other governments to contend with these challenges. However, the effects of the COVID-19 Recession on the state budget are massive. Substantial federal assistance is essential to safeguard core government functions, as well as to support a safe, quick economic recovery.

The May Revision is guided by the principle of prudent fiscal management to: protect public health, public safety and public education; provide assistance to small businesses and Californians most hurt by the pandemic; and to invest in a safe and quick economic recovery. It proposes to strategically use federal Coronavirus Aid, Relief, and Economic Security (CARES) Act funds to support schools, public health and local governments. It is anchored in a commitment to preserving core services and supporting Californians facing the greatest hardships.

Consistent with the state's constitutional obligation to enact a balanced budget and the prohibition against issuing long-term bonds to finance deficits, the May Revision proposes to cancel new initiatives proposed in the Governor's Budget, cancel and reduce spending included in the 2019 Budget Act, draw down reserves, borrow from special funds and temporarily increase revenues. It also reflects savings from the Administration's direction to agencies and departments to increase efficiency and streamline existing efforts. Finally, the May Revision reflects reductions needed to address the remaining budget gap in the event the federal government does not provide states and local governments additional necessary funding to support public health, safety and education, and a safe, swift economic recovery. While under the May Revision the budget would be balanced next year, a significant structural out-year deficit would remain, increasing to over $16 billion by 2023-24.

Immediate action is required for the Governor and the Legislature to enact a balanced budget by July 1. The Administration will work in partnership with the Legislature to enact a balanced budget and to advocate for increased federal funding for state and local governments. In the event that sufficient additional funds do not materialize, the Administration is committed to considering alternatives to protect core services, including additional borrowing, revenue increases, revenue accelerations and other options. To be workable, any alternative solution must mitigate, not exacerbate, the structural deficit the state faces and avoid repeating a pattern of successive years of fiscal and financial distress.

California's Pre-Pandemic Budget and Economy

California began 2020 with a solid fiscal foundation—a strong and diverse economy, historic reserves, and a structurally balanced budget. It had eliminated past budgetary debts and deferrals and was making extraordinary payments to reduce pension liabilities.

In January, a budget surplus of $5.6 billion was projected for the 2020-21 fiscal year. Revenues through March were running $1.35 billion above projections.

COVID-19 Recession

The COVID-19 pandemic and resulting recession has changed the fiscal landscape dramatically. The entrepreneurs who run small businesses throughout California have been severely impacted. Unemployment claims have surged—with increased claims of 4.4 million from mid-March to May 9, and a projected 2020 unemployment rate of

18 percent. Job losses have occurred in nearly every sector of the economy, but they have been most acute in sectors not fully able to telework such as leisure and hospitality, retail trade, and personal services. Lower-wage workers have disproportionately borne the impact of job losses. COVID-19 has amplified the wage disparity that existed before the pandemic—a fact that is particularly concerning as state median income did not return to the pre-Great Recession level until 2018.

Personal income is projected to decline by 9 percent in 2020; in 2023, personal income is expected to return to the 2019 level of $2.6 trillion—$470 billion or 15 percent below the level expected in the Governor's Budget.

COVID-19 IMPACT ON STATE BUDGET

Job losses and business closures are sharply reducing state revenues. Compared to the January forecast, General Fund revenues are projected to decline over $41 billion. This revenue drop, combined with increased costs in health and human services programs and the added costs to address COVID-19, leads to a projected budget deficit of approximately $54 billion before the changes proposed in the May Revision. Without the actions below, the out-year structural deficit would be approximately $45 billion annually.

BALANCED APPROACH TO CLOSING THE BUDGET GAP

The state is constitutionally required to enact a balanced budget. Consistent with this obligation, the May Revision proposes to:

- Cancel $6.1 billion in program expansions and spending increases, including canceling or reducing a number of one-time expenditures included in the 2019 Budget Act. It also includes redirecting $2.4 billion in extraordinary payments to California Public Employees' Retirement System (CalPERS) to temporarily offset the state's obligations to CalPERS in 2020-21 and 2021-22. It further reflects savings from the Administration's direction to agencies to increase efficiency in state operations now and into the future.
- Draw down $16.2 billion in the Budget Stabilization Account (Rainy Day Fund) over three years, and allocate the Safety Net Reserve to offset increased costs in health and human services programs over the next two years. The May Revision reflects the withdrawal of $8.3 billion, including $7.8 billion from the Rainy Day Fund and $450 million from the Safety Net Reserve in 2020-21.

- Borrow and transfer $4.1 billion from special funds.
- Temporarily suspend net operating losses and temporarily limit to $5 million the amount of credits a taxpayer can use in any given tax year. These short-term limitations will generate new revenue of $4.4 billion in 2020-21, $3.3 billion in 2021-22, and $1.5 billion in 2022-23 to increase funding for schools and community colleges and maintain other core services.
- Reflect the Administration's nationwide request of $1 trillion in flexible federal funds to support all 50 states and local governments, and identifies reductions to base programs and employee compensation that will be necessary if sufficient federal funding does not materialize.

See The May Revision Proposes Balanced Solution figure below.

May Revision Proposes Balanced Solution
(dollars in billions)

Cancelled Expansions & Other Reductions	$8.4
Reserves	8.8
Borrowing/Transfers/Deferrals	10.4
New Revenues	4.4
Federal Funds	8.3
Triggers	14.0
	$54.3

USING CARES ACT FUNDS STRATEGICALLY

The May Revision proposes to use federal CARES Act funds to support schools, strengthen local public health preparedness and response, and support health and human services at the local level in response to the COVID-19 pandemic.

Specifically, the May Revision proposes to:

- Use $4.4 billion for schools to run summer programs and other programs that address equity gaps that were widened during the school closures.
- Direct $3.8 billion to protect public health and public safety; $1.3 billion to counties for public health, behavioral health and other health and human services programs; and $450 million to cities for public safety and to support homeless individuals.

PROTECTING PUBLIC HEALTH, PUBLIC SAFETY AND PUBLIC EDUCATION

The May Revision protects public health and public safety. It provides needed funds to contain the spread of COVID-19 and its effects. To that end, the May Revision proposes to:

- Invest in wildfire prevention and mitigation as well as other emergency response capabilities.
- Prioritize $4.4 billion in federal funding to address learning loss and equity issues exacerbated by the COVID-19 school closures this spring. These funds will be used by districts to run summer programs and other programs that address equity gaps that were widened during the school closures. These funds will also be used to make necessary modifications so that schools can reopen in the fall and help support parents' ability to work.
- Reallocate $2.3 billion in funds previously dedicated to paying down schools' long-term unfunded liability to California State Teachers' Retirement System (CalSTRS) and CalPERS to instead pay the school employers' retirement contributions, to address the decline in the constitutionally required funding for schools and community colleges resulting from the COVID-19 Recession.
- Create a new obligation of 1.5 percent of state appropriation limit revenues starting in 2021-22 to avoid a permanent decline in school funding that grows to $4.6 billion in additional funding for schools and community colleges in 2023-24.
- Preserve the number of state-funded childcare slots and expand access to childcare for first responders.
- Preserve community college free-tuition waivers and maintain Cal Grants for college students, including the grants for students with dependent children established last year. Since many workers return to higher education and job training after losing a job, continuing these programs and initiatives will prioritize affordability and access to higher education and job training opportunities.

SUPPORTING CALIFORNIANS FACING THE GREATEST HARDSHIPS

The COVID-19 Recession is making the effects of wage disparity even worse and is having a disproportionate impact on families living paycheck to paycheck. The May Revision prioritizes direct payments to families, children, seniors and persons with disabilities by doing the following:

- Maintain the newly expanded Earned Income Tax Credit, which puts a billion dollars in the pockets of working families with incomes under $30,000, including a $1,000 credit for eligible families with children under the age of 6.
- Maintain grant levels for families and individuals supported by the CalWORKs and SSI/SSP programs.
- Prioritize funding to maintain current eligibility for critical health care services in both Medi-Cal and the expanded subsidies offered through the Covered California marketplace for Californians with incomes between 400 percent and 600 percent of the federal poverty level.

In addition, unemployment insurance benefits in 2020-21 are estimated to be $43.8 billion, which is 650 percent higher than the $5.8 billion estimated in the Governor's Budget. This is primarily supported by federal funding, federal loans, and employer taxes.

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.

The Administration is working to deliver more government services online. This includes expanding the Department of Motor Vehicles' virtual office visits pilot to other departments and agencies with more face-to-face interactions with Californians. The Office of Digital Innovation will continue to assist agencies and departments in automating processes to increase value and provide greater convenience for the public.

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

SUPPORTING JOB CREATION, ECONOMIC RECOVERY AND OPPORTUNITY

During this time of unprecedented unemployment, the Administration will work in partnership with the Legislature to help get people back to work and support the creation of good-paying jobs. It will develop proposals and actions to support a robust and equitable recovery both in the near term and the long term. To this end, the Administration is considering options to support job creation including: assistance to help spur the recovery of small businesses and the jobs they create, support for increased housing affordability and availability and investments in human and physical infrastructure. Any investments and actions will focus on equity, shared prosperity and long-term growth.

Small businesses have suffered massive losses as a result of the COVID-19 Recession. They will face increased costs to modify their operations to reduce the risk of COVID-19 transmission and spread. Given the critical role of small business in California's economy, the May Revision proposes to:

- Augment the small business guarantee program by $50 million for a total increase of $100 million to fill gaps in available federal assistance. This increase will be leveraged to access existing private lending capacity and philanthropy to provide necessary capital to restart California small businesses.
- Retain Governor's Budget's proposals to support new business creation and innovation by waiving the $800 minimum franchise tax for new businesses.

The Governor has convened a Task Force on Business and Jobs Recovery—a diverse group of leaders from business, 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 that were made even worse by COVID-19. The Administration is committed to additional actions, informed by the Task Force and other stakeholders, to support a safe, swift and equitable economic recovery.

The Administration is also committed to working with colleges and universities to build on their experience with distance learning and develop a statewide educational program that will allow more students to access training and education through distance learning. This will allow non-traditional students who are working and parenting the opportunity to complete coursework at their own pace and after hours.

DEFINING THE PATH FORWARD

California's history has been marked by periods of great challenge—brought on by global conflict and change, by natural disasters, and by 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.

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. The May Revision takes a balanced and focused approach. It directs actions to stop the spread of COVID-19; protects core functions like public health, public safety and public education; and supports those facing the greatest hardships. It proposes actions to support a safe, swift and robust economic recovery. It is a responsible fiscal plan for California as it navigates the path to recovery.