

JANUARY 30, 2025

The 2025-26 Budget: Overview of the Governor's Budget

PRESENTED TO:

Senate Committee on Budget and Fiscal Review
Hon. Scott Weiner, Chair



LEGISLATIVE ANALYST'S OFFICE

The Current Landscape

Legislative Action Last Year Addressed Anticipated Budget Problem Proactively. Last June, the Legislature made proactive decisions to address the anticipated budget problem for 2025-26. At the time, this included \$28 billion in budget solutions, but we now estimate these actions will generate about \$23 billion in savings. (Two key areas where these savings have eroded are in the managed care organization tax package and reductions to state operations.) Had the Legislature not taken these actions, the state would face a deficit today.

Revenues Collections Have Improved Since Last June... Collections data to date show stronger-than-anticipated revenue growth across 2023-24 and 2024-25. In November, we estimated revenues had improved by \$7 billion relative to budget act estimates. In the Governor's budget, the administration forecasts a \$16 billion improvement.

...But Spending Is Also Higher. Spending is also higher under both our and the administration's forecasts. Higher revenues result in more required General Fund spending on schools and community colleges under the requirements of Proposition 98 (1988). Also, in November, we found that baseline spending, across the rest of the budget, is higher than the June 2024 estimates by \$8 billion. The administration's estimate is similar.



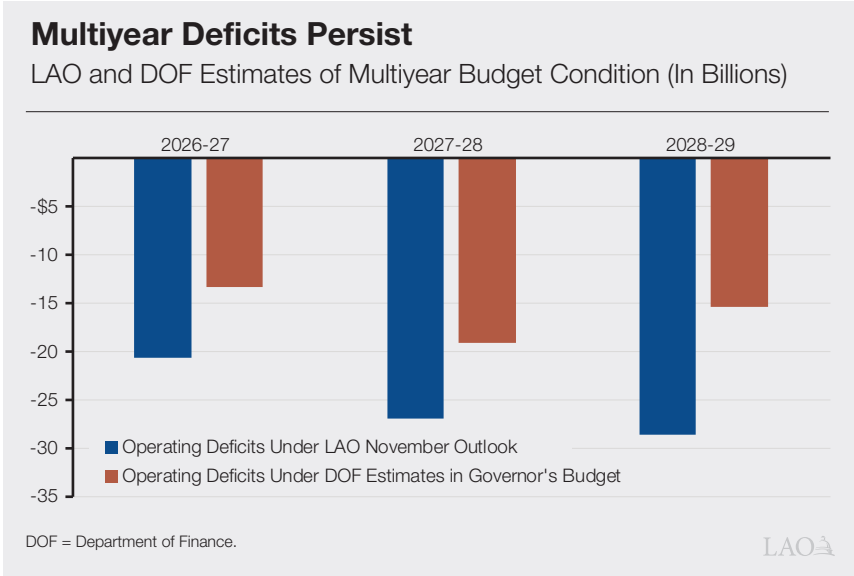
Budget Roughly Balanced

- In our November *Fiscal Outlook*, we found that the underlying condition of the state’s budget was roughly balanced. This remains true under the Governor’s budget.
- In other words, we are not describing the budget as having a surplus or a deficit. Specific budgetary conditions occurring this year—including legislative action taken last year to withdraw more in reserves this year—make interpretation of the budget position more complex.
- On a technical basis, under the administration’s estimates, we estimate the balance of the Special Fund for Economic Uncertainties (SFEU) would be about \$3 billion before the Governor’s proposals.



Multiyear Deficits on the Horizon

The state faces structural deficits under both our and the administration's forecasts for 2026-27, 2027-28, and 2028-29.



Discretionary Proposals in the Governor's Budget

The Governor's budget includes three categories of discretionary proposals, which are those that are not already committed to under current law or policy:

- **Savings Proposals.** The Governor proposes \$2.2 billion in actions that generate short-term budget savings. They include: (1) providing \$1.6 billion less in total funding for schools and community colleges than the estimated constitutional minimum funding level for 2024-25 (this provides one-time General Fund savings in that year, but also creates a “settle-up” obligation); (2) increasing revenues by around \$300 million by changing the rules about how taxable profits are determined for financial institutions; and (3) shifting nearly \$300 million in General Fund spending to the Proposition 4 (2024) climate bond.
- **Spending and Tax Expenditure Proposals.** The Governor's budget includes new discretionary proposals that increase spending or reduce revenues. This includes \$570 million in new discretionary General Fund spending in 2025-26 (after 2025-26, these proposals would add about \$300 million in ongoing spending) and \$150 million in the expansions of existing and creation of new tax expenditures (reaching \$300 million by 2028-29).
- **Discretionary Reserve.** The Governor sets the balance of the SFEU to \$4.5 billion. Recent budgets have set the SFEU between \$3.5 billion and \$4 billion, so this is somewhat higher than typical.



Budget Condition

General Fund Condition Summary			
(In Millions)			
	2023-24 Revised	2024-25 Revised	2025-26 Proposed
Prior-year fund balance	\$50,203	\$35,877	\$26,299
Revenues and transfers	193,269	222,473	225,095
Expenditures	207,595	232,051	228,892
Ending Fund Balance	\$35,877	\$26,299	\$22,501
Encumbrances	18,001	18,001	18,001
SFEU balance	\$17,876	\$8,298	\$4,500
Reserves			
BSA	\$22,902	\$18,045	\$10,945
SFEU	17,876	8,298	4,500
Safety net	900	—	—
Total Reserves	\$41,678	\$26,343	\$15,445

Under Governor’s Budget, Reserves Would Total \$15 Billion by End of 2025-26. Under the Governor’s budget, general purpose reserves would total \$15.4 billion by the end of 2025-26. This includes a balance in the SFEU of \$4.5 billion and \$11 billion in the state’s main constitutional reserve, the Budget Stabilization Account. In addition, the state would have \$1.5 billion in the Proposition 98 Reserve, available only for school and community college programs.



Comments

- ✓ Administration's revenue estimates are reasonable, but we suggest the Legislature avoid putting too much stock in the recent revenue rebound until it is accompanied by clear improvements in California's broader economy.
- ✓ State faces some additional cost pressures not reflected in the Governor's budget.
- ✓ The Governor maintains a \$7 billion reserve withdrawal for this year, and we think this is reasonable.
- ✓ We recommend the Legislature maintain its momentum on solving budget deficits by using the next few months to consider how to begin addressing out-year deficits.
- ✓ Oversight would help provide information needed to make difficult choices.
- ✓ The Governor proposes two first steps to changing reserves, and the interest in enhancing reserve policies is merited.

