

The Governor's Budget & CA's Nonprofits

02.05.24 | Linda J. Rosenthal, JD



The new CEO of the [California Association of Nonprofits](#), Geoff Green, has issued an urgent call to action.

“As we begin the new year, all eyes are on the state budget....” The problem, Mr. Green explains: “California is expecting [the worst budget cycle in a decade](#).” And the Governor’s recent budget proposal for the upcoming fiscal year includes some “... spending cuts and delays” that “would pose significant challenges to progress on accessible childcare, climate resilience, and affordable housing, just to name a few.”

The high-stakes and high-drama activity, carefully prescribed in the California Constitution, begins no later than January 10th with the Governor’s Budget announcement. It must wrap up by June 15th with balanced-budget legislation signed into law. See our post from last week: [CA Budget FY '24-'25: A Big Deal For Nonprofits](#) (January 29, 2024).

It’s the third year in a row that we’re taking a deep dive into this annual political ritual. The fiscal landscape has, indeed, vastly changed: This year’s \$37.86 budget deficit (that must be closed) is in sharp contrast with just two years ago when the state was swimming in money. See [Nonprofits Reaching for Piece of CA Budget Pie](#) (April 11, 2022) [\$29-billion surplus; “defining fiscal dimension: ...a time of plenty.”] and then [That CA Budget Pie?: Much Bigger Than Expected](#) (May 17, 2022) [the January revenue estimate was way understated; the actual surplus is \$97-billion. “That’s three times as much pie. Yum.”]

Focus on Governor’s Proposal



CalNonprofits CEO Green points out correctly that Gavin Newsom’s formal presentation on January 10, 2024, of the (proposed) Governor’s Budget “...is just the beginning of the process...” But “nonprofit leaders across the state are [already] dissecting the proposal and the implications for our communities and nonprofit sector.” He adds: It’s “never too late to engage with our elected representatives on budget issues!”

Each year, the charitable community in California – the nation’s largest – takes a keen interest and active role in the state’s six-months-long budget cycle. CalNonprofits, as usual, is leading the effort to make the budget negotiators from both the executive and legislative branches aware of the opinions and concerns of our sector as well as the impact of any fiscal decisions on the citizens – including charitable beneficiaries – of the state. “CalNonprofits’ focus on policy advocacy helps to ensure that all levels of our government take action to help, not harm, the nonprofit community on which they increasingly rely.”

With that in mind, we’ll zoom in right now *only* on this first step, which is a *proposed* budget based on the revenue data available by late December/early January. It always changes a little bit or a lot by the time of the governor’s release of the “Mid-May Revision,” which is based on actual (rather than estimated) revenue figures for the first quarter of the current calendar year.

For a number of reasons (including those summarized later in this post), the proposed budget numbers are much “softer” than usual for a January budget proposal. (Of course, the actual revenue figures may be worse; we’ll have to wait and see.)

Before turning to a summary of the key factors facing budget negotiators over the next several months, let’s take a quick look at the three elements – [Press Release](#), [YouTube video](#), and [E-Budget](#) – of the Governor’s Budget package.

Helpful hint: For all of us non-budget wonks, the opening sections of the excellent and (relatively) easy-to-read E-Budget publication by the CA Department of Finance are enough to help us grasp the general parameters of this proposed budget along with the multiple factors that have resulted in (a) the rapid (though predicted) slide from vast surpluses in recent years into deficit territory; and (b) the wobbliness of the January estimates. See particularly, under the [Budget Summary](#) tab: the 2-page [Governor’s Message](#) and the 8-page [Introduction](#).

The Budget Package

What, exactly, is the Governor’s Proposed Budget? “The budget proposal provides a detailed overview of the governor’s proposed expenditures for the upcoming fiscal year, estimated expenditures for the current fiscal year, and actual expenditures for the prior fiscal year.”

The California Constitution requires a “balanced budget.” That means if the proposed expenditures for the budget year exceed estimated revenues, the Governor is “required to recommend the sources for the additional funding.” The Governor’s Budget “... must be accompanied by a Budget Bill itemizing recommended expenditures which shall be introduced in each house of the Legislature.” See the Department of Finance’s helpful booklet: [California Budget Process](#).

The January 10, 2024, Governor’s Budget package includes:



- [Press Release: 2024-25 State Budget Proposal Protects Core Priorities and Ensures Fiscal Stability](#), Office of the Governor
- [Formal Presentation: Governor Gavin Newsom Presents the 2024-25 State Budget](#), YouTube, January 10, 2024, 2:14:55
- [E-Budget](#): The Department of Finance's presentation online, divided into multiple clickable linked sections, or the [alternate printable](#) and [PDF](#) (261 pp) version

The [Press Release](#) is what you would expect: a brief but sunny bullet-point summary. The "January budget proposal closes a \$37.86 billion shortfall while protecting key investments in education, public safety, addressing homelessness, mental health care reform, and climate action. Historic reserves and responsible budgeting over past budget cycles enable the state to maintain fiscal stability amid fluctuation in revenues."

The [January 10th Formal Presentation](#), available on YouTube, is just over 2 hours long. It's clear and well-organized, with slides and charts as well as summaries of ten key policy topics. In the second half, the question-and-answer period was worthwhile; the participating reporters – thankfully – were all seasoned politics and policy veterans. Generally, it's duplicative of the content more fully presented in the excellent (written) E-Budget – see particularly, the 8-page [Introduction](#). It's helpful but not necessary viewing for non-budget wonks.

However, Governor Newsom's opening remarks are notable for their framing of the "... the larger narrative" of his proposed budget for FY '24-'25: "We have come to expect the unexpected as it relates to the volatility of our tax system...." It's "... a story of [correction](#), a story of [normalization](#) after a period" of a "tremendous amount of distortion represented in the revenue collection of the state" (See [YouTube](#) video, at 0.25-1.11 of 2:14:55.)

The E-Budget

The [E-Budget](#) is the California Department of Finance's detailed online presentation that was developed over many months in the second half of 2023 and early in 2024 in consultation with each of the executive branch agencies and departments.

It's available in two formats: One is an online PDF version (261 pp.) formatted for printing. The other – and most helpful – is presented online in clickable format for each of several sections.

The clickable online [E-Budget](#) is organized as:

- [Budget Overview](#)
- [Budget Summary](#) [including several key chapters, see specifically: Governor's Message, Introduction, Summary Charts, ten topic-specific categories, i.e., K-12 Education, Higher Education, Climate Change, Natural Resources & Environmental Protection, Health & Human Services, Housing & Homelessness, Criminal Justice & Judicial Branch, Labor & Workforce Development, General Government & Statewide Issues, and Infrastructure, and additional chapters on Economic Outlook, Revenue Estimates, and Demographic Information]
- [Budget Details](#)



- [Statewide \[Financial\] Information](#)
- [Fund Conditions](#)
- [Budget References](#) (i.e. glossary)

Key Factors For Budget Negotiators

The process to develop the initial proposed budget for the fiscal year that starts on July 1st was hamstrung significantly by the inherent structural problems of California’s particular version of progressive taxation along with other budgeting limits and restrictions. But, additionally, there were two external events that have had a huge – negative – impact on this and the previous budget cycle.

Volatility

Governor Newsom’s oral framing of “the larger narrative” hits hard on the volatility that seems to be a feature of, rather than an occasional glitch in, the state’s particular “version of a progressive taxation system.”

Similarly, in his Message to lawmakers, he cautions: “I am proud that California remains the home of innovation and extraordinary entrepreneurship and has so many high-income earners....We ask them to pay their fair share to a state that has provided so much for so many. But this tax system inherently creates swings in revenue....”

The state’s “concentration of high-income earners,” the budget writers explain in the E-Budget Introduction, can have a heightened (negative) revenue impact if the stock market drops. This is exactly what happened recently. “An extremely small share of California taxpayers are responsible for a large share of state revenues....”

These high earners take in “...a significant proportion of their income from stock-based compensation and capital gains, making their income—and the tax revenue it generates—significantly more volatile and subject to swings in the financial markets as opposed to changes in the overall economy.”

In the two fiscal years “following the COVID-19 Recession,” there was unprecedented strength in the stock market as its growth outpaced the slower overall economic recovery. Fueling this growth were capital gains realizations,....” And then, in 2022, the stock market took a nosedive.

Delays in Tax Collection

“The budget shortfall facing lawmakers in 2024—estimated at \$37.9 billion—is rooted in two separate but related developments during the past two years—the substantial decline in the stock market that drove down revenues in 2022 and the unprecedented delay in critical income tax collections.”

There were weather emergencies around the nation in the winter of 2023, so the IRS extended the federal tax-filing deadline from April 15th to October 15th, and then again until November 15th. California reluctantly adjusted its own deadlines accordingly.

“Normally, the bulk of cash data relating to the prior tax year is available by April, leading to a revised May budget informed by actual cash collections.” But last year, “the majority of the state’s revenues did not arrive until October and November. That means the correction that would have come as part



of last year's May Revision is instead being made in this January budget."

Still, the "Governor's proposed budgets in January and May 2023 warned of this uncertainty, and in June, the state passed a budget that planned accordingly, setting aside record reserves of just under \$38 billion."

However, the delay in revenue collection masked the true effect of the stock market drop on the state's highest earners; they owed far less in capital gains taxes than expected – and certainly much less than in the plentiful years. "With reliable tax filing deadlines, the degree of the revenue drop associated with the 2022 market declines would have become evident as tax receipts were received in the spring."

The budget planners in the Department of Finance were "flying blind" until the revenue came in late in 2023. Nevertheless, they were still obligated to prepare the January 2024 Governor's proposed budget

Now, the state faces a budget process that must solve for last year's shortfall while adjusting state spending to ensure continued fiscal stability for years to come."

Structural Constraints on Reserves

The Governor and lawmakers have bumped into structural restrictions limiting them from moving more money from the years of surplus into reserves to protect against the deficits that everyone predicted were just around the corner.

In particular, the 1979 Gann Amendment and the 2014 Proposition 2 unintentionally create straightjackets for budget negotiators. "While both voter-approved initiatives promote fiscal prudence and long-term stability in state finance, their interaction has unintentionally eroded the effectiveness of both measures."

"As we experienced in the past couple of years," the Governor wrote in his Message, "our well-intentioned laws meant to create big reserves and budget resiliency actually end up limiting how much we can put away for rainy days—we should improve the rules governing how much we are able to save in the good times, so we can be even more resilient during the tougher times."

"The Administration and the Legislature should explore changes to law to allow the state to save more during economic upswings, enhancing the state's ability to protect vital programs and services during future budget downturns."

In the January 10th presentation, Governor Newsom noted that, while there seems to be an appetite by legislators to figure out ways to remove some of these structural barriers, a recent survey suggests that the general public is not on board – yet.

Limits on Available "Solutions"

It's critical to understand that in California, closing a budget deficit is not unlike a game of chess. There are clear rules: which ways you can move, and which ways you can't.

When the dust settled on the final version of the January 10th Governor's Budget, it incorporated a mind-numbing array of "solutions" to close the projected budget deficit, as required by the California



Constitution. Among them are: (here omitting the specifics of which budget items were touched, which were included in the Introduction):

- Reserves—\$13.1 billion. The budget draws upon funds from the state’s reserves.
- Reductions—\$8.5 billion. The budget reduces funding for various items.
- Revenue/Internal Borrowing—\$5.7 billion. The budget includes support from revenue sources and borrows internally from special funds.
- Delays—\$5.1 billion. The budget delays funding for multiple items and spreads it across the three-year period, beginning in 2025-26, without reducing the total amount of funding through this period.
- Fund Shifts—\$3.4 billion. The budget shifts certain expenditures from the General Fund to other funds.
- Deferrals—\$2.1 billion. The budget defers specific obligations to the 2025-26 fiscal year

Legislative Analyst’s Office Review

The [Legislative Analyst’s Office](#) is the nonpartisan government agency that has provided fiscal and policy advice to the California Legislature since 1941.

As it does each year, the LAO reviewed the proposed budget. These analysts came up with a different (translation: worse) estimated budget deficit. See [Overview of the Governor’s Budget \(January 2024\) LAO, 12 pp. pdf](#).

But Governor Newsom [addresses that discrepancy](#), asserting how the two figures are not as far off as they appear at first blush, and there is discussion by the Department of Finance’s budget experts in the E-Budget.

The LAO acknowledges that the discrepancies may, in part, be attributable to [differences in classification](#) of some of the component elements of the proposed budget.

Conclusion

“This January budget is based on projections of future revenues. As we learned last year, those [projections can change dramatically](#) based on global and national economic and financial trends. So as we begin our work together this year, we must be mindful of the remaining risks.”

It’s possible, [according to the governor](#), that the Legislature (currently in session) might consider some tweaks right away to the fiscal year ‘23-’24 budget law now in effect but which was off the mark in several respects because of the missing data.

There is a big task ahead for the budget negotiators as well as interested stakeholders including the nonprofit sector.

— Linda J. Rosenthal, J.D., FPLG Information & Research Director