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## **Should Newsom Stay or Should He LAO? California's 2024-2025 Budget**

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### **Abstract**

The FY 2024-25 budgeting cycle in California was far less chaotic than the previous year, when a record \$100 billion budget surplus morphed into a widening deficit. This time, Democratic Gavin Newsom and the Democratic controlled legislature had to tackle that mounting deficit as the state's economy stalled, specifically among the wealthiest Californians, who fund a large portion of the state's government. Neither Newsom nor the two new Democratic legislative leaders had experienced a budget deficit in office, which made coordination additionally tricky. The state is in much better shape than previous deficits, however, with a large reserve and strong budget resilience among its leaders. One problem- the governor increasingly reports different budget numbers than the state's nonpartisan Legislative Analyst Office (LAO), which assesses the administration's budget for the legislature.

## Introduction

California's fiscal year 2023-2024 budget began unbalancing mere moments after its passage. On the one hand, the state failed to collect as much revenue as the budget projected. But as we previously wrote (DiSarro and Hussey 2024), adding to the normal budget complexity was an unusual twist. A strong series of Spring 2023 storms across the state forced the IRS to push back the tax filing deadline for most Californians from April to November. Consequently, the state's budget players had to pass a budget in June 2023 for a 2023-2024 budget without knowing how much revenue the state would receive in 2022-2023.

California miscalculated the strength of its economy and the heady highlights of a few years ago – a decade plus of growth, an unthinkable \$100 billion state surplus – has turned into a more predictable California refrain: the boom and bust budget cycle the state's government is known for (Cummins 2015).

Adding to the story this time was an increasingly fraught tension between Democratic Governor Gavin Newsom and the legislature's independent and impartial Legislative Analyst's Office (LAO). The LAO struck first, with concern over a growing large budget imbalance. Newsom's office has tried to both underplay the difference between his own Department of Finance's (DOF) interpretation of the budget imbalance, but also chastise the media for highlighting the LAO's numbers.

## Background

### *Demographics*

To understand California, it is important to recognize the state's rapidly changing demographics. California has been a majority-minority state since the late 1990s, and is one of the most diverse states in the nation. A decade ago, non-Hispanic Whites held a narrow plurality of 40.1% of the state's population, with non-White Latinos comprising 37.6%.<sup>1</sup> However, based on updated data from the U.S. Census Bureau, non-Hispanic Whites currently account for only 34.7%, while non-White Latinos have achieved a plurality of 40.3%.<sup>2</sup> Forty years ago, non-Hispanic Whites accounted for two-thirds of California's population.<sup>3</sup>

Also of note is the rapid rise in the Asian-American population. Back in 1980, this group accounted for just 7% of the state's population.<sup>4</sup> By 2024, that number had more than doubled to over 16%.<sup>5</sup> When non-White Latinos are combined with Asians, they represent a majority of the state's population; a majority which is nearly identical to that held by non-Hispanic Whites back in 1990.<sup>6</sup> Figure 1 depicts the shifting makeup of the state from 1980 to 2024.

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<sup>1</sup> U.S. Census Bureau, 2024.

<sup>2</sup> U.S. Census Bureau, 2024.

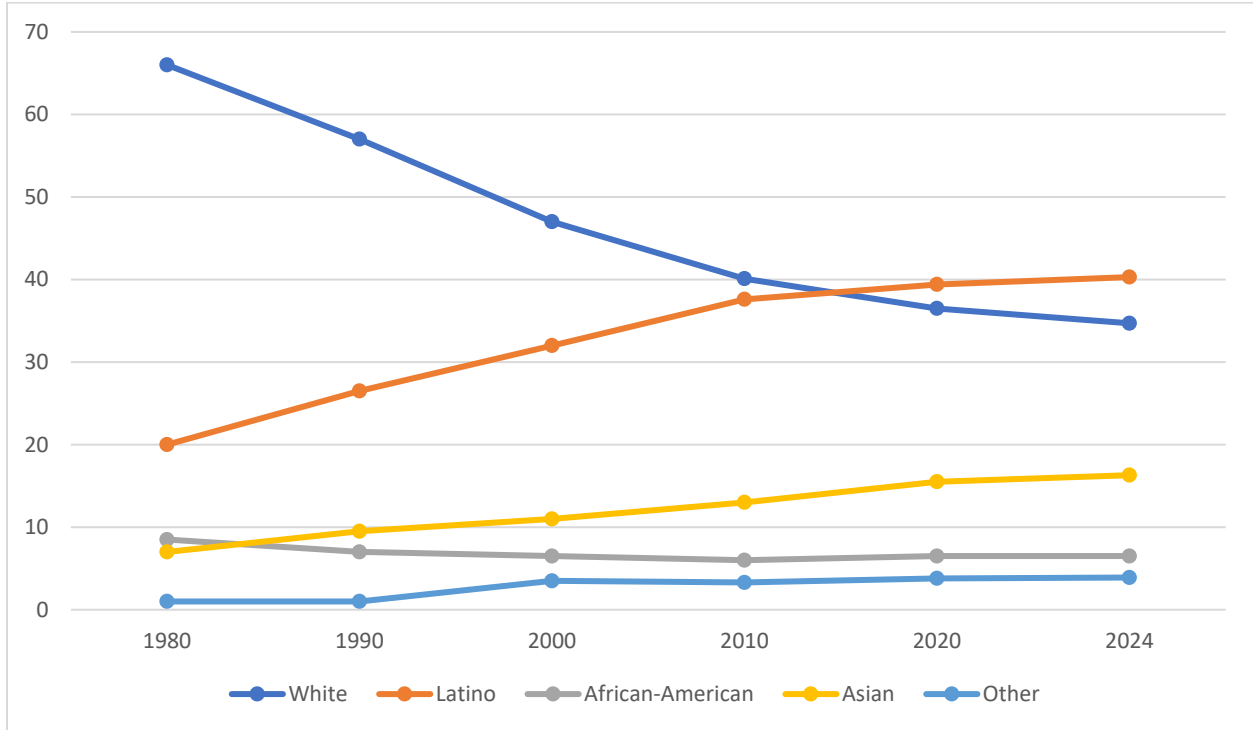
<sup>3</sup> U.S. Census Bureau, 2024.

<sup>4</sup> U.S. Census Bureau, 2024.

<sup>5</sup> U.S. Census Bureau, 2024.

<sup>6</sup> U.S. Census Bureau, 2024.

**Figure 1. Changing Demographics in California, 1980-2024**



Source: U.S. Census Bureau (Percentage of California's population). Non-Latino populations are non-Hispanic.

### *Politics*

As renowned political columnist Dan Walters wrote in 2016, “The state’s Republican Party...failed miserably to adjust to the new demographics. It continued to trumpet themes, such as strident resistance to undocumented immigrants...that alienated not only Latinos and other nonwhite communities but younger, well-educated white Californians as well.”<sup>7</sup>

In the past decade, California has shifted from a Democratic state to a very Democratic state, a place where Republicans have become an endangered species. While Republicanism remains strong in rural California, the Republican brand is cratering in the state’s urban areas, which represent most of its population. The party is also struggling to attract non-white and younger voters, California’s two fastest growing groups. This was brought into stark relief in 2018 when Republican registration briefly fell below “No Party Preference”, leading many Democrats to crow that Republicans had become a “third party” in the state. 2024 is seeing a slight rebound for the party, although there are still almost twice as many Democrats in the state as Republicans.

Democrats now make up 46.2% of the state’s 22 million registered voters.<sup>8</sup> In contrast, Republicans constitute 24.7%, with No Party Preference a close third at 21.9%.<sup>9</sup> In terms of raw numbers, Democrats outnumber Republicans by about 4.7 million voters.<sup>10</sup> This problem is

<sup>7</sup> November 27, 2016. *Sacramento Bee*. How California became a very blue state.

<sup>8</sup> July 5, 2024. *California Secretary of State*. Report of Registration.

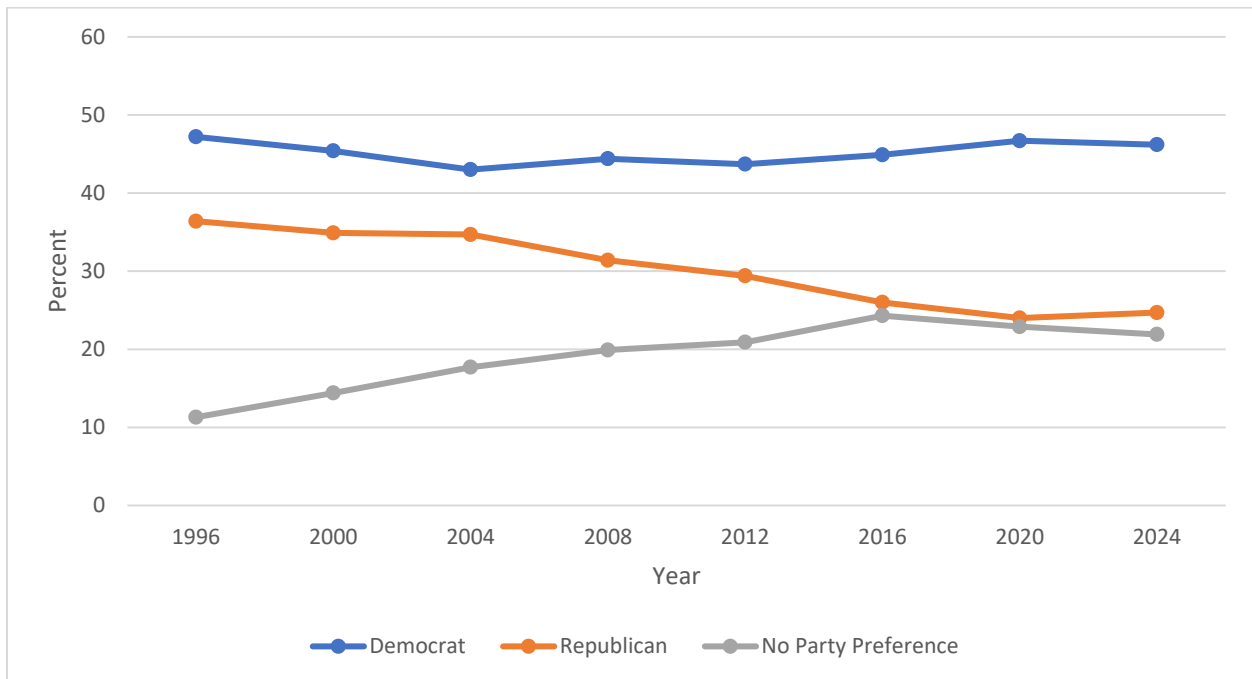
<sup>9</sup> July 5, 2024. *California Secretary of State*. Report of Registration.

<sup>10</sup> July 5, 2024. *California Secretary of State*. Report of Registration.

particularly acute in Los Angeles County and the San Francisco Bay area. In L.A. County, Democrats comprise a majority of registered voters at 52.5%, while No Party Preference has 22.5%, and Republicans garner only 18%.<sup>11</sup> In San Francisco County, only 7.6% of registered voters are Republicans, in contrast to 63.7% Democratic and 23.6% No Party Preference.<sup>12</sup>

Over the past quarter century plus, Republican registration has dropped nearly 12 percentage points while Democratic registration has stayed nearly the same, down only 1% from 1996.<sup>13</sup> Meanwhile, No Party Preference has nearly doubled from 11.3% to 21.9%.<sup>14</sup> Figure 2 depicts the statewide changes in party registration from 1996 to 2024.

**Figure 2. Party Registration in California, 1996-2024**



Source: California Secretary of State. Report of Registration as of July 5, 2024.

### *Unemployment, Housing, & Inflation*

Over the past fifteen years, unemployment has become an increasingly salient issue in California. Since the Great Recession, California’s unemployment rate has always been higher than the nation at large, even in relatively good times. When the COVID-19 pandemic and related economic lockdowns began in Spring 2020, the problem got far worse. California’s unemployment rate reached its zenith in April 2020 at a staggering 16.1%, up from just 4.3% three months earlier.<sup>15</sup> Since then, the state’s jobless rate has dropped considerably to 5.2%.<sup>16</sup> However, California still

<sup>11</sup> July 5, 2024. *California Secretary of State*. Report of Registration.

<sup>12</sup> July 5, 2024. *California Secretary of State*. Report of Registration.

<sup>13</sup> July 5, 2024. *California Secretary of State*. Report of Registration.

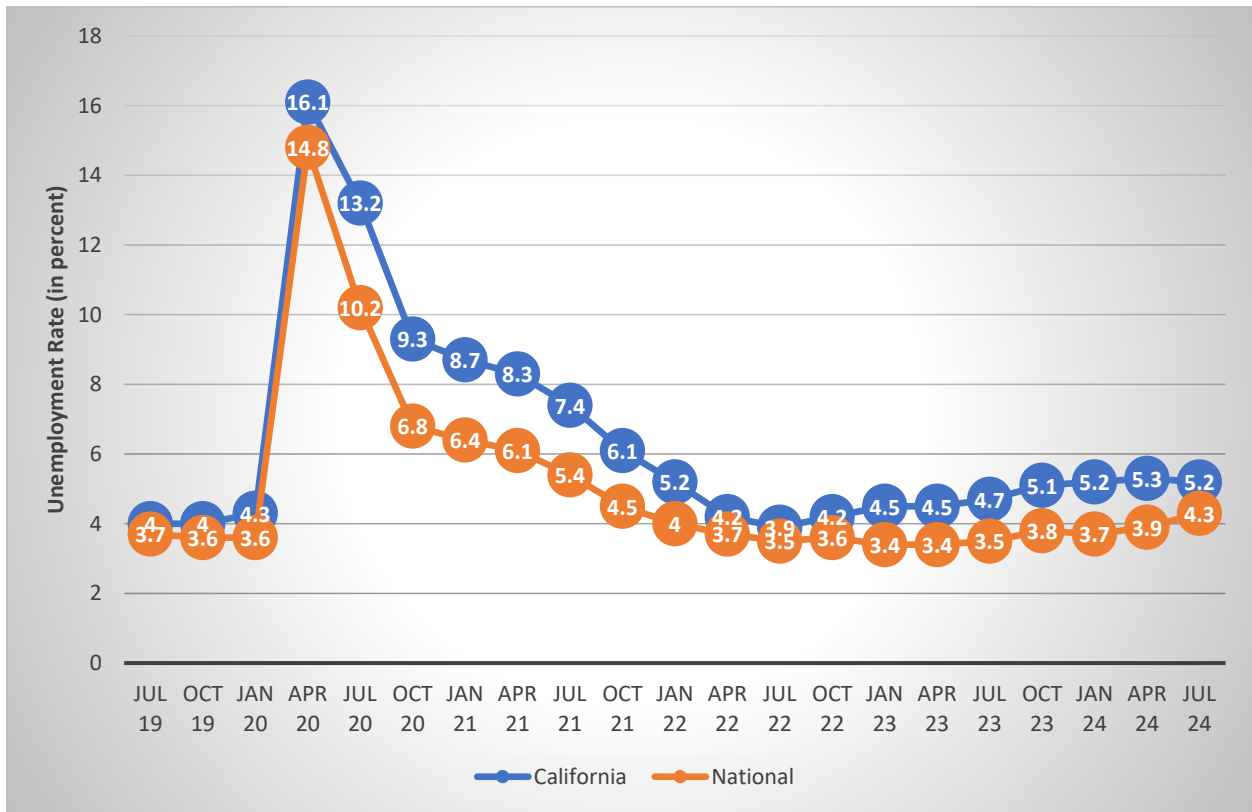
<sup>14</sup> July 5, 2024. *California Secretary of State*. Report of Registration.

<sup>15</sup> U.S. Bureau of Labor Statistics, 2024.

<sup>16</sup> U.S. Bureau of Labor Statistics, 2024.

has an unemployment rate which is nearly 1% higher than that nation at large.<sup>17</sup> Only one other state (Nevada) registered higher unemployment as 2024 began.<sup>18</sup> Figure 3 depicts the California and national unemployment rates from July 2019 to July 2024.

**Figure 3. California vs. National Unemployment Rates (%), July 2019 – July 2024**



Source: U.S. Bureau of Labor Statistics, 2024.

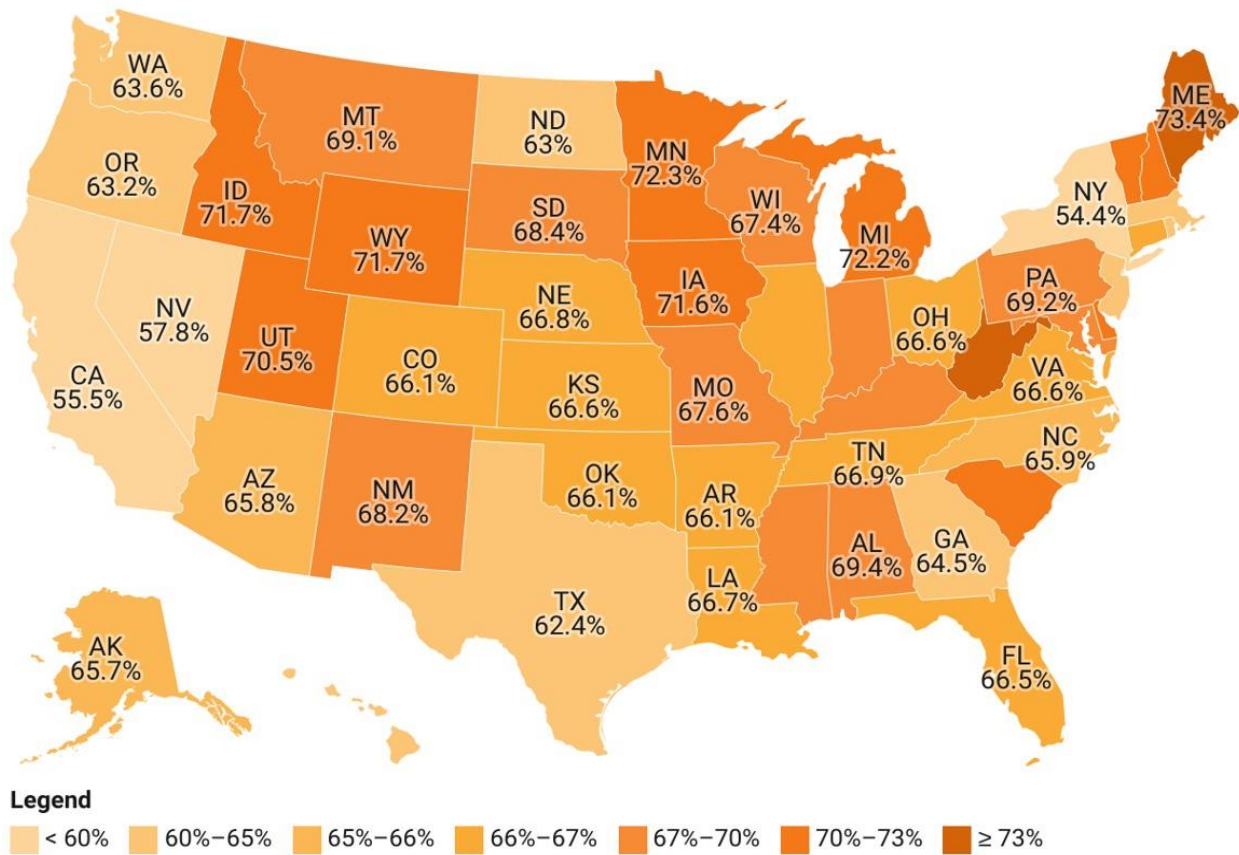
In addition to higher than average unemployment, California has the nation’s highest rate of expanded poverty and the second lowest rate of home ownership, just behind New York (see Figure 4). Even though the state’s population growth has slowed, perhaps even stopped, the state still isn’t building enough housing stock. The state added more than three times the number of people than housing units the past ten years. Only Utah and Hawaii have more people per housing unit, and California’s home prices are the highest in the nation. Rents are also exorbitant. Rent in California is 38% higher than the national median, with the median rent in March 2024 sitting at \$2,755 per month.<sup>19</sup>

<sup>17</sup> U.S. Bureau of Labor Statistics, 2024.

<sup>18</sup> U.S. Bureau of Labor Statistics, 2024.

<sup>19</sup> March 6, 2024. *CalMatters*. Californians face higher costs for goods and services than before the pandemic despite inflation slowing.

**Figure 4. Homeownership Rates by State, 2024**



Source: [www.propertyshark.com](http://www.propertyshark.com) • Created with Datawrapper

Governor Newsom campaigned heavily on housing and housing costs when he initially ran for governor in 2018, promising California would build 3.5 million additional housing units by 2025, requiring the state to quintuple the number of units built each year.<sup>20</sup> But California has not seen a serious uptick in housing construction since Newsom was elected.

Moreover, the state’s homelessness crisis is widely viewed as out of control by the public and policymakers alike. A 2019 survey by the Public Policy Institute of California (PPIC) found that 85 percent of Californians were concerned about the homeless population in their community, with 58 percent saying they were very concerned.<sup>21</sup> While accounting for 12% of the nation’s total population, California accounts for nearly one-third of the country’s homeless population.<sup>22</sup> California has the nation’s highest homelessness rate, with 44 people out of every 10,000 experiencing homelessness.<sup>23</sup> This translates to a homeless population of over 172,000 (nearly equivalent to the size of Eugene, Oregon).<sup>24</sup> More than 115,000 of those are estimated to sleep on

<sup>20</sup> December 7, 2021. *CalMatters*. California housing crisis both wide and deep.

<sup>21</sup> November 21, 2019. *Public Policy Institute of California*. Californians Views on Homelessness.

<sup>22</sup> December 20, 2022. *CalMatters*. California accounts for 30% of nation’s homeless, feds say.

<sup>23</sup> December 20, 2022. *CalMatters*. California accounts for 30% of nation’s homeless, feds say.

<sup>24</sup> December 20, 2022. *CalMatters*. California accounts for 30% of nation’s homeless, feds say.

the streets, in cars, or in tents.<sup>25</sup> Frustratingly, despite billions of dollars spent and Governor Newsom’s insistence on “accountability and results”, the problem continues to get worse. In February 2023, California’s Interagency Council on Homelessness released a report showing the state spent nearly \$10 billion between 2018 and 2021 providing services to more than 571,000 people experiencing homelessness (a number nearly equivalent to the entire population of Wyoming).<sup>26</sup> Despite this, less than half that number ended up receiving housing.<sup>27</sup>

The latest salvo in this political blame game came in September 2023, when Sacramento County District Attorney Thien Ho sued the City of Sacramento, alleging that lax enforcement of city ordinances has led to “Third World squalor” and exposed city residents to hazards, petty crime, and violence.<sup>28</sup> “We have more homeless people in Sacramento than San Francisco. The community is at a breaking point” said Ho.<sup>29</sup> He added that the city was experiencing a “collapse into chaos” reflecting the “erosion of everyday life.”<sup>30</sup> Governor Newsom seemed to agree. He said, “It’s just gone too far. It’s unacceptable, what’s happening on streets and sidewalks. Compassion is not stepping over people on the streets.”<sup>31</sup> He then escalated his criticism of federal judges in the 9<sup>th</sup> Circuit who had made it more difficult to enforce laws against public camping and obligated municipalities to house the unhoused.<sup>32</sup>

However, this all changed in late June 2024, when the U.S. Supreme Court overruled in the 9<sup>th</sup> Circuit in *Grants Pass v. Johnson*. In *Grants Pass*, the Supreme Court held that generally applicable laws prohibiting camping on public property do not constitute “cruel and unusual punishment” for the unhoused, as the 9<sup>th</sup> Circuit had claimed. Newsom hailed the decision, and issued an executive order in July directing state agencies to clear homeless encampments on state land. “There are simply no more excuses,” Newsom said.<sup>33</sup> The move initially drew bipartisan praise, with both San Diego Mayor Todd Gloria (D) and Stockton Mayor Kevin Lincoln (R) endorsing the effort.<sup>34</sup> However, Los Angeles Mayor Karen Bass (D) was more circumspect. She said, “Strategies that just move people along from one neighborhood to the next or give citations instead of housing do not work.”<sup>35</sup>

As the summer went on, tensions between Newsom and reluctant counties, especially Los Angeles County, seemed to grow. The governor made a public show of cleaning up homeless encampments himself in front of TV cameras, and began to threaten counties with funding cuts if they dragged their feet. “If we don’t see demonstrable results, I’ll start to redirect money... I’ll be candid with you... Counties need to do more.”<sup>36</sup> “We’re done with excuses. And the last big excuse was ‘well,

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<sup>25</sup> September 19, 2023. *New York Times*. Sacramento is sued over homeless camps as tensions rise.

<sup>26</sup> February 16, 2023. *CalMatters*. California homelessness: Where are the state’s billions going? Here’s the new, best answer.

<sup>27</sup> February 16, 2023. *CalMatters*. California homelessness: Where are the state’s billions going? Here’s the new, best answer.

<sup>28</sup> September 19, 2023. *New York Times*. Sacramento is sued over homeless camps as tensions rise.

<sup>29</sup> September 20, 2023. *The Daily Mail* (UK). Sacramento DA sues the city over its homeless crisis.

<sup>30</sup> September 20, 2023. *The Daily Mail* (UK). Sacramento DA sues the city over its homeless crisis.

<sup>31</sup> September 19, 2023. *New York Times*. Sacramento is sued over homeless camps as tensions rise.

<sup>32</sup> September 19, 2023. *New York Times*. Sacramento is sued over homeless camps as tensions rise.

<sup>33</sup> July 25, 2024. *Politico*. Governor Newsom issues order to clear homeless encampments on California state land.

<sup>34</sup> July 25, 2024. *Politico*. Governor Newsom issues order to clear homeless encampments on California state land.

<sup>35</sup> July 25, 2024. *Politico*. Governor Newsom issues order to clear homeless encampments on California state land.

<sup>36</sup> August 8, 2024. *Politico*. Newsom to local officials: Clear homeless encampments or else.



the courts are saying we can't do it.' Well, that's no longer the case... So we had a simple executive order. Do your job. No more excuses.," Newsom said.<sup>37</sup> Despite the threats, the governor continued to face pushback. Los Angeles County Board of Supervisors Chair Lindsay Horvath said, "We don't want encampments on our sidewalks, but we cannot, nor are we legally allowed to make jails our de facto housing and shelter"<sup>38</sup> The Board then passed a motion saying that county jails could not be used to house people arrested solely for violating anti-camping ordinances.<sup>39</sup>

Concerns also grew among municipal leaders that homeless residents would simply be shifted from place to place, unless the state better addressed the underlying causes of the crisis. San Jose Mayor Matt Mahan (D) said, "We can't simply wave a magic wand and make encampments disappear. We also have to offer people a place to go... My fear with the Supreme Court decision and the governor's executive order is we could create a race to the bottom in which cities and counties focus their taxpayer dollars on simply shifting people to other jurisdictions."<sup>40</sup>

In addition to housing unaffordability, California's high cost of living and the failure of wages to keep up with inflation are exacerbating these problems. Since 2020, prices have risen by 20% while wages have only grown 15%.<sup>41</sup> As summer turned to fall, the stalemate between Newsom and local leaders continued.

## **The California Budget Process**

The kick-off to budget season is the governor's January budget proposal, which must be submitted to the legislature by January 10 of each year, for the fiscal year beginning July 1. Once submitted, the proposed budget is referred to the Legislative Analyst's Office (LAO) for review. Similar to the Congressional Budget Office, the LAO is tasked with presenting the legislature with independent, objective, and nonpartisan analysis of the state budget. LAO budget analysts craft several detailed reports on the governor's budget, and frequently highlight areas of either inadequate or excessive spending in various departments, as well as highlighting changes from the previous year's budget. The action then shifts to the Assembly Budget and Senate Budget and Fiscal Review Committees, before eventually proceeding to the Assembly and Senate floors for consideration. During this legislative review, the Department of Finance (DOF) issues a revision to the governor's budget numbers in May (colloquially known as the "May Revise") based on updated economic forecasts and revenue projections. The legislature uses these updated figures in crafting its final budget.

Since the adoption of Proposition 25 in 2010, budgets without tax increases require only a simple majority of both houses (41 in the Assembly and 21 in the Senate) to pass, as opposed to the previously required two-thirds vote. Tax increases still require a two-thirds vote of each chamber for passage (54 in the Assembly and 27 in the Senate). Once approved, the budget is sent to the governor for his signature.

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<sup>37</sup> August 8, 2024. *Politico*. Newsom to local officials: Clear homeless encampments or else.

<sup>38</sup> August 8, 2024. *Politico*. Newsom to local officials: Clear homeless encampments or else.

<sup>39</sup> August 8, 2024. *Politico*. Newsom to local officials: Clear homeless encampments or else.

<sup>40</sup> September 1, 2024. *Politico*. A fed-up Gavin Newsom pushes California cities on homelessness.

<sup>41</sup> March 6, 2024. *CalMatters*. Californians face higher costs for goods and services than before the pandemic despite inflation slowing.

At that point, the governor may choose to exercise his line-item veto authority. The governor can zero-out appropriations and other provisions without vetoing the entire budget. However, the governor is not empowered to increase spending on any line-item. Line-item vetoes—like regular vetoes—can be overridden by a two-thirds vote of both houses of the legislature; however, this is exceptionally rare in California. The last successful veto override took place in 1979. Lawmakers have not even voted on a veto override since 2003.<sup>42</sup>

The California Constitution requires the legislature to adopt a budget by June 15, and the governor to affirm his signature by July 1, the beginning of the new fiscal year. This deadline was rarely met in the 1990s and 2000s, owing to the lack of a constitutional enforcement mechanism; Proposition 25 changed the political calculus. Since its adoption in 2010, legislators must pass a budget by the June 15 deadline, or forfeit their pay until one is passed. Prop 25 has proven quite effective in ensuring that California has its new budget in place by July 1.

### **Perennial Obstacles to California Budget-Making**

As we have previously discussed (DiSarro and Hussey 2022), California faces a series of structural and political challenges which tend to make the budget process more difficult than in other states. Several of these perennial obstacles to California budget-making are:

#### *The Balanced Budget Requirement & Boom-and-Bust Budgeting*

Like most states, California is constitutionally required to produce a balanced budget every year. However, unlike most states, California is disproportionately reliant upon income tax and capital gains tax revenue to fund its operations. This creates a boom-and-bust cycle giving the state large surpluses when times are good but huge deficits when times are bad (Cummins 2015). During difficult times, the state is forced to choose between tax increases opposed by Republicans and major spending cuts opposed by Democrats. Both options are politically unpopular with the public.

#### *Supermajority Requirements for Tax Increases*

Over the past 65 years, the Democratic Party has dominated the California Legislature. Republicans have won a majority in the Assembly only twice since 1958, while Senate Republicans have only controlled the chamber once in that time. However, tax increases in California require a two-thirds legislative supermajority, due to Proposition 13, which passed in 1978. Historically, this gave the minority Republicans tremendous leverage over the budget-making process because they possessed an effective veto over tax policy. In recent elections, however, Democrats have frequently won two-thirds majorities (or greater) in the legislature, snatching away one of the minority party's last major influences in state politics.

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<sup>42</sup> October 27, 2015. *Capital Public Radio*. Will California Lawmakers Ever Again Override A Veto?

## *Ballot Box Budgeting*

Of all the states that employ direct democracy, Californians make use of their initiative, referendum, and recall procedures more than citizens of any other state.<sup>43</sup> On any given California ballot, voters can expect to decide the fate of five to fifteen different proposals. Very often, these proposals have significant fiscal impacts. California's reliance upon direct democracy complicates the job of the governor and state legislature in crafting a budget, because certain taxing and spending options are not available to them. For example, Proposition 98 mandates that approximately 40% of the state's budget be allocated for K-14 education (K-12 plus community colleges). Thus, 40% of the budget is off the table before any budget proposals can be made. This system of "ballot box budgeting" also tends to produce structural deficits for the state, even in the best of times. This is because voters have historically approved new spending measures but rejected new tax increases.

### **Previous 2023-2024 Budget**

The final 2023-2024 budget agreed to by Governor Newsom and the legislature was \$310.8 billion, with \$225.9 billion coming from the General Fund and \$84.9 billion coming from other funds (DOF 2023b). Lawmakers managed to close a nearly \$32 billion budget deficit by cutting \$8 billion in spending, borrowing \$6.1 billion, and making up the rest through delaying some planned spending and shifting other expenses.<sup>44</sup>

Both the University of California (UC) and California State University (CSU) systems received 5% base funding rises, representing an increase in ongoing General Fund support of \$215.5 million for the UC and \$227.3 million for the CSU.<sup>45</sup> However, these increases were conditional on enrollment and other metrics.

On the contentious issue of student housing, the budget backed away from earlier plans to provide state grants to colleges and universities to build more housing facilities. Instead, the state proposed that the UC, CSU, and community colleges finance these new construction projects through university-issued bonds. Colleges pushed back, and community college leaders across the state wrote an open letter to the legislature urging them to reconsider. By early September 2023, there seemed to be informal agreement that new student housing would be financed by state issued bonds instead of university issued ones (although this is still subject to approval by the legislature).<sup>46</sup> However, while the politicians were wrangling, students were still trying to find places to stay. At the College of the Redwoods in remote Eureka, California, students were housed in a nearby casino hotel for the fall semester, after an M.O.U. was signed between the administration and the Bear River Rancheria.<sup>47</sup> Whether college students can effectively immerse themselves in academics while staying at a casino is still an open question.

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<sup>43</sup> Initiative & Referendum Institute, 2024.

<sup>44</sup> June 27, 2023. *Associated Press*. California's new budget covers \$32 billion deficit while extending tax credits for film industry.

<sup>45</sup> June 27, 2023. *EdSource*. Legislature, Newsom compromise, quickly pass and sign 2023-24 state budget with fewer cuts for K-12.

<sup>46</sup> September 3, 2023. *San Diego Union-Tribune*. SDCC eyes next step in ambitious affordable student housing project, as state funding shifts.

<sup>47</sup> June 27, 2023. College of the Redwoods Press Release.

The Proposition 98 minimum funding guarantee for K-14 education rose to \$108.3 billion (DOF 2023b). While an increase of \$900 million, this figure fell \$500 million short of Newsom’s original proposal (DOF 2023a). The budget also provided for an 8.22 percent cost of living increase to the Local Control Funding Formula, or LCFF (DOF 2023a). LCFF is a program that funds school districts based on the needs of their students, so higher need students receive more support. There was also good news for the Golden State Pathways program. The program, created in 2022, provides career opportunities in education and the trades for low-income high school students. Originally slated to have most of its funding deferred, the legislature ultimately included the full funding of \$500 million in the budget, a major Newsom priority.<sup>48</sup> Education advocates were pleased.

Meanwhile, the health and human services budget saw much needed increases in reimbursement rates for Medi-Cal providers. CalWORKs also saw new investments, with \$111.2 million earmarked for an ongoing 3.6% increase to CalWORKs grants, beginning October 1, 2023 (DOF 2023b). In addition, the temporary 10% CalWORKs grant increase in the 2022-2023 budget was made permanent, and there were also additional onetime increases to state food assistance (DOF 2023b). The corrections budget was largely static, with only a modest reduction made to the California Department of Corrections and Rehabilitation (CDCR)’s funding from Newsom’s January budget proposal (DOF 2023a, DOF 2023b).

### **LAO’s Fiscal Outlook: “Serious”**

In early December 2023, the state’s impartial Legislative Analyst’s Office released its budget estimate for the current and future fiscal years, projecting a \$68 billion budget deficit created by declining tax revenue. The LAO said revenue declines “similar to those seen during the Great Recession and dot-com bust” were largely driving the shortfall.<sup>49</sup>

While this was the largest projected budget shortfall in dollars – but not percentage – in California history, Legislative analyst Gabriel Petek told reporters the state was in a better economic condition than in previous budget downturns. “I go with the word ‘serious.’ A serious budget problem,” Petek said. “I would stop short of calling it a crisis.”<sup>50</sup>

And the state was also better situated to handle a budget deficit too, as noted by LAO chief budget analyst Ann Hollingshead. “While the revenue drop is comparable to past recessions, including the Great Recession, going into that recession the state had no reserves on hand, while this time it has \$24 billion in reserves.”<sup>51</sup>

H.D. Palmer, longtime spokesperson for Newsom’s Department of Finance, said the administration would have different numbers when the governor presented his plan in January, but

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<sup>48</sup> June 27, 2023. *EdSource*. Legislature, Newsom compromise, quickly pass and sign 2023-24 state budget with fewer cuts for K-12.

<sup>49</sup> December 7, 2023. *New York Times*. California Faces \$68 Billion Deficit Amid Steep Revenue Decline.

<sup>50</sup> December 7, 2023. *CalMatters*. California budget rollercoaster: Analyst predicts \$68 billion deficit.

<sup>51</sup> December 7, 2023. *San Francisco Chronicle*. California schools could face cuts as state budget deficit soars to \$68B.

acknowledged the scope of the budget challenge. “Both the Governor and the Legislature have a substantial challenge before them in closing a very large revenue gap in this budget,” Palmer told *CalMatters*.<sup>52</sup>

The LAO recommended the governor declare a fiscal emergency, allowing California to tap into the state’s “rainy-day” fund created after the last recession. They also suggested the legislature pull back on authorized expenditures not yet spent, along with recalculating mandating funding obligations to K-14 education based on a smaller overall budget. That second option seemed unlikely, however, as new Assembly Speaker Robert Rivas (D-Monterey County) released a statement supporting a budget plan that would protect educational spending.<sup>53</sup>

Despite that, lawmakers seemed to take their responsibility to pass a balanced budget seriously. “I think everything is on the table right now as we consider how to get to where we want to be and where we need to be,” said incoming Assembly Budget Chair Jesse Gabriel (D-Los Angeles). “The top priorities here are to avoid cuts to safety net services for our most vulnerable,” Gabriel told the *Sacramento Bee*. “That’s absolutely the last thing that we want to do. To protect classroom funding, to protect a lot of the progress that we’ve made over recent years, but we’re going to have to make some difficult choices.”<sup>54</sup>

Senate Pro Tem Toni Atkins (D-San Diego) noted that the forecast was “not welcome news,” but that the state also had “record reserves” to cover the shortfall.<sup>55</sup> But Senate Budget Vice-Chair Roger Niello (R-Sacramento County) said any Democratic response that avoided budget cuts entirely was mistaken. “I don’t see this budget being solved without some reductions in spending,” he told reporters. “And to suggest that that doesn’t have to happen, necessarily, is creating expectations that I think are not wise.”<sup>56</sup>

As if on cue, *CalMatters* noted that mere minutes after the LAO released their report, advocates for continued budget spending began releasing press statements supporting the status quo. “California leaders have stepped up before to prioritize Californians who are struggling to get by and they must continue this in 2024,” noted Pete Manzo, president & CEO of United Ways of California.<sup>57</sup>

## **Newsom’s January Proposal**

Newsom released his \$291.5 billion budget proposal – \$19 billion less than the previous budget passed in June 2023 – in early January with a combination of funding cuts and delays, while also tapping the state’s emergency fund to balance shrinking state revenues. Newsom’s Department of Finance projected a \$37.9 billion deficit, smaller than the LAO’s projected \$68 billion.

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<sup>52</sup> December 7, 2023. *CalMatters*. California budget rollercoaster: Analyst predicts \$68 billion deficit.

<sup>53</sup> December 7, 2023. *CalMatters*. California budget rollercoaster: Analyst predicts \$68 billion deficit.

<sup>54</sup> December 8, 2023. *Sacramento Bee*. ‘Everything is on the table’ to fix \$68 billion California budget gap — even a fiscal emergency.

<sup>55</sup> December 7, 2023. *New York Times*. California Faces \$68 Billion Deficit Amid Steep Revenue Decline.

<sup>56</sup> December 8, 2023. *Sacramento Bee*. ‘Everything is on the table’ to fix \$68 billion California budget gap — even a fiscal emergency.

<sup>57</sup> December 7, 2023. *CalMatters*. California budget rollercoaster: Analyst predicts \$68 billion deficit.

“This is a story of correction and normalcy, and one that we in some respects anticipated — the acuity perhaps not — and one we’re certainly prepared to work through,” the governor told reporters.<sup>58</sup> Newsom acknowledged the budget severity in part by advocating the use of \$13.1 billion from the state’s emergency fund – the first for a California governor – while still leaving more than \$18.4 available in case the state’s budget situation continued to decline.

But Newsom downplayed the idea of a budget crisis. “For decades and decades we’ve come to expect the volatility in our tax system,” the governor said, where revenue “goes up during good times, goes down very badly in the bad times.”<sup>59</sup>

While disagreeing with the size of the LAO’s deficit projections, Newsom’s \$38 billion deficit was more than twice the projected shortfall estimated by the state in June 2022. The governor acknowledged budget complications from the 2023 winter storms that delayed tax filings for more than 99% of California taxpayers from April to November. “If you recall, this time last year we were dealing with unprecedented flooding,” Newsom said. “Little did we know that those extreme weather patterns would lead to this extreme volatility in financial projections.”<sup>60</sup>

Newsom also faced questions about differences in the size of the budget deficit between his department and the LAO. The governor largely minimized any difference, claiming it was due to slightly higher projected revenues and other accounting differences. “We’re just a little less pessimistic,” Newsom told reporters, while also repeatedly criticizing the media for reporting the LAO’s numbers. Joe Stephenshaw, Newsom’s budget director, added the administration is less concerned about a potential recession than the budget analyst.<sup>61</sup>

And admittedly, the state is not in a recession. “Until now, California has been growing faster than the U.S., on a per capita basis, and has been one of the fastest-growing states in the U.S.,” Jerry Nickelsburg, an economics professor and director of the UCLA Anderson Forecast told the *Los Angeles Times*. “And now it’s growing at about the rate of the U.S., as really everyone sort of slows down a bit.”

Despite cuts across the budget, K-12 education largely escaped the governor’s fiscal cutbacks, with Newsom’s earlier new programs continuing: the expansion of transitional kindergarten and free school meals for all children. Schools would see only a small reduction, less than \$10 per student compared to the previous year. “This certainly takes the cake on being the best bad-year budget” for K-12, educational budget lobbyist Kevin Gordon told the *Los Angeles Times*.<sup>62</sup>

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<sup>58</sup> January 10, 2024. *Los Angeles Times*. How Newsom plans to fix California’s projected \$37.9-billion budget deficit.

<sup>59</sup> January 11, 2024. *San Jose Mercury*. Gov. Newsom’s budget plan shrinks deficit to \$37.9 billion, solves without major cuts, tax hikes.

<sup>60</sup> January 10, 2024. *Los Angeles Times*. How Newsom plans to fix California’s projected \$37.9-billion budget deficit.

<sup>61</sup> January 10, 2024. *CalMatters*. Digging out: Newsom outlines plan to cover state budget deficit.

<sup>62</sup> January 10, 2024. *Los Angeles Times*. How Newsom plans to fix California’s projected \$37.9-billion budget deficit.

The governor also planned to maintain funding for the expansion of Medi-Cal eligibility to low-income unauthorized immigrants.<sup>63</sup> The state would cut \$8.5 billion from current spending, while delaying and deferring an additional \$7.2 billion.<sup>64</sup> Those delays and deferrals might become longer or even permanent however, if the state continues experiencing budget deficits in future fiscal years.

Multiyear funding to tackle climate change would see an 11% reduction from \$54 billion to \$48.3 billion. Yet administration officials called the cuts “limited” and would not impact the state’s larger climate goals. “\$48.3 billion is a world-leading figure that exceeds [that of] many nations,” said Lauren Sanchez, Newsom’s senior climate advisor.<sup>65</sup> Environmental groups still expressed concern. “It’s a tough economic moment for sure,” Mary Creasman, chief executive of California Environmental Voters told the *Los Angeles Times*. “At the same time, we would have hoped for a little bit more of a courageous proposal — something that is more creative and solutions-oriented about how to fund the transition that is so desperately needed toward clean energy and resilience.”<sup>66</sup>

The state would continue its normal practice in tough budget years of borrowing money and implementing accounting gimmicks. *Los Angeles Times* columnist George Skelton pointed out a California classic, “Pay state employees on July 1 rather than June 30 so the spending can be counted in the next fiscal year.”<sup>67</sup>

The governor also suggested revamping bills he signed last year, including one that will eventually raise wages for health care workers to a \$25 per hour minimum. “The bills that I signed that have new fiscal costs; I think it’s in all of our interest to review them on the basis of the shortfall, and make a determination together whether or not those are still the top priorities of the Legislature,” Newsom told reporters.<sup>68</sup>

Newsom had been signposting this policy change for months. In November 2023, his Department of Finance projected that implementing the new law would cost California approximately \$4 billion in just fiscal year 2024-25. It was expected that approximately 500,00 health care workers would see pay increases once the law went into effect.<sup>69</sup>

And Newsom had previously told the *Los Angeles Times* in December 2023 that his staff was “working behind the scenes” with Democratic lawmakers to mitigate the increased expenditures. Any change, which would require legislative approval, were “all part of an understanding” with

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<sup>63</sup> January 10, 2024. *New York Times*. Newsom Seeks to Close \$37.9 Billion Deficit by Cutting Spending and Using Reserves.

<sup>64</sup> January 10, 2024. *CalMatters*. Digging out: Newsom outlines plan to cover state budget deficit.

<sup>65</sup> January 11, 2024. *Los Angeles Times*. Newsom cuts \$2.9 billion from California climate programs, delays an additional \$1.9 billion.

<sup>66</sup> January 11, 2024. *Los Angeles Times*. Newsom cuts \$2.9 billion from California climate programs, delays an additional \$1.9 billion.

<sup>67</sup> January 11, 2024. *Los Angeles Times*. Newsom’s budget plan reflects his rosy view of the economy.

<sup>68</sup> January 10, 2024. *San Francisco Chronicle*. Gavin Newsom unveils \$291B California budget plan with \$37.9B deficit.

<sup>69</sup> January 11, 2024. *CalMatters*. Newsom OK’d a minimum wage increase for health care workers. Now he wants to delay it.

labor leaders before the governor signed the bill. “We were very upfront with these guys. I said ‘no way in hell,’ and we worked on something, and that will reveal itself in a matter of weeks,” Newsom recalled about his previous conversations leading up the bill’s passage.<sup>70</sup>

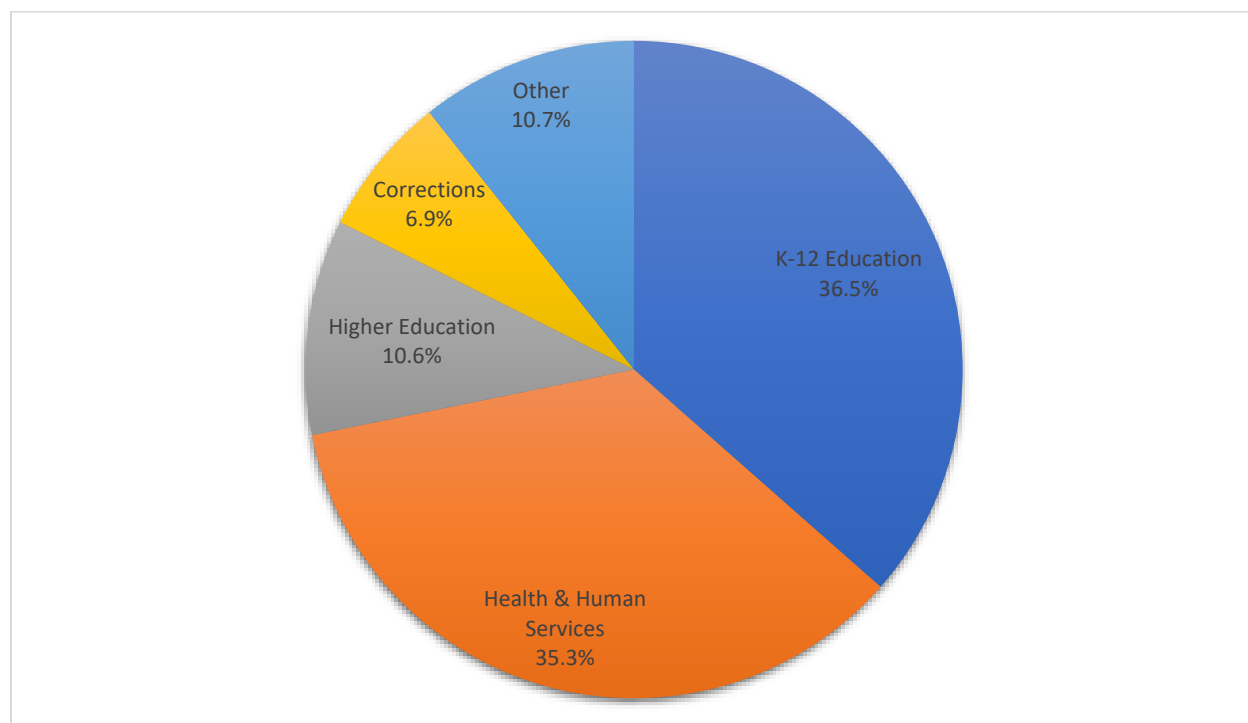
Despite these other cuts and delays, Newsom’s budget proposal maintained \$3.4 billion for homelessness funding, including money to remove encampments. “People have just had it,” he told reporters. “They want these encampments cleaned up. They’re done. They’re fed up.”<sup>71</sup>

Newsom was open to mid-year budget cuts in the current 2023-2024 fiscal budget to generate even additional savings, but deferred to the legislature. “Let’s have that conversation,” he told reporters at his budget press conference.<sup>72</sup>

### **Governor’s Proposed 2024-2025 Budget: The Big Four**

When it comes to expenditures, the “Big Four” in California are K-12 Education, Health & Human Services, Higher Education, and Corrections. In the governor’s proposed budget, K-12 Education made up the plurality of General Fund spending at 36.5%, followed by Health & Human Services at 35.3%, Higher Education at 10.6%, and Corrections at 6.9% (see Figure 5 below) (DOF 2024a).

**Figure 5. Governor’s Proposed General Fund Expenditures, 2024-2025**



Source: California Department of Finance

<sup>70</sup> December 7, 2023. *Los Angeles Times*. As deficit estimate hits \$68 billion, Newsom seeks ‘major changes’ to healthcare wage law.

<sup>71</sup> January 10, 2024. *Los Angeles Times*. How Newsom plans to fix California’s projected \$37.9-billion budget deficit.

<sup>72</sup> January 10, 2024. *CalMatters*. Digging out: Newsom outlines plan to cover state budget deficit.

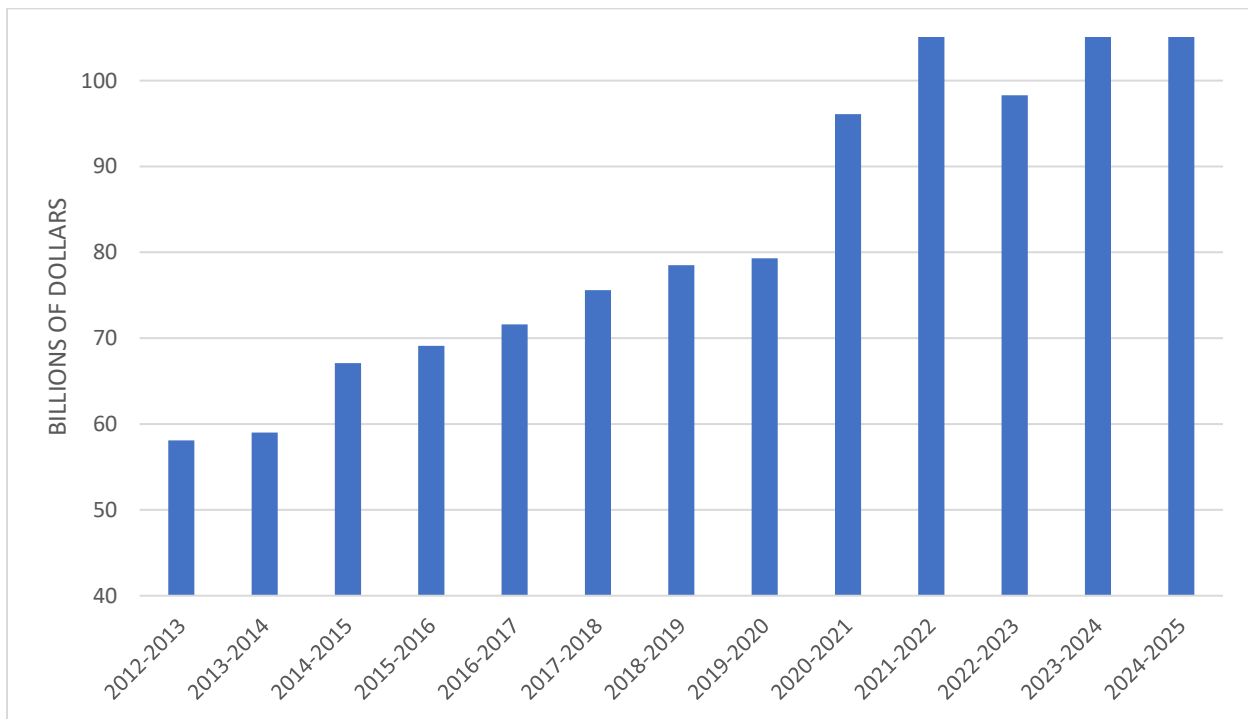


## K-12 Education

The biggest part of the California budget is K-12 education. Governor Newsom proposed to spend \$126.8 billion on education in 2024-2025, with \$76.4 billion coming from the General Fund and \$50.4 billion from other funds (DOF 2024a). This would have brought per pupil spending to \$23,519 in 2024-2025 (DOF 2024a).

Due to lower than expected revenues, and the delay of the tax filing deadline until November 2023, the Proposition 98 minimum funding guarantee for 2024-2025 was lower than was projected back in June 2023 (DOF 2024a). For 2023-2024, it was expected to be \$105.6 billion (DOF 2024a). The governor's budget would raise this by \$3.5 billion to \$109.1 billion in fiscal year 2024-2025 (DOF 2024a). This represented the second highest level of Prop 98 funding ever, behind the \$110.5 billion guarantee in 2021-2022 (DOF 2024a). As Figure 6 illustrates, Prop 98 funding stood at only \$58.1 billion in 2012-2013 and has risen 189% over the past dozen years (DOF 2024a).

**Figure 6. Proposition 98 Funding, 2012-2013 to 2024-2025**



Source: California Department of Finance

Despite the high levels of funding, concerns were growing over both declining enrollment and inequitable outcomes in California schools. In December 2023, the Public Policy Institute of California (PPIC) issued a report projecting a decline of over half a million students by 2031-2032, largely due to falling birthrates and the outmigration of families with school-aged children to other states.<sup>73</sup> Declines are expected to be larger in districts with more English Learner, Asian, Black,

<sup>73</sup> December 2023. *Public Policy Institute of California (PPIC)*. Factors and Future Projections for K-12 Declining Enrollment.

Latino, and low-income students.<sup>74</sup> Los Angeles County alone is expected to see a drop of 19%.<sup>75</sup>

Rural schools also feel they are receiving inadequate attention, and have poorer outcomes as a result. Despite the city-centric image of California, 35% of the state's school districts are considered rural, and by most measures the students there lag behind.<sup>76</sup> Rural students are well behind in English and math, and their graduation rate is only 79% — 12 percentage points lower than the state average.<sup>77</sup> Additionally, only 29% complete the classwork required to attend California's public universities, compared to 50% statewide, and the college-going rate in these areas is nearly 20 percentage points lower than the state average.<sup>78</sup> Rindy DeVoll, executive director of the California Rural Ed Network, said, "We have a system that works through an urban and suburban lens, but leaves rural schools behind. Everyone in education has challenges, but they are amplified for rural districts."<sup>79</sup> Partly, this may come down to politics. Rural districts are overwhelmingly represented by Republicans, which often hold one-third or less of the legislature. Assemblymember James Gallagher (R-Chico) said, "California policy largely does not take into account the needs of rural areas. It's geared toward wealthier, coastal communities. There might be some lip service, but inland, less wealthy areas are stuck with some pretty expensive burdens."<sup>80</sup>

### *Health & Human Services*

The governor's proposed budget included \$253.4 billion in funding for Health & Human Services, with \$73.9 billion coming from the General Fund and \$179.5 billion from other funds (DOF 2024a).

Medi-Cal (California's version of Medicaid) is the largest health care program in the state and has grown substantially over the past decade. It presently provides health insurance for about one-third of the state's population. In 2022, Governor Newsom persuaded the legislature to expand coverage to all those between 26 and 49 years old, regardless of immigration status. This idea did not have universal support, with State Senator Jim Nielsen (R-North Central California) calling the idea "a blank check providing for illegal individuals who have come to California."<sup>81</sup> However, Democrats in the Legislature were more receptive. . In order to fund the expansion, the 2023-2024 budget provided \$1.4 billion, with \$1.2 billion coming from the General Fund (DOF 2024a). In 2024-2025, the governor's proposed budget called for \$3.4 billion in financing, with \$2.9 billion

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<sup>74</sup> December 2023. *Public Policy Institute of California (PPIC)*. Factors and Future Projections for K-12 Declining Enrollment.

<sup>75</sup> December 2023. *Public Policy Institute of California (PPIC)*. Factors and Future Projections for K-12 Declining Enrollment.

<sup>76</sup> March 4, 2024. *CalMatters*. Rural California schools are desperate for state help, from special education to construction.

<sup>77</sup> March 4, 2024. *CalMatters*. Rural California schools are desperate for state help, from special education to construction.

<sup>78</sup> March 4, 2024. *CalMatters*. Rural California schools are desperate for state help, from special education to construction.

<sup>79</sup> March 4, 2024. *CalMatters*. Rural California schools are desperate for state help, from special education to construction.

<sup>80</sup> March 4, 2024. *CalMatters*. Rural California schools are desperate for state help, from special education to construction.

<sup>81</sup> January 10, 2022. *Sacramento Bee*. California lawmakers respond to Newsom's budget: 'Good ideas shouldn't have party lines.'

coming from the General Fund (DOF 2024a). Ongoing expenses were projected to be \$3.7 billion annually, with \$32 billion annually coming from the General Fund (DOF 2024a).

Other major programs in Newsom's Health & Human Services budget included CalWORKs, In-Home Supportive Services (IHSS), and Supplemental Security Income/State Supplementary Payment (SSI/SSP). CalWORKs is California's main social welfare program that offers cash assistance and child care for the poor. The In-Home Supportive Services program compensates individuals for providing domestic care services to low-income elderly, blind, and disabled Californians. Lastly, SSI/SSP is a federal/state program that provides a direct cash benefit to elderly, blind, and disabled residents on a monthly basis.

The governor proposed \$7 billion in spending for CalWORKs in 2024-2025, including a 0.8% increase to the program's Maximum Aid Payment levels (DOF 2024a). For IHSS, the governor's budget called for \$24.3 billion in spending, with \$9 billion coming from the General Fund (DOF 2024a). The average monthly caseload was expected to grow to approximately 691,000 in 2024-2025 (DOF 2024a). And, for SSI/SSP, the budget called for General Fund expenditures of \$3.7 billion, with an average monthly caseload of 1.1 million in 2024-2025 (DOF 2024a). Due to cost of living adjustments, the maximum SSI/SSP grant levels rose to \$1,183/month for individuals and \$2,023/month for couples, effective January 1, 2024 (DOF 2024a).

### *Higher Education*

The governor's proposed budget included \$44.8 billion in funding for Higher Education, with \$26.9 billion coming from the General Fund and local property taxes and \$17.9 billion from other funds (DOF 2024a).

The University of California system would have received approximately \$4.74 billion in ongoing General Fund appropriations (DOF 2024a). This would have represented an increase of only \$17.1 million in ongoing funding compared to 2023-2024 (DOF 2024a). Similarly, the governor's budget called for the California State University system to receive \$5.47 billion in ongoing support from the General Fund (DOF 2024a). This represented an increase of only \$63.7 million in ongoing funding compared to 2023-2024 (DOF 2024a).

The paltry increases resulted from the governor's decision to defer promised annual 5% bumps to the UC and CSU's budgets, known as "the compact," to 2025-2026 (DOF 2024a). For the UC, this would have meant losing out on \$227.8 million of support in 2024-2025. For the CSU, the hit would have been even larger, at \$240.2 million (DOF 2024a). Newsom had promised to restore the compact in 2025-2026, and pay the systems back next year for the money that was not delivered this year. He was also urging both systems to borrow money to cover the missing 5% on the promise that they would be repaid. Higher ed leaders were leery. Steve Relya, executive vice chancellor and chief financial officer for the CSU system, said "The governor's administration has supported and continues to signal future support for the CSU and its compact. But the proposed deferral raises significant concerns, and we must proceed with fiscal prudence and caution."<sup>82</sup> CSU Trustee Julia Lopez warned, "There's a huge gap between what we have to pay for in commitments and the revenues we identified. The conversation in Sacramento is just beginning. We need to have

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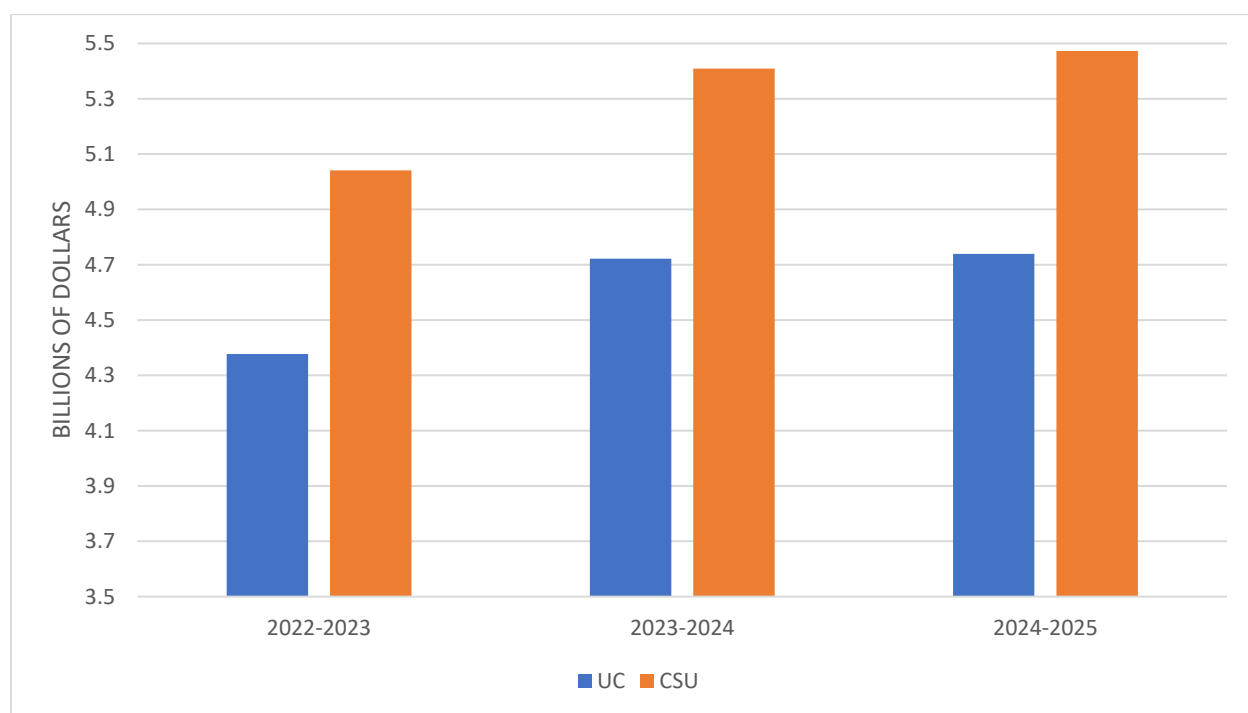
<sup>82</sup> February 1, 2024. *EdSource*. Anticipating less state aid, CSU campuses start making cuts.

our voices heard, and we need to be very clear.”<sup>83</sup>

Further complicating the headaches for the University of California system, progress on admitting fewer out-of-state students and more California residents had stalled, especially at its most prestigious campuses. The legislature had taken notice, demanding the UC administration do more to admit more qualified California residents, one of the key conditions of receiving compact funding.<sup>84</sup>

Figure 7 illustrates the ongoing General Fund budget for the UC and CSU systems over the past three years.

**Figure 7. Ongoing General Fund Support,  
UC & CSU Systems, 2022-2023 to 2024-2025**



Source: California Department of Finance

### *Corrections*

The governor’s proposed budget included \$14.5 billion in funding for the California Department of Corrections and Rehabilitation (CDCR), with \$14.1 billion coming from the General Fund and \$364.3 million from other funds. This represented a slight increase from the 2023-2024 budget (DOF 2023b, DOF 2024a). However, the state said it was likely to realize savings down the line because the average daily incarcerated population is in the midst of a long-term decline (DOF 2024a). In January 2020, CDCR’s population was 123,977, currently it is projected to be 94,222, and by 2026-2027 it should fall to 88,183 (DOF 2024a).

<sup>83</sup> February 1, 2024. *EdSource*. Anticipating less state aid, CSU campuses start making cuts.

<sup>84</sup> March 13, 2024. *EdSource*. UC has enrolled more Californians, but lawmakers says it’s not enough.

## Newsom's Proposed Budget: Reponses

Democratic lawmakers predicatively praised the governor's budget. Senate Pro Tem Toni Atkins (D-San Diego) noted the state was in much better fiscal shape than the previous large deficits in 2010. Assembly Speaker Robert Rivas (D-Monterey County) told reporters his caucus "is committed to fiscal restraint and spending oversight while delivering solutions to improve the quality of life for all Californians and protect the most vulnerable."<sup>85</sup>

Legislative Republicans also predictably criticized Newsom. "As the governor pulls revenue gimmicks and accounting tricks, it's impossible to bury the truth: California is bleeding because of a decade of Democrats' one-party rule and reckless spending," Senate GOP leader Brian Jones (San Diego County) said in a press statement. Vince Fong (Bakersfield), the top Republican on the Assembly budget committee, called for a special session on the budget. "Waiting will not absolve him of his lack of preparation, and will only cause more harm to the most vulnerable Californians," Fong said in a statement.<sup>86</sup>

The liberal nonprofit California Budget & Policy Center criticized Newsom for not proposing to balance the budget with additional tax increases.<sup>87</sup> The governor has consistently disparaged legislative attempts to pass a wealth tax. At his budget conference, Newsom repeatedly lashed out at the *Wall Street Journal* for implying in an editorial the day before he might support such a proposal. "Are you supporting a wealth tax? No, yet again. Why the hell do you keep writing about that?" Newsom said during his budget presentation.

The governor told reporters he was inundated with phone calls about the possibility of a new tax on affluent Californians, arguing the *Wall Street Journal* and other media were "damaging" the Golden State. "The state's been paying a price for the misrepresentation and lies being advanced every single day about this state," he said.<sup>88</sup>

*The New York Times* noted Newsom might be projecting to more than just California with his budget proposal, noting "The state's Democratic leaders are regularly judged by their spending choices, not just by voters in California, and Mr. Newsom has positioned himself ahead of the 2024 presidential election as a defender of Democratic values."<sup>89</sup>

UC Berkely and the *Los Angeles Times* released a joint new poll in early January 2024, with half of California registered voters calling the state budget deficit an "extremely serious" problem, and almost 60% believing the state is headed in the wrong direction. "Voters are concerned about it,

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<sup>85</sup> January 10, 2024. *CalMatters*. Digging out: Newsom outlines plan to cover state budget deficit.

<sup>86</sup> January 10, 2024. *CalMatters*. Digging out: Newsom outlines plan to cover state budget deficit.

<sup>87</sup> January 10, 2024. *CalMatters*. Digging out: Newsom outlines plan to cover state budget deficit.

<sup>88</sup> January 10, 2024. *Politico*. Gavin Newsom slams WSJ on wealth-tax editorial: 'Shameful'.

<sup>89</sup> January 10, 2024. *New York Times*. Newsom Seeks to Close \$37.9 Billion Deficit by Cutting Spending and Using Reserves.

and they're going to hold it against the governor and the Legislature to do something about it," said long-time California pollster Mark DiCamillo, the polls' director.<sup>90</sup>

## The LAO Strikes Back?

The LAO released its initial analysis of Newsom's proposed budget a few days after the governor's submission, suggesting his budget relied too heavily on unexpected revenue, calling it "optimistic but plausible." But the nonpartisan agency largely agreed with the governor, suggesting a much smaller gap between the two estimates than portrayed by the media. In probably the widest area of disagreement, the analyst's office believed the governor's budget did not accurately explain how it planned to save \$8 billion in K-14 funding, "given the administration also indicates the proposal would not impact school and community college budgets."<sup>91</sup>

But by late February, the LAO's budget outlook again darkened, and therefore their predicted budget deficit widened, which once again brought attention to the difference between the LAO analysis and Governor Newsom's proposal. The analyst's office projected a \$73 billion deficit, with recent revenues reflecting "even further weakness" in the state's fiscal future. Assembly Speaker Rivas told reporters the budget deficit was his "biggest concern," and that lawmakers were open to early legislative budget actions. "The governor's budget has been more optimistic than the LAO," Rivas noted. "And I sure hope that the governor is right. We would all like to be wrong when it comes to the deficit. And that's why I firmly believe that it's always better to plan for the worst."<sup>92</sup>

Republicans continued their attacks on Newsom, with Senate Minority Leader Jones releasing a statement criticizing the governor for "trying to fool the public that the deficit is \$38 billion." He asked, "How are we supposed to balance the budget when our governor can't even admit the true size of the deficit his administration racked up?"<sup>93</sup>

The *Sacramento Bee* wisely noted the most important story wasn't the difference between the LAO and Newsom's Department of Finance (DOF) financial figures, but that Newsom was attempting to focus the media away from the LAO's estimates and onto the governor's numbers. As opposed to earlier years, "What has been different is Newsom's insistence that it was wrong for journalists and observers to take the LAO's bigger estimate 'as gospel,' setting up a continuing comparison between the two."<sup>94</sup> This is California's first substantial experience with a declining state budget since Newsom was elected in 2018. As media attention becomes more critical and unfavorable, the governor might be pushing back more than previously.

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<sup>90</sup> January 18, 2024. *Los Angeles Times*. Voters say California's budget deficit is an 'extremely serious' problem, poll finds.

<sup>91</sup> January 17, 2024. *Sacramento Bee*. Gavin Newsom's California spending plan is overly optimistic, budget analyst says. Here's why.

<sup>92</sup> February 20, 2024. *Sacramento Bee*. California's budget deficit is worse than anticipated — and much worse than Newsom projected.

<sup>93</sup> February 20, 2024. *Sacramento Bee*. California's budget deficit is worse than anticipated — and much worse than Newsom projected.

<sup>94</sup> February 25, 2024. *Sacramento Bee*. California has dueling budget deficits. Here's what that means and what lawmakers could cut.

In addition, voters almost defeated a major ballot measure in the March 2024 primary election, heavily supported by Newsom on his signature issue of homelessness. The governor campaigned and spent heavily on Proposition 1, a \$6.4 billion bond to build additional treatment options for the homeless and mental health population. The measure also shifts mental health spending to tackle substance addiction. It won with only 50.2% of the vote, passing with about 30,000 votes out of more than 7.5 million cast.<sup>95</sup>

Although the primary was expected to have a higher share of the Republican vote because of the presidential primary, Newsom made a “strategic decision to place the measure on the March ballot because it believed it could withstand a more conservative electorate,” according to the *Los Angeles Times*. California will see several even larger bonds on the November ballot, which might have doomed Prop 1’s chances as voters decide among several competing financial measures.<sup>96</sup>

But the close election victory was a major shock, and Newsom even postponed his State of the State address when the measure’s outcome was in question.<sup>97</sup> Newsom raised more than \$12 million in his campaign to pass Prop 1, while the opposition campaign, Californians Against Proposition 1, did not even have a bank account a few months before the election to accept contributions.<sup>98</sup>

Newsom’s approval ratings also dropped to 47%, according to a February 2024 PPIC Poll, with 50% disapproval, the first time in his governorship that more voters disapproved than approved.<sup>99</sup> That even includes 2021, when Newsom had to face down a voter recall.

Speaking at a news conference two weeks after its passage, the governor acknowledged the close victory. “We recognize and clearly, soberly, we’re reconciling the fact change has its enemies,” Newsom said. “Change is tough. Change is hard. And so these have been a few long weeks, sleepless weeks.” He told reporters he thought the public was cynical that money would solve the problem, and he shared that cynicism.<sup>100</sup>

Californians Against Proposition 1 released a statement calling the measure’s passing “an embarrassing squeaker of a victory,” for Newsom.<sup>101</sup>

### **“Early Action” on the Budget**

Newsom and Democratic legislative leaders agreed in late March to reduce the budget deficit by implementing cuts to the current FY 2023-2024 budget before passing the FY 2024-25 budget in June. Initially it was unclear what exactly was getting cut, the size of the total cuts, or even if they were cuts, rather than just spending delays. The governor had requested the legislature take “early action” by canceling unspent funding or delaying planned spending. The Senate followed with a \$17 billion plan, but the Assembly stalled.

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<sup>95</sup> April 19, 2024. *Politico*. Inside Gavin Newsom's brush with failure.

<sup>96</sup> March 20, 2024. *Los Angeles Times*. Newsom's Proposition 1 passes in California's primary election.

<sup>97</sup> March 15, 2024. *Politico*. Newsom postpones state address amid Prop 1 uncertainty.

<sup>98</sup> March 2, 2024. *Politico*. ‘Everyone is terrified of King Gavin’: Newsom’s unchallenged anti-homelessness gambit

<sup>99</sup> April 19, 2024. *Politico*. Inside Gavin Newsom's brush with failure.

<sup>100</sup> March 20, 2024. *Los Angeles Times*. Newsom's Proposition 1 passes in California's primary election.

<sup>101</sup> March 20, 2024. *Los Angeles Times*. Newsom's Proposition 1 passes in California's primary election.

Assembly Budget Chair Jesse Gabriel (D-Los Angeles) told reporters he needed more time. “We value process and we value time to consider all of these trade-offs,” Gabriel said, adding the Assembly would release its own proposals in April. Assembly Speaker Rivas was even more circumspect, releasing a statement hailing the non-agreement as “an important first step”.<sup>102</sup> Republicans pounced. The top Republican on the Senate Budget Committee, Roger Niello (R-Sacramento County), called the announcement “unilateral decision-making happening behind closed doors by one political party.”<sup>103</sup>

Newsom both wanted to tackle the budget deficit early as well as get credit for tackling the budget deficit early. Before the announcement, he had met with legislative Democrats caucuses before their spring break with the hope of securing positive news.<sup>104</sup> *Politico* pointed out the announcement offers “Newsom the political benefit of announcing a smaller deficit number alongside his revised budget proposal in May”.<sup>105</sup>

But the only action the Democratic legislature agreed to before the break was to increase the tax on managed care originations, or MCOs, an increase that would also unlock billions in federal funds.<sup>106</sup>

While we previously noted this is the governor’s first experience dealing with a California budget deficit, it’s also the same for the state legislatures as well. “This is going to be a new experience for almost everybody, including me,” Budget Chair Jesse Gabriel admitted to *Politico*. Joe Stephenshaw was also only appointed director of the Department of Finance in summer 2022. “You have new people all around in this budget process,” said Assemblymember Phil Ting (D-San Francisco), the former Budget chair.<sup>107</sup>

Senate Democrats had just sworn in their new leader in February, with Mike McGuire (D-Sonoma County) taking over for Toni Atkins (D-San Diego), who is term-limited. As we discussed in our last budget report (DiSarro and Hussey 2024), McGuire was Atkins’ top deputy and won a quiet insider leadership contest back in 2023, in contrast to the messy and lengthy affair in the Assembly eventually won by Robert Rivas (D-Monterey County). Both Rivas and McGuire represent rural districts in a state overwhelmingly dominated by urban areas.<sup>108</sup>

A couple weeks after the legislative break, the Assembly released their plan, and while it shared the same \$17 billion in total cuts and delays as the Senate package, it contained a big difference. The Assembly plan rejected the governor’s plan to reduce housing and homelessness funding.

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<sup>102</sup> March 21, 2024. *Los Angeles Times*. California has an enormous budget deficit. Newsom and lawmakers say they plan to make a plan.

<sup>103</sup> March 21, 2024. *Los Angeles Times*. California has an enormous budget deficit. Newsom and lawmakers say they plan to make a plan.

<sup>104</sup> March 21, 2024. *Los Angeles Times*. California has an enormous budget deficit. Newsom and lawmakers say they plan to make a plan.

<sup>105</sup> March 20, 2024. *Politico*. Let’s make a deal — later.

<sup>106</sup> April 4, 2024. *Sacramento Bee*. Gavin Newsom, California lawmakers cut \$17 billion deal to shave looming state budget deficit.

<sup>107</sup> March 20, 2024. *Politico*. Let’s make a deal — later.

<sup>108</sup> February 5, 2024. *CalMatters*. Mike McGuire wants to ‘lift up every person’ as new California Senate leader.



Rivas' office confirmed the leaked plan to *Politico*, including the rejection of Newsom's proposed cuts. "It also reflects member feedback and the Assembly's careful, deliberative process," his spokesperson said in a statement. "The Speaker looks forward to refining this plan further in conversation with the Senate and administration."<sup>109</sup>

But those differences were largely set aside, and an agreement was quickly reached, with a joint Democratic proposal to cut or delay \$17.3 billion from the budget, along with pulling \$12.2 billion from reserves. Among other components, the plan would delay \$1 billion in transit funding, pause open hiring for state jobs potentially saving \$700 million, and clawback \$500 million from a program to help K-12 school districts pay for building projects.<sup>110</sup>

The *Sacramento Bee* summarized it as "\$3.6 billion in cuts, \$5.2 billion in delays and deferrals, \$3.4 billion in costs shifted from the general fund to other state funds and \$5.2 billion in revenue and borrowing."<sup>111</sup>

"We are able to meet this challenge thanks to our responsible fiscal stewardship over the past years, including record budget reserves of close to \$38 billion," Newsom said in a statement. "There is still work to do as we finalize the budget and I look forward to the work ahead together to continue building the California of the future." Senate President Pro Tem McGuire told reporters, "We are all committed to delivering an on-time balanced budget, and this early action agreement is a critical first step to shrink the state's shortfall."<sup>112</sup>

The agreement largely mirrored the Senate plan, but included the Assembly's pushback on the governor's homeless cuts acknowledged, with those specific cuts dropped. And the Assembly also won another component: the administration was authorized "to pause one-time spending from prior budget years that has not yet been dispersed."<sup>113</sup>

Rivas told the *Sacramento Bee* he was pleased the Assembly's proposals made it into the final agreement. While he characterized the negotiations as a "partnership" and said they were "not adversarial in any way," he admitted the talks involved "resetting" the relationship with the Senate and administration.<sup>114</sup>

The legislature quickly approved the cuts, delays, borrowing, fund shifts, and paper machete dolls a few days later. Republicans said the deal relied too much on accounting tricks and not enough on real cuts. Senator Niello noted the state "saves" \$1.6 billion by pushing state payroll a day later, into the next fiscal year. "In the interest of transparency, or perhaps a bit of comic relief, I think it's important at this public hearing to point out what I like to call the mother of all gimmicks,"

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<sup>109</sup> April 2, 2024. *Assembly Dems buck Newsom's budget*

<sup>110</sup> April 4, 2024. *Los Angeles Times*. Newsom, lawmakers detail first California budget cuts of \$17 billion.

<sup>111</sup> April 4, 2024. *Sacramento Bee*. Gavin Newsom, California lawmakers cut \$17 billion deal to shave looming state budget deficit.

<sup>112</sup> April 4, 2024. *Los Angeles Times*. Newsom, lawmakers detail first California budget cuts of \$17 billion.

<sup>113</sup> April 4, 2024. *Los Angeles Times*. Newsom, lawmakers detail first California budget cuts of \$17 billion.

<sup>114</sup> April 4, 2024. *Sacramento Bee*. Gavin Newsom, California lawmakers cut \$17 billion deal to shave looming state budget deficit.

Niello said. “It is only a budget gimmick that recognizes \$1.6 billion in savings by delaying recognition of a payment by 24 hours.”<sup>115</sup>

Newsom had done away with the payroll delay five years ago, during headier economic times, but had told reporters then if “I use it in six years, in a recession, forgive me.”<sup>116</sup>

And while the governor and his administration wanted to downplay budget cuts, Sen. Lola Smallwood-Cuevas (D-Los Angeles) worried that some reductions could affect reentry services for those released from prison. “I just would hope that the criteria (for what money is paused or cut) is looking at issues of public safety and that those are being prioritized,” she said during a committee hearing.<sup>117</sup>

From a larger perspective, the *Los Angeles Times* warned “The struggle to reach a consensus up until this point foreshadows the difficult work ahead in May and June for a Legislature and governor with little experience leading through a fiscal crisis as they weigh challenging choices that affect millions of Californians,” noting the “cuts Democrats agreed to make this month are largely considered the easier choices.”<sup>118</sup>

“They are doing things that you normally do in a recession and there is no recession here,” said David Crane, president of the conservative nonprofit Govern for California. “You shouldn’t have to be dipping into reserves to meet a budget deficit if your revenues are 50% higher than they were when you came into office.”<sup>119</sup>

### **May Revise: More Cuts, Delays, and Borrowing**

In early May, Newsom released his May Revision, and it acknowledged a \$7 billion larger deficit than his initial January proposal. Now at \$45 billion, the governor proposed to balance the state \$288 billion budget by in part eliminating 10,000 vacant state jobs, and delaying billions in climate change spending. “These are propositions that I’ve long advanced, many of them. These are things that I’ve supported,” Newsom told reporters during his budget press conference. “But you’ve got to do it. We have to be responsible. We have to be accountable. We have to balance the budget.”<sup>120</sup>

Starting from the \$17.3 billion in savings from the “Early Action” cuts made in April, Newsom’s plan also included money from the state’s rainy day fund, a first since its creation by predecessor Jerry Brown.

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<sup>115</sup> April 11, 2024. *San Francisco Chronicle*. California lawmakers vote to lower deficit by \$17B through cuts and ‘mother of all gimmicks’.

<sup>116</sup> April 11, 2024. *Los Angeles Times*. Newsom called it a ‘gimmick.’ Now he’s using the trick to lower California’s massive deficit.

<sup>117</sup> April 11, 2024. *San Francisco Chronicle*. California lawmakers vote to lower deficit by \$17B through cuts and ‘mother of all gimmicks’.

<sup>118</sup> April 4, 2024. *Los Angeles Times*. Newsom, lawmakers detail first California budget cuts of \$17 billion.

<sup>119</sup> April 11, 2024. *Los Angeles Times*. Newsom called it a ‘gimmick.’ Now he’s using the trick to lower California’s massive deficit.

<sup>120</sup> May 10, 2024. *CalMatters*. Big cuts, no new taxes: Gov. Newsom’s plan to fix California’s budget deficit.

Continuing a theme, Republican Senator Niello noted the budget deficit discrepancies between Newsom’s estimates and the LAO. “He continues to hang on to the unrealistically low deficit with the clear expertise of the LAO stating that the problem is significantly greater than that and that just means that his budget solutions are shooting too low,” Niello told the *Los Angeles Times*. “We’ll get to the end of another fiscal year where we’re in trouble again, just like this one.”<sup>121</sup>

“California’s budget situation is a mess,” echoed Assemblyman Vince Fong (R-Bakersfield), the ranking Republican on Budget Committee. “I have said repeatedly that budget gimmicks, cost shifts and more borrowing only creates more problems in the future. Using budget reserves to prop up unsustainable spending is not only unwise, it’s fiscally irresponsible.”<sup>122</sup>

Democratic legislative leaders were unsurprisingly more supportive, but still cautious. “We are encouraged that the Governor’s May Revision improves budget prospects for future years and saves rainy-day reserves,” Assembly Speaker Robert Rivas and Budget Committee Chair Jesse Gabriel said in a joint statement, adding they “will continue to fight to protect core programs for California’s most vulnerable residents and essential classroom funding.” Senate President Pro Tem Mike McGuire and Budget Committee Chair Scott Wiener (D-San Francisco) also said in a joint statement that their past budgets “have uplifted communities and Californians — this year will be no different.”<sup>123</sup>

Other areas of spending were not cut or delayed, specifically new programs the governor and legislative Democrats have championed recently. *The Mercury News* noted those included transitional kindergarten for 4-year olds, and the expansion of Medi-Cal to unauthorized immigrants, which the LAO estimated would cost \$3.1 billion annually. “Our values are intact despite some tough choices we are making in this budget,” Newsom told reporters.<sup>124</sup>

A few budget and political problems remained. Last year, Newsom signed a bill imposing a \$25 per hour minimum wage for health care workers, after lengthy negotiations in part on the potential cost to the state. Newsom now wanted to revise the deal, or at least delay the state’s costs, which his administration estimated could run \$2 billion in just the first year. While a new compromise was not finalized by the May Revision’s unveiling, the governor told reporters, “This budget will not be signed without that deal.”<sup>125</sup>

Another area of contention is the MCO tax, the aforementioned levy on health care organizers the legislature and Newsom earlier authorized. The governor wanted to use much of that increase to help balance the budget, rather than the original deal to increase rates for Medi-Cal providers. Jodi Hicks, president and CEO of the Planned Parenthood Affiliates of California, said she was “deeply disappointed” by the budget plan, saying it will “jeopardize access to not just sexual and

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<sup>121</sup> May 10, 2024. *Los Angeles Times*. How Newsom plans to offset California's \$45-billion deficit.

<sup>122</sup> May 10, 2024. *Mercury News*. Newsom says state has \$27 billion budget shortfall, but it can be balanced without raising taxes.

<sup>123</sup> May 10, 2024. *CalMatters*. Big cuts, no new taxes: Gov. Newsom’s plan to fix California's budget deficit.

<sup>124</sup> May 10, 2024. *Mercury News*. Newsom says state has \$27 billion budget shortfall, but it can be balanced without raising taxes.

<sup>125</sup> May 10, 2024. *Los Angeles Times*. How Newsom plans to offset California's \$45-billion deficit.

reproductive care but quality, affordable health care across the board for the nearly 15 million Californians who rely on Medi-Cal.”<sup>126</sup>

Health insurance plans originally agreed to increased taxes so the state could claim matching federal funds, potentially up to \$35 billion over four years. As *CalMatters* noted, this “would be invested in the Medi-Cal system to increase reimbursement rates and attract doctors and other providers who otherwise say they don’t get paid enough.” But Newsom redirected those additional funds to help balance the budget deficit, thereby cancelling planned Medi-Cal rate increases for emergency room doctors, specialists and certain other providers.”<sup>127</sup>

“This is mind-boggling for the public, but really the story is about equality,” said John Baackes, chief executive of L.A. Care Health Plan, the nation’s largest publicly operated health plan. “Nobody is saying that the state doesn’t have a (budget) problem. We know they have a problem, but the cost that’s going to be paid by the people who benefit from the Medi-Cal program is very difficult for the providers to accept,” Baackes said.<sup>128</sup>

In later budget hearings, lawmakers who approved the tax deal accused the administration of dishonesty. “I’m just wondering if any of the discussions we’ve had about the shortages, the closures, the issues that we have on the ground, the workforce shortages, if any of those things came into thought as you were trying to preserve core services, which is important, but if you don’t have providers to go to, what have we done?” said Assemblymember Akilah Weber (D-San Diego), an obstetrician, in one of hearings.<sup>129</sup>

Earlier when the May Revision was first unveiled, Newsom acknowledged cuts and delays would annoy interest and constituency groups throughout the state. But he stressed his budget package was better than any alternative. “We have a math problem,” he said. “Is this what I want to do? No.”<sup>130</sup>

“The public wants to see results. They’re not interested in inputs, they’re not interested to talk about how much money we’re spending,” the governor said. “They deserve results and they demand results.”<sup>131</sup>

And as reiterated in past years, Newsom took tax increases off the table. “There are no new taxes. I’ve not been one of those promoting taxes,” the governor said, adding later, “No, I’m not prepared to increase taxes.”<sup>132</sup>

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<sup>126</sup> May 10, 2024. *Los Angeles Times*. How Newsom plans to offset California's \$45-billion deficit.

<sup>127</sup> May 23, 2024. *CalMatters*. The single largest cut in Gavin Newsom's new budget hits California health care providers.

<sup>128</sup> May 23, 2024. *CalMatters*. The single largest cut in Gavin Newsom's new budget hits California health care providers.

<sup>129</sup> May 23, 2024. *CalMatters*. The single largest cut in Gavin Newsom's new budget hits California health care providers.

<sup>130</sup> May 10, 2024. *Mercury News*. Newsom says state has \$27 billion budget shortfall, but it can be balanced without raising taxes.

<sup>131</sup> May 10, 2024. *Los Angeles Times*. How Newsom plans to offset California's \$45-billion deficit.

<sup>132</sup> May 10, 2024. *CalMatters*. Big cuts, no new taxes: Gov. Newsom’s plan to fix California's budget deficit.

But as *CalMatters* noted, the governor did concede he believes in a broader overhaul of California's volatile tax system, but was unwilling to publicly share his ideas in how to untie that Gordian knot. "Should we reform the tax system? The answer is 'yes,'" Newsom said. "How we do that is a more difficult and challenging conversation."<sup>133</sup>

## Enter the Teachers

The thorniest issue with a California budget deficit is how to deal with K-14 education, which has constitutional spending protections due to Proposition 98, passed by voters in 1988. An incredibly complex measure, Prop 98, broadly summarized, requires 40% of the state's General Fund to flow to public schools and community colleges. Any cut to the overall state budget means either cutting educational funding, and risk the wrath of the powerful California Teachers Association (CTA), or establish higher constitutional minimums for educational funding that will be politically and fiscally difficult to square later (Pillar 2021).

To balance the budget, Newsom proposed a "complicated accounting maneuver" that spared education an \$8 billion cut, but reduced the money schools will get in later years by \$12 billion. In response, the CTA began running TV advertisements in Sacramento featuring Newsom in 2021 promising not to cut education funding. "Tell lawmakers and Governor Newsom to pass a state budget that protects public schools for our students and communities," the CTA ad urged.<sup>134</sup>

*Politico* noted the powerful union not only endorsed and supported Newsom for governor in 2018 against other Democrats, but had just donated \$250,000 to Proposition 1, Newsom's ballot measure that barely passed earlier in the spring. The CTA downplayed any conflict, calling Newsom "a steadfast ally" and noted previous targeted ads during budget conflicts. "We have a fundamental disagreement with his approach to the education budget this year and the long term impact on Proposition 98," Goldberg said in a statement. "We have disagreed on things in the past and worked through them."<sup>135</sup>

The union also threatened to sue the state, something it has done frequently in budget fights. Those cases usually don't get resolved until long after the June budget deadline, but they can reshape options governor's have in future budget conflicts. "This is a clear violation of the Constitution," CTA President David Goldberg said at a news conference. "When you have clear violations of the Constitution, often you go to legal remedies, so that is definitely one of the tools in our toolbox."<sup>136</sup>

The LAO had previously warned Newsom's educational spending would create "bad fiscal policy" by establishing a new fiscal and legal precedent. Newsom had defended his plan against the legislative analyst. "We respectfully disagree with that position," Newsom said, "I want to maintain the commitments in terms of the investments we've made, which I think are incredibly important. I don't want to see thousands and thousands of pink slips go out. I don't want to see the disruption in the system."<sup>137</sup>

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<sup>133</sup> May 10, 2024. *CalMatters*. Big cuts, no new taxes: Gov. Newsom's plan to fix California's budget deficit.

<sup>134</sup> May 21, 2024. *Politico*. Teachers helped elect Gavin Newsom. Now, they're angry about his budget cuts.

<sup>135</sup> May 21, 2024. *Politico*. Teachers helped elect Gavin Newsom. Now, they're angry about his budget cuts.

<sup>136</sup> May 21, 2024. *Politico*. Teachers helped elect Gavin Newsom. Now, they're angry about his budget cuts.

<sup>137</sup> May 21, 2024. *Politico*. Teachers helped elect Gavin Newsom. Now, they're angry about his budget cuts.

Democratic legislators largely wanted to stay out of the dispute. “There’s points to be noted on both sides,” said Senator John Laird (D-Santa Cruz), chair of the Senate’s education budget subcommittee. “It’s the governor’s call on how to handle this with the education interests,” Laird added.<sup>138</sup>

The Governor’s Office declined to comment on the CTA advertisement, but H.D. Palmer, the Department of Finance’s longtime spokesperson, defended the governor’s plan. “This budget proposal is not only legal and constitutional in our view, but is designed to provide predictable and stable support for K-12 schools and community colleges in the wake of last year’s unprecedented disruption in revenue projections,” Palmer released in a statement.<sup>139</sup>

A week later, a compromise was reached: no clawback for already appropriated education spending above Prop 98 minimums, and Newsom would give education groups their demanded funding in future years. The legislature would suspend Prop 98 for the first time since the Great Recession in FY 2010-11, with any delayed money owed to schools, called the “maintenance factor” in Prop 98 speak, to be repaid over time. “The agreement reached with the governor to protect public school funding is a critical step forward for California’s schools and communities,” said CTA President Goldberg. “It ensures that students, educators, and families aren’t impacted by cuts to the classroom and includes protection against additional layoffs of educators.”<sup>140</sup>

“This agreement is a smart and balanced policy solution that incorporates feedback from California’s educators,” Newsom said in a statement. “Working together, we are protecting California’s students, families, and educators and putting the state on a fiscally sound and sustainable path.”<sup>141</sup> Finding the additional funding as part of the guarantee would be left to a future Newsom to deal with, but for now, one of the largest obstacles to a budget deal was eliminated.

### **Out of the Education Frying Pan, Into the MCO Fire**

In early June, lawmakers released their own plan to balance the deficit, reducing Newsom’s reductions in homelessness spending by calling for deeper cuts in climate change programs and the state prison system. “These were difficult choices,” Assembly Budget Chair Gabriel said in an Assembly budget hearing. But he added the legislature restores “many of the most painful cuts to safety net programs, housing and health,” proposed by the governor.<sup>142</sup>

Legislators also weighed into the fight over the minimum wage for health care workers that was still taking place behind the scenes between Newsom and the health care labor unions. Many stakeholders disagreed with Newsom’s \$2 billion cost estimate, placing it closer to \$300 million,

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<sup>138</sup> May 21, 2024. *Politico*. Teachers helped elect Gavin Newsom. Now, they're angry about his budget cuts.

<sup>139</sup> May 21, 2024. *Politico*. Teachers helped elect Gavin Newsom. Now, they're angry about his budget cuts.

<sup>140</sup> May 29, 2024. *EdSource*. Gov. Newsom, school groups settle funding fight, with some more money coming as IOUs.

<sup>141</sup> May 28, 2024. *Politico*. Gavin Newsom and teachers union resolve their budget beef.

<sup>142</sup> June 5, 2024. *Los Angeles Times*. With deadline nearing, Newsom and lawmakers disagree over solutions to California budget crisis.

and Democratic legislators proposed a \$100 million appropriation for the pay raises the first year, which would increase to \$300 million over time.<sup>143</sup>

But the largest sticking point remained the MCO tax, the complicated and obscure health care levy, and where that additional revenue should go. As a brief summary, a California MCO taxes health care providers, allowing new revenue to be matched with additional federal Medicaid funding, increasing overall spending within California's Medi-Cal (DOHS 2023). The levy usually manifests as a tax on managed care plans per member. Kinnucan (2024) points out California is at the forefront of states using this process to acquire additional matched federal funding, even if the federal government isn't always so pleased states find clever new approaches to increase federal spending with these targeted taxes.

While virtually every California stakeholder supported the increased tax, disagreement remained on how to use the additional funds. Newsom wanted to apply the extra funding for general Medi-Cal costs, to help balance the budget. In contrast, a coalition of health care groups wanted the money to go to higher provider rates, an agreement Newsom made previously during headier economic times. Doctors and other providers even placed an initiative on the November 2024 ballot that would permanently establish the MCO tax and direct much of that additional revenue to higher provider rates.<sup>144</sup>

Legislative Democrats struck a middle position, rejecting the governor's plan to eliminate the provider rate increase scheduled for January 1, 2025. But at the same time, lawmakers delayed most provider increases until 2026.<sup>145</sup>

This insider and private fiscal policy conflict over an obscure but important component of state funding eventually began bubbling to the public surface. Jim DeBoo, a California super-lobbyist and Newsom's former chief of staff, confirmed to *Politico* in mid-June he was stepping away from his leadership role over the MCO ballot measure. "My agreement with the coalition from March [2023] was always [that] if the Administration and coalition couldn't reach an accord, I wouldn't continue working on the measure," DeBoo texted the online media newspaper.<sup>146</sup>

The lobbyist noted he didn't want to be connected to a measure that the governor has privately resisted. Jarrod McNaughton, the CEO of Inland Empire Health Plan, previously accused Newsom of forcing DeBoo to resign, but DeBoo told *Politico* it was entirely his choice. "The accusation from someone I've never met that the Governor forced me to do anything is offensive to me as a professional," DeBoo countered.<sup>147</sup>

The constitution requires the legislature to pass a balanced budget by June 15 or forfeit their pay. It does not require them to pass a final budget, just any budget. Consequently, the legislature passed

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<sup>143</sup> June 5, 2024. *Los Angeles Times*. With deadline nearing, Newsom and lawmakers disagree over solutions to California budget crisis.

<sup>144</sup> June 5, 2024. *Los Angeles Times*. With deadline nearing, Newsom and lawmakers disagree over solutions to California budget crisis.

<sup>145</sup> June 5, 2024. *Los Angeles Times*. With deadline nearing, Newsom and lawmakers disagree over solutions to California budget crisis.

<sup>146</sup> June 13, 2024. *Politico*. Top Newsom adviser steps away from health care initiative amid standoff with allies.

<sup>147</sup> June 13, 2024. *Politico*. Top Newsom adviser steps away from health care initiative amid standoff with allies.

a preliminary placeholder budget in mid-June, while still working on a final deal with Newsom. The plan was for the remaining components to be implemented in later supplemental legislation.<sup>148</sup>

And about a week after the June 15 deadline, legislative leaders and Newsom finalized a \$300 billion state budget deal that included \$16 billion in cuts or delays. That state would declare a fiscal emergency and draw \$5 billion from the state's rainy day fund, with even more planned the following fiscal year. Both sides agreed to limit business tax credits, and the state will pause an operating loss deduction for large business from 2024 through 2026. Newsom whittled down the initial legislative plan to cut \$1 billion from corrections to \$750 million, with \$400 million coming from eliminating vacant positions.<sup>149</sup>

The governor was also able to delay implementation of the minimum wage hike for health care workers until October 15, with a further delay possible if collected state revenue doesn't meet projections, or additional federal funding fails to materialize.<sup>150</sup> Dave Regan, president of SEIU United Healthcare Workers West, admitted "workers are disappointed about the delay," but he added, "in future years workers will be able to count on the wage increases agreed upon without doubt, delay or further debate."<sup>151</sup>

And the solution to the MCO tax debate? Stalemate, with the coalition of providers refusing to remove their ballot measure locking in MCO funds for higher reimbursement rates, and the governor insisting on using the additional MCO funding to help balance the budget this year. Lawmakers and Newsom offered a smaller pot of money for provider rate increases as part of the budget compromise, but that funding becomes "inoperable", or eliminated, if the MCO measure is approved by voters in the fall.<sup>152</sup>

In a statement to the media, the governor declared victory. "This agreement sets the state on a path for long-term fiscal stability — addressing the current shortfall and strengthening budget resilience down the road," he said. "We're making sure to preserve programs that serve millions of Californians, including key funding for education, health care, expanded behavioral health services and combating homelessness."<sup>153</sup>

Legislative leaders released similarly positive statements. "The Assembly fought hard to protect the public services that matter most to Californians, and we are delivering a budget that prioritizes affordability and long-term stability," Speaker Rivas said. "Make no mistake: This is a tough budget year, but it also isn't the budget situation we were originally fearing," President Pro Tem McGuire said. "This balanced budget helps tackle some of our toughest challenges with resources

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<sup>148</sup> June 13, 2024. *New York Times*. How California, Once Flush, Got Stuck With a Budget Shortfall.

<sup>149</sup> June 22, 2024. *Los Angeles Times*. Newsom, Democrats use cuts, reserves and 'budget emergency' declaration to solve California deficit.

<sup>150</sup> June 22, 2024. *Los Angeles Times*. Newsom, Democrats use cuts, reserves and 'budget emergency' declaration to solve California deficit.

<sup>151</sup> June 23, 2024. *Washington Post*. How California's \$100 billion surplus became a 'budget emergency'.

<sup>152</sup> June 22, 2024. *Los Angeles Times*. Newsom, Democrats use cuts, reserves and 'budget emergency' declaration to solve California deficit.

<sup>153</sup> June 22, 2024. *CalMatters*. What you need to know about the California budget deal.



to combat the homelessness crisis, investments in housing, and funding to fight wildfires and retail theft.”<sup>154</sup>

Critics were less generous. Rob Stutzman, a Republican strategist blamed the deficit on Democratic mismanagement. “It continues to suggest that the California progressive dream — the California way — isn’t such a great model of governance,” he told the *Washington Post*. “It makes it hard to imagine why a California governor would be elected beyond California.”<sup>155</sup>

### **State of the State Address: Like and Subscribe**

Remember the State of the State address Newsom delayed back in March because his homelessness ballot measure was too close to call? The governor finally delivered his address in late June, after finalizing the budget with legislative Democrats. Continuing a pattern from previous years, Newsom didn’t appear in the Capitol, but rather in a nontraditional video posted on social media. The governor dislikes using teleprompters because of his dyslexia.<sup>156</sup>

“Our values and our way of life are the antidote to the poisonous populism of the right, and to the fear and anxiety that so many people are feeling today,” Newsom told...the Internet. “People across the globe, they look to California and see what’s possible, and how we can live together and advance together and prosper together across every conceivable and imaginable difference.”<sup>157</sup>

Newsom boasted his administration’s work on housing, homelessness and crime, policy areas that have occupied much of the governor’s attention, and perhaps related, are major concerns in the state. “When it comes to America’s homeless problem, California’s detractors have similarly offered nothing but rhetoric, moaning and casting blame,” the governor said. “No state, by the way, has done more as California in addressing this pernicious problem of homelessness plaguing cities and towns.”<sup>158</sup>

Newsom criticized national conservatives over the issue of abortion, and definitely aimed his address at more than a California audience. But the *Los Angeles Times* also noted, “in a lighter moment, he described the state as a ‘weird, wild, free-spirited’ creative haven, home to the heavy metal band Metallica and rapper Kendrick Lamar and a place that invented ‘the popsicle, blue jeans and Barbie.’”<sup>159</sup>

Traditionally delivered in January at the start of the budget process, insiders suggest the address was a way for governors to push policy proposals while also showing deference to lawmakers by appearing in their chamber. Rusty Areias, a former Democratic assemblyman in the 1980s and 1990s, was upset Newsom upended that tradition and didn’t appear in front of lawmakers. “I hope it’s the last time it ever happens,” he told the *Times*. “It’s one of the things that members always look forward to. I understand the governor is very busy. I understand that there are national and

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<sup>154</sup> June 22, 2024. *CalMatters*. What you need to know about the California budget deal.

<sup>155</sup> June 23, 2024. *Washington Post*. How California’s \$100 billion surplus became a ‘budget emergency’.

<sup>156</sup> June 25, 2024. *Los Angeles Times*. Newsom attacks ‘delusional California bashers’ in unorthodox speech.

<sup>157</sup> June 25, 2024. *Los Angeles Times*. Newsom attacks ‘delusional California bashers’ in unorthodox speech.

<sup>158</sup> June 25, 2024. *Los Angeles Times*. Newsom attacks ‘delusional California bashers’ in unorthodox speech.

<sup>159</sup> June 25, 2024. *Los Angeles Times*. Newsom attacks ‘delusional California bashers’ in unorthodox speech.

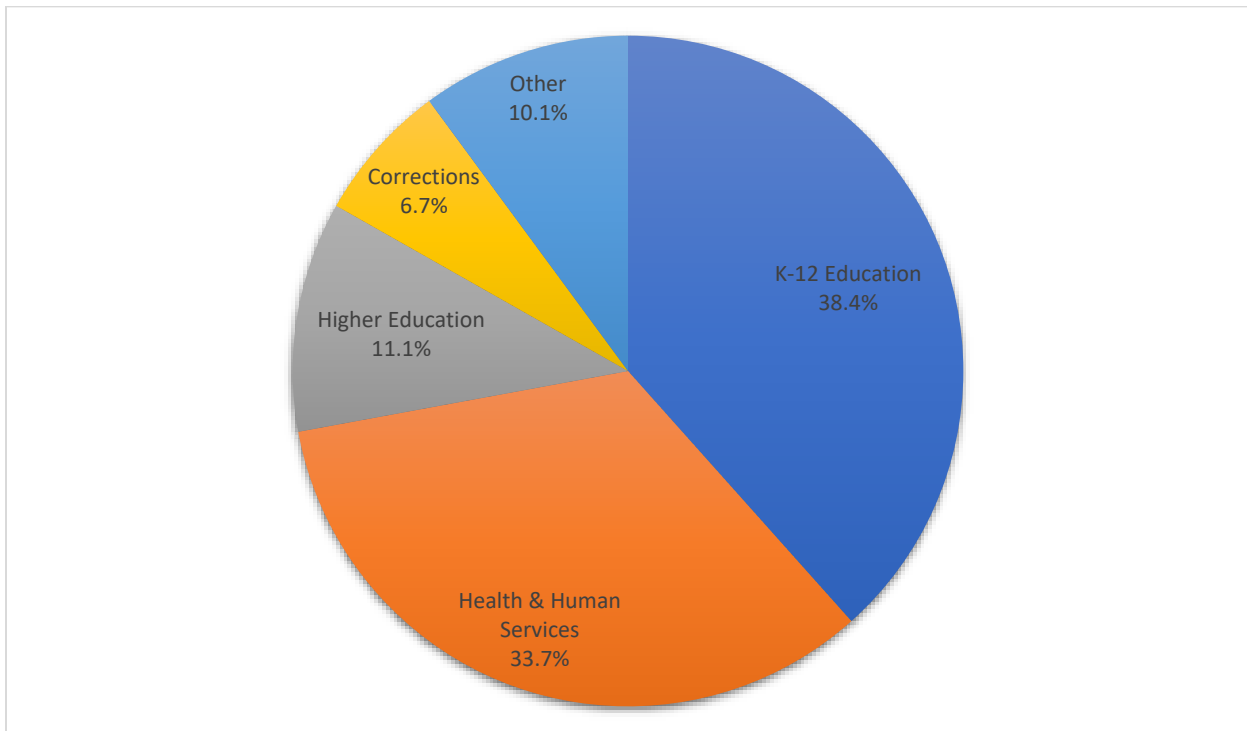
international issues that are probably more important, but it is a tradition that in my mind is worth maintaining.”<sup>160</sup>

Throughout the address, interspersed with videos and pictures, the governor positioned California as a “beacon” of exceptionalism. “There’s only one state in America with a dream — the California Dream,” he said. “It’s a dream built on opportunity, a dream built on pushing boundaries and celebrating, not merely ‘tolerating,’ diversity.”<sup>161</sup>

### **The Final 2024-2025 Budget: The Big Four**

The final state budget agreed to by Newsom and the legislature was \$297.9 billion, with \$211.5 billion coming from the General Fund and \$86.4 billion coming from other funds (DOF 2024b). In the final budget, K-12 Education accounted for 38.4% of General Fund expenditures, Health and Human Services for 33.7% , Higher Education for 11.1%, and Corrections for 6.7% (see Figure 8 below) (DOF 2024b).

**Figure 8. California's General Fund Expenditures, 2024-2025**



Source: California Department of Finance

### *K-12 Education*

K-12 education is the single largest expense facing the state of California, and consumed nearly

<sup>160</sup> June 25, 2024. *Los Angeles Times*. Newsom attacks 'delusional California bashers' in unorthodox speech.

<sup>161</sup> June 25, 2024. *Politico*. Newsom warns of 'forces of darkness' ahead of presidential debate.

40% of General Fund revenues in 2024–2025 (DOF 2024b). Overall, the state provided \$133.8 billion of funding to support primary and secondary education, with \$81.5 billion coming from the General Fund and \$52.3 billion coming from other funds (DOF 2024b).

Despite all the drama earlier in the year, the budget deal between Newsom and legislative leaders largely kept K-12 funding flat, and some of Newsom’s proposed cuts were restored, such as \$60 million for the Golden State Teachers Program and \$100 million for preschools to provide better special education services.<sup>162</sup> In addition, the budget provided for an 1.07% cost of living increase to the Local Control Funding Formula (LCFF) (DOF 2024b). Despite the increase, this was much less than the 8.22 percent COLA for LCFF in the prior 2023-2024 budget (DOF 2023b).

However, this deal came at the cost of financial gimmicks that could be problematic for the state in years to come. For example, the budget drained the state’s \$8.4 billion rainy day fund, and created \$6 billion worth of debt that will take 12 years to be repaid (assuming all goes well).<sup>163</sup> In addition, the agreement delayed payments to schools and community colleges and suspended the state’s Prop 98 obligations for the current school year, with a promise to pay them back in the future.<sup>164</sup>

Reaction was mixed. Rob Manwaring, senior policy and fiscal adviser for Children Now, said “While the final budget is perhaps the best schools could anticipate given the budget challenges, we worry about the size of the suspension for schools, \$8.3 billion. Schools will eventually get paid back those funds in future years on top of the minimum guarantee, but these payments will result in increased school funding volatility and uncertainty until they are paid back.”<sup>165</sup> However, Kevin Gordon, president of the school consultancy Capitol Advisors Group, said “This budget remarkably insulates K-14 funding from cuts, abides by constitutional requirements to restore funding in the future, and even provides a modest cost-of-living increase, all amid a record budget shortfall. Pretty amazing.”<sup>166</sup>

### *Health & Human Services*

Health, welfare, and social service programs were the second largest General Fund expense in the 2024–2025 budget, accounting for 33.7% of all state spending (DOF 2024b). The budget provided a total of \$260.8 billion for such programs, with \$71.6 billion coming from the General Fund and \$189.1 billion coming from other funds (DOF 2024b).

Medi-Cal is the largest health care program in the state and has seen substantial growth over the past decade. In addition to rising caseloads, there has also been expanded eligibility. The 2022-

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<sup>162</sup> June 24, 2024. *EdSource*. Gov. Newsom’s twists and tricks to spare cuts to schools and community colleges in state budget.

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<sup>164</sup> June 24, 2024. *EdSource*. Gov. Newsom’s twists and tricks to spare cuts to schools and community colleges in state budget.

<sup>165</sup> June 24, 2024. *EdSource*. Gov. Newsom’s twists and tricks to spare cuts to schools and community colleges in state budget.

<sup>166</sup> June 24, 2024. *EdSource*. Gov. Newsom’s twists and tricks to spare cuts to schools and community colleges in state budget.

2023 budget expanded eligibility to all Californians up until age 25 and over age 50, regardless of their immigration status. The current budget fills that 26-49 “donut hole” and expands eligibility to all income eligible Californians, also regardless of immigration status (DOF 2024b). This is projected to cost \$3.3 billion (\$2.8 billion General Fund) in 2024-2025 and \$3.4 billion (\$2.9 billion General Fund) ongoing (DOF 2024b).

CalWORKs also saw adjustments in its budget to provide for a 0.3% increase to the CalWORKs Maximum Aid Payment level beginning on October 1, 2024 (DOF 2024b). The average monthly CalWORKs caseload is expected to be 354,772 in 2024-2025 (DOF 2024b). There were also additional onetime increases to state food assistance (DOF 2024b).

### *Higher Education*

Higher education was the third largest area of state spending in 2024–2025, consuming 11.1 percent of General Fund revenues (DOF 2024b). Overall, the state provided \$44.6 billion in funding, with \$28.3 billion coming from the General Fund and local property taxes, and \$16.3 billion coming from other funds (DOF 2024b).

Unlike K-12 education, higher education did not fare as well in the final budget deal. On the plus side, both the University of California and California State University systems received their 5% “compact money” increases, which Newsom had originally proposed delaying. This much-needed infusion of cash amounted to \$227.8 million for the UC and \$240.2 million for the CSU.<sup>167</sup> However, the promised 5% increase for 2025-2026 will now be delayed until 2026-2027.<sup>168</sup> The UC and CSU will also face onetime cuts of \$125 million and \$75 million, respectively, in 2024-2025.<sup>169</sup> The state is promising to restore those cuts in 2025-2026.<sup>170</sup> Finally, both the UC and CSU will face a 7.95% cut in their administrative expenses in 2025-2026.<sup>171</sup> Given the combination of cuts, increases, and repayments facing higher ed over the next several years, it is no wonder university budget analysts are confounded and cautious.

However, the budget deal did contain a bright spot for students. At the legislature’s insistence, the \$637 million in ongoing funding for the middle-class scholarship will continue, along with a onetime \$289 million increase in 2024-2025.<sup>172</sup>

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<sup>167</sup> June 24, 2024. *EdSource*. Gov. Newsom’s twists and tricks to spare cuts to schools and community colleges in state budget.

<sup>168</sup> June 24, 2024. *EdSource*. Gov. Newsom’s twists and tricks to spare cuts to schools and community colleges in state budget.

<sup>169</sup> June 24, 2024. *EdSource*. Gov. Newsom’s twists and tricks to spare cuts to schools and community colleges in state budget.

<sup>170</sup> June 24, 2024. *EdSource*. Gov. Newsom’s twists and tricks to spare cuts to schools and community colleges in state budget.

<sup>171</sup> June 24, 2024. *EdSource*. Gov. Newsom’s twists and tricks to spare cuts to schools and community colleges in state budget.

<sup>172</sup> June 24, 2024. *EdSource*. Gov. Newsom’s twists and tricks to spare cuts to schools and community colleges in state budget.

## *Corrections*

Corrections is the last of the “big four” spending categories, with funding for the California Department of Corrections and Rehabilitation (CDCR) accounting for 6.7% of the 2024-2025 General Fund budget (DOF 2024b). Overall, CDCR received a total of \$14.3 billion in funding, with \$13.9 billion coming from the General Fund and \$380.4 million coming from other funds (DOF 2024b). Of this, \$4 billion of General Fund support was allocated to health care programs providing medical, dental, and mental health treatment to incarcerated individuals (DOF 2024b). CDCR’s final budget was down \$200 million from Newsom’s original January budget proposal (DOF 2024a).

## **Epilogue: Waiting for Godot and the LAO**

The legislature quickly passed the additional components of the budget comprise, and Newsom signed the budget a few days later, before the start of the July 1 fiscal year. Republicans felt left out of the budget negotiations, because in fact, they were. They have been after voters passed Proposition 25 in 2010 that lowered the budget threshold in the legislature from a two-thirds to majority vote. Democrats have even more than a two-thirds majority in each chamber now, so Republicans are going to be an afterthought in the budget process in so long as California stays blue.

The budget was finally passed, but is not yet finished, since a lot of questions remain. The LAO will release its own detailed analysis in the fall. The big question: how much larger will the deficit rise compared to the administration’s figures, and therefore did the legislature and Governor Newsom successfully balance it?

But other issues remain too, including the political fight over the MCO tax, that eventually shifted from budget talk to ballot talk. Prop 35 is in front of voters this November, and providers are raising plenty of money to lock in MCO funding for provider rate increases. Supporters have raised millions to pass it, and while Newsom is unhappy with the measure, he has not officially opposed it as of September 2024.<sup>173</sup>

And through tricky accounting maneuvering on Prop 98 funding, Newsom and legislative Democrats successfully survived a political and legal challenge from the CTA, but budget forecasting for K-14 education is often more art than science. New fiscal challenges will always emerge with a morphing budget, and the education lobby will always argue for a greater share of the state budget.

Newsom and the legislature seem interested in making significant long-term budget changes. Many people, including the governor, are open to widening the rainy day fund to collect more revenue during the boom part of the state’s boom and bust budget cycle. Other changes batted around include less state reliance on income tax due to their volatility.

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<sup>173</sup> August 34, 2024. *Los Angeles Times*. Your guide to Proposition 35: Taxing managed care organizations.

But among the public, these questions and concerns will be swallowed up by the 2024 presidential race, far from this state, but whose winner and policies will play maybe even a larger role in the future of California, its people, and its budget politics.

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