



Economic Development Analysis Governor's May Revise FY 25-26 Budget

The California Association for Local Economic Development (CALED) is the voice of economic development practitioners and stakeholders. With over 1,000 members, CALED is one of the largest economic development associations in the country. We are pleased to share this economic development analysis of Governor Newsom's May Revise to the proposed FY 2025-2026 budget.

The Governor projects a \$12 billion deficit based on the increasing costs of state programs, including Medi-Cal, and declining economic conditions from a "growth recession" caused by federal policies, including elevated tariffs, immigration enforcement, and federal job reductions. The Governor proposes to address this deficit by freezing the expansion of the Medi-Cal program, securing \$5.3 billion in solutions via borrowing and revenues, and shifting \$1.7 billion in Cal Fire costs to the Greenhouse Gas Reduction Fund.

During his presentation, the Governor touted the importance of California's economy as the 4th largest in the world and how it compared against the economies of Texas and Florida. He framed most of the state's current budgetary challenges and reduced revenue projections on the "reckless...assault" by President Trump on various growth engines, leading to declines in trade and tourism and creating economic uncertainties for business, and a loss of \$16 billion state revenue over two fiscal years. As with previous budget presentations, the Governor noted the reliance of the state budget on capital gains tax, and that long-term change in tax policy is needed to address the volatility.

Minor Impacts to Governor's Economic Development Proposals

Other than withdrawing a proposal for \$60 million in California Competes grants, and reducing funding for a regional labor coordination initiative from \$4 to \$1 million, the May Revise maintains the Governor's January proposals to bolster economic development and job creation, including by increasing the state's film tax credit from \$330 to \$750 million annually. During his presentation, the Governor also highlighted the state's investment in the 13 regional Jobs First plans funded through existing commitments.

Still, deeper concerns with the direction of California's economy are evident in the "Economic Outlook" portion of the May Revise, which reveals the state is losing higher wage business/professional jobs (-7,000 per month), and manufacturing jobs (-3,000 per month), a trend expected to continue between 2024 and 2028. Another sobering projection is that the state's major projected job growth is "driven by health care and social assistance and government jobs."

- Link to May Revise document is [here](https://ebudget.ca.gov/budget/2025-26MR/#!/BudgetSummary): <https://ebudget.ca.gov/budget/2025-26MR/#!/BudgetSummary>
- The initial analysis by the Legislative Analyst's Office is [here](https://lao.ca.gov/reports/2025/5044/2025-May-Revision-Initial-Comments-051725.pdf).
<https://lao.ca.gov/reports/2025/5044/2025-May-Revision-Initial-Comments-051725.pdf>

Darker Clouds Exist for State's Finances

The Governor's May Revise reflects the beginning of what may become deeper deficits for state finances. For example, the proposed budget does not account for the potential of an economic recession, or cuts to health, welfare and other programs in the federal budget, which would exacerbate the state's budget conditions. Also, the Governor and Legislature have been spending down the state's reserve funds over the last two fiscal years, from \$22.5 billion (FY 23-24) to \$11.5 billion (proposed FY 25-26 budget).

It all comes back to spending. Last year, largely because expenses were outstripping revenue growth, legislators adopted a two-year budget solution, which included withdrawing from budget reserves. The budget the Governor proposed in January was barely balanced, despite a projected increase of \$16.5 billion in revenue over projections, and withdrawing another \$7.1 billion in reserves.

Deep multi-year deficits remain. On February 10, the Legislative Analyst’s Office (LAO) report on the proposed January budget estimated annual deficits ranging between \$13 to \$28 billion over the next three fiscal years. More recently, the LAO’s initial comments on May Revise reveal that state baseline budgetary spending has increased by \$12 billion since January, and operating deficits totaling \$42 billion by FY 28-29.

Cost pressures from expanded programs are evident in a summary chart of General Fund allocations in the May Revise (below), which includes a dramatic \$8.8 billion increase to the Health and Human Services Agency for FY 25-26, with corresponding reductions to most other areas of state government.

General Fund Expenditures by Agency

(Dollars in Millions)

	2024-25	2025-26	Dollar Change from 2024-25
Legislative, Judicial, Executive	\$11,013	\$8,195	-\$2,818
Business, Consumer Services & Housing	3,917	491	-3,426
Transportation	718	724	6
Natural Resources	9,244	3,836	-5,408
Environmental Protection	627	121	-506
Health and Human Services	76,494	85,362	8,868
Corrections and Rehabilitation	13,992	13,406	-586
K-12 Education	84,813	80,344	-4,469
Higher Education	22,963	23,058	95
Labor and Workforce Development	1,108	946	-162
Government Operations	3,770	2,698	-1,072
General Government:			
Non-Agency Departments	2,398	1,285	-1,113
Tax Relief/Local Government	653	556	-97
Statewide Expenditures	1,529	5,354	3,825
Total	\$233,238	\$226,376	-\$6,863

Note: Numbers may not add due to rounding.

Statewide Infrastructure

Included within the budget document are several Administration infrastructure proposals of statewide interest:

- Funding the High-Speed Rail project at \$1 billion annually from the Cap and Trade program – now proposed to be called the “Cap and Invest” program, and extended from 2030 to 2045.
- Streamlining administrative processes to expedite the Delta Conveyance Project.
- Shifting \$47 million in financial support for an offshore wind generation program at the California Energy Commission from the General Fund to the Climate Bond.

Master Plan for Career Education Funding Reduced

In January’s budget presentation, the Governor highlighted his proposals in the Master Plan for Career Education to grant individuals college credit for previous life and work experience, such as service in the military or as a police officer. This issue was again mentioned by the Governor in the May Revise presentation, along with a proposal to exempt up to \$20,000 in military retirement income from state income taxes. The May Revise document, however, reveals significant cuts for these programs. Funding for the Career Passport proposal is reduced from \$50 million to \$25 million one-time. The Credit for Prior Learning proposal is also reduced from \$50 million to \$15 million one-time, and from \$7 million to \$5 million ongoing. A related proposal for a \$5 million allocation to the California Education Interagency Council, as part of the implementation of the Master Plan, is withdrawn.

Housing and Homelessness

No new affordable housing construction or homeless shelter funding is proposed. Rather, the May Revise focuses on recapturing \$37.7 million previously allocated to several housing programs, and establishing a stand-alone

Housing and Homelessness Agency. Interest, however, is expressed on working with the Legislature on a Housing and Infrastructure Bond.

During his presentation, the Governor made repeated references to recent and planned allocations of Proposition 1 Behavioral Health (2024) bond funds, and recounted numerous housing actions by his Administration over the years. He was most energetic when discussing local government accountability and regulatory streamlining. He lauded Assemblymember Buffy Wicks (D-Oakland) and Senator Scott Wiener (D-San Francisco) for their pending bills related to streamlining urban development, saying, *“Thank you for your two bills. Let’s go!”* *“It’s time to get serious about this issue. Period. Full stop.”* A similar housing development streamlining proposal is expected to be included in a budget trailer bill.

Yet, a major disconnect continues between Legislative and Administration’s policies and rhetoric on housing which have focused mostly on local governments, and the economic realities of actual production described in the “Economic Outlook” portion of the budget. There, housing production expectations are significantly “downgraded” over prior forecasts due to high interest rates and tariff impacts, and not expected to “pick up very slightly” until mid-2027.

Public Safety

At last November’s election, voters approved Proposition 36 by large majorities. This measure altered and reversed provisions of Proposition 47 of 2014, and increased penalties and criminal accountability in response to challenges faced by businesses and communities with rampant theft and lawlessness. The Governor who was a supporter of Prop. 47, and opponent of Prop. 36 –in response to a press question--described Prop. 36 as an *“unfunded mandate.”* He pointed out that *“The irony, for some,”* was that *“Prop. 47, of which they decry and criticize, is the source of those funds.”* He described that the savings (from reduced incarceration) incurred by Prop. 47 will decline from currently \$91.5 million to \$27.8 million in FY 2027-28. The Governor stated that while the impacts of Prop. 36 were still in its infancy, the state currently expects the prison population to increase slightly, then level-out in several years, and resume declining. He also said that increased costs are expected for probation and the Judicial Council, and announced that he was proposing to close another state prison in 2026.

Cannabis

The May Revision includes several proposals to strengthen enforcement against the illegal market, by funding an increase in enforcement staff by 27 to support additional inspections, stabilizing enforcement funding by shifting it to the Cannabis Tax Fund, and allowing unlicensed premises to be sealed when they are involved in illicit activities. In addition, \$454.3 million will be available from the Cannabis Tax Fund to address cannabis impacts through existing programs:

- \$272.2 million for education, prevention and treatment of youth substance use disorders.
- \$90.9 million for clean-up, remediation and enforcement related to illegal cultivation.
- \$90.9 million for public safety-related activities. The May Revise also made a slight adjustment to the annual interest (\$642.8 million) the state must pay to the federal government for unemployment insurance debt.

Next Steps

Program cuts are always hard. The Governor’s cuts to health and social programs will be unpopular with many legislators. In addition, legislators are being pressured to fund other priorities not addressed by the Governor, such as transit operations, housing the homeless, and backfilling the budget deficit in Los Angeles. Legislators may look to cut other programs, shift costs, borrow, and otherwise delay making difficult decisions.

The Legislature must send the Governor a budget by June 15, and the Governor must sign one by July 1. These deliberations are compounded by tensions and uncertainties over federal policy and budgetary decisions. Potentially, whatever is adopted in July will need to be revisited. As always, CALED will monitor activities and keep its member updated on developments.