



May 24, 2025

The 2025-26 Budget Multiyear Budget Outlook

Summary

This analysis presents our assessment of the budget's condition under our revenue forecast and spending estimates of the Governor's May Revision spending proposals. Fundamentally, our assessment and that of the administration are very similar—the state is likely to face persistent future deficits. These deficits range from \$10 billion to \$20 billion through 2028-29. As such, the Governor's approach to the May Revision reflects the reality of the budget challenge before the Legislature. While the Governor focuses solutions in Medi-Cal—constituting \$11 billion of the total \$16 billion in solutions—the Legislature could pursue a different mix of spending and/or revenue solutions than those proposed. Either way, we recommend the Legislature maintain at least the level of ongoing solutions proposed by the Governor. This is important because, going forward, the budget problems will become more difficult to solve. The Legislature likely will need to adopt additional solutions that increase ongoing revenues or reduce ongoing spending—both of which involve the most difficult and consequential trade-offs for policy makers.

Introduction

Our annual May Outlook presents our office's forecast of the condition of the state General Fund budget through 2028-29 under our revenue and spending estimates and assuming the Governor's May Revision policies are adopted. (Our earlier analysis, *The 2025-26 Budget: Initial Comments on the Governor's May Revision*, differed in two ways: [1] it provided our assessment of the budget condition in the near term only, and [2] it was predicated on the administration's revenue and spending estimates.) The first section of the post presents our estimates of the budget condition under these assumptions. The second section provides our analysis and comments.

Budget Condition

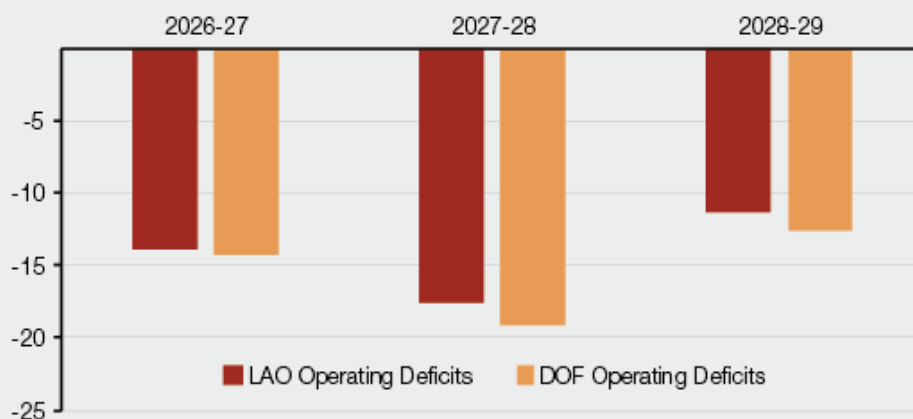
This Year's Budget Problem Very Similar to Administration's Under LAO Estimates. We independently assessed the state's budget condition using our own revenue and spending estimates, assuming the Governor's May Revision policies are implemented. Across the budget window (2023-24 to 2025-26), we estimate the budget condition improves by nearly \$2 billion relative to the administration's projections. This modest improvement reflects our somewhat higher revenue estimates, partially offset by slightly higher projected spending. As a result, if the Legislature were to use our estimates as a starting point, it would need to identify somewhat fewer solutions to balance the budget.

Both Our Office and the Administration Forecast Persistent Future Deficits. Using our own revenue and spending assumptions, we assessed the state's multiyear budget condition under the Governor's May Revision policies. As shown in Figure 1, our estimates are broadly consistent with those of the administration. Both our office and the Department of Finance (DOF) project operating deficits ranging from \$10 billion to \$20 billion over the multiyear period. These shortfalls represent future budget problems that would require additional budget-balancing decisions. That said, the actual budget condition will differ, possibly significantly, from

these projections, primarily due to revenue volatility. While our revenue forecast is designed to balance the risk of over- and underestimation, history shows that actual revenues can vary from our median projection by billions or even tens of billions of dollars over a multiyear period.

Figure 1

LAO Assessment of Future Budget Problems Very Close to Administration's Estimates (In Billions)



DOF = Department of Finance.

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Higher Spending Estimates Mostly Offset by Higher Revenue Estimates. While our overall budget estimates closely align with the administration's, we have modest differences at a more detailed level. Specifically, our revenue estimates exceed the administration's estimates by \$5 billion to \$7 billion annually from 2026-27 to 2028-29—differences we consider very minor given the size of the budget and uncertainty in revenue forecasting. Offsetting this, our projections for school and community college spending are higher, reflecting Proposition 98 (1988) formulas that typically increase (or decrease) with changes in revenue. Additionally, our estimates for spending in other areas—primarily health and human services programs—are somewhat higher than the administration's projections.

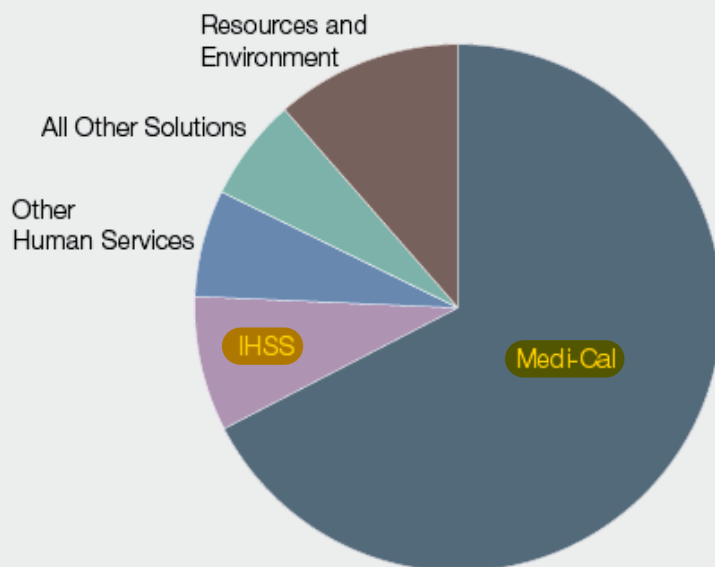
Analysis and Comments

Budget Solutions

May Revision Ongoing Solutions Focus on Medi-Cal. Figure 2 shows the distribution of ongoing solutions in the May Revision by program area in 2028-29, which total \$16.3 billion. Ongoing solutions in Medi-Cal reflect about two-thirds of the total. The largest service-related solutions in Medi-Cal include freezing enrollment for adults with unsatisfactory immigration status, charging monthly premiums for the same population, and reinstating the asset test for seniors and individuals with disabilities. Other Medi-Cal solutions aim to constrain costs—for instance, increasing pharmacy rebates—and end some forms of additional rate and service payments. One of the other large areas of solutions is in In-Home Supportive Services (IHSS). IHSS solutions have some overlap with Medi-Cal, including terminating services for adults with unsatisfactory immigration status and reinstating the asset test. In addition, the state would lower the IHSS provider overtime cap, among other solutions. The major solution in the resources and environment area is the shift of nearly \$2 billion of California Department of Forestry and Fire Protection costs from the General Fund to the Greenhouse Gas Reduction Fund.

Figure 2

Ongoing Spending Reductions by Program and Area



IHSS = In-Home Supportive Services.

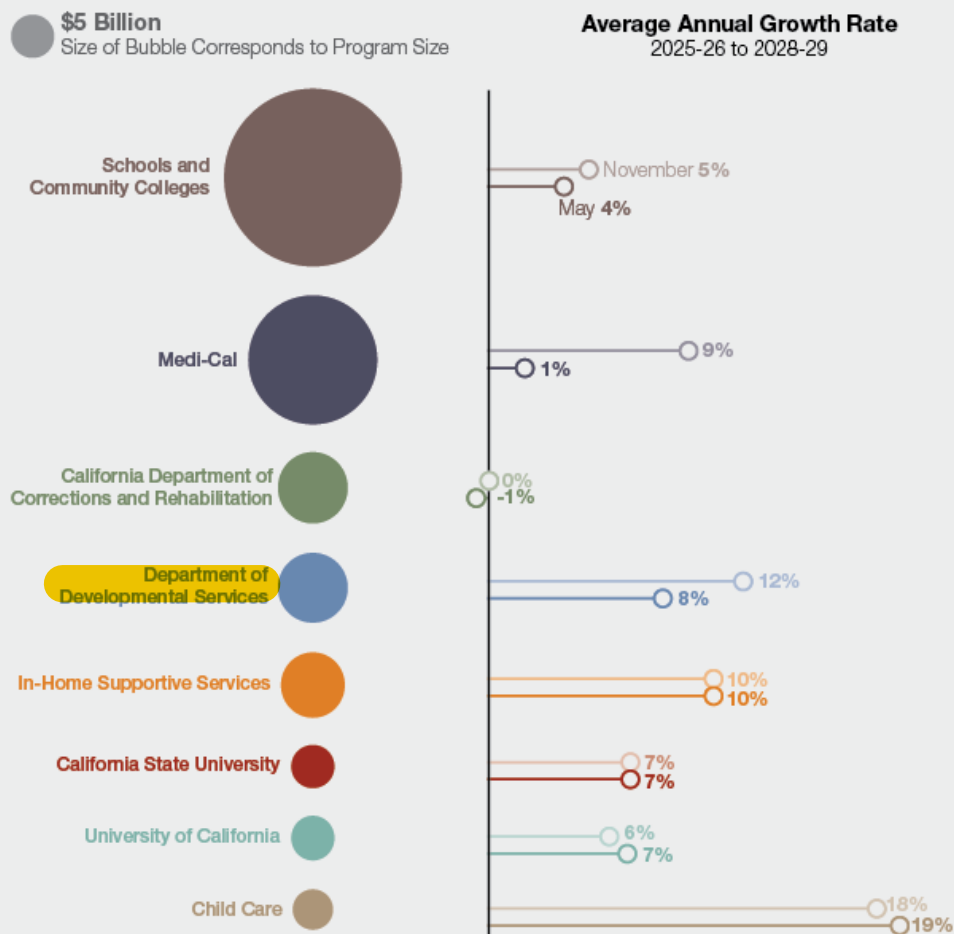
LAOA

May Revision Significantly Reduces Growth in Medi-Cal, but Most Other Major Programs' Growth Rates Mostly Unchanged. Figure 3 provides a broader perspective on changes in long-term spending across major programs—largely reflecting the May Revision’s ongoing solutions. (However, the figure also captures the effects of updated assumptions and estimates.) The figure compares average annual program growth from 2025-26 to 2028-29 under two scenarios: our November Outlook (based on current law) and our May Outlook (reflecting May Revision policy choices). In some cases, such as K-14 education and Department of Developmental Services, slower growth is primarily due to changes in our underlying assumptions. In others—most notably Medi-Cal—reduced growth mainly reflects the choices in the May Revision. Meanwhile, growth in programs like the universities and child care see little change, as they were not subject to major ongoing reduction proposals in the May Revision.

Figure 3

Comparing Growth of Major State Programs

November to May



Note: Growth rates reported for November are based on our office's forecast under current law and policy at that time. Growth rates for May reflect our updated forecast incorporating the May Revision proposals. Importantly, our projections for the May Revision differ from the administration's in several respects.

LAO

New and Existing Budgetary Borrowing Increase Out-Year Budget Problems.

Since 2023-24, the Legislature has addressed a cumulative total of \$82 billion in budget shortfalls, with the May Revision reflecting another shortfall. While the majority of those deficits have been solved using spending reductions, a non-negligible share of the solutions have relied on budgetary borrowing. Some of this borrowing is similar to the measures used during the Great Recession—collectively previously referred to as the state's

“wall of debt,” which was defined as nonroutine borrowing mechanisms enacted to address persistent deficits. As shown in Figure 4, the May Revision adds \$5 billion in new borrowing, increasing the total outstanding amount from \$12 billion to \$17 billion. Importantly, while some of this new borrowing is incorporated into the multiyear outlook, other components are not. As a result, these obligations will place additional pressure on the state’s future budgets.

Figure 4

State’s New Borrowing to Balance the Budget
(In Billions)

Borrowing Type	Amount	Accounted for in Outlook?
Existing		
Payroll deferral	\$1.6	No
Proposition 98 Maneuver (cash borrowing)	6.4	Partially
Special fund loans	4.0	Yes
Total	\$12.0	
Newly Proposed		
Medi-Cal Maneuver (cash borrowing)	\$3.4	Partially
Settle up	1.3	No
Special fund loans	0.6	No
Total	\$5.3	
Total Budgetary Borrowing in May Revision	\$17.3	

Note: Includes new borrowing used in 2020-21 and later to balance the budget.

Overarching Comments

Governor’s Solutions Reflect Reality of Budget Challenges. The Governor’s May Revision proposes over \$16 billion in ongoing spending reductions—primarily in Medi-Cal—and approximately \$300 million in ongoing revenue increases. Ongoing solutions are necessary given the state’s persistent multiyear fiscal challenges. Even with these changes, however, budget problems are likely to continue. As such, we recommend the Legislature maintain at least the May Revision level of ongoing solutions in the final budget

package. That said, the Legislature has flexibility to adopt a different mix of solutions than those proposed by the Governor. As we noted in our *Initial Comments*, this includes alternative choices regarding which program areas to target and how to structure those reductions.

The Legislature also could choose to lessen spending reductions by raising revenues. Whether or not to do so ultimately is a difficult judgement call for the Legislature. In making this decision, the Legislature will need to weigh many questions, such as: What is the appropriate size of state government? How will taxpayers respond to additional costs created by the state and how consequential are those responses? Should additional resources be redistributed from those with more to those with less? These are questions without objectively correct answers and come down to the priorities of the Legislature.

Federal Budget Changes Likely to Create Additional Fiscal and Policy Pressure. The House of Representatives recently passed H.R. 1: One Big Beautiful Bill Act. If passed by the Senate and signed by the President, the legislation would make a variety of changes to federal spending. The impacts on the state budget generally fall into two categories: (1) direct General Fund costs and (2) reductions in federal funding that create state budget pressure. Changes with direct General Fund costs include many changes to Medicaid and food assistance. These have the potential to directly increase state General Fund costs in Medi-Cal and CalFresh by billions of dollars annually. In addition, some of the changes included in the bill would create budget pressure to the extent the state considers creating “state-only” programs for individuals no longer eligible for federal-state partnership programs. Other areas that could create state budget pressure include reductions to federal support for drinking water projects, zero-emission vehicles, and flood protection. The May Revision appropriately excludes the potential fiscal impacts of pending federal actions, as these effects remain uncertain. We encourage the Legislature to keep these potential fiscal pressures in mind, however, as it crafts the final budget package.

Future Budget Problems Likely to Become More Difficult to Solve.

This May Revision marks the third consecutive year the Legislature has needed to close a budget shortfall. While the Governor’s proposal makes some progress toward narrowing the state’s persistent multiyear gaps, both our office and DOF project continued multiyear deficits. These shortfalls will become increasingly difficult to resolve over time, as the state has already relied on the least disruptive solutions—such as reducing one-time and temporary spending, drawing down reserves, and increasing borrowing—although notably the state still has \$11 billion in reserves under the May Revision proposals. To balance the budget going forward, the Legislature will likely need to adopt additional solutions that increase ongoing revenues or reduce ongoing spending—both of which involve the most difficult and consequential trade-offs for policymakers. Further, although there is a possibility that revenue growth could ease future deficits, it is equally likely that the budget problem will grow larger than our forecast suggests. In short, the Legislature faces a challenging budget landscape in the years ahead.
