March 7, 2022

The Honorable Gavin Newsom
Governor, State of California
State Capitol
Sacramento, CA 95814

Delivered via electronic mail

Governor Newsom:

For the past two years, Californians have faced unprecedented challenges and hardships. Schools were closed, thousands of businesses shuttered their operations, and millions of workers lost their jobs or suffered reduced hours. Even when they stayed afloat many small and large businesses lost revenue, all while making hundreds of millions of dollars in investments to keep our employees and customers safe. For those able, we quickly adapted our business operations to transition to work-from-home and we kept the economy, and state budget revenue, moving forward.

Despite seemingly insurmountable odds, sectors of the business community thrived during the pandemic. And thanks to that innovation and those sectors, we continue to see unprecedented state revenue growth and multi-billion-dollar surpluses. There is certainly reason to celebrate the budget surplus and the certainty it can bring to the budget process and those who rely on state funding for support. It is important to remember, however, that the state budget does not reflect the realities of what is happening to countless families and businesses not yet recovered from the economic shut down and ongoing impediments to economic stability.

In your annual budget proposal, you lay out not just the fiscal, but the policy priorities for your administration for the year. Given the ongoing economic realities and issues facing the business community and our employees, we wanted to take this opportunity to directly address your budget proposals, policy priorities, and how these will impact statewide economic recovery, business growth and family budgets.

The Proposed FY 2022-23 Budget Builds on Your Ongoing Efforts to Support Business Recovery. We appreciate your leadership in safely reopening the economy in June 2021, supporting important economic recovery policies in last year's budget, and the priorities you highlight in this year's budget, which are critical as we build back the 5th largest economy in the world. Your budget proposal this year recommits and strengthens your ongoing efforts and includes important programs and support for the business community that can help as we work to rebuild the economy. We look forward to working with you and the Legislature to build support for these budget priorities and complementary legislative efforts. We discuss some of these priorities in further detail below:

> Providing tax credits to businesses working to recover. This year's early action budget items restored a series of tax credits eliminated in response to uncertainty following the initial outbreak of COVID. Both the net operating loss carryover and the R&D tax credit are critically important tools to help not just recover from the pandemic recession, but transition to job growth. The innovation economy continues to drive economic growth and budget revenue to the state, and a reinvestment in the R&D tax credit will help this sector invest and grow in California. In addition, the conformity to the federal tax treatment of the Restaurant Revitalization Fund grants and Shuttered Venue Operators grants are critically important as well. Restaurants continue to be disproportionately impacted by COVID and its variants, with many shutting down for days and weeks due to staff shortages and decreased in-person dining.
>
> Understanding the impact to hardest-hit industries during the pandemic**.** The budget also rightly acknowledges the disproportionate impact the recession had on certain industries and sectors. Inclusion of additional support for these sectors, specifically hotels and tourism and the $45 million for tourism media, will help industries still grappling with the effects of COVID variants, labor shortages and delayed economic recovery. Providing tax credits to those businesses unable to operate for more than a year—and still struggling now—will help offset some of the cost-pressures threatening to shutter even more of these businesses.
>
> Investments in addressing increase in crime and retail theft. Organized theft, whether at a retail establishment, at a warehouse or at a railyard, has deeply impacted the business

community. While we work to bring customers and employees back to stores after COVID-related shutdowns, safety concerns regarding retail theft are keeping people away. These thefts have caused major retailers and small businesses to close their doors in some communities, forcing residents to travel further for critical goods like medicine and food. Organized theft is being felt all along the supply chain, including mass raids on freight cargo on rail. The commitment of additional funding for businesses affected by retail theft, and the investment in tools to combat future theft is an important first step in addressing this crisis. We strongly support the inclusion of this funding and look forward to working with your office and the Legislature to enhance this funding through additional policy actions, including SB 301 (Skinner), to combat retail theft at all levels of the supply chain.

<u>Investments in addressing the goods movement crisis</u>. Unfortunately, retail theft is only one of many crises affecting the supply chain and goods movement in and through our state. Efforts your administration undertook in December 2021 were important first steps in addressing immediate concerns, but there are still more than 100 ships loitering offshore waiting to unload or load at ports in southern and northern California. We continue to see empty shelves or reduced inventory—a crisis made worse by the ongoing labor shortage—and do not expect the supply chain to "normalize" in 2022. The initial funding investment in your budget proposal will be critical as we look at short, mid and long-term solutions. We also look forward to working with you to secure funds from the recently passed federal infrastructure package to ensure our investments are met with federal support as well.

But Critical Issues Need to Be Addressed. While the budget includes important economic stimulus and addresses two of the most important crises facing the state and business community, ongoing and new issues, including an upcoming $40 billion tax increase[1] and expensive new employer mandates, threaten to wipe out any gains mentioned above.

[1] The estimated $40 billion tax increase combines both the debt to be paid at the federal level and the continuation of the higher (F+) rates that will be paid during this period at the state level. Not only are businesses required to pay the $21 billion to pay off the federal debt (based on current EDD projections of $21.5 billion by end of 2022), but business will be locked in to paying the highest F rate, plus a 15% surcharge, for at least the next decade. The additional nearly $20 billion in higher state taxes was estimated through a cash flow analysis using generalized factors from the EDD's biannual fund reports and the LAO's previous cash flow analysis. This assumes the state average F+ rate returns to 4.0% by 2026 and stays at that level. This also assumes the average rate declines on a trend similar to the experience from 2015-2019. The difference between the average F+ rate and the average C rate then eventually becomes 1.327%--the premium to estimate how much more businesses would be paying under the state tax. Employer payments are estimated from the following: assumes reimbursements return to the $300 million level from 2015-2019 and no interest is earned by the fund in the cash flow period; using DOF projections, nonfarm jobs return to 2019 levels in 2023 and continue to grow 1.7% thereafter; the raw nonfarm job numbers are adjusted to account for full-time/part-time breakdowns in overall employment plus accounting for churn over the period of a year based on the relationship of calculated contributions using historical job numbers to actual contributions as indicated in the EDD data; employer payments are then calculated by applying the adjusted numbers, current wage base, and the state and federal tax rates. Benefit payments are assumed to return to the previous $5.1 billion a year by 2023. The payments then are assumed to increase based on Finance's inflation forecasts (California CPI).

Unemployment Insurance Fund debt eclipses any proposed relief for business community. When the stay-at-home order was issued in March 2020 and large swaths of workers were out of a job, it was not a state-funded program that kept people afloat, it was the employer-funded Unemployment Insurance Fund. While this fund was supplemented with federal dollars through Pandemic Unemployment Assistance (PUA), the pandemic has left the state's most important safety net program insolvent once again, this time with a $20 billion debt.

This year's budget commits $1 billion to paying down that debt, with an additional commitment of $2 billion next fiscal year. We appreciate this contribution towards paying down this debt. However, with recent projections that the state will have an even higher budget surplus than originally anticipated – as much as $23 billion higher, we respectfully request additional funding to pay down this debt. **We support the recent letter from Assembly Democrats asking for an appropriation of $7.25 billion** from the state's surplus to provide one-time support for this critically important fund. Such a commitment to the fund would help bring the fund back to solvency faster and contribute greatly to our economic recovery.

Business support for ongoing COVID-19 mitigation lacking. Despite overwhelming scientific evidence that workplaces are not "super-spreader" events, California businesses continue to pay the costs associated with the state's COVID response measures. Recent changes to the Cal/OSHA Emergency Temporary Standard, return-to-work criteria and supplemental paid sick leave have and will significantly increase the cost burden for all businesses. We appreciate your recognition of the potential cost associated with these requirements, and your willingness to consider tax credits for businesses as a part of the May Revise to offset some of the financial burden associated with providing this leave. Several legislators, including Budget Chair Assemblymember Ting made similar comments regarding tax relief for small businesses during the debate of SB 95 (Skinner).

We look forward to working with you and the Legislature on finding ways to mitigate this financial stress through future budget actions.

Addressing School Facility Funding. The business community was proud to support your efforts in 2020 to pass a school facilities bond. While that measure was unfortunately not supported by California voters, the need to address funding to invest in improved school facilities continues. This funding is crucially important not just for schools, but is a critical tool to combat the state's ongoing housing crisis. Your allocation of $2.3 billion in school facilities funding is a positive first step, however additional funding needs to be contemplated as the proposed funding does not even meet the current backlog before the State Allocation Board. Absent additional funding, local housing developers will be subject to Level III impact fees, dramatically increasing the cost of housing at the worst possible time.

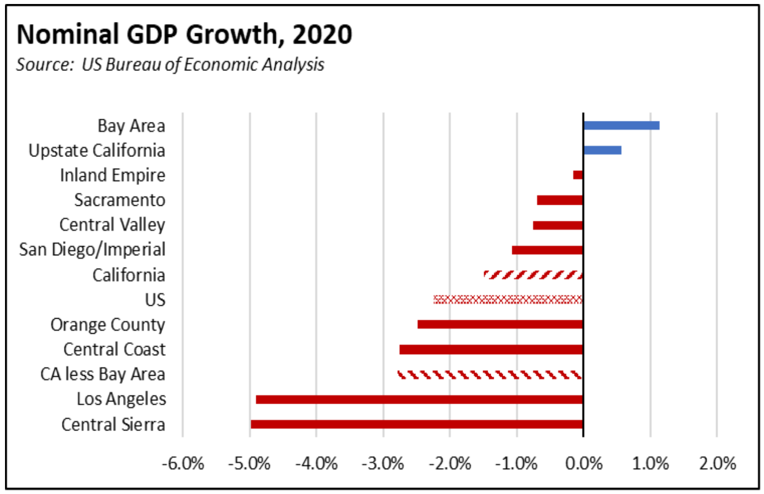
Working together to transition to an Endemic Economy. As COVID becomes endemic, it is important that the state budget and ongoing response to the virus shift to reflect this reality. As you indicated with your announcement of the SMARTER plan, it is not March 2020 anymore; we have vaccines, boosters, testing, therapies and understand better how COVID spreads through the community. We appreciate this recognition and look forward to working with you to develop consistent policies and guidance that will create some predictability for employers and employees, despite dealing with a virus that is unpredictable. The ongoing and ever-changing mandates, guidance and regulations have made it difficult for business to rebound after the state reopened in June 2021 and continues to be a barrier to economic recovery. This uncertainty is one of the biggest barriers to economic recovery.

The Surplus Is Significantly Higher Than Estimated. While your January Budget Proposal estimates a $46 billion surplus ($21 billion of which is for discretionary spending), that is just a fraction of the additional funds the state has at its disposal. The state currently has an additional $37 billion in unexpended funds from this fiscal year, and the schools have an additional $30 billion in unexpended pandemic assistance funding. Moreover, it is likely that this year's $46 billion surplus will be significantly higher by the May Revise. December 2021 revenue came in at 50 percent higher than the current year budget estimate due in large part to additional IPO activity, and January 2022 shows year-to-date revenue running 15 percent above even the strong gains projected in the January budget proposal. These are historically some of the "slow" revenue months. Like last fiscal year, we anticipate that with the May Revise budget surplus, plus the carryforward from last year and unexpended school funding, **the state and school districts will collectively have more than $100 billion in surplus or unexpended revenue.**

The State's Fiscal Health Does Not Reflect the Reality of Family and Small Businesses Still Struggling. The state yet again has another multi-billion-dollar budget surplus. Thanks to the ongoing strength of the tech sector, venture capital dollars and a series of successful IPOs, state tax revenue is strong. However, this is not the reality for many families. While the Bay Area and other regions continue to succeed, not all regions have recovered equally. For example, the recent Bureau of Economic Analysis release of county GDP estimates for 2020 show that nominal GDP in the Bay Area grew 1.1 percent during the pandemic year, while the rest of the state saw contractions. Santa Clara County grew 5.6 percent during this time, while the Los Angeles region contracted by 4.9 percent.

When looking at policies and budgeting for this fiscal year and into the future, it is critically important we recognize the role that the Bay Area economy has in both short-term revenue gains but also ongoing revenue volatility. The Bay Area, with just 20 percent of residents, accounts for more than 40 percent of state personal income tax revenue. Absent substantive changes to tax policy in California, our budget health will continue to heavily rely on this small sector of the economy and state.

Looking beyond the Bay Area, it is clear that the economy is still suffering and small businesses and family budgets are paying the price. Employment still remains 751,000 lower than pre-pandemic levels, with employment gains deviating only slightly since July 2021. Additionally, our labor force participation rate of 61.3 percent remains well below the pre-pandemic level of 62.5 percent. Accounting for workers leaving the workforce since February 2020, there were 1.6 million Californians out of work in December.



Labor shortages, supply chain disruption, inflation and the surges of COVID-19 have created substantial disruption in businesses' ability to recover from the pandemic recession. These pressures and uncertainties cannot be ignored as the state crafts its final budget and makes policy decisions this year.

Spending Continues to Outpace Record Revenue.

The threat of new and higher taxes continues, despite massive budget surplus. As reported by the Department of Finance, General Fund revenue is already running $16 billion ahead of the Proposed Budget estimates for just the first seven months of the current budget year. However, this is a period that should otherwise be slower than the upcoming big revenue months, indicating that the projected surplus is likely to be much larger, perhaps even double the current estimate. Despite revenue into the General Fund doubling since 2010-11, spending is still projected to grow faster. The multi-year forecast shows a negative balance in 2023-24, but closing to less than $1 billion by the end of the 2025-26 forecast period.

The state is expected to have a budget deficit just as we predict the economy will finally recover from the effects of COVID-19 (though the latter depends heavily on current and future state action to assist business in recovery). This projected deficit only adds to the ongoing uncertainty the business community faces, as previous deficits have often led to tax increases levied on the business community. As previously stated, business is already facing a $40 billion tax increase, absent substantial action from the state. Further tax increases, or even the threat of tax increases, will have a major destabilizing effect on the entire business community and economic recovery.

Looking Ahead: Building an Equitable Recovery. As the state and business community continue to transition to economic recovery, our focus should be to learn from previous missed opportunities in order to create pathways for economic growth in all regions of the state and at all economic levels. After the Great Recession, due in large part to significant regulatory barriers, middle-income job growth was minimal. Instead, job growth was concentrated in the very high-income jobs, including those in the tech industry, and very-low wage jobs, primarily in service and accommodations. The focus in our previous recovery was solely on the unemployment number, without looking at the types of jobs that were created.

This two-tiered economy played itself out during the COVID pandemic recession. High-wage tech jobs have sustained and increased state revenue, while millions were out of work in lower-wage service-sector jobs.

Working together, we can learn from the last recession and recovery to build tools that allow job growth in all regions and along the economic wage ladder. We cannot ignore the need to invest and grow middle-income jobs, which are the pathway out of poverty for countless working families. We are committed to working with you and the Legislature to ensure a more equitable recovery that not only creates critically needed middle-income jobs, but also creates more stability for families and future state budgets.

Thank you for the opportunity to provide our initial input on your FY 22-23 budget proposal. We look forward to working with you and the Legislature in the days and months ahead to build a budget that creates certainty, stability and support for the business community so we can do what we do best—continue to build a world-class economy, create well-paying jobs and promote economic opportunities for all working families across the state.

Thank you,

Robert C. Lapsley

Rob Lapsley
President, California Business Roundtable

Jennifer Barrera
President and CEO,
CalChamber

Lance Hastings

Lance Hastings
President and CEO,
California Manufacturers & Technology Association

Rachel Michelin
President and CEO, California Retailers Association

Jot Condie
President and CEO, California Restaurant Association

John Kabateck
State Director, National Federation of Independent Business, California

Matthew Hargrove
President and CEO, California Business Properties Association

Lynn Mohrfeld
President and CEO, California Hotel and Lodging Association

Dan Dunmoyer
President and CEO, California Building Industry Association

Tracy Hernandez
Founding CEO, Los Angeles County Business Federation, BizFed

Paul Granillo
President and CEO, Inland Empire Economic Partnership

Hon. Mike Roos
President and CEO, Southern California Leadership Council

Maria Salinas
Los Angeles Area Chamber of Commerce

Jeff Ball
Orange County Business Council