climate 100
A project by NextGen Policy

2024.7.26 CLIMATE 100 REPORT:

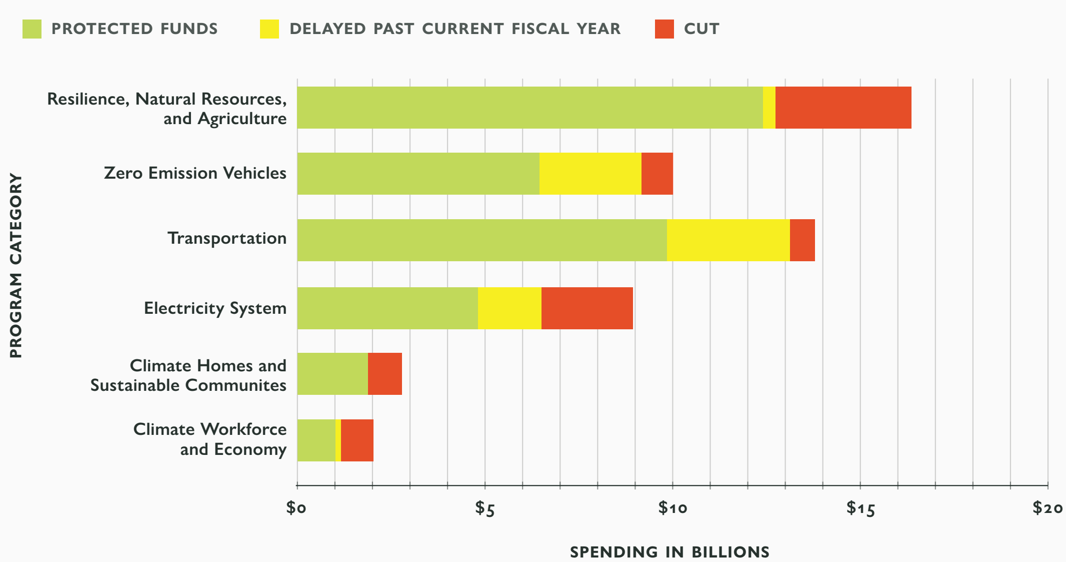
California Climate Commitment 2.0? Looking Toward a Fair and Sustainable Climate Budgeting Policy

Executive Summary

With the enactment of the 2024 budget, California has reached the conclusion of its first iteration of the Climate Commitment, a historic initiative that dramatically augmented state climate spending by tens of billions of dollars over the course of several years. The Commitment began in 2022 as a 5-year $54 billion investment plan. It has shrunk and changed considerably since then, but still represents a massive new investment. This report will look back at how the California Climate Commitment changed over time and provides recommendations for how the state can better budget for climate investments going forward.

There are three major takeaways from the 2024 budget agreement that point to the end of this unprecedented funding effort. **First,** the majority of the Commitment's funding — $36 billion in funding from the General Fund and Cap and Trade — has now been successfully appropriated. **Second,** the remaining unappropriated sum of the Commitment outlined in this year's budget is slated to come primarily from revenues generated by the Cap and Trade Program. This shift should be understood as a reduction in the overall level of climate investment from the original commitment. Cap and Trade spending is a baseline for climate investment, not an augmentation to climate programs spurred on by the Commitment. **Third,** and finally, dim projections for state revenues in future years mean that there is little hope that new general fund infusions can revive the Commitment and restore cuts in the near or medium term without bond-based borrowing or creating new revenue sources.

Fig 1. How the Climate Commitment has Changed since 2022



"The original $54 billion Commitment has been winnowed down to $45 billion, with almost a third of its spending being offloaded to Cap and Trade revenues, where it will crowd out the potential for discretionary spending on other climate programs."

Simply put, the Climate Commitment appears to have found its final level, and California now stands poised to return to last decade's business-as-usual approach to climate investments, which pits necessary investments against each other within the limited pot of funding provided by Cap and Trade. This zero-sum approach is not sustainable in the face of an accelerating climate crisis, and taxpayers should not have to pick up the bill that climate polluters have given us to deal with.

The time for a more holistic approach to climate budgeting has come. That means taking a fresh look at the climate budgeting tools available to the state, such as:

Finding Find new ways to invest in solutions now before it is too late by — for example — authorizing rapid investment from the climate resilience bond on the November ballot, if voters approve it;

Making polluters pay by closing tax loopholes exploited by fossil fuel companies, holding them financially accountable for the damages they are causing, and increasing the stringency of regulatory programs like Cap and Trade; and

Aligning all parts of the state's budget to be consistent with the demands of responding to the climate crisis and ensuring that individual agencies are not acting as obstacles to statewide goals.

How Did We Get Here?

In 2022, NextGen launched the Climate 100 Project, which posits that by adopting an all-of-government approach to budgeting for climate action, California can mobilize an historic level of ongoing climate investments, bolster its path towards carbon neutrality, and set an enduring example for policymakers across the country – and the world.

A Climate 100 policy towards budgeting boosts investments in climate programs, inoculates them against economic volatility, and ensures that peripheral components of a budget do not undermine, but rather complement climate progress. Government budgets should reflect the reality that climate action is not a luxury, but a necessity.

The California Climate Commitment temporarily expanded climate investments far beyond the limited revenues available from Cap and Trade, bringing a welcome infusion of additional funding for critical decarbonization and resilience programs.

However, the doldrums of the 2023 and 2024 budget cycles have brought home the importance of the Climate 100 approach: The original $54 billion Commitment has been winnowed down to $45 billion, with almost a third of its spending being offloaded to Cap and Trade revenues, where it will crowd out the potential for discretionary spending on other climate programs. Meanwhile, the impact of discretionary climate investments will be muted by ongoing public financing of fossil fuel infrastructure, such as buildings dependent on fossil fuels for heating and cooling and freeways that increase traffic and tailpipe pollution. A better way is available.

The Lessons of California's First Climate Commitment Budget

In late June 2024, after weeks of intensive negotiations, Governor Gavin Newsom and legislative leaders agreed upon a final state budget for the 2024-2025 fiscal year. This year's budget process was a painful one. Cratering tax revenues pushed the state further into one of its worst deficits in decades, and revenue forecasts for the years ahead promise little relief. Thus, for the second year in a row, policymakers were challenged to take on the difficult ritual of whittling down the statewide budget – cutting, delaying, and shifting funds for critical public programs – to close the gap between previously planned spending and fiscal reality.

Climate investments in particular suffered setbacks this year. The 2024 budget agreement cut what began in 2022 as a $54 billion Climate Commitment down to $45 billion funding plan – about 83% of the original sum, spread over a longer time, and with even less incremental climate investment beyond business-as-usual levels. Looking to 2025 and beyond, revenue forecasts remain grim. Funds that have not already been appropriated face the possibility of being cut during future budget cycles.

Even if this proposed level of investment does materialize, it will be funded mainly by unspecified cuts to other climate investments that would ordinarily come from the Cap and Trade Program.

The diminution of the Climate Commitment represents a serious loss for California and will hurt our progress toward a safer, greener, and more prosperous future. But it is worth taking stock of what has been accomplished in the face of declining state revenues.

> ***"Until climate spending is better protected against the vagaries of the business cycle and all of California's public agencies fully embrace their climate mandates, necessary investments will continue to compete with each other for a small pot of available funding."***

Upon the 2024 budget enactment, the state has managed to shepherd about $36 billion in discretionary spending to climate programs, even amidst a run of volatile budget cycles; the rest of the Commitment's investments have been scheduled for future years. Policymakers should do everything within their power to make sure those future allotments actually get appropriated, but the level of accomplishment up until now is huge. As of today, there are tens of billions of dollars already spent or on their way out the door to help decarbonize industry, put more clean energy sources onto the grid, build resilient communities, deploy nature-based solutions, and leverage billions more in federal matching funds to transform the State of California, all in the face of the generational threat posed by climate change.

More investment is going into cutting climate pollution and protecting people and ecosystems than ever before – that is something to celebrate. Nevertheless, the scale of the climate crisis demands larger, more transformative approaches than this temporary infusion of capital can provide.

As the books close on the 2022 Climate Commitment budget, California should look to redouble its efforts with a "Climate Commitment 2.0" that drives more investment, more reliably across all parts of government. Now more than ever, it is time for a Climate 100 approach to budgeting.

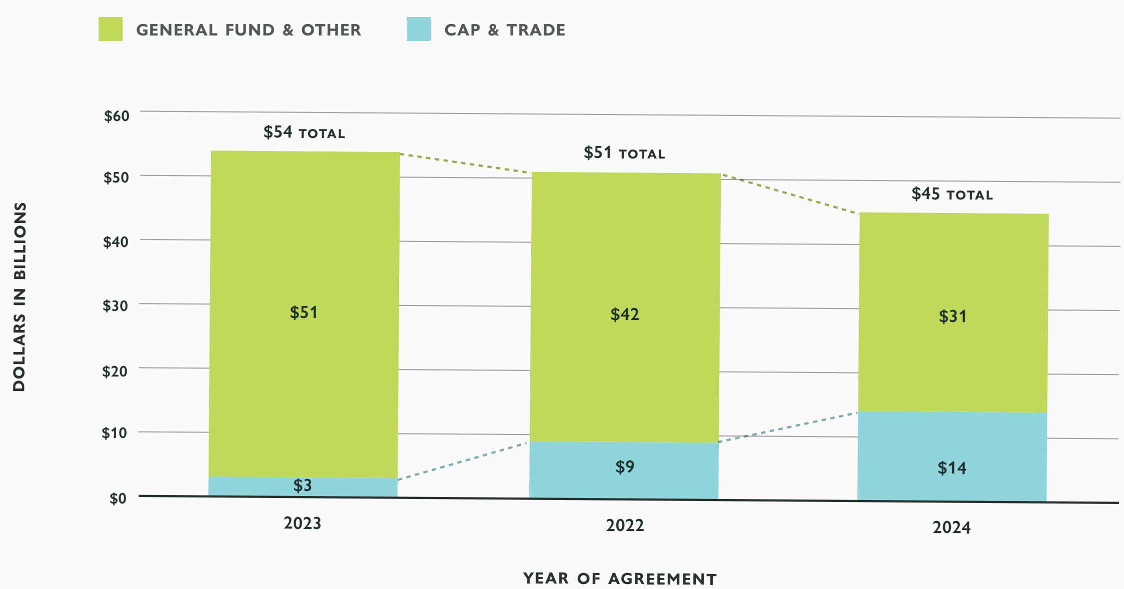
An Increasing Reliance on Cap and Trade

The 2024 budget enactment sees the continuation of a trend that began during negotiations over the Climate Commitment in the previous budget cycle. For the second year in a row, General Fund spending on programs in the Commitment has been supplanted by an over $5 billion multi-year infusion from the Greenhouse Gas Reduction Fund (GGRF), which gets its funding from Cap and Trade auctions. This brings the total sum of GGRF outlays in the Climate Commitment to $14 billion – just about a third of the overall remaining commitment. Figure 2 illustrates the increasing reliance on Cap and Trade with each iteration of the overall Climate Commitment spending plan.

Moreover, the GGRF spending plan in this year's budget deal identifies another roughly $6 billion over the next five years in discretionary spending previously allocated to the General Fund. This means that of the remaining $9 billion in Climate Commitment spending scheduled for future years, about two thirds of it is accounted for by Cap and Trade funds. Figure 3 illustrates how the ratio of Cap and Trade investments to investments from other funds increases dramatically for Commitment spending that has yet to be appropriated.

Fig 2. The Climate Commitment, Over the Years

Total multi-year budget agreements

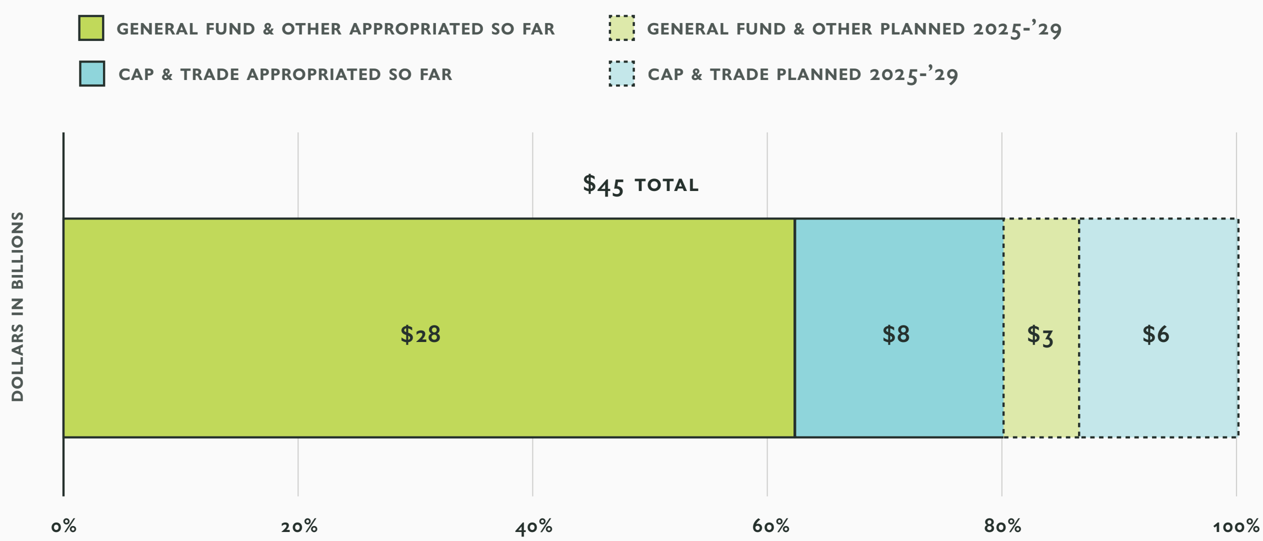


Resourcing the Climate Commitment out of the GGRF makes some practical sense: climate programs can be insulated against declining General Fund revenues by drawing from the more steady stream of funds provided by Cap and Trade revenues. The GGRF must be spent on programs that help reduce emissions, so the pieces of the Climate Commitment that it funds will face less competition from other state budget priorities in deficit years.

On the other hand, it is because Cap and Trade revenues are reserved for emissions reduction programs that they should be viewed as a baseline for discretionary climate spending. From this perspective – one that excludes GGRF funds from the accounting of augmented climate investment spurred by the Climate Commitment – the Commitment has succeeded in augmenting discretionary climate spending by $28 billion to date, and barring further general fund cuts, it will top out at $31 billion when all is said and done.

Cap and Trade revenues may be stable, but they are also limited. Offloading General Fund obligations from the Climate Commitment to Cap and Trade revenue crowds out other discretionary climate spending. Future legislatures and administrations may in fact reclaim their discretion over these funds – the GGRF spending plan agreed upon this year is not binding.

Fig 3. Already Appropriated vs. Planned Spending in the $45 Billion Climate Commitment (as of the 2024 Budget Agreement)



An Enduring Vision for California's Climate Commitment 2.0

In crafting the second iteration of the California Climate Commitment, policymakers, agencies, and everyday Californians have opportunities to make each element of a Climate 100 budget into reality. Here is how:

1. **KEEP GROWING THE CLIMATE BUDGET:** California should mobilize new sources of climate investing beyond Cap and Trade proceeds – the climate resilience bond that will appear on the November 2024 ballot is a good start towards authorizing additional General Fund investment in climate resilience and ecosystem health.

2. **MAKE POLLUTERS PAY:** Lawmakers should eliminate subsidies to big polluters that allow them to saddle taxpayers with paying for the harm they cause – this means strengthening climate rules like the Cap and Trade program and Low Carbon Fuel Standard, and creating new polluters-pay funds like SB 1497 (2024, Menjivar) proposes. It also means ending lucrative tax breaks for fossil fuel companies.

3. **ADOPT CLIMATE 100 BUDGETING ACROSS STATE AGENCIES:** California's government should realign existing funding streams to adhere to climate goals across every state agency, starting especially with reforming how funding decisions at California's Department of Transportation (Caltrans) are made, so that the billions of dollars that flow through this agency help, rather than hinder climate efforts.

A more detailed discussion of each of these recommendations follows.

1. KEEP GROWING THE CLIMATE BUDGET

Just before the 2024 legislative summer recess began, California lawmakers passed the Safe Drinking Water, Wildfire Prevention, Drought Preparedness, and Clean Air Bond Act. The bill places a $10 billion climate bond on the November 2024 ballot as Proposition 4.

This funding would be additional to current sources of revenue such as the Cap and Trade fund: to the extent the Legislature authorizes investment under the bond authorization, bond repayment would most likely largely come from the state's General Fund.

Proposition 4 is California's next best opportunity to once again dramatically increase the amount of funding for climate programs statewide. If a majority of voters approve the bond, however, it can restore a significant portion of funding for programs that have been scratched from the Climate Commitment since 2022, with a general focus on improving climate resilience and reducing the vulnerability of ecosystems and natural resources that provide vital climate mitigation services.

Passing a climate bond will not deliver sufficient or ongoing funding to any of these priorities, let alone the many other initiatives that got cut back from the original Climate Commitment and left out of the bond, such as the Equitable Building Decarbonization program. But it will deliver $10 billion worth of investments to help deal with the impacts of climate change, at a time when every dollar counts. Moreover, of the several recommendations in this brief, passing Proposition 4 is the one that can be accomplished with the greatest immediacy, and with the direct participation of the voters of California this November.

2. MAKE POLLUTERS PAY

In addition to California's existing polluters-pay funds, including both the Cap and Trade program and the Low Carbon Fuel Standard (both of which should be significantly strengthened through their current regulatory proceedings at CARB), lawmakers should (A) create a new fund specifically geared towards requiring corporations that have profited by causing the climate crisis to pay for a portion of the damage they have already done to our state, and (B) eliminate tax subsidies for polluting corporations.

A Climate Superfund

In late spring of 2024, the state of Vermont passed the Climate Superfund Act, establishing a first-in-the-nation mechanism to charge big oil and gas companies for the climate damages they have imposed on Vermonters through the extraction and combustion of fossil fuels. A similar bill is sitting on New York Governor Kathy Hochul's desk, awaiting her signature. And here in California, the Legislature may still take up Senator Caroline Menjivar's Senate Bill 1497, the Polluters Pay Climate Cost Recovery Act before the end of this session, or adopt similar legislation next session. This bill would put California in the running to be the second or third state to start setting up a climate superfund – and certainly the largest.

A climate superfund would create a major new ongoing source of funding for addressing existing climate impacts. Importantly, the superfund would hold Big Oil financially liable for the damage it has caused to the state, instead of placing the burden on taxpayers.

The impacts of climate change are already racking up costs that strain comprehension. In 2020, wildfires alone accounted for over $19 billion in direct economic losses statewide — to say nothing of the indirect effects of those wildfires on public health, or the damages caused by extreme heat, flooding, and all the other hazards that are becoming more frequent and intense thanks to the burning of fossil fuels.

California currently has no major dedicated source of funding to deal with these impacts. Cap and Trade revenues are statutorily required to be spent on programs to reduce pollution that causes global warming. A climate superfund would offer a much-needed complement to the Cap and Trade fund by creating a stable and dedicated funding source for responding to the impacts of climate change, in addition to their cause.

It is not yet clear how much revenue SB 1497 or similar legislation would generate – the fee mechanism proposed in the bill before the Legislature now would largely be dependent on agency rulemaking. For comparison's sake, the New York climate superfund law would set a highly conservative liability limit at $3 billion every year. Adjusting on a per-capita basis, a similar limit in California would set the cap for liability fees at roughly $6 billion each year.

This amount, while it appears large, is miniscule compared to the real damage of climate change that Californians pay for with their pocketbooks and lives every year, and should in no way be taken as sufficient to address the harms that oil and gas companies have caused to our state. Our hope is that California lawmakers require these corporations, which amount to the most profitable enterprise in human history, to cover a significantly larger portion of the damages they have imposed on us all.

Still, a $6 billion annual budget supported by a climate damages superfund comes out to roughly triple the level of investments in resilience programs within the Climate Commitment; it would also be ongoing. Compared to the status quo, recovering even a fraction of the cost of damages caused by the state's worst polluters would be a game changer for climate efforts.

Eliminate Tax Subsidies for Big Polluters

In January 2024, NextGen joined over 60 organizations calling for policymakers to eliminate subsidies for the oil and gas industry that are paid out in the form of exemptions and loopholes in the tax code.

In particular, multinational oil companies like Chevron benefit from a provision called the "Water's Edge Election" tax exemption, which allows them to calculate their tax filing based on an excessively narrow interpretation of what amount of corporate income is taxable in California.

By failing to require a global accounting from oil and gas corporations, the Water's Edge policy in California empowers these companies to lower their California tax incidence and engage in tax avoidance via offshore tax havens. The impact of this policy is twofold – giving these companies a tax break sanctions the continued extraction and burning of fossil fuels, and forgoes revenue in the budget that could be useful towards augmenting or maintaining climate spending – especially during a deficit year.

This year's budget eliminated some tax subsidies for fossil fuel corporations, which will likely result in $10 to $20 million in additional revenue from these companies. But the Water's Edge loophole represents an several-orders-of-magnitude larger loss to Californians, and an estimated $4.4 billion in 2022-23 alone, across all industries. This subsidy disproportionately goes to the benefit of the same corporations that are costing us so dearly through the health and climate impacts of their operations. It should be a top priority for lawmakers to eliminate this loophole as soon as possible.

3. ADOPT CLIMATE 100 BUDGETING

California's siloed approach to climate investment allows massive flows of state dollars to continue to undermine climate progress, even as other parts of government work tirelessly to make progress on this pressing crisis. When it comes to legacy funding practices of some individual agencies, a failure to update policy has allowed for the ongoing expansion of harmful infrastructure with taxpayer dollars.

This approach does not make sense and should end. For state-level climate action to succeed on the necessary timeline — carbon neutrality by 2045 — each component part of state government must be pushing carbon emissions in the same direction.

One of the most flagrant examples of misaligned spending is California's Department of Transportation (Caltrans)'s wasteful spending on traffic-generating highway expansions.

The climate impact of Caltrans's failure to get traffic under control is huge. Passenger vehicle tailpipes are the largest single source of climate pollution in the state, accounting for more emissions than the entire buildings and electricity sector combined. The state's Scoping Plan for how to achieve our legislatively-required pollution reduction targets has identified transportation mode shift as a key strategy for decarbonization of the sector. The Scoping Plan calls for California to reduce traffic by 30% below 2019 levels in 2045. But highway spending continues to be a key driver of worsening traffic and pollution: unless Caltrans changes course, we will fail to reach these targets, in violation of multiple state laws.

> ***"Large swaths of government spending continue to undermine climate progress or proceed as if the climate crisis does not exist."***

It has long been established that highway expansions serve only to increase traffic and incentivize sprawl. That is, every time we add a lane to a highway, commutes get longer and the number of car tailpipes on the road increases. Despite being fully aware of how this is a self-defeating and wasteful approach to transportation investment, Caltrans continues to allocate billions of taxpayers dollars to highway projects that it knows will make traffic, air quality, and climate pollution worse.

An analysis by Natural Resources Defense Council (NRDC) puts some numbers to the scope of highway spending at the state level. Sorting through the state's largest transportation investment programs, NRDC found that $16.1 billion out of some $22.2 billion total scheduled funds from 2019 — 2027 did nothing to reduce traffic, and a further $2.2 billion in state funds was committed to traffic-generating projects.

The simple fact is that California's transportation spending does not match its climate ambition.

The fiscal impact of Caltrans's misaligned spending is substantially larger than even the numbers above suggest. State investments work in concert with local measures and federal grants to fully fund projects. Each year, the state's billions of dollars facilitate an even larger spend on those projects from the federal government and local governments. Much of this wasteful spending comes from highly-regressive local sales taxes.

If Caltrans turns off the tap on these pointless, climate-harming expenditures, the agency can free up that money to be otherwise put towards good things – like actually reducing traffic, making roads safer, fighting air pollution, and bringing down emissions, without needing to find any new sources of revenue.

Climate 100, Looking Ahead

One-time infusions of cash – even at the unprecedented scale of the California Climate Commitment – are inherently risky and unreliable vehicles for climate investments. Budgeting for an ongoing and accelerating crisis that touches every part of our state should not be done in a manner that is so exposed to the boom and bust of volatile annual revenue cycles.

Moreover, as long as the climate crisis is siloed off from other governmental priorities, or treated as a luxury to be funded only in boom times, the relatively scarce funding that does go to climate cannot be managed efficiently. Large swaths of government spending continue to undermine climate progress or proceed as if the climate crisis does not exist. At a time when we need to be sprinting faster every year on the path to carbon neutrality, California's status quo approach to budgeting risks keeping us stuck in a slow shuffle toward our climate targets, perpetually taking two steps forward and one step back.

On its own terms, and compared to previous efforts, the California Climate Commitment was a rousing success, delivering a massive amount of new investment for climate priorities in our state; its next iteration needs to go much further. California now has the opportunity to adopt a holistic, structural approach to climate investments. Let's make the Climate Commitment 2.0 a Climate 100 budget.