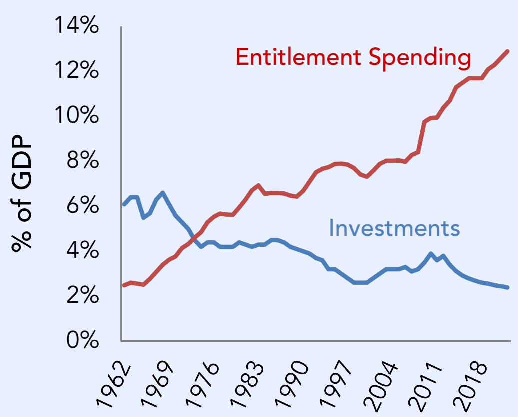
REPORT

NOW OR NEVER | JULY 2012

Collision Course: Why Democrats Must Back Entitlement Reform

By Jessica Perez, Gabe Horwitz, and David Kendall

Since the 1960s, the priorities of President Johnson's Great Society and President Kennedy's New Frontier have been on a collision course that threatens to obliterate public investments. Ever since the dramatic expansion of entitlements that began under the Great Society, investments have occupied a decreasing share of our federal budget. And as the Baby Boomers enter retirement, entitlements will encroach upon an even greater portion of the federal dollars once reserved for building roads, educating kids, and paving the way for technological breakthroughs.



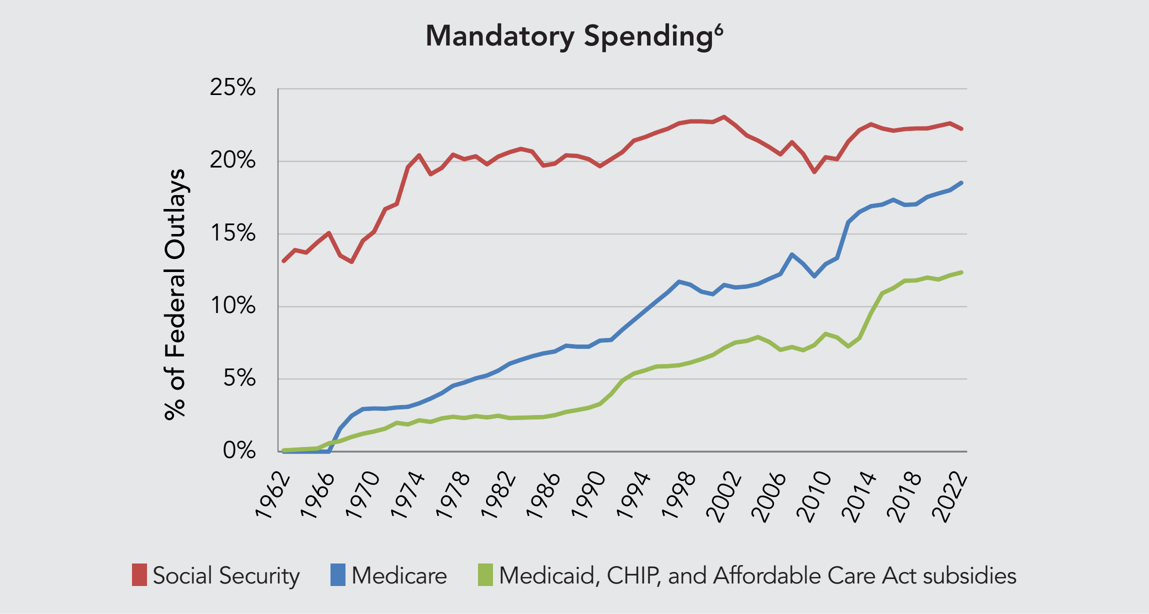
Entitlements are a critical part of economic security, but without change, investments will all but dry up, threatening our economy's ability to grow and create opportunity in the 21st century.[1]

LBJ vs. JFK: Entitlement Spending is Crushing Public Investments

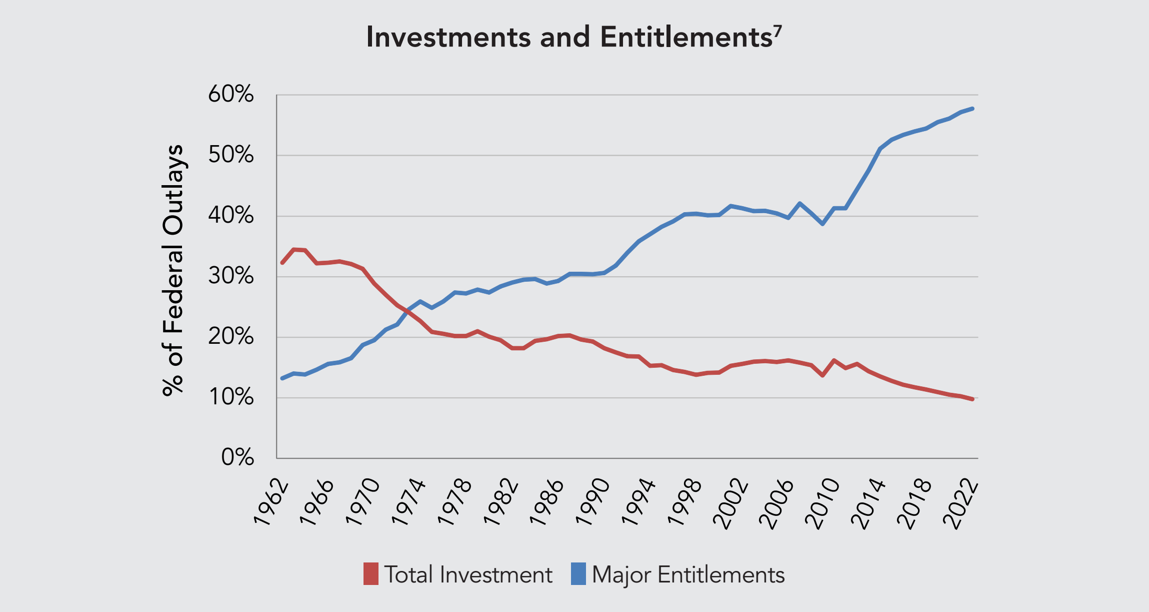
Entitlement costs are consuming an ever-increasing portion of our federal dollars. The budget share of major mandatory spending programs—Social Security, Medicare, and health care programs for the poor—has more than tripled since the 1960s.* And an aging population will lead entitlement spending to skyrocket even further—in ten years, Social Security alone will occupy almost one-fourth of our budget.[2]

* Unless otherwise noted, statistics and graphs in this paper do not account for changes in the cost of servicing the debt that may result from increased or decreased spending levels.

So while 14 cents of every federal dollar not going to interest was spent on entitlements in 1962,[3] today that amount is 47 cents.[4] By 2030, 61 cents of every non-interest dollar will go toward funding these programs.[5]



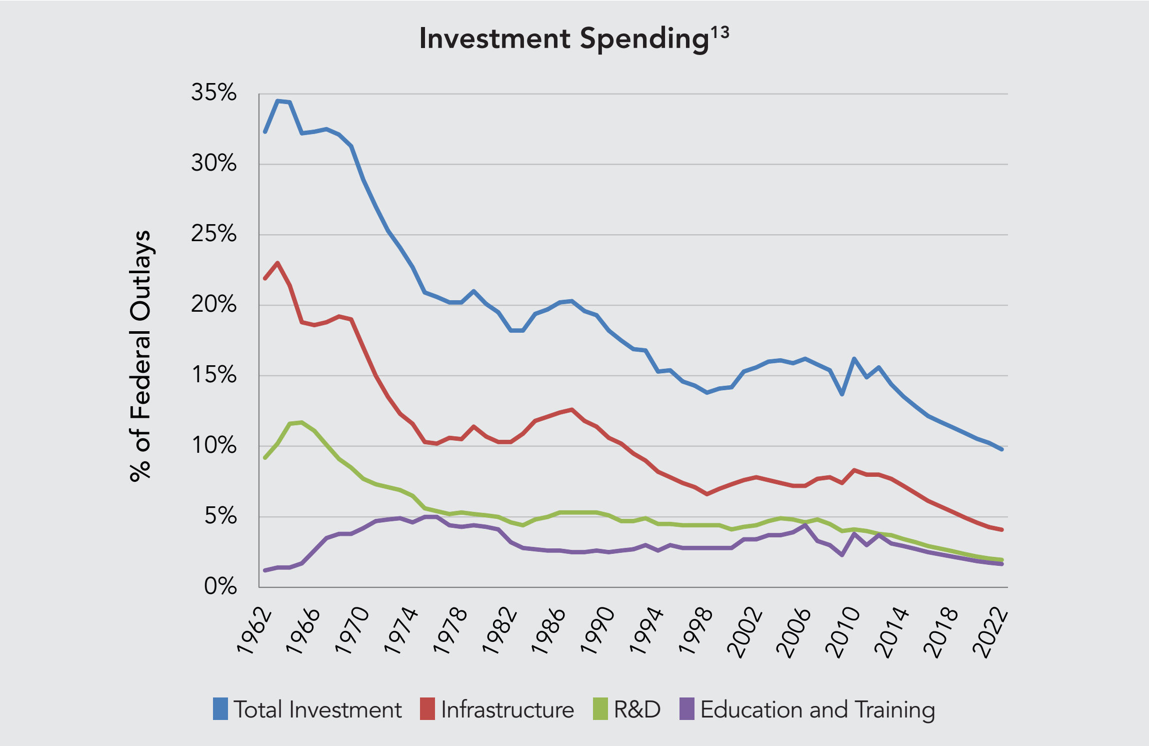
The result of this dramatic expansion? Entitlements are squeezing out public investments. In 1962, spending on investments was two and a half times that of entitlements. But today, as a result of this Great Inversion, entitlement spending is three times that of investments. And this trend will only accelerate in time as the Baby Boomers retire and their benefits grow faster than inflation and wages.



Since the 1960s, this squeeze on investments has translated to a race to the bottom among core Democratic funding priorities. It's clear that America experienced a golden age of investment, during which programs peaked before their funding streams began to deteriorate. Early losers included water infrastructure built by the Army Corps of Engineers, as well as NASA—the poster child of the New Frontier.[8] These investments reached their height in 1966 before declining. Other Democratic priorities, such as federal aid highway construction, training and employment services, and funding for the Department of Energy have all peaked and are now heading downhill.[9]

Some programs, such as the National Institutes of Health and National Science Foundation, remain strong.[10] But if entitlements are not reformed, a similar fate awaits these vital investments. **Today, there is a $1 trillion gulf between what we are spending on major entitlement programs and the money we devote to public investments. In ten years, the gap will be $2.6 trillion.**[11]

In effect, while investments were once one of the largest parts of our budget, today they are one of the smallest. In fact, public investments represented a full one-third of the budget in the 1960s. Today they have dwindled to less than 15% as a result of more and more federal dollars going to entitlements. And as the budget caps set forth in the *Budget Control Act* take effect, **investment spending will fall below the rate of inflation, plummeting to 5% of our budget by 2040.**[12] This fiscal path translates to a less-skilled workforce, lower rates of job creation, and an infrastructure unfit for a 21st century economy—hardly the Great Society LBJ envisioned.



Investments Foster Economic Growth

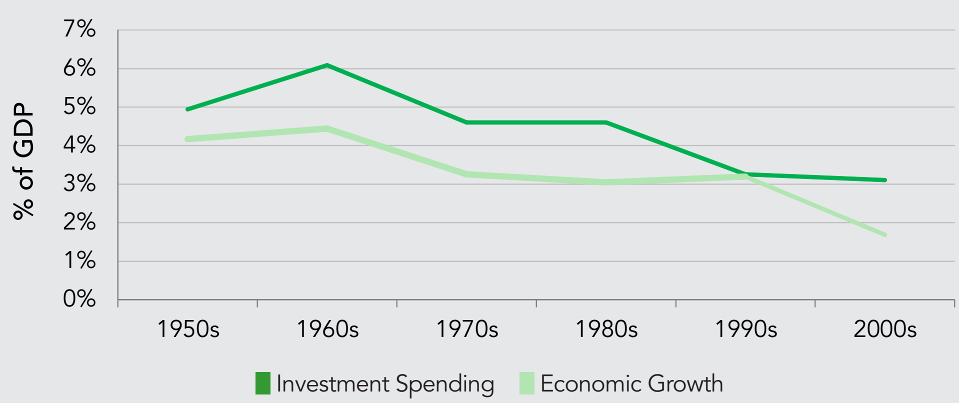
The fact that entitlement spending is crushing investments is bad news for U.S. growth. History is proof of the crucial relationship between investment and economic growth, and a failure to protect investment funding threatens our economy's ability to support a healthy middle class.

In the 1820s, New York's construction of the Erie Canal decreased the price of shipping flour from Buffalo to New York City from $120 to $6 per ton, resulting in more business opportunities and lower prices for consumers.[14] In the twentieth century, forward-looking government investments like federal student loans and the GI Bill, the interstate highway system, and the space program were the heartbeat of economic growth and opportunity in America. They increased college attainment, gave our nation a robust infrastructure backbone, and made the United States the global leader in science and technology—in short, they helped to create the largest middle class in the world.

We looked at public investment since the 1950s and compared investment levels to the economy's average rate of growth. **We saw that periods with high levels of investment experienced higher growth, and as investments declined, so did our economy's rate of expansion.** Investments averaged roughly 5% of GDP in the 1950s and 6% in the 1960s. These decades were marked mostly by robust growth. Following the height of public investment in the 1950s and 1960s, our nation's economy grew at an annual average of more than 3% from the 1960s through the 1990s.[15]

As we've devoted a dwindling share of resources to priorities like cutting-edge technologies and better roads, however, economic growth has declined. Our growth rate fell below 2% in the 2000s, and CBO projects growth rates around 2.3% in the coming decades. While we understand that there are numerous factors affecting the nation's growth, this overall trend threatens middle class opportunity and our nation's ability to compete and prosper.

Average Federal Investment Spending & Economic Growth by Decade[16]



Conclusion

Democrats argue that programs like Social Security, Medicare, and Medicaid are vital to the economic security of retirees. We agree. But a healthy level of investment is also crucial to ensuring opportunity for tomorrow's middle class. And the level of public investments is becoming more anemic each year, putting future generations at risk.

So how do we ensure that a robust investment budget continues to fuel middle class growth? Revenue can and should be part of a solution. But because entitlements are growing faster than earnings, it's simply not enough. Even if in 2014, we increased revenue to 21% of GDP—the highest it's been since the creation of the modern tax code[17]—by 2040, we would still face an annual deficit of more than $4 trillion in 2012 dollars.[18]

Cutting defense spending is also not the silver bullet that many progressives like to believe it is. Even before sequestration, its share of the budget has been close to flat for 20 years. With sequestration, discretionary defense spending will continue to decline, dipping to less than 14% of outlays by 2022.[19]

The fiscal cliff provides Democrats with a unique now or never moment—a moment to secure a grand bargain on the deficit that is balanced *and* preserves Democratic priorities. As we have argued in past Third Way papers, the lame duck represents the best moment to set in motion a bipartisan deal—a deal that can ensure that entitlements are put on firm financial footing, revenue is increased, and investments remain a central role of government.

Republicans must relinquish their choke hold on revenues. But Democrats must also put entitlements on the table. It's the only way the visions of both LBJ and JFK can succeed.

* * *

THE AUTHORS

Jessica Perez is a Policy Advisor for the Third Way Economc Program and can be reached at jperez@thirdway.org. Gabe Horwitz is the Director of the Third Way Economic Program and can be reached at ghorwitz@thirdway.org. David Kendall is the Senior Fellow for Health and Fiscal Policy at Third Way and can be reached at dkendall@thirdway.org.

ABOUT THIRD WAY

Third Way is a think tank that answers America's challenges with modern ideas aimed at the center. We advocate for private-sector economic growth, a tough and smart centrist security strategy, a clean energy revolution, and progress on divisive social issues, all through a moderate-led U.S. politics.

For more information about Third Way please visit www.thirdway.org.

ENDNOTES

1 The classification of federal spending as investments comes from the Office of Management and Budget. According to the OMB: "Federal investment is the portion of Federal spending intended to yield long-term benefits for the economy and the country." This classification includes physical investment such as federal buildings and weapons systems, research and development such as the National Institutes of Health, the National Science Foundation, and NASA, and education and training such as college loans. See United States, Office of Management and Budget, "Budget of the United States Government: Analytical Perspectives—Special Topics," Fiscal Year 2013, p. 355. Accessed July 2, 2012. Available at: http://www.whitehouse.gov/omb/budget/Analytical_Perspectives. Authors' calculations based on United States, Office of Management and Budget, "Total Investment Outlays for Major Public Physical Capital, Research and Development, and Education and Training: 1962–2013," Accessed June 29, 2012. Available at: http://www.whitehouse.gov/omb/budget/Historicals/.; See also United States, Office of Management and Budget, "Outlays for Mandatory and Related Programs: 1962–2013," Accessed June 29, 2012. Available at: http://www.whitehouse.gov/omb/budget/Historicals/.; See also United States, Congress, Congressional Budget Office, "Supplemental Data," *The Budget and Economic Outlook: Fiscal Years 2012 to 2022*, January 31, 2012, Accessed June 29, 2012. Available at: http://www.cbo.gov/publication/42905.; See also United States, Congress, Congressional Budget Office, "Supplemental Data—Figure 30.2," *The 2012 Long Term Budget Outlook*, June 2012, Accessed June 29, 2012. Available at: http://cbo.gov/publication/43288.

2 Authors' calculations based on United States, Congress, Congressional Budget Office, "Supplemental Data—Figure 30.2," *The 2012 Long Term Budget Outlook*, June 2012, Accessed June 29, 2012. Available at: http://cbo.gov/publication/43288.

3 Authors' calculation based on: United States, Office of Management and Budget, "Outlays by Superfunction and Function," Accessed June 29, 2012. Available at: http://www.whitehouse.gov/omb/budget/Historicals/.; See also United States, Office of Management and Budget, "Outlays for Mandatory and Related Programs: 1962–2013," Accessed June 29, 2012. Available at: http://www.whitehouse.gov/omb/budget/Historicals/.

4 Authors' calculations based on Authors' calculation based on United States, Congress, Congressional Budget Office, "Supplemental Data," The Budget and Economic Outlook: Fiscal Years 2012 to 2022, January 31, 2012, Accessed July 17, 2012. Available at: http://www.cbo.gov/publication/42905.

5 Ibid.

6 Authors' calculation based on United States, Office of Management and Budget, "Outlays for Mandatory and Related Programs: 1962–2013," Accessed June 29, 2012. Available at: http://www.whitehouse.gov/omb/budget/Historicals/.; See also United States, Congress, Congressional Budget Office, "Supplemental Data—Figure 30.2," *The 2012 Long Term Budget Outlook*, June 2012, Accessed June 29, 2012. Available at: http://cbo.gov/publication/43288.

7 These numbers do not include changes in the cost of servicing the debt that may result from increases or decreases in spending. Authors' calculations based on: United States, Office of Management and Budget, "Total Investment Outlays for Major Public Physical Capital, Research and Development, and Education and Training: 1962–2013," Accessed June 29, 2012. Available at: http://www.whitehouse.gov/omb/budget/Historicals/.; See also United States, Office of Management and Budget, "Outlays for Mandatory and Related Programs: 1962–2013," Accessed June 29, 2012. Available at: http://www.whitehouse.gov/omb/budget/Historicals/.; See also United States Congress, Congressional Budget Office, "Supplemental Data," *The Budget and Economic Outlook: Fiscal Years 2012 to 2022*, January 31, 2012. Accessed June 29, 2012, Available at: http://www.cbo.gov/publication/42905.; See also United States, Congress, Congressional Budget Office, "Supplemental Data—Figure 30.2," *The 2012 Long Term Budget Outlook*, June 2012, Accessed June 29, 2012. Available at: http://cbo.gov/publication/43288.

8 United States, Office of Management and Budget. " Outlays by Agency: 1962-2017," Accessed June 28, 2012. Available at: http://www.whitehouse.gov/omb/budget/Historicals.

9 These numbers do not include changes in the cost of servicing the debt that may result from increases or decreases in spending. Authors' calculation based on United States, Office of Management and Budget, "Budget of the United States Government: Public Budget Database," Fiscal Year 2013. Accounts 025-06- (86) -0162, 012-05- (16) -0174, and 021-15- (69) -8083 Accessed March 28, 2012. Available at: http://www.whitehouse.gov/omb/budget/Supplemental/ See also United States, Office of Management and Budget, "Outlays by Agency: 1962-2017," Accessed June 28, 2012. Available at: http://www.whitehouse.gov/omb/budget/Historicals.

10 United States, Office of Management and Budget, "Outlays by Agency: 1962-2017," Accessed June 28, 2012. Available at: http://www.whitehouse.gov/omb/budget/Historicals. .

11 Authors' calculation based on United States, Office of Management and Budget, "Total Investment Outlays for Major Public Physical Capital, Research and Development, and Education and Training: 1962–2013," Accessed June 29, 2012. Available at: http://www.whitehouse.gov/omb/budget/Historicals/.; See also United States, Congress, Congressional Budget Office, "Supplemental Data," *The Budget and Economic Outlook: Fiscal Years 2012 to 2022*, January 31, 2012, Accessed June 29, 2012. Available at: http://www.cbo.gov/publication/42905.; See also United States, Congress, Congressional Budget Office, "Supplemental Data: Summary Alt. Ext. Fiscal," *The 2012 Long Term Budget Outlook*, June 2012, Accessed June 29, 2012. Available at: http://cbo.gov/publication/43288.

12 Authors' calculations based on United States, Office of Management and Budget, "Total Investment Outlays for Major Public Physical Capital, Research and Development, and Education and Training: 1962–2013,"spreadsheet. Accessed June 29, 2012. Available at: http://www.whitehouse.gov/omb/budget/Historicals/.; See also United States, Congress, Congressional Budget Office, "Supplemental Data," *The Budget and Economic Outlook: Fiscal Years 2012 to 2022*, January 31, 2012, Accessed June 29, 2012. Available at: http://www.cbo.gov/publication/42905.

13 These numbers do not include changes in the cost of servicing the debt that may result from increases or decreases in spending. United States, Office of Management and Budget, "Total Investment Outlays for Major Public Physical Capital, Research and Development, and Education and Training: 1962–2013," Accessed June 29, 2012, Available at: http://www.whitehouse.gov/omb/budget/Historicals/; See also United States, Congress, Congressional Budget Office, "Supplemental Data," *The Budget and Economic Outlook: Fiscal Years 2012 to 2022*, January 31, 2012, Accessed June 29, 2012. Available at: http://www.cbo.gov/publication/42905.

14 John Steele Gordon, *An Empire of Wealth: The Epic History of American Economic Power*, HarperCollins, New York, NY, 2005, pp. 104-110, Print.

15 Authors' calculation based on: United States, Department of Commerce, Bureau of Economic Analysis. "Gross Domestic Product, Percent change from preceding period," Accessed June 27, 2012, Available at: http://bea.gov/national/index.htm#gdp.; See also: United States, Office of Management and Budget, "Total Investment Outlays for Major Public Physical Capital, Research and Development, and Education and Training: 1962–2013," Accessed June 29, 2012. Available at: http://www.whitehouse.gov/omb/budget/Historicals/.; See also United States, Congress, Congressional Budget Office, "Supplemental Data," *The Budget and Economic Outlook: Fiscal Years 2012 to 2022*, January 31, 2012, Accessed June 29, 2012. Available at: http://www.cbo.gov/publication/42905.; See also United States, Congress, Congressional Budget Office, "Supplemental Data," *The Budget and Economic Outlook: Fiscal Years 2012 to 2022*, January 31, 2012, Accessed June 29, 2012. Available at: http://www.cbo.gov/publication/42905. ; See also United States, Congress, Congressional Budget Office, "Supplemental Data: Summary Alt. Ext. Fiscal," *The 2012 Long Term Budget Outlook*, June 2012, Accessed June 29, 2012. Available at: http://cbo.gov/publication/43288.

16 Authors' calculation based on: Bureau of Economic Analysis. "Gross Domestic Product, Percent change from preceding period." Accessed June 27, 2011. Available at: http://bea.gov/national/index.htm#gdp. See also United States, Office of Management and Budget, "Total Investment Outlays for Major Public Physical Capital, Research and Development, and Education and Training: 1962–2013,"Spreadsheet. Accessed June 29, 2012. Available at: http://www.whitehouse.gov/omb/budget/Historicals/.; See also United States, Congress, Congressional Budget Office, "Supplemental Data," *The Budget and Economic Outlook: Fiscal Years 2012 to 2022*, January 31, 2012, Accessed June 29, 2012. Available at: http://www.cbo.gov/publication/42905.; See also United States, Congress, Congressional Budget Office, "Supplemental Data: Summary Alt. Ext. Fiscal," *The 2012 Long Term Budget Outlook*, June 2012. Accessed June 29, 2012. Available at: http://cbo.gov/publication/43288.

17 Tax Policy Center, "Historical Source of Revenue as Share of GDP." Accessed June 27, 2012, Available at: http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=205.

18 This calculation accounts for changes to the cost of servicing the debt that would result from higher levels of revenue. Authors' calculations based on United States, Congress, Congressional Budget Office, "Supplemental Data," *The 2012 Long Term Budget Outlook*, June 2012. Accessed July 2, 2012. Available at: http://cbo.gov/publication/43288.

19 Authors' calculation based on: United States, Office of Management and Budget, "Outlays for Discretionary Programs: 1962-2017," Accessed June 28, 2012. Available at: http://www.whitehouse.gov/omb/budget/Historicals.; See also United States, Congress. Congressional Budget Office, "Supplemental data: Discretionary Spending," Updated Budget Projections: Fiscal Years 2012 to 2022, March 2012, Accessed June 28, 2012. Available at: http://www.cbo.gov/publication/43119.