

SHORT-TERM GAINS AND LONG-TERM PAIN

THE HISTORY OF US ENTITLEMENTS

By Mark J. Higgins

“It is not improper to observe, that pensions in all countries begin on a small scale, and are first generally granted on proper consideration, and then they increase till at last they are granted often on whim or caprice as for proper considerations... It will drain any treasury, no matter how full.”

—Nathaniel Macon, former Speaker of the House (January 1818)

ON JANUARY 1, 2025, the gross federal debt of the United States exceeded 120% of GDP, surpassing the previous all-time-high of approximately 119% set at the end of World War II. Recent projections by the bipartisan Congressional Budget Office (CBO) are even more alarming. As of March 2025, the CBO estimated that current spending and tax policies will cause the gross federal debt to rise steadily to 169% of GDP by 2055. These estimates do not account for unforeseen crises, which make it conceivable that future debt levels will rise considerably higher.

The greatest financial challenge for the United States in the 21st century will almost certainly involve reining in the nation’s unsustainable spending and debt accumulation. Solving this problem is difficult under any circumstances, but what makes it especially daunting is the fact that few politicians acknowledge that the primary cause is unsustainable spending on entitlements. In 2024, mandatory spending on programs, such as Social Security, Medicare, Medicaid, unemployment and other aid programs constituted roughly 55% of non-interest, federal spending. In 2055, these programs are projected to absorb approximately 67% of non-interest

spending. The sheer magnitude of entitlement program costs makes it impossible to solve the nation’s debt problem unless government policymakers commit to altering them in a meaningful way.

The Danger of Depleted Borrowing Capacity

“Exigencies are to be expected to occur, in the affairs of nations, in which there will be a necessity for borrowing. That loans in times of public danger, especially from foreign war, are found an indispensable resource, even to the wealthiest of them... On the one hand, the necessity for borrowing in particular emergencies cannot be doubted, so on the other, it is equally evident, that to be able to borrow upon good terms, it is essential that the credit of a nation should be well established.”

—Alexander Hamilton, first US Secretary of the Treasury

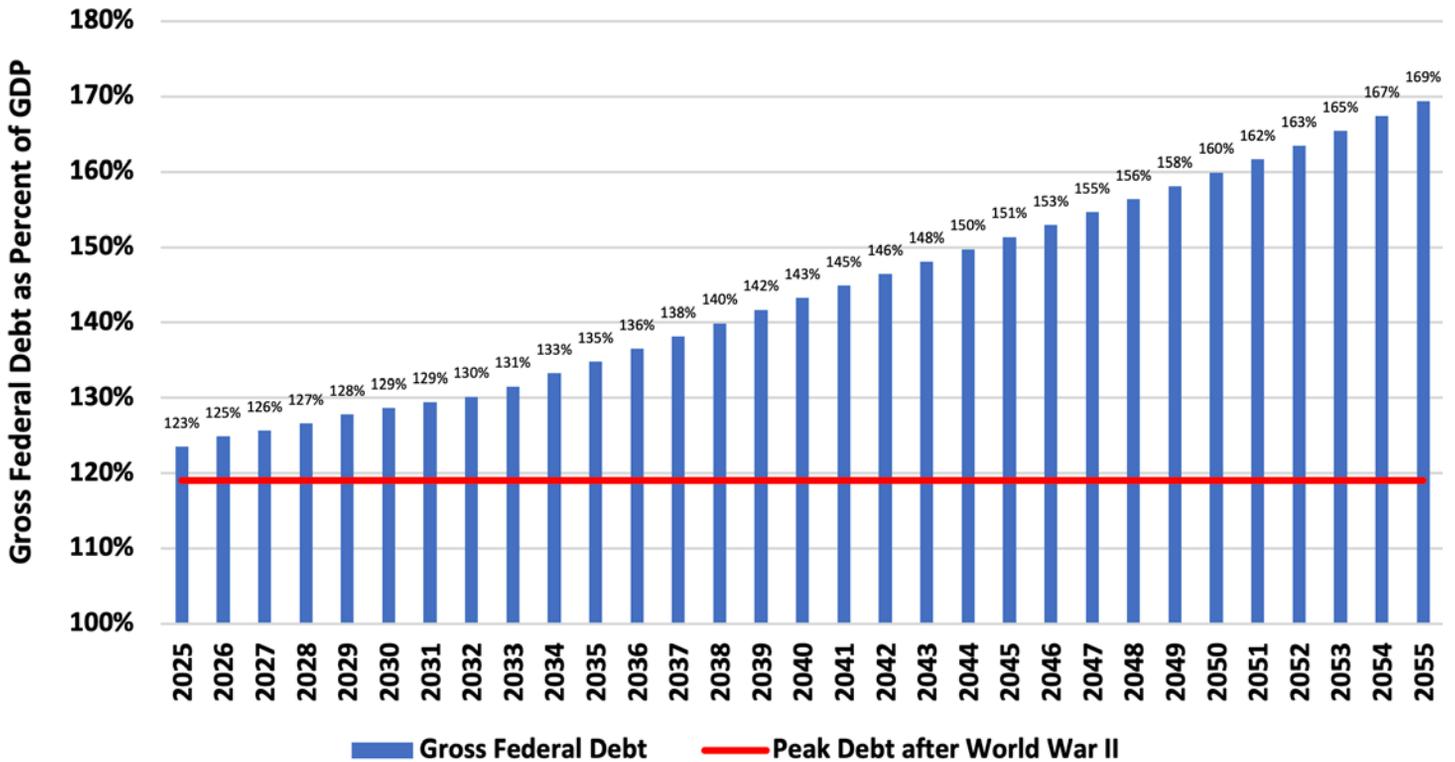
The last time the credit of the United States was called into serious question was in 1790. At the time, many states had defaulted on bonds issued to fund the Revolutionary War. In extreme cases, some states even failed to fully compensate veterans for their service in the war. But the United States was fortunate that President George Washington appointed Alexander Hamilton to serve as the nation’s first Secretary of the Treasury. In addition to creating the nation’s first central bank, Hamilton consolidated the war debt of the states under the federal government and selectively raised tariffs to ensure adequate coverage of interest and principal payments. He also articulated two fundamental principles regarding the

use of public debt in his *First Report on the Public Credit*. The first was that it should be used primarily to address *public dangers*, especially foreign wars. The second was that the debt should be extinguished when the danger subsided. In combination, Hamilton’s programs and principles repaired the nation’s credit and established a solid foundation for future economic growth.

The United States largely abided by Hamiltonian principles for approximately 150 years, thus ensuring adequate borrowing capacity to finance successful responses to public dangers, such as the War of 1812, the Civil War, World War I, the Great Depression and World War II. But emboldened by extraordinary post-World War II wealth and armed with the world’s new dominant reserve currency under the Bretton Woods Agreement, Congress massively increased entitlement spending for the last 80 years. Now, in 2025, the debt reckoning of the United States has arrived, and Americans must choose whether to continue spending beyond their means.

This article focuses on a critically important issue related to the health of the nation’s finances. It explains the history of US entitlement programs and how they have evolved and expanded over more than two centuries. The purpose is not to advocate for specific solutions, but rather to take the first step and explain the severity of the problem. Solutions will inevitably require painful sacrifices that will likely entail a distasteful combination of benefit reductions and tax increases. Many who are called to make such sacrifices will feel they are unfair—and, in many cases, they will be unfair. Perhaps understanding how the nation arrived at this point will help people appreciate why such sacrifices are necessary, nonetheless. The alternative is to saddle future generations with the debts of their ancestors, thereby condemning them to confront public dangers armed only with a maxed-out line of credit.

Estimated Gross Federal Debt of the United States of America (2025 to 2055)



Source: Congressional Budget Office (March 2025)

Veterans' Pensions and the Entitlement Expansion Cycle

The first US federal entitlement programs consisted of pension plans for war veterans. Unlike modern pensions, veterans' plans only provided benefits to disabled veterans. The first plan was created in 1789 when the newly formed federal government took over a plan established for Army veterans prior to the ratification of the US Constitution.

Over the next 80 years, the Revolutionary War pension plan followed a pattern of incremental expansion that would repeat with future veterans' plans. Initially, such plans covered a specific set of conditions for a well-defined cohort of eligible participants. For example, the Revolutionary War plan restricted coverage to veterans who suffered disabilities stemming from wounds or illnesses acquired in the line of duty, as well as widows of eligible veterans. But over time, Congress steadily expanded benefits and loosened eligibility criteria. Expansions typically occurred around critical election years, especially when they coincided with a strong economy. In the case of the Revolutionary War pension, major benefit and

eligibility expansions occurred in 1806, 1818, 1832 and 1836. In combination, incremental expansions over multiple decades massively increased plan costs, placing unanticipated strain on federal budgets.

One key difference between veterans' plans and modern entitlement programs, however, is that distributions inevitably declined as veterans passed away. In the case of the Revolutionary War plan, distributions ended when the last pensioner, Daniel T. Bakeman, passed away on April 5, 1869. Similar to veterans' pensions established during the War of 1812, the Civil War and World War I, the aggregate costs of the Revolutionary War veterans' pension far exceeded initial estimates. Even so, the costs would soon be dwarfed in the 20th century by entitlement programs that covered a much larger portion of the US population.

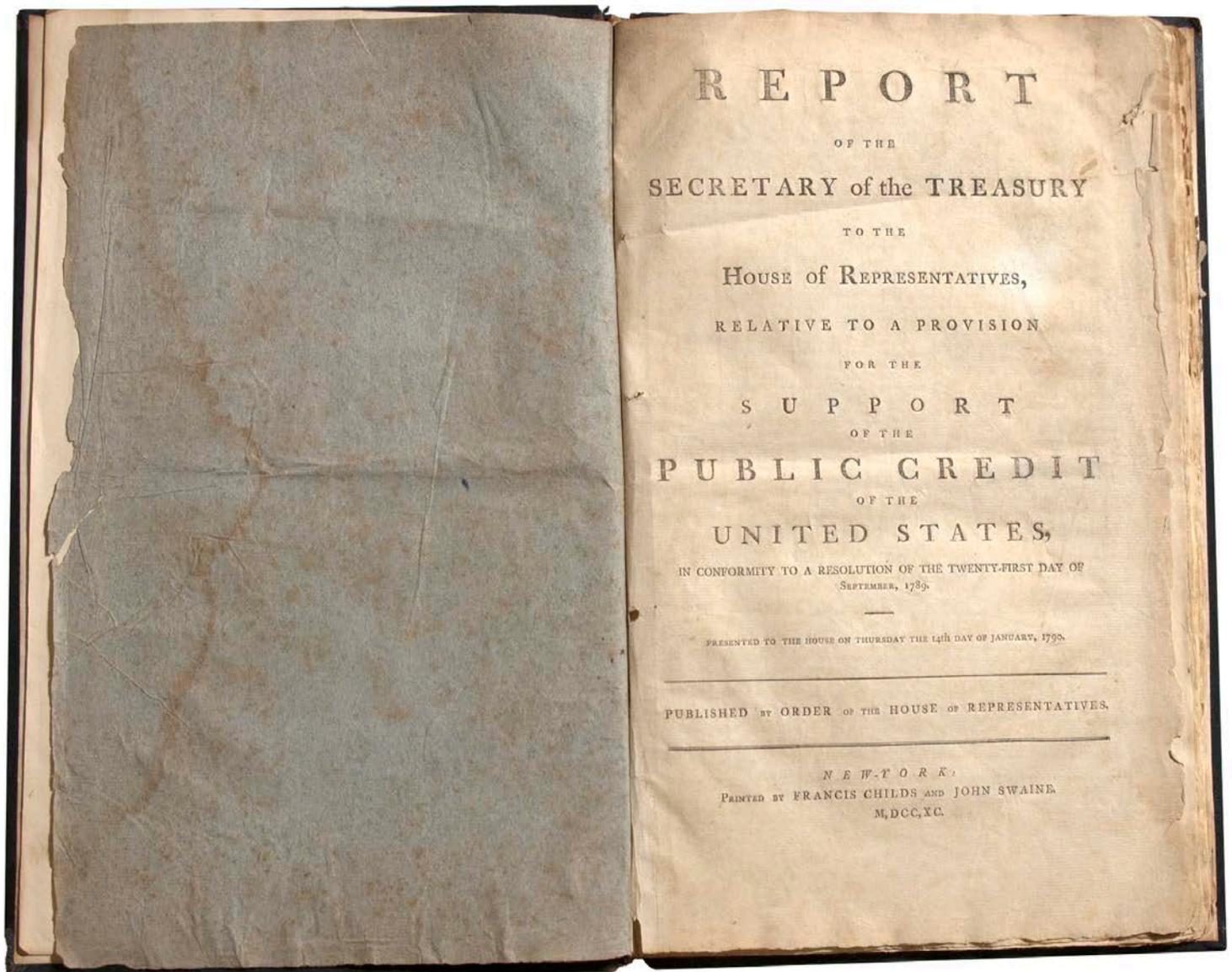
A New Deal for Entitlements

“Security was attained in the earlier days through the interdependence of members of families upon each other and of the families within a small

community upon each other. The complexities of great communities and of organized industry makes less real these simple means of security. Therefore, we are compelled to employ the active interest of the nation as a whole through government in order to encourage greater security for each individual who composes it.”

— President Franklin D. Roosevelt

The Great Depression was the worst economic catastrophe in US history. Real GDP contracted by nearly 30% from 1929 to 1933, and unemployment averaged approximately 18% for the entire decade. The misery of the 1930s was amplified by the transformation of the United States from an agrarian to industrial economy over the prior century. All else being equal, family and community bonds were weakened, leaving many vulnerable populations without a support network. Prior to the Depression, poverty and unemployment were largely handled by family members, private charities and local government. Looser family and community



The first page of Alexander Hamilton's *Report on the Public Credit*, which is considered to be the financial equivalent of the US Constitution.

bonds rendered traditional lines of defense less effective, and public support for a federal solution intensified as the Depression persisted. The elderly and unemployed were deemed especially vulnerable.

On August 14, 1935, President Franklin D. Roosevelt signed the Social Security Act of 1935. The Act included old age insurance, unemployment insurance and various funding programs to assist state-level programs to aid vulnerable populations. The Social Security Act also introduced a payroll tax to fund benefits. Proponents of the Act considered the payroll tax especially important, as it provided the perception that Social Security was an *earned right*, rather than a handout. The earned right claim was further reinforced with the passage of the

Social Security Amendments of 1939, which established the Social Security Trust Fund.

The reality, which few Americans appreciate to this day, is that there is a weak link between one's contributions into the Social Security program and the level of one's benefits. For example, the first generation of recipients, on average, received benefits that far exceeded their contributions, whereas future generations will likely contribute far more than they receive. During a conversation with a Treasury official, President Roosevelt conceded this fact, stating, "I guess you're right on the economics. They are politics all the way through. We put those payroll contributions there so as to give the contributors a legal, moral and political

right to collect their pensions and their unemployment benefits. With those taxes in there, no damn politician can ever scrap my Social Security program."

The Social Security Act marked a monumental shift in federal entitlement policy. Prior to its passage, entitlement programs consisted almost entirely of pensions for veterans and selected groups of government employees. In contrast, Social Security offered benefits to a much broader constituency and was perceived as an earned right due to the existence of the payroll tax and Social Security Trust Fund. These precedents created a legal and philosophical foundation upon which new entitlement programs were launched in the decades following World War II.

Inflated Expectations

“This administration today, here and now, declares unconditional war on poverty in America... It will not be a short or easy struggle, no single weapon or strategy will suffice, but we shall not rest until that war is won. The richest Nation on earth can afford to win it.”

—President Lyndon B. Johnson,
State of the Union (January 8, 1964)

Economic conditions during the 15 years following the end of World War II were diametrically opposed to conditions during the 15 years preceding it. Major cities across Europe and Asia lay in ruins, while the United States was significantly strengthened. In 1945, the United States possessed approximately 70% of the world's gold, a vastly expanded industrial infrastructure, a massive technological edge relative to global competitors and the privilege of issuing the world's new

dominant reserve currency. Emboldened by what seemed like bottomless financial reserves, the existence of poverty became less tolerable in the United States. This increased pressure on elected officials to expand Social Security benefits both in terms of coverage and level of distributions throughout the 1950s. Then, in the mid-1960s, another fundamental shift in entitlement spending occurred.

On January 20, 1965, President Lyndon B. Johnson was inaugurated for his first elected term. Channeling the public's growing distaste for poverty, President Johnson declared an ambitious goal of eliminating poverty entirely in the United States. Dubbed the Great Society, Johnson worked with Congress to create a slew of new entitlement programs. The Social Security Amendments of 1965, which created the Medicare and Medicaid programs, constituted his signature legislation. Johnson also signed laws approving large benefit increases for Social Security, as well as substantial expansion of the disability program. Combined with

numerous anti-poverty initiatives enacted under the Economic Opportunity Act of 1964, President Johnson massively increased the level and scope of federal spending on entitlements.

President Johnson's programs were well-intended but proved costly, both politically and financially. On March 31, 1968, President Johnson announced that he would not seek reelection. His presidency suffered from a disastrous escalation of the war in Vietnam, the onset of elevated inflation levels and dreadful results of the Great Society. Richard Nixon defeated Vice President Hubert Humphrey in the 1968 presidential election and entered office with the intent of reining in wasteful spending. Surprisingly, however, the net impact of President Nixon's reforms was further expansion of entitlements. For example, Nixon approved a series of Social Security benefit expansions, including costly legislation in 1972 that indexed future distributions to inflation. The cost of these expansions was substantially amplified by an error in

COMMON ATTRIBUTES OF PENSION BENEFIT EXPANSION CYCLES

The cycle of benefit expansions for veterans' pension plans shared many common attributes. Politicians repeated the cycle because the glacial pace of expansion occurred over multiple decades, making it difficult to detect the repetition. Several of the more important attributes included:

- **Equally Worthy Claims:** Pension plan eligibility often expanded when individuals who just barely failed to meet qualification criteria claimed that they were *equally worthy* of benefits. The problem is that after eligibility expanded, it created a new cohort of individuals who resided on the fringe of eligibility. Over many years, the repetitive process of expanding benefits to cover each new cohort of equally worthy claimants created a much larger group of eligible participants than was originally intended.
- **Election Proximity:** The passage of pension benefit expansions often coincided with major elections. The reason is because satisfying the demands of individuals with equally worthy claims often promised to tip a close election in one party's favor.
- **Correlation with Strong Economies:** There was a tight correlation between the strength of the economy and pressure to expand benefits. Tragically, quite a few benefit expansions of veterans' plans occurred immediately prior to major economic downturns, making the costs far more difficult to

bear in subsequent years. For example, in the case of the US Navy Pension Plan, a large benefit expansion occurred within months of the Panic of 1837. The combination of massive distributions and a collapse in asset values forced the plan to liquidate its entire portfolio of securities by 1841.

- **Chronic Cost Underestimation:** The financial health of pension plans often suffered from chronic cost underestimation. Sometimes it was purposeful, but often it was simply because politicians failed to anticipate how the populace would alter their behavior in response to plan changes. For example, incremental enhancements to veterans' plans invariably created powerful incentives for healthy veterans to report less severe disabilities. In more egregious cases, it also attracted claimants who fabricated disabilities or never even served in the military.

In combination, the above factors explain why veterans' pensions repeatedly experienced increases in costs. But the deepest root of the problem was the collective amnesia of politicians who allowed the cycle to repeat. The only saving grace for veterans' plans was the eventual mortality of beneficiaries. But beginning in the mid-1900s, the cycle of expansion became much more costly when permanent entitlements were launched in the aftermath of the Great Depression and World War II.



Harry S. Truman Library

President Lyndon B. Johnson signs the Medicare Bill at the Harry S. Truman Library, 1965.

an indexing formula, which was not corrected until 1977.

By the mid-1970s, most major entitlement programs that are in place today were well established. By the 1980s, mounting costs already weighed heavily on the federal budget. To address the nation's deteriorating finances, the last two decades of the 20th century were relatively light on program expansions. Unfortunately, politicians were also insufficiently aggressive on cost containment—even after considering the brief federal budget surpluses in the late 1990s. Spending on entitlement programs grew less rapidly, but still expanded from roughly 9% of GDP in 1980 to roughly 10% in 1999.

Laying the Final Straws

On March 23, 2010, President Barack Obama signed the Affordable Care Act (ACA) into law. The legislation fell short of the Democratic party's long-standing

goal of creating a national healthcare program. Political resistance forced Democrats to settle for expanded coverage and subsidies. The ACA was the last major entitlement program expansion in the 2000s. For the remainder of the 2010s, persistent fiscal deficits, which substantially increased in the aftermath of the Global Financial Crisis (GFC), had become too worrisome. But the 2020s would make the problem considerably worse.

In March 2020, the COVID-19 virus metastasized into a global pandemic. During and immediately after the crisis, the United States passed several fiscal stimulus packages, which added approximately \$5 trillion in federal spending. Federal deficits for the five fiscal years ending September 2024 ballooned to an average of nearly \$2.2 trillion per year, adding a total of \$10.8 trillion to the national debt. Making matters even worse, massive fiscal and monetary stimulus stoked inflationary pressures, which fueled higher interest

rates across the entire yield curve. In 2025, interest payments on the public debt are expected to be nearly \$1 trillion, exceeding the entire defense budget. Analysis by financial historian Niall Ferguson identified this as a worrisome inflection point because, in the past, it had preceded the decline of many empires. In combination, these developments sent a clear signal that the debt reckoning of the United States had arrived.

Debt Reckoning and the Challenge of Worthiness

“You will perceive, Sir, I have neither flattered the state nor encouraged high expectations. I have thought it my duty to exhibit things as they are, not as they ought to be.”

—Alexander Hamilton

Over the past 235 years, politicians have engaged in many fierce debates over entitlement spending in all its forms. Central to that debate is determining who is worthy of benefits and how much is warranted. If the bar is set too low, entitlement programs encourage unnecessary dependency that is harmful to society, as well as the individuals who become overly dependent on them. If the bar is set too high, it causes needless suffering that could otherwise be mitigated at an acceptable cost.

The challenge of determining worthiness is made considerably more difficult because public perceptions vary depending on prevailing economic conditions. During periods of plenty, thresholds tend to decline and politicians feel pressure to increase benefits and expand eligibility. The problem, however, is that when economic conditions inevitably deteriorate, the shift in perspective is asymmetrical. The electorate is far less willing to pressure politicians to reduce benefits—even if the benefits never would have been granted had the period of economic plenty never occurred.

The asymmetric variability of the public's perception of worthiness is especially problematic when a nation experiences an extended, but anomalous, period of economic plenty. It is this scenario that lies at the heart of the entitlement spending problem in the United States in 2025. Social Security, Medicare, Medicaid and

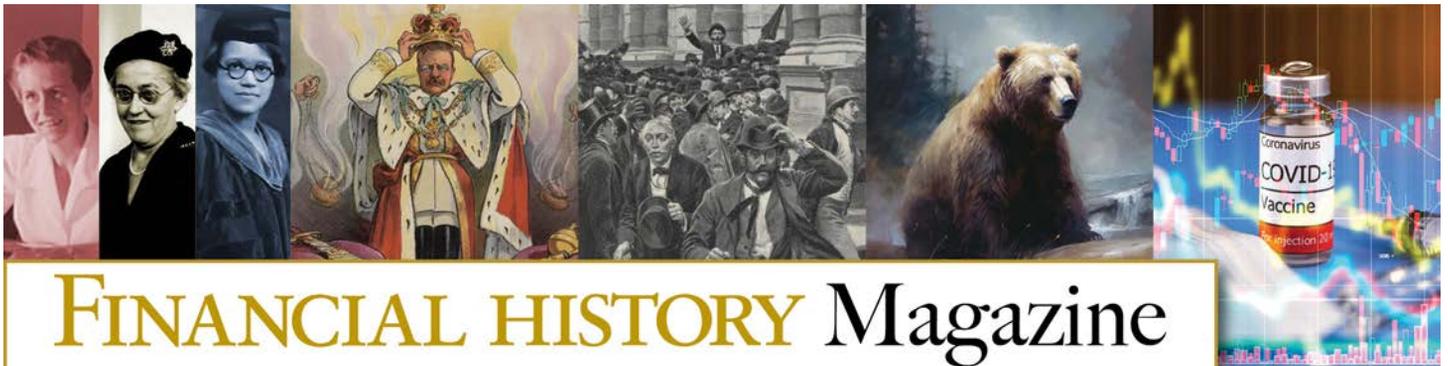
a variety of other assistance programs were established and/or expanded during the uniquely bountiful decades following the end of World War II. Many Americans erroneously concluded that these conditions constituted a new normal. Although the United States remains relatively wealthy today by global standards, it is not at a level that supports existing and projected levels of entitlement spending.

The inconvenient truth in 2025 is that few Americans can bear the thought of cutting entitlement benefits, in large part because a sizable percentage of citizens now depend on them. Politicians and economists who dare to propose efforts to reduce entitlement spending are vilified for their perceived cruelty. Absent from such criticism, however, is consideration of how unsustainable entitlement spending affects future generations. Demanding sacrifices from current generations is deemed immoral, but laying higher taxes on future generations and depriving them of similar benefits is considered acceptable. Even worse, few Americans consider the moral implications of failing to provide future generations with adequate borrowing capacity to fund the unpredictable, but inevitable, public dangers that Hamilton rightfully feared in 1790. It is this element of America's fiscal problem that qualifies it as the greatest financial challenge for current generations and an existential threat to future ones. 💰

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