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Austerity Versus Stimulus: Theoretical Perspectives and Policy Implications

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Attempts to respond to the negative social and economic effects of the Great Recession have been cast in terms of the austerity versus stimulus debate. Although oversimplified, this debate reflects wider theoretical analyses of market economies and normative prescriptions for enhancing their functioning. Referencing the historical evolution of economic thought, these theories and their policy implications for responding to recessions are summarized and their relevance for social welfare is examined in the light of recent events.

Key words: *austerity, stimulus, social welfare, Great Recession, economic thought*

The austerity versus stimulus debate has become prominent since the onset of the Great Recession in the autumn of 2007. Advocates of austerity policies urge governments to retrench public spending, ease taxes and regulations and adopt other measures that will restore business confidence prompting entrepreneurship, investment and economic revitalization. On the other hand, advocates of stimulus policies urge governments to increase public spending through borrowing in order to create employment, maintain incomes and stimulate consumption so that demand for goods and services will increase and foster growth and prosperity.

However, it is simplistic to reduce the debate to these polar opposites, since few governments have, in fact, taken a clear position on either austerity or stimulus, and some have adopted measures that give expression to both positions. In addition, many have responded haphazardly to the recent recession, and often their responses have been shaped by electoral pressures. Economists themselves are divided on which

policies are likely to be the most effective. Some have taken a very clear position arguing vigorously for either austerity or stimulus, while others propose a pragmatic mixture of the two. Nevertheless, a preference for either austerity or stimulus can be detected in the policy preferences of different governments. These two approaches have also featured prominently in political and media discourse in recent years.

The debate reflects wider ideological differences about how market economies function and how they should function. This invariably involves a larger debate about the role of government in economic and social affairs, which has a long and rich intellectual history. Although complex, there are opposing arguments on the question of state involvement which have direct relevance for the austerity versus stimulus debate. One position is that the economic market is self-equilibriating and that governments should refrain from intervening so that its unencumbered internal mechanisms can function and produce prosperity for all. The other posits that widespread prosperity will only be achieved when efficient governments committed to promoting the well-being of their citizens direct the economy for social ends.

These two positions are discussed in this article with reference to the problem of 'business cycles' which appear to be inherent in market economies. Since the 18th century, economists have been aware that periods of prosperity are followed by periods of declining economic activity which may lead to a recession, high unemployment and falling living standards. In addition to documenting the occurrence of business cycles, various explanations of their causes have been offered. Perhaps most importantly, different normative accounts of how their negative effects can be remedied have been formulated. The current policy debate about austerity versus stimulus is based on these conceptual endeavors.

Since the debate has direct implications for social well-being, social welfare scholars should understand its intellectual origins and better appreciate policy proposals for addressing the negative effects of economic volatility. The article begins with a brief discussion of opposing conceptual representation of market economies and explanations of the causes of economic cycles, and it then considers competing policy proposals for responding to these cycles. It concludes by reviewing

the limited social welfare literature on the issue of austerity versus stimulus and discusses its relevance to social welfare.

Conceptualizing the Economy and Explaining Business Cycles

In his extensive history of economic thought, John Kenneth Galbraith (1987) points out that systematic academic enquiry into economic institutions can be traced back to the 18th century when some Enlightenment thinkers began to speculate about the nature and dynamics of economic growth. Some argued that growth occurs because enterprising individuals create surpluses which are reinvested, stimulating more economic activity and generating employment, higher incomes and prosperity. Reflecting earlier mercantilist ideas, others took the view that nations become prosperous because they have strong governments that promote investments, protect the domestic economy and secure advantage in international trade. Although rooted in classical political economy, these two positions continue to shape economic analyses and policy prescriptions today.

However, these positions represent a simplistic dichotomy of a complex body of explanatory and normative theory on growth and prosperity. While Adam Smith is often associated with the view that prosperity flows from the natural workings of the market economy and the rational pursuit of self-interest by enterprising individuals, he also believed the governments have a role to play by, for example, preventing the formation of monopolies, maintaining a legal framework for trade, and promoting education. Similarly, John Maynard Keynes is usually linked to the view that government should direct the economy, but he also believed that long-term prosperity depends on forging a strong partnership between the state and business. Other economists, such as Karl Marx and Thorstein Veblen, do not fit neatly into these two categories. Nevertheless, the market and state interventionist positions continue to dominate economic analyses and policy prescriptions for attaining prosperity. They are also central to contemporary explanations of business cycles.

Also known as trade or economic cycles, perennial fluctuations in economic performance have been extensively

documented, but their causes and the extent to which they are amenable to policy remedies are hotly disputed. Similarly, there is no standardized definition of these cycles or of the difference between economic fluctuations, recessions, slumps and full-blown depressions. In addition, different types of downturns are often treated as if they were the same phenomenon, when it is obvious that a downturn caused by financial speculation such as the recent Great Recession and one caused by the oil shocks of the 1970s are very different. To complicate matters further, some scholars believe that each recession is unique that no generalizations about their causes are possible.

Economists attribute business cycles either to external or exogenous factors such as war, bad harvests or climatic adversity, or to endogenous factors such as the supply of money or the level of consumption. In addition, financial bubbles, panics and manias have, as Charles Kindelberger (1978; Kindelberger & Aliber, 2011) demonstrated, been a major cause of economic instability over the centuries. He also drew attention to the fact that many economic crises are the result of fraud and corruption. One of the first explanations of the endogenous causes of slumps came from Thomas Malthus in a debate with his friend, David Ricardo, over the cause of the post-Napoleonic recession of the early 19th century. He is also credited with articulating the first underconsumptionist theory of recession, claiming that the failure of capitalists to reinvest profits in industry reduced production and employment with the result that consumption fell, causing a slump. Ricardo disagreed, citing the views of the French political economist Jean-Baptiste Say, that there can be no underconsumption in a market economy if prices adjust and create their own demand. This idea was subsequently adopted by neoclassical scholars and remains influential today.

Say's analysis drew on Smith's formative notion that the market forces of supply and demand create a natural equilibrium which, when disturbed, will automatically be rebalanced by the internal workings of the market. Smith's Newtonian view of the economy as a highly integrated and harmonious system laid the foundations not only for Ricardo and Say's writings, but for John Stuart Mill, the neoclassical marginalists and Alfred Marshall, whose mathematical models of the

workings of the economy exerted enormous influence. Since then, the neoclassical conception of a self-regulating economy that automatically resolves economic cycles has been widely accepted in economic and policy circles. It found expression in Friedrich von Hayek's highly influential work and in the writings of Milton Friedman, as well as a large number of contemporary neoclassical thinkers who are today popularly known as neoliberals.

The argument that markets do not automatically equilibriate and that governments should adopt policies to address economic cycles and their deleterious effects can be traced to Jean Charles Sismondi, who published one of the first systematic studies of economic recessions in 1819. In times of economic boom, he argued, competition and the drive for profits rapidly increase production, which in turn results in overproduction and declining profits followed by falling wages, unemployment and a decline in consumption. Although he conceded that this problem might resolve itself in the long run, it causes widespread suffering. Influenced by Robert Owen's work, he argued for a socialist, state-managed economy that would foster economic stability. Marx was sympathetic to his ideas, agreeing that economic downturns are associated with the falling rate of profit, but he also argued that they were symptomatic of capitalism's crisis tendencies and a precursor to its ultimate collapse. As is well known, both he and Friedrich Engels dismissed the argument that government should intervene, since the problem will only be resolved when the capitalist mode of production is replaced by socialism.

Marx's work influenced Joseph Schumpeter (1939), who was one of the most important 20th century scholars of business cycles. He disagreed with the neoclassicists and their static conception of the economy as a stable, self-regulating system and, adopting the historicism of Hegel, Marx and the German Historical School of Economics, he focused on long-term economic growth and argued that bursts of innovation brought about by creative entrepreneurs propel the economy towards prosperity. However, he believed that this process is accompanied by volatility and constant renewal, characterized by the "creative destruction" of inefficient enterprises. Downturns are an integral part of the process of creative

destruction which occurs when entrepreneurial innovations are emulated by less able imitators, resulting in the overproduction of mediocre goods and services and a general decline in economic activity. Eventually, the downturn is corrected by a new spurt of innovation and renewed growth. Despite their volatility and destructive effects, recessions purge and renew the economy and are essential for long-term prosperity.

Working with Ludwig von Mises, Hayek (1931) attributed business cycles to monetary factors which occur when easy credit stimulates the overproduction of consumer goods, distorting the economy and causing prices and ultimately wages to fall. Although Keynes described Hayek's interpretation as a "frightful muddle," it contributed to the formulation of monetarist explanations that subsequently became highly influential. At this time, the American economist Irving Fisher augmented the monetarist analysis by arguing that financial crises can be eased if reserve banks manipulate the money supply by adjusting interest rates. His formative ideas had a major influence on Keynes and subsequently on Friedman's monetarist theory which contends that economic stability is dependent on a sound monetary system. Restricted money supply due to high interest rates dampens growth and causes a downturn which leads to recession. On the other hand, easy money causes inflation and harms the economy. These views have had a major influence on policy, but it will be shown that both Fisher and Friedman were reluctant interventionists contending that the economy's self-regulating mechanism should not be disrupted through injudicious state intervention.

Keynes took a different position. Rejecting the neoclassical paradigm and Say's work in particular, he argued that downturns are not a temporary aberration but can result in permanent stagnation. Challenging the belief that a depressed economy will recover in the long run, he famously quipped that "in the long run we are all dead." He also took issue with those who claimed that if wages were allowed to adjust to demand, unemployment would disappear. Falling wages, he countered, would not only immiserize workers but reduce aggregate demand, having wider negative effects. Having specialized in probability theory as a student, he also challenged the neoclassical idea that future economic events could be predicted with a high degree of reliability. Uncertainty, he argued,

plays a major role in economic downturns.

Keynes's explanation of the causes of business cycles is complex and some argue, ambiguous and even contradictory. Certainly, his ideas evolved in the light of changing policy events during his lifetime, but essentially he argued that slumps are due to a fall in aggregate demand caused by excessive savings and a lack of productive investment. When investment falls, production and employment decline, leading to a downward spiral which, unless checked, causes a recession. He claimed that monetary accumulation does not necessarily result in productive employment-generating investments but often fosters reckless speculation, which results in financial bubbles. This idea influenced Hyman Minsky's (1986) analysis of financial crises, which was also shaped by the ideas of his teacher, Schumpeter. Minsky formulated a stadial model of financial bubbles which posited that during times of rapid growth, confidence and speculative borrowing escalates, eventually reaching the point when debts cannot be repaid, triggering a financial collapse. Known as the financial instability hypothesis, his work has been widely commended for its prescient relevance to recent events.

Keynes was also concerned that excessive speculation created anxiety among investors whose natural "animal spirits" were inhibited by the risk of financial collapse. Sensing a looming downturn, they hoard cash, further curtailing investment and demand. He also drew attention to the role of international factors, pointing out that the obsession with maintaining the gold standard at the time was highly detrimental. In addition, he made a novel contribution to understanding business cycles by showing that bad policy can cause and exacerbate economic downturns. His experience at Versailles at the end of World War I and his subsequent writing on the subject revealed the extent to which he recognized the role of policy ineptitude in creating economic instability.

Friedman and Anna Schwartz (1963) made a similar argument, claiming that the Great Depression was caused by the Federal Reserve Bank, a government agency which had failed to ease the money supply, turning a mild economic downturn into a major recession. As noted earlier, monetary factors are central to Friedman's analysis of business cycles. Together with Hayek, he is regarded as the doyen of modern

neoliberalism, and both have also been at the forefront of the attack on Keynes's analysis and policy prescriptions. Their writing also inspired new versions of the neoclassical approach, such as the efficient market hypothesis, real business cycles theory and rational expectations. These contend that markets are inherently efficient and that provided governments limit their involvement, economic downturns will only occur occasionally. Indeed, neoliberals such as John Taylor (2009) argue that since the 1980s, the adoption of market reforms have been accompanied by relatively little financial turbulence. Although the recent Great Recession has dented neoliberal optimism about the efficiency of markets, sharp differences about how to deal with its effects have not been resolved. These include differences among neoliberal scholars themselves about the nature and extent of state intervention. As will be shown, some believe that government intervention in the form of austerity policies is appropriate, while some others contend that the market can resolve economic downturns without state interference.

Normative Perspectives and Policy Options

The failure to formulate a standard explanation of the causes of business cycles has impeded the formulation of a standard, agreed upon prescription for addressing their negative effects, and today a variety of policy options are available. Although these are often encapsulated within the austerity versus stimulus debate, it was noted earlier that this is an oversimplification. Nor is it simply a matter of government intervention versus non-intervention. Few neoliberal scholars today advocate a radical laissez-faire position and, as will be shown, some statists recommend the adoption of austerity measures. Clearly the issues are complex and require an analysis that draws on the insights of the major schools of contemporary political economy which offer different policy prescriptions for responding to recessions.

The first policy approach reflects the work of Keynes and his followers, who advocate a proactive role for governments in economic management. Although Keynes's ideas are usually associated with the use of countercyclical policies, his biographer, Robert Skidelsky (2009), points out that his

prescriptions for achieving long-term stability are of greater significance than his proposals for responding to crises. Rejecting the neoclassical position, as well as democratic socialism and communism and their advocacy of nationalization and centralized economic planning, Keynes favored policies that enhance the functioning of markets. These include monetary policies to control inflation and foster growth, as well as fiscal policies which involve manipulating tax rates and increasing public spending. If used judiciously, both would promote investment, stimulate demand and create employment.

Keynes initially agreed with Fisher that business cycles can be managed through monetary policy, but he was subsequently persuaded that fiscal measures were also required. However, Robert Cord (2007) observes that, contrary to popular belief, he was cautious on the question of deficit spending and argued that a balanced budget is necessary for long-term economic health. While he favored deficit spending during downturns, fiscal policy should primarily be used in times of prosperity to promote investment and maintain employment. In this regard, the state has a pivotal role to play in what Keynes called the "comprehensive socialisation of investment" (Skidelsky, 2009, p. 97). It should not only invest in infrastructure but "organize" investment by forging a strong partnership with the business community. Greater international cooperation to address crisis tendencies in the global economy is also needed. Also, as mentioned earlier, Keynes was critical of what he regarded as bad policy and published withering critiques of inept politicians on this issue. Sound policy is dependent on a technocratic and efficient state that proactively fine-tunes both monetary and fiscal policy for the benefit of its citizens.

Keynes's policy prescriptions were subsequently developed by his own students, such as Richard Kahn and Joan Robinson, and by numerous admirers in the United States and elsewhere, including luminaries such as Paul Samuelson, Gunnar Myrdal, James Tobin, John Kenneth Galbraith, Paul Krugman and Joseph Stiglitz, to name but a few. Keynesianism also influenced social policy. Social insurance and other cash transfers, which had been introduced in many Western countries in the early decades of the 20th century, were linked to Keynesian policies and viewed in economic rather than welfare terms as helping to maintain demand and to function

as "automatic stabilizers" in times of economic downturn. Although Keynesianism is credited with promoting steady growth and widespread prosperity in the Western countries in the 1950s and 1960s, it appeared to be less effective in addressing the phenomenon of "stagflation" which emerged in the 1970s. Extraordinarily high levels of inflation but persistent unemployment were impervious to Keynesian remedies, and coupled with the effects of the oil shocks, paved the way for the popularization of neoliberal policies. It was only with the onset of the Great Recession that Keynesian prescriptions have again attracted attention.

Many progressive commentators (Blinder, 2013; Grunwald, 2012; Krugman, 2009, 2012; Kuttner, 2013; Stiglitz, 2010, 2012) propose the use of stimulus measures based on Keynesian ideas which they contend will revive the economy. Although applauding the Obama administration's recovery package (authorized in terms of the American Recovery and Investment Act of 2009), they argue that it did not go far enough and is in part responsible for the country's slow recovery. The second policy approach is based on the neoclassical approach which is comprised of different strands including monetarism, rational expectations and the efficient market hypothesis. These all posit that the unencumbered market economy will of its own accord generate growth and prosperity. Impenetrable mathematical models formulated by contemporary neoliberal scholars have demonstrated that markets cannot be manipulated by investors, corporations, politicians or bureaucrats, but that the rational behaviors of millions of individual economic actors are in the aggregate the basis for market efficiency. Since it has been "scientifically" proven that unencumbered markets cannot fail, attempts to regulate them are not only unnecessary but counterproductive. Similarly, rational expectations theory contends that people anticipate government policy decisions, rendering them ineffective. These ideas have been widely adopted since the Reagan years and also justified financial deregulation in the 1990s.

Nevertheless, it has been shown already that few neoliberal economists believe that governments have no role to play. Instead, as Hayek argued, government should create favorable conditions for entrepreneurs and investors to pursue profits,

and this requires low taxes, deregulation, denationalization and other policies that promote innovation and competition. In a recent account, Taylor (2012) restates these ideas, outlining the key principles on which sound economic policy should be based. These include the centrality of markets and the rule of law, a limited role for government, incentives and a predictable market-friendly policy framework. Keynesianism, he claims, does not provide a predictable framework, because its continual economic fine tuning is subject to error and creates uncertainty. Like Friedman and Schwartz, Taylor (2009) attributes recessions to economic mismanagement. The Great Recession, he claims, was the result of deficit spending by the Bush administration, unrealistically low interest rates and haphazard action in response to the bank failures of 2008. Also, like Friedman, he believes that the money supply should not be frequently manipulated but governed by a fixed target, such as Friedman's constant monetary growth rule or his own Taylor rule, which automatically adjusts money supply in the light of changing events. This creates a stable and predictable environment for investors and entrepreneurs and maintains sound economic "fundamentals."

By ensuring the fundamentals, governments prevent recessions from occurring, and in the unlikely event of a downturn, most neoliberal scholars believe that governments should embrace austerity policies. As will be shown, only a few economists, such as Schumpeter, believe that recessions should be allowed to run their "natural" course. By implementing austerity policies, the state signals investors and entrepreneurs that it is serious about promoting recovery, that it will live within its means, and above all, that taxes will not be raised to meet deficits. In this climate, entrepreneurs will confidently invest in the resurgent economy. Reserve banks augment this approach by easing the money supply and providing ready credit for investment. As confidence is boosted, new investments create businesses and jobs and foster what is sometimes referred to "as expansionary austerity." Contrary to the Keynesian view that austerity is deflationary, neoliberal scholars believe that austerity actually promotes growth. Studies by Alberto Alesina and his colleagues (Alesina & Ardagna, 1998; Alesina & Perotti, 1995) contend that many countries which

have adopted austerity policies have been restored to normal economic functioning. Deficit spending not only exacerbates the problem but, as Carmen Reinhart and Kenneth Rogoff (2010) claim, it impedes growth. Although Mark Blyth's (2013) detailed analysis of the evidence strongly disputes these findings, they have been widely used to support of the neoliberal agenda.

Schumpeter is associated with the neoclassical position, but as was noted earlier, he disagreed with its static view of the economy and argued instead that the long-term health of the economy depends on a dynamic process of growth characterized by creative destruction, renewal and regeneration. Although recessions have unfortunate social effects, they are necessary for development. In this regard, his ideas echo the Social Darwinist belief that evolutionary change through natural selection improves society and that protecting "the weak" through social welfare programs is harmful. Accordingly, governments should not intervene to mitigate or correct recessions, nor should they seek to prevent them. Although Schumpeter's ideas resonate with some politicians and members of the business community, his proposals are not widely accepted today. As presidential candidate Mitt Romney realized during the 2012 election, recommending the liquidation of bankrupt automotive firms is not electorally popular. On the other hand, David Stockman's (2013) recent restatement of the Schumpeterian approach attracted widespread media attention.

The third policy approach is associated with the imposition of austerity policies by the European Central Bank at the behest of the German government which has funded rescue packages for several of the Union's member states. Known as *ordoliberalism*, it requires a strong state which forges durable corporate arrangements with the business community and trades unions within a policy framework that shapes market behavior. As its name implies, ordoliberalism seeks to maintain an orderly economic system which minimizes conflict between labor, business and the state. It also promotes economic growth, and particularly industrialization, in collaboration with all partners. Social policies that support economic development and promote solidarity are integral to the ordoliberal model. The

state invests heavily in infrastructure, supports educational and training programs that prepare workers for industrial employment and maintains fiscal discipline. Budget deficits are not only viewed as harmful because they impede growth but because they undermine the whole system.

Although ordoliberalism is market-based, its advocates reject the neoliberal view that the decisions of myriads of individual economic actors are the source of prosperity and believe instead that the market should operate within a system of rules that facilitates competition. Of particular importance are rules that prevent large corporations from creating monopolies and dominating the economy. Ordoliberalism is in many respects similar to Keynesianism and also to the corporatist approaches adopted in European countries such as Austria and Sweden (Williamson, 2010). However, unlike Keynesianism, it rejects deficit spending as well as continual economic fine-tuning, relying instead on a comprehensive, rule-based or "constitutional" economic system which is maintained by laws, central banks, technocrats and a large number of boards, advisory committees and other entities that negotiate and secure consensus from different partners in the corporate system.

The ordoliberal approach was formulated in the 1930s by Walter Eucken and his colleagues at the University of Freiburg. It is rooted in the 19th century industrialization policies of the Prussian government, which invested heavily in education and infrastructure and secured the support of nascent industrialists for its effort to enhance its global status. These events were bolstered at the time by writings of Friedrich List who claimed that the British commitment to laissez-faire was little more than a ploy to maintain its own imperial position. Since then, German governments have disavowed market liberalism and relied instead on a strong state to direct economic development. Although sullied by Nazi totalitarianism, this approach was revived with the support of the Marshall Plan after World War II and, in the guise of the Social Market Economy, it shaped the country's impressive economic and social development. Despite facing serious economic challenges following reunification, the government's continued commitment to economic corporatism has ensured widespread prosperity. However, with the adoption of labor flexibility and economic

liberalization policies in recent years, there is concern about whether the ordoliberal model can be sustained.

Variations of the ordoliberal model which to different degrees combine corporatism, Keynesianism and French *dirigisme* are found in other countries, and perhaps most notably in the developmental states of East Asia which emerged as major industrial nations after World War II (Leftwich, 2000; Woo-Cumings, 1999). However, as the East Asian financial crisis of the late 1990s reveals, state-directed development is not immune to recession and even stagnation. Nevertheless, austerity has not featured prominently in their responses to economic downturns. In fact, they and other rapidly growing economies in the developing world have quite successfully adopted stimulus policies. For example, the government of China implemented a massive stimulus package in the wake of the Great Recession and has been able to maintain steady, albeit somewhat slower growth in recent years. A vigorous reflationary policy was also introduced in Japan following the recent election of Prime Minister Shinzo Abe and his government.

The final policy approach, which is not grounded in a coherent theory of political economy, advocates a cautious response based on experiment and incremental decision-making. As an opinion piece in *Business Week* (Engardio, 2008, p. 22) in the early months of the Great Recession summarized: "Forget Adam Smith—whatever works!" Arguing pragmatically for a mix of austerity and stimulus, this approach proceeds incrementally to test various options. However, it is subject to electoral pressures so that a fluid and even haphazard response often emerges. Decisions to implement austerity or stimulus proposals frequently falter, resulting in incoherent policy decisions. For example, Philippe Pochet and Cristophe Degryse (2010) report that the European Union's comprehensive economic recovery plan of 2008 unraveled as the crisis worsened, electoral opposition in Germany to rescue packages increased and struggles between the Union's leadership intensified. The result, as Blyth (2013) notes, is a chaotic situation which has in fact exacerbated the problem.

Similarly, the Obama administration retreated from its original stimulus approach in the face of sustained political opposition and, in the light of the current stalemate in the Congress, the situation has become muddled. However, the Federal

Reserve resolutely adheres to its monetary policy. In Britain, the Conservative Coalition's original commitment to austerity was also eased after it suffered several byelection defeats, even though the government insists that it will balance the budget. On the other hand, countries such as Greece and Cyprus have been subjected to the callous dictates of austerity with devastating consequences for their citizens. Faced with these confused policy responses, the International Monetary Fund (IMF) recently urged its member states to proceed cautiously and experiment with a mix of austerity and stimulus policies. The intervention of the IMF serves as a reminder that global economic forces have further complicated matters and affected policy responses directed at resolving domestic problems.

Social Policy Responses

Policy recommendations for mitigating the effects of recessions are usually couched in economic terms, but as recent events reveal, recessions have serious social consequences. In the United States and other Western countries, unemployment soared and the incidence of poverty and deprivation increased in the wake of the financial crisis. Millions of families lost their homes through mortgage foreclosures and many elderly people struggled to make ends meet as their pension fund accumulations dwindled. Rising public sector deficits resulted in severe retrenchments in education, health and social services with detrimental implications for social well-being. Even in developing countries that were not directly affected, falling commodity prices and demand for their export goods reduced the incomes of millions of workers. The human costs of these events are huge and require a coordinated and systematic social policy response.

Prior to the great depression of the 1930s, responses to economic downturns were nonexistent or haphazard, and it was only with the Roosevelt administration's New Deal that a systematic approach which integrated social and economic interventions was implemented. There were similar developments in Europe. Although the New Deal and the adoption of the Beveridge proposals in Britain are often seen as "welfarist" innovations, both were an integral part of wider economic policies designed to promote recovery and promote long-term

prosperity. The German social market economy mentioned earlier is another example of how social and economic policies were closely linked at the time. By integrating economic and social policies, social programs not only served as automatic stabilizers during recessionary periods but contributed positively to economic prosperity.

Since then, the close association between economic and social policy has been severed. Changing economic and social conditions, as well as rising affluence and individualism, accompanied by electoral resistance to public spending have contributed to the relegation of social welfare as of secondary importance to economic policy. As Midgley (2008) suggests, these changes have also been fostered by the popularization of the neoliberal argument that social spending is inimical to economic growth. Paradoxically, social policy scholars such as Richard Titmuss (1974) and T. H. Marshall (1950) contributed to the separation of welfare and the economy by arguing that social policies should be motivated by altruism and social rights rather than economic criteria. These developments had a major impact, contributing to the segregation of economic and social policy, as well as the fraying of the so-called safety net. Today, welfare programs no longer function effectively as automatic stabilizers, nor do they promote wider economic goals.

For example, increasingly stringent enrollment and other requirements have reduced the coverage of unemployment insurance as well as benefit levels in the United States. Similarly, the abolition of the country's social assistance program for families with children in 1996 and its replacement with a new welfare-to-work program (known as Temporary Assistance for Needy Families, or TANF) has seriously undermined the welfare system's role as an automatic stabilizer. In a recent study of TANF coverage, Keith Bentele and Lisa Nicoli (2012) report that take-up has fallen to historically low levels, even though need has increased dramatically. Sasha Abramsky (2012) notes that budgetary supplements to the program, which were introduced as a part of the Obama stimulus package, were inadequate, and some states even declined to accept these funds. In Arkansas, Alabama and Mississippi, less then 15 percent of families in poverty received TANF benefits

during the recession. The Supplemental Nutrition Assistance Program (SNAP), previously known as food stamps, has more extensive coverage, but benefits levels are also low. To make matters worse, Congress proposed major reductions to the program in 2013. Natasha Pilkauskas and her colleagues point out that although the food stamp program alleviated hardship during the Great Recession, its ability to function effectively in the future may be undermined by budgetary reductions (Pilkauskas, Currie, & Garfinkel, 2012).

Although these social programs have been severely retrenched and face further cuts, they continue to play a critical role in preventing destitution among very poor people in the United States. As Luke Shaefer & Kathryn Edin (2013) contend, the incidence of absolute poverty would be even worse without them. Jared Bernstein (2013) agrees, pointing out that programs such as food stamps, tax credits and healthcare assistance, which were boosted by the Obama administration's stimulus initiative, kept as many as fifty million people above the federal government's poverty line—this figure includes approximately nine million children. In view of recent Congressional battles over public spending, he is not optimistic about the future of these programs.

Naren Prasad and Megan Gerecke's (2010) comprehensive overview of policy responses to the Great Recession shows that the governments of many Western countries failed to use social welfare programs to respond to the crisis. In many cases, these programs are underdeveloped or had been weakened over the years. Although some European countries had programs that had a positive countercyclical effect, they were in a minority. Bernard Casey (2012) notes that even in Europe, the response was highly uneven. In some cases, governments retrenched social spending, while in others they responded haphazardly to political pressure and increased spending. For example, in Sweden, automatic reductions to the state pension program, which are required when revenues decline, were suspended in response to these pressures (Scherman, 2012). In Britain, the Conservative Coalition cynically used the financial crisis to introduce a number of "welfare reforms," claiming that the budget deficit requires sacrifices from everyone, including those receiving benefits. Social assistance payments

were capped, the country's historic universal child benefit program was means-tested, and its child savings account abolished.

In many developing countries, social protection programs were also retrenched in response to the recession. Anna McCord (2010) reports that the governments of many developing countries were more concerned with reflation rather than meeting increased social need. Part of the problem is that relatively few of these countries have well-developed social insurance or social assistance programs. George Mpedi (2009) contends that the situation in Africa is particularly dire. On the other hand, Prasad and Gerecke (2010) point out that recessions have in the past prompted social welfare expansion. In addition to the examples of the United States and Britain given earlier, they note that developing countries such as Mexico and Korea introduced new programs in response to financial crises. The expansion of social protection in Korea in the wake of the 1997 financial crisis has been particularly well documented (Hwang, 2006; Kwon, 2001). The Great Recession, Prasad and Gerecke suggest, may also foster a recommitment to social welfare.

Karl Polanyi (1944) famously made a similar observation in his account of how the welfare state emerged as a reaction to the excesses of rampant 19th century capitalism. However, there are few indications that an effective countervailing force has emerged. The Occupy Movement, which expresses the anger of millions of ordinary Americans about the financial crisis and the privileges enjoyed by the top one percent of income earners, passed without significant reforms. Although new regulations have been imposed on the financial industry, Robert Kuttner (2013) and others doubt whether they will be effective. Certainly, financial elites continue to wield enormous power, and the extreme inequalities which scholars such as Raghuram Rajan (2010) and Robert Reich (2010) believe actually caused the recession have not been addressed. Although Krugman (2012), Stiglitz (2012), Kuttner (2013) and others argue that the current deficit can be addressed by raising taxes on those with high incomes, there is little if any political support for these proposals. In addition, recent Congressional hearings on tax avoidance by large multinational firms are

unlikely to produce any significant changes. On the other hand, attacks on social programs such as food stamps, Medicare and Social Security continue unabated. Clearly, sharp differentials in power, income and wealth continue to shape policy responses to the Great Recession.

A much more vigorous social policy response is needed if the serious social consequences of financial crises are to be addressed and if long-term prosperity is to be assured. A solid intellectual basis for social welfare that has electoral appeal and can be championed by progressive politicians is sorely needed. In the 1930s, Keynesianism offered an intellectual framework of this kind which, coupled with Beveridge's work and that of European Social Democrats, legitimated social spending. Since the 1980s, neoliberal economics has offered an equally effective intellectual counterargument. There is an urgent need for a reinvigorated theory that provides a viable rationale for social welfare. This will require that the current obsession with static welfare state typologies, as well as rhetorical indulgences based on postmodernist and abstract critical theories, be transcended with workable, pragmatic proposals (Stoesz, 2005). The growing interest in social policy circles in the interface between economic and social policy, and in social investments that can revitalize social policy's contribution to economic development, may form the basis for proposals of this kind.

It could be that an opportunity has been missed to formulate new and politically viable approaches in response to the social crisis resulting from the Great Recession. However, it has brought the issues into sharp focus. Certainly, many more people today are supportive of the need for concerted action. Indeed, many have been affected by the crisis. A renewed commitment to address the challenge by formulating innovative and appropriate social policy responses and advocating for their adoption is now required.

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