I. Introduction

The debate about the best path to development is as old as capitalism itself, from the time when England was the center and North America was on the periphery. The official line propagated by the free traders who have come to dominate economic theory has been to let the market work its magic: *Laissez Faire*, minimize the State, adapt your mindset, have faith in the miracle that awaits.

The catechism begins with the standard training in economics, whose purpose is to inculcate a reflexive attachment to a heavenly vision of capitalism: infinite knowledge, hyperrational choice, perfect competition, optimal outcomes, general equilibrium, the firm as servant, the consumer as king, full employment as automatic, and optimal use of all resources as a given. Mathematics, which has its proper uses, here becomes a liturgical language, the Latin of the High Mass. All is best in this best of all possible worlds, this world of magical unrealism.

Reality has always been different. From the very start, successful development has gone hand in hand with trade protectionism and state intervention. In the fourteenth and fifteenth centuries, Britain promoted its manufacture of woolen goods by taxing the exports of raw wool to its competitors and by attracting away their workers. From the early eighteenth to the mid-nineteenth centuries, it used trade and industrial policies to protect its industries until its own global competitive advantage was great enough for it to begin championing global free trade. Britain's American competitors were not fooled: "the Americans knew exactly what the game was. They knew that Britain reached the top through protection and subsidies and therefore that they needed to do the same if they were going to get anywhere. . . . Criticizing the British preaching of free trade to his country, Ulysses Grant, the Civil War hero and the US president between 1868–1876, retorted that 'within 200 years, when America has gotten out of protection all that it can offer, it too will adopt free trade"' (Chang 2002b). And this is exactly what happened in the twentieth century. Similarly, countries such as the Netherlands and Switzerland only adopted the free trade mantra in the late eighteenth century after they were already leading competitors in the world market. And of course we know that the development of the West was attended by colonization, brutal force, pillage, slavery, mass slaughter of native peoples, and the deliberate destruction of the livelihoods of potential competitors (Milanovic 2003, 5–6). This is globalization and development as it has proceeded under the rule of the rich.

We know that the subsequent development of Japan, South Korea and Taiwan also came through highly-selective trade policies" (Rodrik 2001, 12). Most recently, China and India have demonstrated that development can accelerated by the directed actions of the State. Indeed, even in the developed world itself, the State continues to play a major role in supporting innovation and shaping international trade (Mazzucato, 2013).

How should we incorporate such facts into standard economic theory? The safest way is to tweak the theory on the margin, most often by introducing "imperfections" of various sorts. For instance,

microeconomists and game theorists have recently "discovered" (!) that people do not always behave in textbook fashion, while macroeconomists have come to admit that information may not always be symmetric, expectations not always rational, money and credit not always secondary, and so on. While these modifications aim to accommodate some (occasional) aspects of reality, they actually serve to keep us tied to the church of orthodox economics: imperfections always require perfections as their point of departure.

Post Keynesian (PK) economics, in its Kaleckian form, goes a step further by representing consumption behavior as an automatic response to income (the consumption function) and substituting *monopoly* power for (perfect) competition among firms. In the latter case, firms set prices through monopoly-determined markups on costs. Then demand only affects quantities, not relative prices, and aggregate demand determines aggregate output and employment. This is particularly attractive to the Left, because in modern fiat-money regimes the State can supposedly create as much purchasing power as it needs in order to bring about effective full employment. Within this theoretical framework, in a closed economy prices begin to rise as full employment approaches, so one must curtail the stimulus at a level of employment consistent with a tolerable level of inflation (the old Phillips Curve dilemma). In an open economy an induced trade deficit may choke off an expansion even prior to that: as output expands so does the domestic demand for imports; at the same time, as export prices rise in the face of domestic inflation, the foreign demand for exports may fall. Thus full employment policies may give rise to a trade deficit (the old elasticities problem) leading to a shortage of foreign exchange, thereby forcing the State to cut back its stimulus well before full employment. Alternately, if growth is sustained through foreign borrowing, this increases foreign debt and interest payments until at some point the piper must be paid, growth has to be curtailed and stimulus gives way to austerity. A further complication in PK models is that reduction in unemployment may give rise to an increase in the wage share and hence a decrease in the profit share. On the consumption side, this is assumed to have a net positive effect on total consumption demand because workers tend to spend a greater proportion of any change in income (MPC) than do firms and property owners, so the increase in worker consumption will outweigh the decrease in property owner consumption. However, higher wage costs can be detrimental to international competitiveness and thereby decrease export demand, and can reduce the domestic profit rate and thereby reduce investment demand. If the overall effect on the *level* of aggregate (consumption, export and investment) demand is positive this is called a wage-led demand regime; in the opposite case it is a profit-led demand regime. Finally, even in wage-led demand regime, the growth of capital is similarly indeterminate because higher aggregate demand raises capacity utilization and stimulates growth but a lower profit rate tends to dampen investment and hence weaken growth. Econometric estimates turn out to be highly sensitive to details of their specifications, so it is not surprising that there is no consensus about which regime (if any) obtains in any given country in any given time (Blecker, 2016, pp. 374-379).

New Developmentalism (ND) retains the basic structure of PK macroeconomics, although it rejects the recourse to persistent fiscal deficits as a form of "fiscal populism), and rejects the "exchange rate populism" claim that persistent current account deficits are a source of foreign savings. However, at the micro level ND replaces the PK focus on monopoly power with classical one on competition. It returns to

the notion that the market-regulating price (price of production) of a good in a given country is determined by the good's unit cost plus a competitive profit-margin arising from the equalization of profit rates. At the international level this is taken to imply that the "value of the foreign money is, simply, the value that covers the *cost plus reasonable profit* of the companies that participate from foreign trade. The value, on its turn, depends on the variations of the country's comparative unit labour cost." As such, this competitive exchange rate is generally different from to the conventional "equilibrium exchange rate" which supposedly balances the current account. Further, "in dynamic terms, the capital inflows required to finance the deficit also appreciate the national currency". Five key policies are then proposed: keep the interest rate neutral at a point or two above the world rate; get companies to use the best available technology so that domestic productivity is high; keep wages growing along with productivity grows so long as the rate of profit remains satisfactory; keep the rate of inflation low (presumably by not getting too close to the PK full employment limit); and maintain an exchange rate which "essentially level[s]… the playing field for the [domestic] manufacturing industry" in the world market (Bresser-Pereira, 2017, pp. 5, 6, 9, 10, 12)

I share the development goals underlying both schools. My aim here is to engage in a constructive discussion about underlying theoretical arguments and their implications for desired outcomes.

II. Real competition and real macrodynamics

There are several theoretical issues at stake in the preceding arguments. First, the determinants of the balance of trade and of the real exchange rate. Second, the determinants of aggregate demand. Third, the determinants of the level of employment. Fourth, the determinants of inflation. Fifth, the implications for the possibilities and limits of stimulus policies.

I wish to argue in favor of a framework that offers a systematic alternative to *both* neoclassical and Post Keynesian approaches, provides different answers to these fundamental questions, is consistent with the empirical evidence, and yields distinct policy implications. All of this without *any* reliance on rational choice and perfect competition, or on the supposed imperfections which are their duals. The framework I propose derives from the works of four great economists: Smith, Ricardo, Marx, and Keynes, each of whom developed their ideas from a rigorous study of the history and operations of actual capitalism. When I say "derives from", I mean that there exist major commonalities in each of their works from which one can construct a consistent path to the structural patterns of capitalism. I apologize in advance for the brevity of the arguments that follow, because these are only brief sketches of material which is summarized in considerable detail elsewhere (Shaikh, 2016)[1].

[1] My book *Capitalism: Competition, Conflict, Crises* (Shaikh 2016) lays out the theoretical and empirical content of my framework. It covers long term economic patterns, consumer and production behavior, the theory and history of money, theories of capital and profit, the theory and evidence on real competition and perfect and imperfect competition, and applications of real competition to the explanation of relative prices, interest rates, international competition and exchange rates. Then it

Turbulent Regulation

The starting point of the alternate approach is the recognition that capitalism is a dynamic, evolving, expanding system whose balances come about only through over- and-under-shooting. Demand and supply, output and capacity, wage and profit rate arbitrage, growth through cycles, financial bubbles and busts, long waves and recurrent depressions, are all examples of capitalism's turbulent form and characteristic pattern recurrence. Balances are moving centers of gravity operating through perpetual fluctuations. Equilibrium is never an achieved state because the system's order is only achieved in-and-through-disorder. This much is evident from the data. Hence representations of micro and macro patterns must use conceptual, mathematical and econometric tools appropriate to its non-linear stochastic dynamics. Neither static equilibrium nor balanced growth should be treated actual states (Shaikh, 2016, Chs. 2-3).

Real competition

Real competition is as different from perfect competition as war is from ballet. The theory of real competition provides an explanation for Kalecki's finding on inter-industry pricing and profits. It also provides a natural foundation for Keynes' own theory of effective demand, which he insisted was grounded in competition. Much of what post-Keynesian economics sees as non-perfect ("imperfect") competition can be derived as necessary outcomes of real competition. Firms *set* prices with the aim of undercutting their competitors, and the survival advantage goes to firms with lower costs. Hence firms are relentlessly driven to cut costs, to pursue cheaper resources and lower wages, and to develop cost-reducing technologies. Winners grow and losers surrender or die, that is the whole point. The struggles between capital and labor over the length, intensity and payment of the working day, the mobility of capital to cheaper national and global regions, the depredation of the environment, and the never-ending drive for technical change are all rooted in the imperatives of real competition.

At the microeconomic level, firms continue to invest only if their expected return on investment exceeds the safe yield afforded by the interest rate: i.e. only if the expected *net* rate of return on investment is positive. This same net rate motivates the flow of capital across industries, which is the basis for the

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moves to the history and structure of various schools of modern macroeconomics before demonstrating that the classical concern with profitability provides a natural foundation for Keynes' emphasis on the relative autonomy of effective demand, while also explaining its risks and limits. After this comes the analysis of wages and unemployment, of modern money and inflation, of the recurrence of long wave patterns and crises, and finally the analysis of inequality and global development and underdevelopment. Each chapter presents a main argument, contrasts it with the equivalent neoclassical and Keynesian/Post Keynesian ones, and compares them all to the empirical evidence. Videos of lectures on various aspects of the arguments, all published reviews of the book, and all data along with sources and methods are all available on the book webpage http://realecon.org/. Ongoing applications are available on my homepage http://www.anwarshaikhecon.org/index.php/all-publications. The Turkish translation of the book appeared in August 2018, the Chinese translation is due in the Fall of 2018, and the Spanish translation is due by the end of 2018.

turbulent equalization of industry rates of return on investment around an economy-wide average rate. This means that actual market prices are regulated by prices reflecting the economy-wide rate of return on new investment, as can be shown at an empirical level (Shaikh, 2016, Chs. 7-8).

International trade and real exchange rates

In a comparable manner, the *real exchange rate*, which is simply the relative international prices of exports and imports expressed in common currency (the terms of trade) is regulated by the corresponding real production costs of exports and imports (Shaikh, 1980). Moreover, because relative costs generally have trends, the real exchange rate will not be stationary so that Purchasing Power Parity will not generally hold – as has been repeatedly demonstrated. A further implication is that a country's terms of trade will *fall*, i.e. its real exchange rate will depreciate, if its real costs fall relative to its competitors. This is a consequence of success in international competition, not of perverse import-elasticities or the monopoly power of its trading partners. Finally, a country with a high inflation rate will see its nominal exchange rate depreciate almost proportionately in order to keep the real exchange rate in line with slowly changing relative real costs (Shaikh and Antonopoulus, 2012a; Shaikh, 2016, Ch. 11 Sections V-VI).

Conventional theory is rooted In Ricardo's famous comparative cost argument. Under a regime of fixed exchange rates, any country with high production costs would experience a trade deficit that would lead to an outflow of money to cover the excess of imports over exports. Ricardo hews to the quantity theory of money, so a fall in the stock of money in the trade deficit country would lower its internal prices and make it more competitive on the world stage. The opposite would hold in a country with lower costs: its trade surplus would lead to a money inflow, which would raise its national price level and make it internationally less competitive. Since these processes arise from trade imbalances, they would continue until trade is balanced. If the nominal exchange rate is fixed, the price level movements amount to adjustments in the *real* exchange rate (the terms of trade): the deficit country experiences a fall in its real exchange rate and the surplus country a corresponding rise, until trade balances in both. If the nominal exchange rate is flexible then a country with a persistent trade deficit will need a net amount of foreign currency to settle the excess of its imports over exports, which will raise the price of foreign currency relative to the domestic one – i.e. depreciate the nominal exchange rate, until trade is balanced. The opposite would obtain in the trade surplus country, whose nominal exchange rate is assumed to appreciate. In neither case is there any necessary effect on the price level. So once again, the real exchange rate *automatically* depreciates in the trade deficit country and appreciates in the trade surplus country until trade is balanced in both (Shaikh, 2016, Ch. 11 Sections II-IV).

The standard theory has two major difficulties. First, it forgets that while the depreciation of a currency may lower the relative international selling price of exportable goods at *given* relative costs, it also raises the relative costs of these same goods by raising the prices of imports and import-competing goods. Insofar as real wages are maintained, a depreciation also raises the price of labor-power. Then comparative costs, the prices of exportable goods relative to those of the same goods produced by international competitors, may not change at all, may fall but not sufficiently to change the direction of trade, or may even rise (Shaikh, 2016, Ch. 11, Sections IV-V; Sraffa, 1960, Chs. I-II). On the other hand, if

currency depreciation results in a fall in the real wage because labor is unable to keep up with a rise in consumption prices, the competitive gain comes from the decline real wages for which currency depreciation was just the means.

The second problem with the conventional approach is that there need not be any pressure for real exchange rates to change in the face of persistent trade imbalances. As pointed out by Marx (1967, Ch 34, p. 551) and rediscovered by Harrod (1957, Chs. 4, 7, 8), the money flows set into motion by trade imbalances create supporting counter-flows. High-cost countries will tend to run trade deficits and hence suffer an outflow of money, which will decrease national liquidity and hence raise their interest rates. On the other hand, low-cost countries will have trade surpluses giving rise to an inflow of money, which will in turn increase liquidity and lower their interest rates. The resulting differences in interest rates will induce short-term capital flows from trade surplus countries with lower interest rates to trade deficit countries high interest rates. The end result is familiar: trade surplus countries will become exporters of short-term capital (international lenders) while trade deficit countries will become importers of short-term capital (international debtors). This argument is easily extended to cover long-term capital flows. A country's balance of payments is the sum of net inflows into the country: exports minus imports (the trade balance), direct investment in the country by foreigners minus investment abroad by domestic agents, and short-term capital inflows such as private or business bonds purchased by foreigners minus similar financial transactions made in foreign countries by domestic agents. Thus if a trade surplus country such as China is also the recipient of net foreign direct investment (FDI) this supplements the money inflow from the trade surplus, enhances the rise in liquidity and leads to a larger corresponding fall in its risk-adjusted interest rate. If a trade deficit country such as the US were a net source of FDI this would increase its money outflow, its decline in liquidity and the rise in its risk-adjusted interest rate. The overall result would be an even greater impetus to send short-term capital from the surplus country to the deficit one – all through the workings of free trade itself.

The foregoing arguments have direct implications for Post Keynesian and New Development propositions. First, while the net direction of trade will be determined by real cost differences, the volume of trade can be affected through the Keynesian channel by the levels of output and import propensities of each country (Harrod, 1957, pp. 130-139; Shaikh 2016, pp. 504, 521). Hence the Post Keynesian argument that relatively faster growth can harm the trade balance may be true, but this cannot induce a trade deficit unless free trade tends begins from balanced trade – which is exactly the conventional assumption. But then, if the conventional argument is accepted, the real exchange will simply depreciate and restore the trade pattern. That this does not happen is evident throughout history. China is a prime example of the fact that a country with lower costs can maintain a large trade surplus while *also* maintaining the highest growth rate.

On the New Developmentalism side, it is true that a country can avoid inflation by keeping fiscal deficits in hand (more on that later); that the "value of the foreign money is, simply, the value that covers the *cost plus reasonable profit* of the companies that participate from foreign trade…[that this] value … depends on the variations of the country's comparative unit labour cost"; that this competitive exchange rate is generally different from to the conventional "equilibrium exchange rate" which

supposedly balances the current account; that a country can improve its international competitive position by upgrading its productivity through the use of modern technology; and that a country can avoid debilitating foreign indebtedness by keeping its interest rates in line with international ones. But if a country is still not internationally competitive, it cannot "level the playing field" by adjusting its nominal exchange rate unless that is a roundabout means of lowering real wages – contrary to the progressive aims of the theory. Finally, the ND observation that that "in dynamic terms, the capital inflows required to finance the deficit also appreciate the national currency" (Bresser-Pereira, 2017, p. 12) does not appear to distinguish between normal trade-induced capital flows and extra-ordinary ones. On the Marxian-Harrodian argument, the cost-determined real exchange rate of a high cost country leads to a trade deficit that will induce covering capital inflows. In this sense, induced capital inflows *support* the real exchange rate. The US is a prime example of a country with a large trade deficit supported by large foreign capital inflows. But an extraordinary influx of foreign capital, such as that into the US in 1980s, can cause the real exchange rate to rise above its cost-determined level for some time and then fall below it thereafter, before returning to its cost-driven trend (Shaikh, 2016, Figure 11.4, pp. 530-531). This is exactly what is meant by turbulent equalization.

Aggregate effective demand

Under real competition, investments by individual firms are motivated by their expected *net* rates of return, i.e. by the difference between their rates of return and the interest rate. It follows that aggregate investment is also driven by the difference between its expected rate of return (Marx's regulating rate of return, Keynes' Marginal Efficiency of Capital) and the interest rate. The theory of real competition therefore provides a natural foundation for the theory of effective demand. Expected investment profitability is regulated by actual profitability in a turbulent manner, the latter is determined by the wage share and the capital intensity of production, and the interest rate determined by either market forces or monetary policy. In either case, changes in interest rates directly affect net profitability (Shaikh, 2016, Ch. 13, Section III). Finally, it is important to recall that Keynes insisted that his theory of effective demand was based on "atomistic competition", not imperfect competition (Davidson, 2000, p. 11; Leijonhufvud, 1967, p. 403), and that even Kalecki's original formulation of his own theory of effective demand was based on the notion of "free competition" (Kriesler, 2002, 624-625). This part of my work therefore seeks to return the theory of effective demand to its proper ground. I will return to the important policy implications of this understanding.

There are several further implications. In the dynamic classical-Keynesian framework, it is the rate of growth of capital (the ratio of aggregate investment to the stock of capital) which is regulated by the net rate of return in the long run and affected by excess demand and capacity utilization over shorter runs. On a log scale, growing output can be depicted as a rising line whose slope is the rate of growth. So if a Keynesian stimulus raises the level of output without affecting long run growth, this involves an increase in rate of growth until the new level of output and employment has been attained, after which growth returns to it previous rate. Once things settle down, the new output and employment path lines will be parallel to the old ones but at higher levels. *This is the classical equivalent of the Keynesian multiplier*. Now consider the opposite case in which the rate of profit falls temporarily before it returns to its old

rate. Then growth will fall temporarily, so the output and employment path lines will shift down before ending up parallel to the old lines. Other things being equal, the stimulus will have raised the output and employment lines, while a temporary fall in the rate of profit will have caused those same lines to shift down. The two possibilities are linked through the effect of reduced unemployment on the wage share. A continuing stimulus will increase the levels and growth rates of output and employment while tightening the labor market and increasing real wages. Then if real wages rise faster than productivity, the wage share rises, the profit rate falls, and the growth rate falls (Shaikh, 2016, Ch. 13).

The persistence of unemployment

Involuntary unemployment is a self-reproducing feature of capitalism. Neoclassical theory argues that full employment is the normal state of affairs. Keynesian and post-Keynesian theories admit that there can be persistent unemployment but argue that it can eliminated by appropriate policies. I would argue that there are intrinsic feedback loops that tend to reinstate a persistent level of unemployment unless explicitly blocked (see below). When for any reason the labor market becomes tight, real wages tend to rise relative to productivity (i.e. real unit labor costs increase) which makes profitability falls relative to its trend induced by changes in capital-intensity. The decline in profitability decelerates growth and hence the demand for labor. At the same time, it accelerates the displacement of labor by machines, which further decelerates the demand for labor. Finally, rising unit labor costs increase the incentives of employers to induce more workers to join the labor force (drawing on women, children and excluded minorities) or to import them from elsewhere (such as the vast pool of global labor), which accelerates the supply of labor. Under normal circumstances the net result of these market responses is to restore some level of unemployment (Shaikh, 2016, Ch. 14). Note that this does not exclude a rising wage share due to tightening of the labor market, nor a falling rate of profit due to increases in capital intensity (Shaikh, 2016, Ch. 16).

Inflation

Neoclassical economics assumes that a free market automatically leads to the full employment of labor at some equilibrium real wage, in which case inflation comes about when the money supply rises faster than that required by full employment growth. From this perspective, if unions raise the real wage of some workers above the equilibrium wage they displace other workers from employment. At the same time, welfare state policies such as unemployment insurance, minimum wages and income support create an incentive for people to avoid employment. So existing unemployment is said to actually represent effective full employment, a socially induced "natural rate of employment" characteristic of modern capitalist economies (Friedman). Then inflation is said to arise when stimulus polices mistakenly try to lower the actual rate of unemployment below the natural rate. On the other side, Post Keynesians insist that the so-called "natural rate" largely represents involuntary unemployment which can, and should, be eliminated through appropriate stimulus policies.

Fiscal stimulus policies raises nominal output by creating additional purchasing power. Neoclassical economists say that all of this goes into inflation because the system is generally at effective full employment. Keynesians and Post Keynesians say that this leads to increased output and employment until a point (near) full employment, with inflation only arising after this point. It is striking is that both

sides associate inflation with effective full employment. But if the capitalist system automatically refills the pool of unemployed labor when it gets too low, then labor cannot be the long term constraint on the growth of real output. In this regard, it is important to recall that Ricardo and von Neumann long ago showed that even when labor is not a constraint, there still exists an (abstract) upper limit to the balanced growth rate of capital: the rate which would obtain when the whole surplus was reinvested, i.e. when the growth rate of capital was equal to the profit rate. It follows that the ratio of the actual growth rate to the profit rate is an index of the utilization of the system's growth potential, the classical equivalent to the utilization rate of labor (the employment rate) upon which both neoclassical and Keynesian theories base their arguments. From this new perspective, the growth of aggregate demand creates a *pull* on the growth of nominal output, while the tightness of the growth-utilization rate creates a *resistance* in the growth of real output. The rate of inflation is the difference between the growth rates of nominal and real outputs. This approach is able to explain modern inflation in a variety of places and times, and to explain the "puzzle" of rising inflation alongside rising unemployment in the 1970s throughout the world (Shaikh, 2016, Ch. 15, Sections IV-IX).

Limits to stimulus policies

It follows that while stimulus policies can have positive impacts on output and employment, they can undermine these same effects *if* they broach the limits of net profitability. In the 1930s Germany eliminated massive unemployment through large budget deficits, while directly controlling prices, wages and interest rate. Real wages fell while productivity increased substantially, so that from 1931-1939 the wage share fell and the profit rate rose fourfold. In the United States during World War II, Federal spending rose six-fold, the public debt relative to GDP rose from 50% to 120%, national output shot up and 17 million new civilian jobs were created. Here too, interest rates were kept low, and wages and prices were regulated so that real wages rose far more slowly than productivity, the wage share fell, and after-tax corporate profits doubled. In both cases the State was able to suppress the normal feedback loops between massive stimuli and increases in the wage share and in the interest rate, i.e. was able to prevent decreases in the net rate of return on investment.

The situation was very different in the first half of the Post-war era from 1947-1980: stimulus policies were modest, and prices, wages, productivity and interest rates were left to market forces. Yet, despite modest stimuli, real wages rose faster than productivity, wage shares rose and rates of profit fell. At the same time, interest rates also rose so that net rates of profit fell even faster. Unemployment crept upward, and each successive Keynesian stimulus ended up raising the rate of inflation. Stagnation-with-inflation, *stagflation*, became the new norm in the very heart of advanced capitalism. The subsequent neoliberal reaction reversed these trends: in the US, from 1982-2007 the wage share fell, the profit rate stabilized, interest rates were more than halved so that the *net* rate of profit rose substantially, and unemployment fell from about 10% to 4.6%. But inequality also increased dramatically, financial activities were deregulated, and financial capital poured over the whole globe. The resulting financial and speculative bubble finally burst in 2008 (Shaikh, 2016, Ch. 16).

I would argue that the same dynamic operates in the developing world. In Brazil, the first and second Lula governments (2003-2010) focused on the expansion of mass consumption by providing additional income to previously excluded working families, and on increasing public and private investment in infrastructures. Fiscal policy was used to fund social transfers, increases in minimum wages, and increased expenditures on housing, infrastructure, and health and education. At the same time, credit was expanded "via the development bank (BNDES), which financed an increasing volume of private investment at subsidized interest rates, and the public commercial banks (Caixa Econômica Federal and Banco do Brasil), which increased the supply of credit for housing and agriculture and also provided a growing volume of consumer credit". Poverty fell, income inequality was reduced, unemployment fell, and growth averaged a robust 4%. Even after the global crisis of 2008, the government was able to induce a relatively fast recovery by expanding "public investment and credit policies, while maintaining social programs". But in this boom 2003-2010 period, *the wage share rose and the real exchange rate appreciated.* Over the next three years from 2011-2014, the growth rate fell by half to 2.14%, and in 2015 it went sharply negative to – 3.8%, while the real exchange depreciated by 45% in the face of the crisis and imposed regulations (Carvalho & Rugitsky, 2015, pp. 4, 14-15)

What happened to cause this switch in direction? From a PK perspective, a higher wage share will generally underpin a wage-led boom because of its positive effects on consumption demand. At the same time, it is possible that higher wage costs could undermine export demand, and through a lowered profit rate, could undermine investment demand. Hence it is possible that at some point total demand may decelerate or even fall (Carvalho & Rugitsky, 2015, p. 15). Two things are important to note here about the PK argument: first, that a rising wage share is the critical factor; second, that wage-led and profit-led growth are alternate possibilities. By contrast, in the classical-Keynesian framework, a rising wage share will induce a falling rate of profit that will necessarily lead to a downturn. Put differently, a contained wage share in which productivity rises faster than real wages is one of the secrets of successful capitalist development. It is my hope that the historical evidence and the theoretical arguments presented here will persuade at least some readers to consider the classical-Keynesian approach as a viable point of departure.

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