Chapter 2 :

The evolution of economic thought

Preview

The study of intellectual development is crucial for understanding any science. And economics is no exception; to understand and comprehend its dimensions and branches, one must study the evolution of economic thought, as economic thought provides us with many opinions and ideas about the economic phenomena that societies have witnessed and continue to witness. The economic idea, in the end, like human ideas in general, does not arise from a vacuum but rather from social and human interactions that seek to understand and interpret the problem to reach a solution. This chapter sheds light on the evolution of economic thought, starting from ancient times up to the latest known economic schools of thought.

1. Economic thought in ancient times

Despite the limited economic activity and the primitive economic life in ancient civilizations, these civilizations produced economic ideas that paved the way for the emergence and development of economics later on. In the following sections, we will present the most important economic ideas that addressed various economic issues arising in Greek and Roman civilizations, which are considered the first human societies to produce economic ideas, albeit modest ones.

1.1. Economic thought in the Greek era

Th The Greek civilization was characterized by the flourishing of philosophy, which dominated human thought. Many economic ideas addressing various economic issues emerged within the context of philosophical research by philosophers such as Plato, Aristotle, and others. Accordingly, political economy in Greek thought was characterized by dependency, and economic ideas were limited.
In his book "The Republic," which explores the topic of the ideal state and city, Plato presented some economic ideas within the context of his discussion of the just city. He traced the origin of the city or state to an economic factor, which is the need for individuals to cooperate collectively to meet their needs. An individual alone cannot fulfill all their needs, so people come together to satisfy theirs and achieve self-sufficiency, thus creating an entity and a group known as the state. The economic foundation for the emergence of the state formed the intellectual basis for what is now known as social solidarity. Plato believed that the continuation of the state's function depends on its organization through the division of labor to achieve the ideal state, where each person specializes in one profession instead of engaging in all tasks and professions in which they may not excel. Plato relied on two arguments in his defense of the division of labor, which are

- That each person has their own talents and competencies (natural factors), which qualify them to perform a specific profession or activity.
- The specialization of each person in the profession for which they are naturally qualified leads to an increase in individual productivity in terms of quantity and quality, that is, an increase in productivity.

Plato's proposal of the idea of division of labor marked the beginnings of an intellectual movement that studied this phenomenon in greater depth, initiated by Adam Smith in the eighteenth century. However, Smith differed from Plato in that he did not base the division on natural talents.

To achieve the ideal city or state, Plato believed that all economic activities should be subjected to precise organization. He proposes dividing society into three classes or groups, with each group overseeing a specific type of activity:

- The first class, which is the class of producers, includes everyone who works to satisfy the material needs of the city or state.
- The second class, which includes the soldiers tasked with defending the city from external attacks.
- The third class, which is the class of rulers responsible for governing the city, enacting laws, and ensuring their enforcement, with the rulers being philosophers.

As mentioned earlier, Plato based his division of social classes on talents without distinguishing between genders. To achieve the optimal goal of social stratification, Plato saw the necessity of providing suitable conditions for each class. He believed that the ruling class must dedicate all their time to serving the citizens and should not have individual ownership or form families. Thus, he abolishes individual ownership and families to spare this class from temptations and emotional weaknesses. It is worth noting that the abolition of family and private ownership was extended to include the class of soldiers, as Plato sought to spare both classes from the temptations of money and their weakness toward relatives. On the other hand, Plato exempted the class of producers, enabling them to establish families and own property. Plato set limits on the freedom of ownership, as the state intervenes to prevent extreme poverty and excessive wealth due to their negative impacts on production. Excessive wealth may lead to laziness, while extreme poverty may prevent individuals from possessing the necessary means of production, thereby weakening their productive advantages and talents. The increase in production resulting from specialization and division of labor leads to a greater need for money to facilitate the exchange of products. Therefore, Plato limited the function of money to a medium of exchange or a tool for barter, which derives its legitimacy from general acceptance rather than the metal it is made from. Plato also prohibited interest[1].

As for Aristotle, despite agreeing with Plato on subordinating economics to ethics and political philosophy, his ideas presented in his two books, "Ethics" and "Politics," highlight his opposition to many of the topics and ideas that Plato believed in. Aristotle's observations are considered more precise than those of his predecessor, Plato, and he focused his economic views on the proper management of the household, defining economics as the art of managing household affairs, which aims at achieving self-sufficiency. Aristotle did not stop at merely sketching the ideal city; he had a broader perspective, and his ideas provided a more profound analysis of economic problems and phenomena. In fact, some of his views laid the groundwork for many subsequent economic theories, which propelled economics to become a distinguished science. Regarding the foundation of the state, Aristotle went further, seeing that states are not formed solely due to economic motives represented by the satisfaction of material needs, but there is a natural motive represented by the gathering of families into tribes, then villages, cities, and finally states to achieve a happy and independent life. Aristotle criticized collective ownership, which later formed the basis for what is known as communism, due to the conflicts it generates among individuals over the distribution of production, leading to the collapse of the system as a whole. Therefore, he supported private ownership of property because it is more effective at reducing conflicts and encourages interactions among individuals. This is because it responds to the individual's love for ownership and satisfies their instincts, driving them to increase their production to enhance and maintain their property, with the condition that what is produced is used to benefit everyone[2]. Aristotle criticized commercial activities and considered them to be unvirtuous endeavors that drive their owners to seek profit, thus following an unnatural lifestyle imposed by trade[3].

Regarding his view on slavery, despite the emergence of writings in his era that criticized the institution of slavery for its contradiction with the principle of justice, Aristotle defended natural slavery and legitimized it based on the natural differences among individuals. Some individuals are born to be masters and rulers, while others are born to submit to others. Aristotle's defense of natural slavery, based on the talents bestowed by nature, stems from his concern for serving the Greek economy, which relied on slaves to perform arduous labor[4]. It is worth noting that the emergence of

[1] Labib Shaqir, History of Economic Thought, Nahdet Misr for Printing, Publishing, and Distribution, Egypt, 1988, pp. 16-23.
[2] Ibid, pp. 24-27.
[3] Yanis Varoufakis & Joseph Halevi & Nicholas L.Theocarakis, Modern Political Economics: Making Sense of the Post-2008 World, Routledge Press, 2011, p. 20.
[4] Labib Shaqir, op.cit, pp. 27-28.

slavery planted the seeds of what became known as specialization and division of labor. The slave class specialized in performing productive tasks for the benefit of the slave owners, who were free individuals possessing all civil rights in ancient civilizations. Slaves were viewed as cheap and profitable labor and one of the forms of wealth that belonged to the free individuals. And in turn, the class of free people was divided into landowners and small producers (farmers and artisans) who owned the means of production. The division of society into two contradictory classes led to an increased need for the existence of states to regulate the relations between them, ensure the dominance of the minority class of free people, and maintain the stability of production relations[1].

Re Regarding monopolies, Aristotle advocated for combating them because they involve the seller exploiting the buyer, achieving profits by imposing a price that suits the seller on the buyer.

One of the important economic topics that Aristotle addressed is the origin of money, its functions, and the basis for its acceptance by people. Aristotle believed that people initially resort to barter to obtain what they need, but the difficulties of barter lead them to choose a certain commodity to serve as a medium of exchange, which in turn leads to the emergence of money. To facilitate exchanges, many societies resorted to accepting one of the metals and making it currency, assigning a specific weight to each exchange, which was stamped on it, thus eliminating the need to weigh it each time. Aristotle differed from Plato in defining the function of money, as he did not limit it to being merely a medium of exchange. His writings indicate that money plays a role in measuring the value of goods and serves as a tool for saving due to the acceptance it enjoys in transactions. Thus, Aristotle is considered one of the first to address monetary issues.

In his view on borrowing with interest, Aristotle criticized interest on the grounds that it is an increase in money without justification. Money was made to be a medium for exchanging goods for other goods. So, Aristotle thought interest is a deviation from money's true nature, which is to exchange goods. Thus, Aristotle was able to identify the first function of money as a medium of exchange. His rejection of hoarding wealth beyond necessity led him to discover the second function of money as a store of value. When he opened the discussion on exchange, buying, and selling, he paved the way for uncovering the third function of money as a measure of value[2].

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[1] K.V Ostrovityanov, Political Economy, Translated by C.P. Dutt & Andrew Rothstein, Lawrence & Wishart, London, 1957, pp. 29-30.

[2] Mohamed Adel Zaki, The Political Economy of Underdevelopment with Special Reference to Sudan and Venezuela, op. cit., pp. 9, 89.

Aristotle's economic ideas, despite their dependence on ethics and political philosophy and his defense of Greek interests in his time, provided a strong impetus for economic thought in later eras, significantly influencing economic ideas that followed his time, especially during the Middle Ages[1].

Unlike Aristotle, Xenophon, the warrior, historian, and student of Plato, authored a book titled "Oeconomicus" that contained ideas ahead of its time and bore some aspects of capitalism. Xenophon praised agriculture in his book and made it the foundation of economic wealth. He preferred that states encourage navigation and trade, and he called for the extraction of silver to increase general wealth. He supported the formation of joint-stock companies in which individuals participated in carrying out work. He considered peace better than war and favored large cities because they were the most suitable places for practicing specialization and division of labor on a large and efficient scale. Despite his disagreements with Aristotle and Plato on many topics, he agreed with them in supporting slavery[2].

1.2. Economic thought in the Roman era

The field of law flourished during the era when Roman civilization thrived, as the Romans did not have the same passion for philosophy as their Greek predecessors, which was reflected in the relatively sparse economic ideas that emerged. Some economic ideas in the Roman era, albeit few in number, emerged in the context of proposing theories and ideas that aimed to organize society from a legal perspective. Cicero established a hierarchy of professions and crafts, placing agriculture at the top while criticizing other professions such as industry and trade, as well as interest. As for Seneca, he considered money the root of all evils and sins and the source of injustice. Pliny added that usury is considered a crime akin to murder.

Some Romans noted that the most profitable use of land depends on its distance from the market where its products are sold. Despite the scarcity of economic ideas, the spirit of Roman law, its methodology, ideas, and way of thinking influenced later economic studies. It is enough to say that the most widely recognized individuals who conducted economic studies at that time or in the subsequent periods were legal professionals or clergy with legal training. The idea of natural law, formerly known as the law of nations [3], derived from Aristotle's ideas, was one of the most prominent concepts influenced by Roman law on economic thought. The economists of the classical school, in particular, believed in the existence of a natural law that governs

[1] Labib Shaqir, op.cit, p. 29.

[2] George Sol, Major Economic Doctrines, translated by Rashid Al-Braawi, Al-Nahda Al-Masriya Library, Egypt, 1953, p. 22.

[3] The Romans had two laws: the civil law applied to Romans, and the law of nations applied to non-Romans and those under their control.

and organizes economic life, attributing to the law the qualities of permanence and universality, as it is constant and unchanging and applies to all societies without exception.

The Romans believed in the doctrine of individualism[1] and made it one of the legal principles, as the doctrine encouraged absolute private ownership, the freedom to engage in economic activities, and the individual's freedom to dispose of their possessions. The individualism doctrine acknowledges the necessity of allowing individuals to engage in economic activities without restrictions, with the state not intervening in these activities. This contrasts with Aristotle's view, who advocated for regulating economic activities with ethical and legal constraints. This doctrine laid the foundation for what later became known as the capitalist system[2]. Despite the limited intellectual output in the field of economics, the Roman era witnessed the emergence of banks in their primitive form starting from the 14th century, which were separate from the state treasury. Roman legislation permitted individuals to take up banking as a profession, and they became known as bankers or Argentarii, who dealt in buying and selling gold and silver and lent money at interest. Rome considered banks to be free trade. The private banks in the Roman era were based on the funds of their founders and wealthy individuals, opened current accounts, accepted transfers, and maintained organized ledgers[3].

2. Economic thought in the Middle Ages (5th-15th century)

Intellectual production in general and economic thought during the feudal period, which extended from 476 AD to 1453 AD, were minimal, corresponding to the economic and social stagnation that prevailed in Europe during that time and the state of chaos that engulfed Europe due to the collapse of the central state represented by the Western Roman Empire.

2.1. Economic thought in Europe

The economic thought in Europe was characterized by stagnation, which can be attributed to several factors, the most important of which are:

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[1] There are fundamental differences between thought and doctrine. Doctrine is an organized, unified, and coherent set of economic ideas, while a thought or idea is merely an opinion on an economic phenomenon to explain it. Doctrine does not just explain economic phenomena but also attempts to evaluate them. In addition, the idea differs from policy, which is the application of the economic idea, taking the form of a theory, with the aim of changing economic realities.

[2]Labib Shaqir, op.cit, pp. 30-34.

[3]Zakaria Mehran, The Central Bank in Different Eras, Hindawi Publishing Corporation, United Kingdom, 2019, pp. 16-17.

- The control of the Catholic Church over human thought and economic activity, as every economic idea was subject to the Church's approval.
- To entrench control and attract the feudal class, the Church established two prominent economic principles: (1) glorifying work and making it noble and necessary, and (2) inequality between classes, which formed the basis for the Functional Theory of Class Organization proposed by Tawney. This theory posits that class differences are essential for each class to fulfill its function, as society resembles the human body, where each member has a role to perform. Each class should not demand more than it deserves and should not take more from the output than another class.
- To entrench the prevailing class division, a moderate intellectual trend dominated, advocating against excessive accumulation of wealth and calling for individuals to receive only what they need according to their class conditions, as excessive accumulation might lead individuals to make wealth the ultimate goal above religious principles. The application of this principle has weakened the incentive to undertake large economic projects and contributed to the stagnation that characterized economic activity in feudal religious societies.
- The churchmen prohibited interest-bearing loans, considering that money perishes with its use and that interest is illegitimate because it represents the price of use. Thomas Aquinas saw that attempts to legitimize interest on the basis that it is a concession from the moneylender for a period of time were illegitimate. Their argument was that time belongs to God and that the moneylender should only receive the loan because interest is unjust[1]. However, there were some who permitted dealing with interest as long as it was low, which contributed to the increased activity of some small family businesses and even companies owned by certain rulers who engaged in banking activities by lending to individuals, the government, and nobles with interest, and in return, they enjoyed their protection and support[2].
- Agriculture was considered the most important activity and the primary source of wealth in the feudal system, as the emergence of feudal estates aimed at achieving self-sufficiency in agricultural products. Additionally, the feudal lords imposed transit fees on their estates, which led to the decline of trade and industry, which were limited to some artisanal industries in the cities[3].

Agriculture in the feudal era was characterized by primitiveness, as old production techniques were used and the machines employed remained primitive. Additionally, the export of production outside the feudal domain was prohibited unless authorized by the feudal lord. Consequently, agricultural production was weak due to

[1] Khaled Saad Zaghloul Helmy, Political Economy, 2nd edition, Dar Al-Wafa Legal Publishing, Egypt, 2001, pp. 21-22.
[2] Zakaria Mehran, op.cit., p. 18.
[3] Khaled Saad Zaghloul Helmy, op.cit., p. 23.

the restrictions imposed on farmers, and most of the production was directed towards consumption and did not enter the sphere of external exchange. As for industry, its importance declined, and the significance of cities diminished, turning them into mere agricultural villages. The taxes imposed on city dwellers, travelers, and merchants transporting their goods from one city to another increased. To protect their interests and avoid the danger of competition among themselves, artisans established the guild system, which was an organization specific to each craft. Each guild acquired rights and privileges, so no one was allowed to open a workshop without its permission, and it also settled disputes among its members[1]. The guild system prevailed until the French Revolution in 1789, which introduced radical changes in labor relations, abolished the guild system and professional monopolies, and made professions and crafts available to anyone who wanted to pursue them freely[2].

It can be said that economics during these periods was not a study that could be separated from the study of other aspects of human activity, such as politics, philosophy, religion, or ethics[3].

2.2. Economic thought in Islamic civilization

The Arab Islamic civilization in the Middle Ages made some intellectual contributions to the field of economics, although it lacked precise and independent scientific analysis. Muslim thinkers did not separate economic ideas from their jurisprudential, philosophical, and historical research and studies, possibly due to religious considerations. Greek philosophy influenced Muslim philosophers' perspectives on the emergence of the state. Al-Farabi provided an economic explanation for the emergence of the state, which is the gathering of individuals in groups to satisfy their needs due to the individual's inability to meet all their needs alone.

The Quran and the Sunnah are considered the most significant sources of economic thought in Islamic civilization. The Quran acknowledged private property, and Muslim thinkers greatly respected private ownership, which led to the recognition of class differences among people. There was an acknowledgment of the existence of the rich and the poor, along with a reverence for initiatives aimed at reducing this class gap for doctrinal and societal reasons, in accordance with the principle, "Indeed, the believers are brothers." Class disparity in Islam differs from previous civilizations, as Islam did not attribute its causes to natural endowments or an individual's social status. Instead, Islam went further by imposing obligations on the wealthy toward the poor

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[1] Labib Shaqir, op.cit, pp. 35-49.

[2] Ben Brika Ibrahim, The Phenomenon of Work and Its Development Through the Ages, Journal of Science Horizons, University of Djelfa, Algeria, Volume 1, N° 2, March 2016, p. 20.

[3] George Sol, op.cit., pp. 25-26.

and requiring the state to intervene to assist them, even if they were non-Muslims. Regarding work, Islam glorified labor and condemned laziness and abstaining from work, even for the wealthy. It viewed all work as important and valuable, especially trade, which held a special status[1].

It is worth noting that work holds an important place in Islam, which encourages it and considers it one of the highest forms of worship. It links reward to the amount of effort put into production and urges the provision of a fair wage sufficient to meet basic needs, ensuring the continuity of economic activities, increasing the wealth of society, and strengthening the Islamic state[2]. Regarding usury, Islam prohibited it on the basis that banning usury would prevent the exploitation of the needs of the needy and push them to borrow to meet their needs and also prevent the emergence of a social class that receives returns without exerting effort or work and without facing the risks of profit and loss. Islam did not prohibit a person from investing their money in a project, but it required them to bear the risk of loss if the project failed[3].

Islam prohibited monopolies to prevent the monopolist from exploiting consumers by excessively raising prices. Islam preferred perfect competition, where the price is determined by supply and demand conditions without state intervention, ensuring that profit is fair and reflects the level of effort, which applies to other economic activities as well[4]. In the case of economic imbalance, he believed in the necessity of state intervention to restore balance, encourage trade, and combat certain negative phenomena such as monopolies and excessive pricing without economic justification. He also emphasized the importance of providing incentives to workers to increase production, which are efforts required to achieve social justice and economic development[5].

As for money, it received a share of Islam's attention, which acknowledged its importance. The Umayyad civilization during the reign of Abd al-Malik ibn Marwan was the first to mint an independent currency (the dinar and dirham) and abolished the use of inferior and counterfeit Persian coins (application of Gresham's Law). The minting process was overseen by a government minting institution (Dar al-Darb) that was directly under the caliph's authority. In the Abbasid era, Caliph Harun al-Rashid

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[1] Labib Shaqir, op.cit, pp. 49-60.

[2] Ben Brika Ibrahim, op.cit., p. 21.

[3] Islam, for example, prohibited exchanging a specific quantity of wheat for a larger quantity of wheat, which is known as Riba al-Fadl.

[4]Labib Shaqir, op.cit, p. 60.

[5]Bouili Sakina, Economic Thought of Ibn Khaldun and Al-Maqrizi – A Comparative Analytical Study in Light of Global Economic Theories –, PhD Thesis in Economic Sciences, Hajj Lakhdar Batna1 University, Algeria, 2014/2015, pp. 50-53.

strengthened the independence of monetary authority by appointing a minister specialized in it[1].

Among the topics that have attracted the attention of Muslim thinkers is saving, as Islam encouraged saving and warned against the phenomena of hoarding[2] and stinginess due to their negative repercussions on the Islamic economy. Ibn Khaldun is considered one of the most prominent thinkers who focused on the study of saving, as he encouraged saving by attempting to demonstrate its benefits, including protection from future economic fluctuations, achieving future gains, and increasing the strength of the Islamic state[3].

The Arab philosopher Ibn Khaldun is considered one of the most famous Muslim thinkers during the Middle Ages. Ibn Khaldun believed that trade is productive because it creates utility and benefit without creating the thing (the commodity) itself. He thought that a merchant's profit could be achieved either by storing the commodity until its price rises or by transporting it temporally or spatially to areas where demand is high and prices are elevated[4]. He considered that foreign trade is more profitable than domestic trade, despite the many risks surrounding foreign trade that drive them to sell their goods in other countries at higher prices. Thus, Ibn Khaldun linked prices to risk, a concept that has been extensively studied in recent times[5]. Ibn Khaldun divided monopoly into a monopoly on necessities, which is condemned because it takes people's money unjustly, and a monopoly on luxuries, which is not condemned because consumers buy them voluntarily without coercion. Thus, Ibn Khaldun was pioneering in distinguishing between elastic and inelastic demand[6]. Ibn Khaldun's analysis of production is considered pioneering and distinctive, as he preceded the classical school in this regard. He mentioned that the production process requires the availability of essential elements, which are labor, capital (equipment and tools), and natural resources. He also linked economic growth in a direct relationship with factors such as the division of labor, the degree of urbanization, and prices[7].

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[1] Akram Mahmoud Al-Hourani & Abdul Razak Hassan Hassani, Money and Banking, Damascus University Publications, Syria, 2010, pp. 58, 59.

[2] Hoarding is defined as possessing unproductive financial values due to the removal of capital from the economic activity sphere and its freezing, so it does not contribute to real investment and loses its economic meaning.

[3] Medoun Elias, "Savings between the Literature of Islamic Economic Thought and Positivist Theories," Journal of Economic Studies, Al-Basira Center for Research, Consulting, and Educational Services, Algeria, Vol 20, N° 2, 2020, pp. 78-79.

[4] Mohamed Ashour, Pioneers of Arab Economics, 1st edition, Dar Al-Amal, Egypt, 1998, pp. 123-145.

[5] Bouili Sakina, op.cit., p. 155.

[6] Mohamed Ashour, op.cit., p. 145

[7] Bouili Sakina, op.cit., p. 138.

Ibn Khaldun focused on work by examining economic life and various aspects of social life. He saw work as the pursuit of earning a livelihood (food, clothing, and shelter) and satisfying his essential needs through natural channels represented by agricultural production (including animal husbandry, hunting, silk extraction from silkworms, and honey from bees), industrial production, or trade. Ibn Khaldun classified economic activities as agriculture first, then industry, and lastly trade, as it mediates between buyer and seller. He considered trade a non-productive but important and necessary activity, a natural way to earn a living[1]. Except for trade, he considered service, especially directed towards rulers and high-income individuals, an unnatural and unproductive economic activity that is consumptive and reinforces class disparity under the pretext that it is unnecessary for the continuation of people's lives. He also regarded government jobs as unnatural activities because they are a source of income acquisition in an unnatural way, relying on power and domination[2]. Ibn Khaldun was very interested in industry and believed that it starts in a simple form and then becomes complex, requiring knowledge, thought, and deduction. In this regard, he was ahead of his time, as modern industry relies on technology, which in turn is based on the sciences of mathematics, physics, and others. In this context, Ibn Khaldun believed that as societies progressed, the level of manufacturing increased, and industries diversified and advanced. Societies transitioned from demanding essential goods to demanding luxuries. Ibn Khaldun linked the development of industry to the division of labor, praising it as the means capable of multiplying production and as a condition for mastering any work or profession. He also considered it a prerequisite for social construction, as it requires the concerted efforts of individuals and increased cooperation among them to meet their needs.

Ibn Khaldun believed that work makes the individual interact with nature to meet their needs, and it is what confers the material its utility value and provides wealth its economic dimension. Thus, Ibn Khaldun was able to link consumption with production thanks to the division of labor, as the utility value of a commodity is determined by the benefit derived from it. Thus, he linked the value of the commodity and the value of the labor expended in its production with a direct relationship, so the value of the commodity increases as the value of the labor expended in its production and transportation increases, and vice versa. In addition to the use or consumption value, Ibn Khaldun mentioned the exchange value that labor can add to the material. He provided an example of a merchant who transports the material from one location to another and assumes the associated risks, which increases the commodity's value. The exchange value of the commodity is determined by the exchanges that occur between

[1] Abdelkader Adala, Ibn Khaldun's Economic Theory between Abdelmajid Meziane's Approach and Contemporary Western Thought, Asoor Journal, Oran 1 University, Algeria, N° 37, October-December 2017, pp. 22-35.

[2] Bouili Sakina, op.cit., p. 138.

individuals and groups. Ibn Khaldun combined the exchange value with the law of supply and demand, linking price increases to a decrease in supply[1].

Ibn Khaldun preceded the mercantilists and the physiocrats with his ideas, as he advocated for economic freedom without restrictions and opposed state intervention in various aspects of economic activity, including trade. He indicated this with the phrase "Let nature take its course and let things go." Ibn Khaldun believed that government intervention would hinder economic life and individual freedom because state intervention would harm competition and equal opportunities, undermine market freedom, disrupt the law of supply and demand, and lead to the emergence of monopolies due to the privileges granted to the sultan or some major traders, enabling them to sell goods at lower prices and exclude other competitors among traders and farmers[2]. Similarly, Ibn Khaldun believed that the rulers' imposition of increased taxes to finance the armies and their expenses would lead to higher costs and, consequently, higher prices and market stagnation[3]. Ibn Khaldun believed that the disappearance of a productive class of farmers and merchants from the market due to state (sultan) intervention will lead to the disappearance of capital, resulting in a form of economic sterility for states and fluctuations in prices, sometimes falling and sometimes rising, due to the state's entry as a buyer or seller and the decline in tax collection. Ibn Khaldun considered that falling prices are harmful to manufacturers, merchants, and farmers alike.

Ibn Khaldun opposed the reduction of the population and considered that an increase in population is an important factor in boosting economic activity, as an increase in population would lead to increased production and lower prices due to the division of labor. Ibn Khaldun called for the government to continue spending because its cessation of spending and the establishment of various projects would lead to a state of economic stagnation and crises. At that point, the activities' ability to pay taxes would be paralyzed due to the lack of profits, and the government would be incapacitated [4]. Ibn Khaldun touched upon money (gold and silver) and saw it as the source of all gains, stating that no gains from economic activity can be realized without its employment[5]. Ibn Khaldun pointed out the modern roles of money, which are a measure of value, a store of value, a medium of exchange, and a means of settling payments[6].

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[1] Abdelkader Adala, op.cit., pp. 22-35.
[2] Mohamed Ashour, op.cit., pp. 123-140.
[3] Bouili Sakina, op.cit., p. 197.
[4] Mohamed Ashour, op.cit., pp. 140-145.
[5] Bouili Sakina, op.cit., p. 184.
[6] Akram Mahmoud Al-Hourani & Abdul Razak Hassan Hassani, op.cit., p. 63.

Despite the importance of the economic ideas proposed by Ibn Khaldun, many believe they lacked independence from other social ideas. Nevertheless, many agree that Ibn Khaldun's analysis of the economic problems faced by societies in his time was characterized by depth and precision[1]. t can be said that Ibn Khaldun preceded Adam Smith by centuries and believed that the wealth of nations is represented in what they produce in goods. For Ibn Khaldun, the wealth of nations arises from human labor[2].

Ibn Khaldun is considered the first to attempt to separate economic problems from religious and moral considerations, as he is the first to try to uncover the economic factors that govern the economic behavior of individuals and groups. For example, Ibn Khaldun explained how the development of cities, the advancement of civilization[3], and the increase in wealth can transform luxury goods into necessities and increase the demand for industrial goods. He also clarified how supply and demand affect prices [4]. In this regard, Ibn Khaldun attributed the rise in prices to several factors, linking the prices of essential goods to urban development (population growth and the expansion of cities and states) and demand, while linking the prices of luxury goods to the demand for those goods and their supply[5]. Ibn Khaldun is famous for his analysis of the phenomenon of rent, which consumed a significant part of the research of economists in the 19th century. He believed that the increase in economic activity and the strengthening of the state would lead to a rise in property prices, where the difference in property prices with urban expansion constitutes the rent that goes to landowners. For Ibn Khaldun, rent is not realized through the owner's work and effort but is a result of the advancement of urban conditions, which we currently refer to as the increase and expansion of economic activity.

Ibn Khaldun's analysis of the division of labor is considered one of the most significant economic ideas in Arab thought during the Middle Ages, as he was the first to address it in a scientific and logical manner, which laid the foundation for Adam Smith's theory. Ibn Khaldun believed that the division of labor is necessary due to the individual's inability to perform all activities to meet their needs, which leads to cooperation among individuals, especially with the increase in population and the diversity of tasks. The increase in population leads to the division of labor, which in turn increases production and surpasses the needs of society. Society then directs part

[1] Labib Shaqir, op.cit, p. 60.
[2] Chris Hann & Keith Hart, Economic Anthropology: History, Ethnography, and Critique, translated by Abdullah Fadel, 1st edition, Arab Center for Research and Policy Studies, Qatar, 2014, p. 42.
[3] Ibn Khaldun meant by "urbanization" everything that pertains to the necessities of urban development, including the extent of market development, the circulation of goods, the level of income and expenditure, as well as the development of buildings and other facilities and the extent of city expansion.
[4] Labib Shaqir, op.cit, pp. 60-61.
[5] Bouili Sakina, op.cit., pp. 127-128.

of its productive activity towards the production of luxury goods, as the rising demand for these goods will drive new industries to emerge and flourish to satisfy the new demand. In summary, population growth leads to the division of labor, which increases production, thereby increasing income and raising the demand for goods. New industries emerge, leading to further income growth, and so on. Thus, Ibn Khaldun preceded classical economists in pointing out the division of labor, but he did not elaborate on its causes and limited them to the inability of humans to meet their needs alone[1].

Ibn Khaldun considers labor to be the true source of value, as it is labor that creates the essential benefits of natural resources. Without labor, natural resources cannot possess their value. Through labor, useless resources in their primitive state can be transformed into useful goods and services. Thus, Ibn Khaldun is regarded as the first to lay the foundation for what is now known in contemporary political economy as the labor theory of value[2].

3. Economic thought in the Renaissance

After a period of economic stagnation that prevailed in Europe under the feudal system, some social changes began to emerge on the horizon, paving the way for the emergence of numerous ideas that formed the foundations of economics as an independent science.

The merchants, both politicians and businessmen, contributed as a prominent intellectual current to enriching the field of economics with many important ideas. The economic ideas, guidelines, and solutions they provided to rulers were characterized by deep intellectual and analytical depth, which continued to guide economic policy in Europe until the emergence of the classical school in the mid-eighteenth century. The French writer Antoine de Montchrestien presented a book titled "Political Economy" in 1615, which contained a series of advice for the city's ruler on how to manage the city's finances and ways to increase and distribute its wealth. Thus, political economy, at its inception, focused on ways to increase wealth and solve the economic problems faced by states and cities[3].

3.1. The development of the mercantilist movement

The mercantilist movement emerged as a response to the social developments occurring in Europe. The ideas of the mercantilists defended the existing social organization and the interests of the new political system with the establishment of

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[1] Labib Shaqir, op.cit, pp. 60.63.
[2] Khaled Saad Zaghloul Helmy, op.cit., p. 26.
[3] Ibid, p. 29.

modern states on the ruins of the feudal system and the emergence of a new merchant class. This changed people's perception of economic activity and profit, and it supported the intellectual renaissance that emerged in Europe, which aimed to limit the church's control. These changes emerged in the book "The Prince" by Niccolò Machiavelli, who advocated for the separation of politics from ethics and religion and defended the importance of having a prince who achieves the unity and strength of the state, justifying any means to achieve that. The ideas of the mercantilists were welcomed by the kings of European countries, spreading from England, France, and the Netherlands to the rest of Europe, and these ideas continued to guide European politics until the mid-eighteenth century[1].

The merchants tried to define the nature of some economic phenomena and sought to answer some important questions: What is wealth? How can it be increased? How is it distributed among different countries? What is the reason for the price increase in Europe?

The mercantilists believed that the purpose of the economic system was to serve the state in order to increase its power, which is known as the theory of economic power, where the strength of the state is measured by the wealth it possesses. However, the mercantilists limited wealth to gold, silver, and other precious metals, as money during the mercantilist era was metallic currency, and paper money had not yet appeared due to the absence of banks. To increase the power of the state, the mercantilists advocated that countries should strive to obtain the maximum possible amount of those precious metals, particularly by exploiting the gold and silver mines located within their territories and expanding their colonies that ensured the mines. The merchants advocated that economic policy should aim to increase the quantity of gold and silver to maximize a state's wealth and enhance its power. In this context, merchants believed that a growing population positively contributes to enhancing the economic and military power of nations. An increase in population provides soldiers to occupy territories and subsequently supplies raw materials for industries (importing at low prices) and ensures markets for selling products (exporting at high prices).

The merchants believed that the quantity of precious metals in the world was limited and called for their countries to seek to obtain them from other nations either through friendly means (trading and exchanging them for other goods and manufactured products) to achieve a positive trade balance (a trade surplus) or through hostile means (direct colonization). In order to increase the state's wealth in gold and silver, the mercantilists called for state intervention in economic life to achieve a positive trade balance, that is, a trade surplus with other countries. In this regard, the emerging European states, influenced by mercantilist ideas, adopted various policies to

[1] Khaled Saad Zaghloul Helmy, op.cit., p. 29.

bring gold and silver from other countries. Spain implemented the easiest methods to obtain and retain gold and silver through a mercantilist policy that included (1) extracting and bringing gold and silver from its colonies in the New World, (2) preventing their outflow from Spain as much as possible by implementing several measures, including mandating the use of Spanish ships to transport Spanish goods abroad and to transport gold and silver to Spain from the colonies, (3) obligating foreign traders in Spain to spend their metallic money on purchasing Spanish goods, and (4) exempting the outflow of metallic money only to pay the king's debts and the expenses of the holy missions the king sends abroad. The Spanish policy caused prices to rise due to the increased influx of gold and silver[1].

The merchants encouraged private ownership and made it the foundation of economic activity, while the state's intervention was limited to regulation for the purpose of achieving specific goals[2].

The growth of exchanges and trade during the Age of Mercantilism provided an opportunity for the expansion of business activities based on credit. These conditions allowed for the possibility of earning profits through lending money at interest, which compensated the lender for accepting the risk. Thus, banks began to emerge and expand as institutions that create credit[3].

Regarding the rise in price levels, which was a general phenomenon in Europe during their era, the mercantilists offered various explanations. Jean Bodin attributed it to the increase in the quantity of gold and silver that flowed into Europe from the New World. He argued that as the quantity of money increased, prices rose and the purchasing power of money decreased, and vice versa. This explanation formed the basis of the "quantity theory of money," which influenced subsequent economic thought. The mercantilists advocated for increasing the amount of gold, considering it the way to reduce interest rates, encourage investments, and subsequently increase the level of employment. In the context of explaining the rise in inflation rates and subsequently the value of currency, the Englishman Gresham proposed his famous saying, "bad money drives out good money," after observing that people in Spain, in particular, hoarded the gold flowing from the American continent after the government minted coins from other metals to provide liquidity for trade, as people saw gold as having a stable purchasing power[4].

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[1] James Fulcher, A Short Introduction to Capitalism, translated by Ali Refaat El-Sayed, 1st edition, Dar Al-Shorouk, Egypt, 2011, pp. 7-9.

[2] Labib Shaqir, op.cit, pp. 69-78.

[3] Sami Khalil, Money and Banking, Kazma Publishing, Translation, and Distribution Company, Kuwait, 1982, p. 161.

[4] Ahmed Hani, Currency and Money, University Publications Bureau, Algeria, 2006, pp. 42-43.

The merchants' focus on foreign trade was reflected in their view of fiscal policy. Thomas Min considered taxes to be a nonessential source for financing state activities. Instead, he believed that the state should rely on increasing its export capacity and achieving a surplus in the balance of payments to finance its expenditures. The ideas of Min were supported by the thinker William Petty, who called for rationalizing government expenditures and limiting the role of the state to providing essential services such as administration, defense, and justice, with the possibility of offering support to the unemployed[1].

The ideas of the mercantilists contributed to freeing economic research from its moral and religious character, as their economic analyses were characterized by a high degree of independence. Moreover, the European policies derived from the ideas of the mercantilists contributed to the development of industry and trade, and many countries still implement them, particularly in the aspect related to achieving a positive trade balance. Additionally, the increase in money led to a greater need for repositories to safeguard it, paving the way for the emergence of banks and the expansion of their activities[2].

3.2. Physiocrats

At a time when mercantilist ideas dominated economic policies in Europe, a new intellectual current emerged in the form of the Physiocrats, who opposed the mercantilists and called for reducing government intervention in economic life[3]. The Physiocratic School was founded in France in the mid-18th century by the physician François Quesnay, who authored the book "Tableau Économique." Or “The Economic Table.”

The Physiocrats believed in the idea of natural law that Aristotle wrote about, and they defended the idea of the natural system, believing that all economic phenomena and economic and social behavior are governed by natural laws that humans cannot change and that are in accordance with human nature. Individuals in their economic actions remain subject to the principle of personal utility, which drives them towards the most beneficial economic activities, and at the same time, they will face competition with other individuals. The naturalists advocated for individuals to produce within a free economic system governed by competition[4], without state

[1] Bahaeddine Touil, The Role of Fiscal and Monetary Policies in Achieving Economic Growth – A Case Study of Algeria: 1990-2010, PhD Thesis in Economic Sciences, Hadj Lakhdar Batna University, Algeria, 2015/2016, p. 42.
[2] Labib Shaqir, op.cit, p. 80.
[3] Khaled Saad Zaghloul Helmy, op.cit., p. 35.
[4] Labib Shaqir, op.cit, pp. 83-84.

intervention, according to the principle of "let it work, let it pass"[1]. Quesnay believed that under the natural system, the prices of the outputs of the production process are higher than the prices of the inputs to the extent that they consume labor. Therefore, the prices of goods should be based on the cost of labor, which paved the way for the labor theory among classical economists[2].

The naturalists viewed economic life, which is governed by natural laws, with optimism, believing that each individual striving to achieve their personal interests would contribute to the benefit of the community[3].

The naturalists believed that production is the source of wealth, as wealth for the naturalists is any work that creates a net output (outputs greater than inputs). They concluded that agriculture is the only activity capable of meeting the condition of wealth because the output from crops exceeds the inputs of raw materials and seeds in both quantity and value. Thus, value comes from the land. As for industry and trade, the naturalists considered them unproductive activities that depend on agriculture. Thus, the naturalists consider that the class of farmers is the only productive and wealth-creating class, while merchants and industrialists remain a sterile class. Accordingly, the naturalists urged the kings to support the farmers to increase the wealth of the states and prioritize them over industry and trade. However, the naturalists encouraged industry and trade, despite classifying them as unproductive activities, considering them as sectors that assist agriculture and contribute to improving the conditions of farmers through price increases. Industry, in their view, could increase the demand for agricultural products and reduce waste, while trade would help in promoting and marketing both raw and processed agricultural products and also reduce waste[4].

Naturalists consider the economic cycle one of their most important intellectual contributions. In his book "The Economic Table," François Quesnay addressed the analysis of the economic cycle of net output, likening the circulation of products to the human body. The economic cycle begins with the class of farmers who spend part of the net output they receive, giving a portion to landowners in exchange for using their land and keeping the rest for themselves. Landowners spend what they receive from the farmers on acquiring what they need from the farmers, traders, and craftsmen. Farmers buy goods from merchants and craftsmen, who get part of their income from the farmers. In return, the merchants and craftsmen spend their income acquiring

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[1] John Kenneth Galbraith, The Anatomy of Power: The Past as a Mirror of the Present, translated by Ahmed Fouad Belba, Series: The World of Knowledge, National Council for Culture, Arts, and Letters, Kuwait, 2000, p. 64.

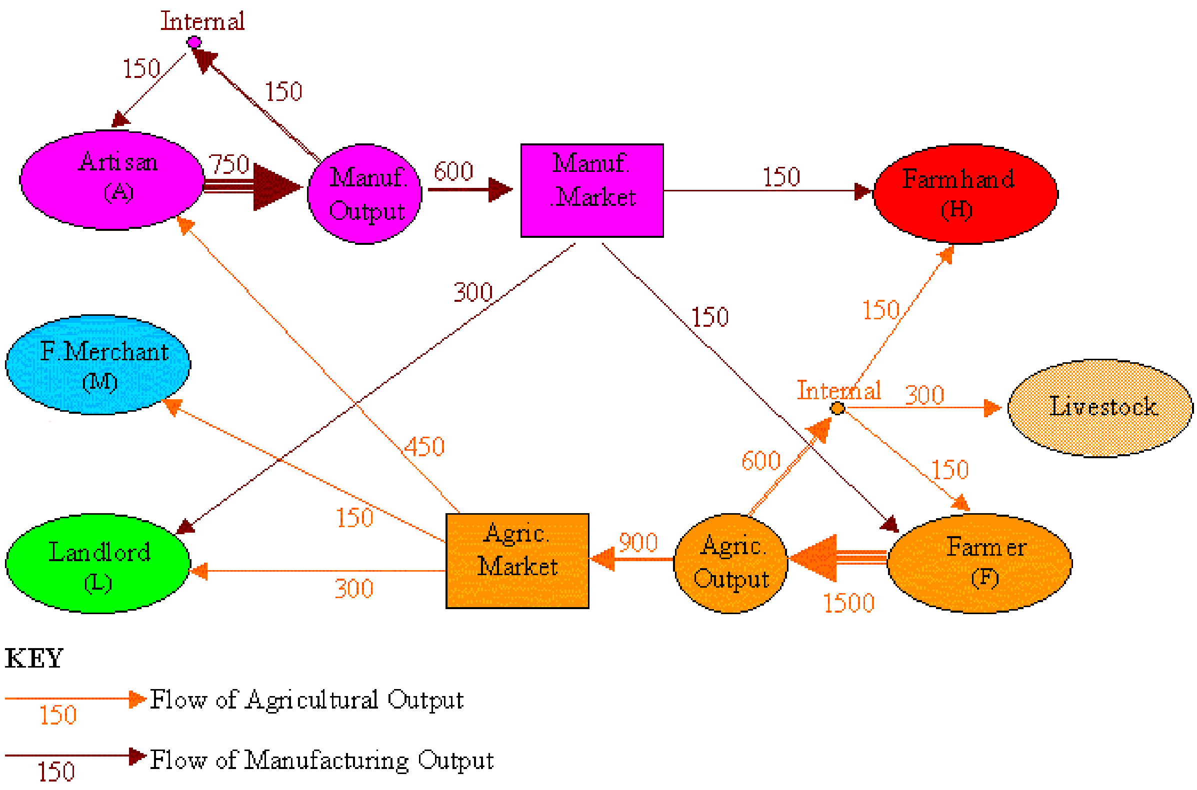
[2] George Sol, op.cit., p. 59.

[3] Labib Shaqir, op.cit, p. 86.

[4] John Kenneth Galbraith, op.cit., p. 65.

products and raw materials from the farmers that their activities require. In the end, all income returns to the farmers' class, as products and income originate from the farmers and end with them[1]. Accordingly, the economic table that summarizes the economic cycle encompasses a theory that corresponds to what is currently referred to as national income. The following figure illustrates what has been mentioned about the economic cycle:

Figure 1: The economic cycle of physiocrats



Source : Wikipedia, Tableau économique, edited on 27 May 2025, consulted on 28 June 2025, at https://en.wikipedia.org/wiki/Tableau_%C3%A9conomique

Considering agriculture as the only productive activity, the naturalists demanded, to save effort, the imposition of a single moderate tax on agriculture because farmers would transfer its burden to the class of merchants and manufacturers. If a tax were imposed on merchants and manufacturers, they would transfer it to the farmers, disrupting the economic cycle and conflicting with natural laws[2].

Regarding economic policy, the belief of the Physiocrats in the freedom to engage in economic activity led them to demand limiting state intervention in economic life

[1] Labib Shaqir, op.cit, pp. 86-87.
[2] John Kenneth Galbraith, op.cit., p. 65.

and abandoning the practices that were prevalent in the mercantilist era, due to the conflict of such intervention with the natural law that can achieve complete harmony between individual interests and the interest of the community[1]. The naturalists called for limiting state intervention to (1) maintaining internal and external security, (2) protecting private property, (3) enforcing contracts, and (4) undertaking tasks and works that individuals are unable to perform, such as constructing infrastructure.

4. Modern economic schools

The first Industrial Revolution, starting in the eighteenth century, paved the way for the emergence of economic ideas that shaped what is known as economics as an independent science, along with the emergence of new schools of thought. This chapter highlights the most important modern schools of thought.

4.1. The Classical School

The book "The Wealth of Nations" by Adam Smith, published in 1776, established the first independent school of thought in economics, known as the Classical School. Its influence on economic thinking and the direction of national economic policies persisted longer than any other school until the early twentieth century, specifically until the outbreak of the Great Depression in 1929[2]. The classical school was characterized by a diversity of economic ideas that addressed numerous topics, some of which had never been previously discussed and were neglected for various reasons.

The classical thinkers were influenced by the ideas of the naturalists and believed in the concept of the scientific natural law, which states that there are scientific natural laws governing the world, where the importance of the individual and individualism was emphasized [3].

4.1.1. Theory of exchanges and foreign trade

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[1] Ensuring that public opinion forces the government to comply with natural laws requires a level of education, which is why naturalists advocated for state spending on education.

[2] Some believe that political economy emerged independently through Richard Cantillon, who authored the book "Essay on the Nature of Trade" around 1730, while others think that the science began in France with the natural school around the mid-eighteenth century. In addition, despite the intellectual mark left by Adam Smith, there is a current of writers and thinkers who categorically reject attributing the credit for the emergence of political economy to Smith. This current is led by Joseph Schumpeter, who believed that many intellectual schools and thinkers, both before and after Smith, contributed to establishing the foundations of political economy.

[3] Mohamed Adel Zaki, op.cit., p. 93.

The classical thinkers criticized the policy of trade restrictions and exaggerated the importance of free exchange[1]. The ideas presented in the book "The Wealth of Nations" defended mercantilist ideas that formed the foundations of the beliefs of mercantilists, who viewed the wealth of nations as being measured by their possession of money, specifically gold and silver, which could only be achieved through trade by selling as much as possible to others (exports) at the highest price and buying as little as possible from others (imports) at the lowest price[2].

The role of the state, according to the classical economists, lies in liberating trade from restrictions, providing subsidies and tax incentives for exports, imposing restrictions on imports, encouraging local industries, and protecting them from foreign competition by supporting producers and imposing tariffs on imports. These measures lead to an increase in exports and a reduction in imports, resulting in a trade surplus that transforms into positive cash flows, contributing to the increase in the state's wealth.

Exchange is considered vital by classical economists, as it allows countries rich in agricultural land and water to specialize in rice production and export large quantities of it (the surplus) instead of cultivating several agricultural crops that may not meet their needs and importing their wheat requirements from countries that possess natural advantages and labor. Exchange benefits all parties involved[3].

In the context of explaining trade exchange, Adam Smith proposed the theory of absolute costs, which advocates that countries or enterprises specialize in producing goods in which they have an absolute advantage, meaning they produce goods that their natural conditions allow them to have an absolute advantage in producing, and then exchange the surplus of their production with the surplus needs of other countries for goods in which they have an absolute advantage in production[4].

Despite the importance of the principle of specialization and division of labor in explaining why countries engage in trade, it failed to explain the occurrence of trade in

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[1] There are five types of barriers that hinder the free flow of trade: (1) natural barriers such as transportation costs, distance, and natural terrain, (2) cultural barriers from differences in cultures and languages, (3) market barriers such as unfair competition, monopolies, price differences, and exchange rates, (4) political barriers such as tariffs, customs duties, import licenses, quotas, technical and environmental restrictions, local production subsidies, and even import bans, and (5) service systems and regulations that restrict trade in services, such as national regulations that limit foreign supplier entry, restrictions on foreign financing, and limitations on the movement of foreigners when providing services.

[2] Graham Dunkley, Free Trade: Myth, Reality, and Alternatives, translated by Mostafa Mahmoud, 1st edition, National Center for Translation, 2009, pp. 14, 23.

[3] Eamon Butler, The Austrian School of Economics: A Brief Introduction, translated by Khadr Mohamed Fathi, 1st edition, Hindawi Foundation for Education and Culture, Egypt, 2013, p. 38.

[4] Mahmoud Younes, International Economics, Al-Dar Al-Jamiya, Egypt, 2000, p. 24.

cases where countries specialize in producing the same good. The concept of opportunity cost attempted to explain this by encouraging the parties involved in trade to exchange goods that they produce at relatively lower costs and to abandon the production of other goods, meaning producing a good at the lowest opportunity cost. This principle was termed the "Law of Comparative Advantage," known as the Theory of Relative Costs, which was first proposed by David Ricardo and influenced the interpretation of trade relations between countries. The law determines the specialization of countries in international trade based on comparative advantage, meaning at the lowest relative costs, which are based on the abundance of economic resources. Countries with vast agricultural lands will specialize in producing and exporting agricultural goods, while countries with an abundance of capital compared to land or labor will specialize in producing machines that require significant capital[1]. The theory differs from the absolute cost theory proposed by Smith, which failed to answer some questions, the most important of which is how a country deprived of any absolute advantage in producing any good can be a party in any trade exchange. In other words, how can the value of the goods subject to exchange be determined? Like other classical ideas, the theory of comparative costs advocated for the principle of specialization and division of labor and called for countries to specialize in producing goods in which they have a comparative advantage, meaning they can produce them at relatively low costs, while importing goods in which they do not have any comparative advantage compared to other countries, meaning their production costs are relatively high.

Accordingly, it can be said that international or local trade, according to the theory of comparative costs, occurs when the relative costs of producing goods differ between countries. For example, a country like Egypt can produce both rice and wheat; however, because of its abundance of water and agricultural land, it is more advantageous for Egypt to specialize in rice production and dedicate all its land to cultivating rice, as the cost of producing rice is lower than that of producing wheat. It can then exchange the surplus rice for wheat produced in Russia, which specializes in wheat production due to the suitable climate for wheat cultivation compared to rice. The theory of comparative costs involves the opportunity cost, which indicates that engaging in trade entails the sacrifice of units of other goods by the state in favor of other countries to produce a unit of the good in which it specializes[2].

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[1] James Gwartney & Richard Stroup, Macroeconomics: Private and Public Choice, translated by Abdel Fattah Abdel Rahman & Abdel Azim Mohamed, Dar Al-Mareekh Publishing, Saudi Arabia, 1988, pp. 58-61.

[2] George B. Becker & Sumit D. Desai, Everything You Need to Know About Economics, translated by Ahmed Al-Maghrabi, 1st edition, Dar Al-Fajr for Publishing and Distribution, Egypt, 2013, p. 111.

Despite the importance of the theory of comparative costs in explaining trade between countries or between projects, Ricardo did not specify the exchange ratio at which goods are exchanged internationally. This is what John Stuart Mill attempted to address in his book "Principles of Political Economy," published in 1848, which included the theory of international values. Mill saw that the internal exchange ratio between the two parties is determined by the relative costs through the supply and demand for the two goods, and he called it "the mutual demand of the two countries." The theory of absolute values bases exchange on the relative efficiency difference between the two countries. Thus, Mill differed from Ricardo, who focused on the relative cost of labor in determining the cost of the goods being exchanged and consequently the establishment of trade. Mill explains the mechanism of forming the international price of goods subject to exchange. In Algeria, the cost of producing 5 units of shoes is equivalent to the cost of producing 10 coats, whereas in Tunisia, the cost of producing 5 units of shoes is equivalent to the cost of producing 5 coats. Therefore, in Algeria, one unit of shoes is priced at two coats, while one coat is priced at 0.5 units of shoes; conversely, in Tunisia, one unit of shoes costs one coat, and one coat costs one unit of shoes. This is because the relative costs of producing shoes in Tunisia are lower than in Algeria, while the cost of producing coats in Algeria is lower than in Tunisia. Accordingly, a trade exchange can occur between Algeria and Tunisia, with Algeria exporting coats to Tunisia and importing shoes from it. This international price is considered the prevailing market price between the two countries. The trade exchange between the two countries continues until the relative costs of producing the two goods change, leading to a disruption in supply and demand in both countries, or until transportation expenses rise to the point where the total cost of Algerian coats in Tunisian markets exceeds their production cost in Tunisia, or similarly for Tunisian shoes in Algerian markets.

Moreover, John Stuart Mill, in his work "Principles of Political Economy" in 1848, attempted to explain international trade by proposing the theory of international values, which showed that the international value of the exchanged commodity is not determined based on its production cost but rather at the point where the balance between supply and demand for different goods from both countries is achieved, which Mill referred to as the reciprocal demand for the two goods. The equilibrium exchange rate is achieved when the total value of what one country can export to another is sufficient to cover the total value of what the other country can import[1].

In the context of explaining how exchange occurs within and between countries, the value of things is determined by the amount of labor expended in their production.

[1] Ayatollah Moulhassan, the World Trade Organization and its Impact on the Foreign Trade Sector: A Case Study (Algeria-Egypt), PhD Thesis in Economic Sciences, Hajj Lakhdar Batna University, Algeria, 2010/2011, p. 6.

If producing a ton of wheat consumes 10 hours of labor and producing a ton of oil requires 1 hour of labor, then exchanging a ton of wheat would be equivalent to at least 10 barrels of oil.

The classical theory regarding the value of exchangeable goods is still used today. Despite the evolution of economic life, labor remains the most significant portion of production costs and the primary contributor to the increase or decrease in production costs depending on various factors. In addition to labor, we previously mentioned land and capital as other production factors. Adam Smith referred to capital as "stock," which capitalists strive to accumulate to maximize their profits. Production, which is exchanged to increase the wealth of nations, cannot occur without the presence of all three factors together and mutual dependence among their owners. In return for participating in the production process, the owners of the factors of production receive compensation in the form of wages for labor and rent or rental returns for landowners, while capital owners receive interest and profits. These returns (rent, wages, and profits) constitute the national income, which is equivalent to the gross domestic product[1].

4.1.2. Theory of production and labor

The classical economists perceive the individual as the primary unit and driver of economic activity, and they hold the belief that an unseen force orchestrates activities to achieve a harmonious balance between individual and community interests[2]. Adam Smith and the classical economists differed from the mercantilists and physiocrats regarding wealth, as they believed that the wealth of nations is measured by the goods and services they possess, not by the quantity of gold and silver. Thus, the wealth of nations increases as the state's ability to produce goods and services increases, which led classical economists to attack all restrictions that limit productive capacities and to advocate for the liberation of production from all constraints, allowing the private sector to take over production processes without government intervention.

The elements of production according to the classical economists are nature, labor, and capital, but labor remains the most important element and the primary determinant of the value of goods and services[3]. Smith believed land is worthless without labor, as it cannot be cultivated without someone to farm it. Additionally, trade exchanges occur on goods produced thanks to labor power. Thus, for Smith, labor is in fact the primary and sole source of wealth.

Work was divided into productive and unproductive; productive work is that which produces goods of utility value and adds to the wealth of nations, believing that

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[1] Eamon Butler, op.cit., pp. 38-40.
[2] Khaled Saad Zaghloul Helmy, op.cit., p. 42.
[3] Eamon Butler, op.cit., p. 40.

trade and land leasing are unproductive activities. Accordingly, the classical economists divided society into three classes: (1) workers who own labor, (2) landowning aristocrats who own land, and (3) industrialists and capitalists who own capital. Each class receives income in return for their contribution to the production process, represented respectively by wages, land rent (economic rent), and the remainder being profits, which decrease as capital accumulation increases[1]. Naturally, the political economists of that time viewed profit as a reward for the capitalist for introducing machines into the production process, undertaking a risky relationship with bankers (without whom they could not provide loans to workers and other suppliers), and generally for organizing production. Thus, profit was seen as a return on capital and a measure of the surplus of the market society[2]. In this regard, Smith divided capital into fixed capital used for acquiring land and machinery and circulating capital used for purchasing raw materials and labor[3].

To achieve an increase in production, Smith advocated for the division of labor, or specialization in work, believing it capable of accumulating capital and creating the value of goods. The real reason for the tendency towards specialization in production is humanity's inclination towards barter and trade to satisfy their needs with the least possible effort and cost. The division of labor, according to Smith, allows for a significant increase in production that can be exchanged with others, as each worker, according to specific qualifications and specializations, performs certain tasks that contribute to increasing their output. The larger the market size, the greater the possibility of applying the division of labor on a wide scale, while the smaller the market, the less incentive there is to specialize in a particular task. Marshall agrees with Smith, but he added that the increase in labor skill resulting from specialization will lead to increased productivity and a surplus in production, thereby improving the living conditions of the population[4].

It should not be understood that the expansion of the market required to achieve specialization in the division of labor refers only to the population size; it also includes per capita income. Moreover, specialization is not limited to labor but extends to other factors of production as well [5].

To achieve the maximum benefit from the division of labor, Smith proposed the theory of the invisible hand, which advocates for free markets. The theory suggests that the entire system of organizing production, distribution, and consumption operates in

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[1] Ashraf Mansour, Neoliberalism: Its Intellectual Roots and Economic Dimensions, Egyptian General Book Organization, 2008, pp. 88, 90, 95, 96.

[2] Yanis Varoufakis & Joseph Halevi & Nicholas L.Theocarakis, op.cit., pp.35-36.

[3] Mohamed Adel Zaki, op.cit., p. 96.

[4] George Sol, op.cit., pp. 67, 154.

[5] Sami Sayed, Principles of Economics, Cairo University, 2018, pp. 279, 282, 283.

the interest of all individuals within a competitive environment. The division of labor within these markets will enhance the countries' capabilities for economic expansion by encouraging innovation and investment, leading to increased productivity, wages, and improved living standards[1]. In the context of analyzing the value of labor, Ricardo proposed his theory on the relationship between labor and wages, arguing that wage differences arise from the varying skills of each worker, which he believed do not remain constant over time[2].

The increase in the productive capacities of countries as a result of the division of labor will, in Smith's view, lead to the accumulation of capital among capitalists. Smith believed in the principle of the neutral or guardian state[3], where the private sector undertakes economic activities. Market forces automatically restore market equilibrium, maximize wealth, and thus increase the power of states, whose role lies in protecting and developing that wealth without intervening in economic activities. Market forces alone and automatically are capable of satisfying individual desires and efficiently allocating labor and other economic resources. If the demand for a certain good increases, producers will respond and try to take advantage of the opportunity of rising prices to maximize their profits by increasing production and their investments to enhance the production capacities of those goods, which will lead to an increase in demand for labor (labor pull) on one hand and a reduction or cessation of production for the goods that have seen a decline in demand on the other hand. However, the success of market forces in performing their function can only be achieved in an environment dominated by competition and free trade, away from monopolies and restrictions on economic activity, where it is the responsibility of governments to ensure the creation of such an environment[4].

Competition is associated with the price mechanism, which plays a role in correcting market conditions. In the case of an excess supply of a good with reduced demand from society, its prices will decrease until the good disappears from the market, and vice versa[5].

The classical economists' focus on production led David Ricardo to propose the Law of Diminishing Returns, which explains how the increase in production can begin

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[1] John Cassidy, How Markets Fail: The Logic of Economic Calamities, translated by Samir Karim, 1st edition, National Center for Translation, Egypt, 2013, p. 46.

[2] Bouili Sakina, op.cit., p. 311.

[3] According to Adam Smith and classical economists, the primary tasks of the state are: maintaining security, defending the state, administering justice through adjudication, establishing infrastructure, and promoting education, as these tasks serve the capitalist class and contribute to facilitating and developing their businesses.

[4] Eamon Butler, op.cit., pp. 44-45.

[5] Mohamed Adel Zaki, op.cit., pp. 93-94.

to decline after a certain stage, despite the increased employment of production factors[1].
Ricardo advocated for fixing wages at subsistence levels, defining wages as "the price necessary to enable the laborers to survive and for their element to continue existing without increase or decrease." This view became known as the Iron Law of Wages, which the classical economists considered the natural price of labor, or the equilibrium price of labor, meaning the level at which wages tend to stabilize if all other factors remain unchanged[2]. Capital remains the determinant of wage levels, as the higher the capital, the greater the demand for labor from entrepreneurs, leading to improved wages. However, the increase in capital that raises wages will result in a decrease in profits due to increased competition[3].

The discussion of production led classical thinkers to study savings, which they referred to as the fundamental phenomenon at the economic level. The classical economists consider saving as the abstention from current consumption to maximize future consumption, which is the foundation for capital formation and subsequently achieving economic prosperity, given that saving transforms into investment automatically under the influence of rising interest rates, which are considered the main determinant of saving. In the context of analyzing savings, the classical economists addressed hoarding, which they considered a temporary phenomenon that would disappear over time and was inconsistent with the concept of economic rationality, one of the foundations of the classical school[4].

4.1.3. Theory of employment

The classical economists agreed in their belief that the level of employment must be determined at the full employment level, which is one of the arguments classical economists relied on in defending capitalism for its ability to employ factors of production, especially labor, at the maximum level, leaving no room for permanent unemployment. In the case of unemployment resulting from labor supply exceeding demand, this situation is considered exceptional by the classical economists, as competition will eliminate this imbalance. Due to increased competition for existing job opportunities, labor suppliers will be forced to accept lower wages, which will encourage employers to hire them to take advantage of the opportunity to reduce costs

[1] Labib Shaqir, op.cit, pp. 109-110.
[2] John Kenneth Galbraith, op.cit., pp. 95, 97, 98.
[3] Adam Smith, An Inquiry into the Nature and Causes of the Wealth of Nations, translated by Zeina Hosni, 1st edition, Institute of Strategic Studies, Iraq, 2007, p. 129.
[4] Medoun Elias, Savings between the Literature of Islamic Economic Thought and Positivist Theories, Journal of Economic Studies, Al-Basira Center for Research, Consulting, and Educational Services, Algeria, Volume 20, N° 2, 2020, pp. 81-82.

and increase their profits. Thus, unemployment will disappear, and the economy will return to operating at full employment[1].

The classical economists believed that the worker's wage in return for their contribution to production should be equal to their subsistence level, which is sufficient to purchase the basic goods that keep them alive. In other words, the classical economists acknowledged that achieving full employment of resources requires the wage to be equivalent to the marginal product of labor[2].

4.1.4. Theory of distribution

Ricardo is considered one of the most prominent classical thinkers who addressed distribution, differing from Smith in his conception of the subject of economics. While Smith saw production as the primary concern of economics, Ricardo believed that the fundamental issue in economics is uncovering the laws that govern the process of production distribution or income distribution. Distribution is linked to solving the riddle of value. Ricardo distinguished between use value and exchange value based on the scarcity of goods. Some goods have high use value but low exchange value due to their abundance, such as water and air, while the opposite is true for other goods like gold. The exchange value that concerns economics depends on the idea of scarcity and the amount of labor required to produce them, which determines their natural price. If the price differs from the natural price, we are faced with the market price determined by market forces[3]. Ricardo published a book in 1817 titled "Principles of Political Economy and Taxation," in which he explained that an increase in population and steady, continuous growth would make land scarce compared to other goods. According to the law of supply and demand, a shortage would lead to an increase in land prices and rents paid to landowners, resulting in them receiving a larger share of the national income. This prompted Ricardo to advocate for imposing progressive taxes on land rents[4].

Ricardo's research is considered pioneering in the analysis of rent. He believed that the increase in population (Malthusian theory) would lead to a scarcity of arable land to meet demand, which would result in the cultivation of all fertile lands and the rise in prices of the most fertile lands, thereby increasing the rent received by the owners of fertile lands. With the increase in population, the fertile lands become insufficient, and they shift to cultivating less fertile lands that require greater

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[1] Labib Shaqir, op.cit, pp. 109-110.

[2] John Maynard Keynes, The General Theory of Employment, Interest, and Money, translated by Ilham Eidaros, 1st edition, Abu Dhabi Authority for Culture and Heritage (Kalima), United Arab Emirates, 2010, pp. 65, 73, 74.

[3] Mohamed Adel Zaki, op.cit., pp. 98-100.

[4] Thomas Piketty, Capital in the Twenty-First Century, translated by Wael Gamal and Salma Hussein, Dar Al-Tanweer, Egypt, 2016, pp. 11-12.

investments to obtain the maximum possible amount of agricultural products. Since the costs of rehabilitating less fertile lands are higher than those of fertile lands, the owners of the latter receive the difference between the production costs of the two types of land, which is what he called rent. Rent is the difference between the price of products, which is determined based on the production costs in less fertile lands and the costs in fertile lands. Accordingly, the rent increases as the population rises, forcing producers to cultivate less fertile lands and rehabilitate them for use[1]. Thus, the classical economists and many contemporary economists view rent as a monopolistic price and one of the manifestations of market inefficiency, which creates undeserved and unjustified income and harms the principle of fair competition, making rent synonymous with an economic disease that needs to be fought[2].

Workers participating in production receive wages in exchange for selling their hours of labor to producers. Accordingly, the classical economists treat labor like other goods, so the price of labor is determined according to their theory of value based on the hours of labor spent in the production of goods. Therefore, the wage is the price of the labor commodity, which the classical economists determined based on the amount of food necessary to sustain the workers' lives (the natural level). The classical economists defended the hypothesis of long-term wage stability at this level, arguing that an increase in wages would encourage workers to reproduce and multiply, which would increase the number of workers available for employment; competition among these workers would then drive down wages back to the natural level. A decrease in wages below the natural level causes malnutrition and famine, leading to the death of many workers, which reduces the number of workers and raises wages back to the natural level.

The iron law of wages, which forbade workers and producers from violating natural law, led to the rejection of any negotiation with workers[3].

4.1.5. Theory of population

The classical economists relied on Thomas Malthus's population theory in their analysis of many economic phenomena related to population. Malthus's theory starts from the premise that there is a tendency for the population to double every 25 years. However, this increase in population exceeds the increase in food production, making population control inevitable. The human capacity to reproduce surpasses the land's ability to provide the necessary food to satisfy this population increase[4]. Population growth, according to Malthus, is governed by the availability of means of subsistence,

[1] Labib Shaqir, op.cit, p. 111.
[2] Thomas Piketty, op.cit., pp. 451-452.
[3] Labib Shaqir, op.cit, pp. 111-112.
[4] Ibid, pp. 10, 107.

particularly food. The more these means increase, the greater the tendency of the population to grow at a rate higher than the increase in means of subsistence[1]. Malthus believed that the imbalance between the increase in population and the amount of food will lead to famines and the spread of epidemics. Conditions will be ripe for wars to break out to seize the food supplies of other groups, resulting in the elimination of part of the population and restoring the balance between the population and the increase in food supplies[2]. Malthus believed that the application of the iron law of wages will contribute to limiting the population's tendency to increase. When wages fall below the subsistence level, the surplus population will perish, and balance will be restored between the number of people and the available food supplies capable of meeting their needs[3].

4.1.6. Theory of interest rates

The interest rate is defined as the compensation received by the saver in exchange for forgoing their money for a certain period and not using it for immediate consumption, deferring it to a later time[4]. The classical economists believe that the interest rate is the factor that achieves the balance between the demand for investment and the desire and readiness to save. Investment represents the demand for investable resources, while saving represents the supply. Therefore, the interest rate will stabilize at the point where investment equals saving. If the demand for investment increases, the interest rate will tend to rise, and vice versa. However, if the inclination to save increases, this will push the interest rate down[5].

4.1.7. Theory of money

Among the criticisms directed at classical ideas is their view of money, which they limited to merely being a medium of exchange and a tool for measuring values, ignoring its role as a store of value and a means of saving. Accordingly, any increase in the money supply will lead to a proportional rise in prices, and the level of production will move towards the point where full resource utilization is achieved, with wages and prices being perfectly flexible[6].

The classical economists believe that exchange does not consist of an exchange between a commodity and money, but rather an exchange between a quantity of labor

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[1] John Kenneth Galbraith, op.cit., p. 92.
[2] Labib Shaqir, op.cit, pp. 107-108.
[3] George Sol, op.cit., p. 75.
[4] Medoun Elias, op.cit., p. 82.
[5] John Maynard Keynes, op.cit., pp. 221-222.
[6] Nizar Kazem Al-Khaikani & Haidar Younes Al-Moussawi, Economic Policies: The General Framework and Their Impact on the Financial Market and Macroeconomic Variables, 2nd edition, Al-Yazouri Scientific Publishing and Distribution, Jordan, 2015, p. 27.

in the first commodity and a quantity of labor in the second commodity within the framework of the law of value. Thus, the exchange is between a commodity and money, and then money for a commodity, meaning that money does not possess any special utility, and its utility is derived from the utility of the goods that can be purchased with it [1].

The classical economists focused on the supply side in their monetary theories, considering that money is a physical commodity like other goods, its value determined by supply and demand forces.

The classical economists' neutral view of money eliminated any possibility of money causing financial crises. Their focus on the real economy that produces goods and services (with no importance given to the monetary sector) led them to believe that equilibrium is achieved when supply and demand for goods and services match supply and demand for money. Additionally, the classical economists' neglect of the role of money as a store of value disrupted the two traditional functions of money: its function as a medium of exchange is hindered by hoarding (and speculation), and its function as a measure of value is disrupted when money itself becomes a commodity demanded for its own sake, thus eliminating an accurate measure for evaluating goods[2].

The classical economists explained fluctuations in the general price level using the quantitative theory, which posits that changes in the quantity of money lead to changes in the general price level in the short term. The relationship between the quantity of money and the price level is a strong direct relationship [3].

4.1.8. Theory of financial crises

Jean Charles Léonard de Sismondi attributed the financial crises that began in the 19th century to an imbalance between production and consumption, as well as between income and consumption, which was caused by the spread of machines that increased both the volume and pace of production while replacing a significant portion of the workforce. Sismondi added that the nature of the capitalist system and the tendency of capitalists to maximize competitive ability and monopolize the market, thereby increasing profits through the accumulation of capital and wealth and cutting expenses, including wage reductions, lead to the bankruptcy of small producers, layoffs, deterioration of workers' conditions, and the emergence of large monopolies. As for Lauderdale, he criticized the capitalist economic policy that leads to the poor distribution of income and wealth, increased savings, and consequently insufficient

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[1] Victor Morgan, A History of Money, translated by Nour El-Din Khalil, Egyptian General Book Organization, Egypt, 1993, pp. 11, 12.

[2] Mahmoud Hussein Al-Wadi & Hussein Mohammed Samhan & Suhail Ahmed Samhan, Money and Banking, 1st edition, Dar Al-Maseera for Publishing and Distribution, Jordan, 2010, pp. 44-45.

[3] Labib Shaqir, op.cit, pp. 121-122.

demand, resulting in the emergence of crises and unemployment. John Atkinson Hobson agrees with him that the poor distribution of income leads to an increase in the income of a certain class and consequently an increase in their savings, which are directed towards building factories and expanding projects, thus increasing production beyond demand. This is because the income of the poorer classes, who are the most numerous, does not allow them to increase their consumer demand, and thus crises are created.

The previous opinions differ from those of Smith, Ricardo, and Say, who denied the occurrence of crises under the capitalist system due to the market forces' ability to eliminate imbalances and transient phenomena without them developing into a crisis that the system could not address without external intervention. Experiments have proven these opinions wrong and led to the emergence of opposing views from both supporters and opponents of capitalism[1].

4.1.9. Economic policy

The classical economists advocated leaving economic activity to the private sector of individuals and companies, while the role of the state remained limited to facilitating and supporting the private sector's work by protecting private activities and properties from internal and external aggressions, ensuring the execution of contracts between individuals and companies, and undertaking projects that individuals are unable or unwilling to carry out due to the large capital required for their completion, such as infrastructure. Thus, the state, in the eyes of the classical economists, is the guardian of economic activity [2]. The classical economists' defense of government neutrality resulted in the demand that the government set the goal of maintaining the balance of the general budget. This narrow perspective led to a limited role for public spending, considering that an expansion in spending would disrupt economic balance. Therefore, the classical economists opposed both surplus and deficit in the public budget. A surplus could lead to an increased financial burden on individuals, potentially allowing the government to waste resources on inefficient spending. This is because the state plays a significant role in the production process, which can negatively impact economic activity. As for the deficit, the classical economists viewed it as a threat to economic balance due to the government's compulsion to resort to borrowing to cover it, which could crowd out the private sector from resources and lead to the wastage of national savings on consumption, as these savings are primarily intended to finance investment[3].

[1] Labib Shaqir, op.cit, pp. 122-126.
[2] Ibid, pp. 109-115.
[3] Nizar Kazem Al-Khaikani & Haidar Younes Al-Moussawi, op.cit., pp. 52-53.

The absolute economic freedom resulted in the absence of protection for workers when they fall into unemployment. Any intervention by the state for these workers would hinder the functioning of the automatic mechanism that leads to balance and eradicates unemployment. The classical economists referred to this mechanism as the "invisible hand," which works to absorb the unemployed by reducing wages, thereby encouraging producers to increase their demand for labor[1]. The classical economists' excessive belief in the ability of free market forces to achieve equilibrium led to the dismissal of the possibility of financial crises. Say's Law summarized this view by stating that every supply creates its own demand, whether in the goods market or the money market. Consequently, there was no room for prolonged recessions or financial crises in capitalist systems. Accordingly, the classical economists attributed the crises that might occur to (1) government intervention in the monetary sphere in violation of natural laws and (2) the excessive issuance of currency by banks, increasing the circulating money supply to a level exceeding their reserves of gold and silver[2].

4.2. Socialism School

Karl Marx is considered the founder of scientific socialism after he published his book "Capital" in 1867, which carried revolutionary ideas that formed the intellectual foundations of the socialist system. The term socialism refers to that system in which the ownership of wealth is transferred to the state, meaning collective ownership, particularly of the means of production such as land, machinery, and factories. Thus, socialism differs from capitalism, which is characterized by individual ownership of all types of wealth and means of production.

Marx focused in his analysis on attacking the capitalist system by concentrating on the inherent economic forces within it that lead to its demise. To achieve this, Marx focused on the following points:

4.2.1. Theory of value of labor and surplus value

In his analysis of the value of labor, Marx distinguished between use value and exchange value. The former constitutes the material content of wealth in society, while the latter is a quantitative relationship in which use values of one commodity are exchanged for use values of another commodity (substitution). He used relative value as a substitute for exchange value[3]. Marx considered that labor does not only give material its use or consumer value but also creates new needs among individuals through production. Consumer needs are what drive production, and in turn, production

[1] Labib Shaqir, op.cit, pp. 115-119.
[2] Nadia Lakoun, Economic Globalization and Financial Crises: Prevention and Treatment "A Study of the Subprime Mortgage Crisis in the United States of America," PhD thesis in Economic Sciences, Hadj Lakhdar University Batna, Algeria, 2012/2013, p. 27.
[3] Mohamed Adel Zaki, op.cit., p. 141.

provides the required material for consumption. In other words, production, through labor, creates consumption; it does not merely provide a material for consumption but also generates a need for the material, that is, it produces the need[1].

Marx attacked the classical economists, who considered labor a commodity like any other with a market. He focused in his critique on the classical economists' calls to keep wages at the level sufficient to buy the necessities of life—food, clothing, and shelter—that keep the worker alive and able to work, which led to the exploitation of workers by capitalists. The theory of value states that the worker sells their physical and mental labor to the capitalist, who uses it for more hours. The surplus value, which represents the capitalist's profit from exploiting the working class, is the difference between the wages paid to the worker and the gains the capitalist makes from selling the goods produced by that labor. Therefore, Marx considers that the capitalist's profit is a result of the exploitation of the workers.

In order to maximize surplus value, Marx believed that the capitalist resorts to replacing labor with machines that reduce the value of labor power and render workers unemployed[2]. Marx believed that the introduction of machines and their improved performance will transform the conflict between the worker and the capitalist into another conflict between the worker and the machine itself, which the capitalist uses to force the worker to work for lower wages. Marx saw that the introduction of machines has led to the decline of the utility value of labor and its exchange value, reducing the price of labor power to less than its value and causing misery for the workers who compete with them.

Marx believed that surplus value is one of the main causes of financial crises that have swept through the capitalist system, which he saw as inevitable. The capitalists' insistence on paying low wages to workers prevents them from purchasing all the goods they need, leading to a contraction in demand. Meanwhile, the pursuit of profit maximization drives capitalists to increase production to the maximum extent possible, exceeding the demand's capacity to absorb it. This results in a surplus of goods and services and an imbalance between production and consumption, or supply and demand, leading to widespread recession, bankruptcy, unemployment, and inequality[3]. Marx did not deviate from the classical school in determining the value of goods based on the amount of labor expended in their production[4].

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[1] Abdelkader Adala, op.cit., pp. 29, 32.

[2] Mohamed Adel Zaki, op.cit., pp. 102-105.

[3] Mohamed Amin Walid Taleb, The Role of Monetary Policy in Addressing Financial Crises "The Case of the European Central Bank (ECB) and the Financial Crisis 2007-2008," PhD Thesis in Economic Sciences, Mohamed Khider University of Biskra, Algeria, 2015/2016, p. 70.

[4] Eamon Butler, op.cit., pp. 71-71.

4.2.2. Theory of economic freedom

Marx called for the abolition of private property and the restriction of absolute individual economic freedom to serve development and achieve the primary goal of production, which is to satisfy needs, instead of striving to maximize profits in capitalist systems that have led to the exploitation of workers and the outbreak of financial crises. Marx called for the establishment of collective ownership of the means of production and the adoption of central planning for the national economy to achieve the goals of the socialist society correctly. Through central planning, the state can achieve several objectives, the most important of which are the inventory of human and material resources and their fair redistribution to achieve the maximum possible societal satisfaction and progress in development[1].

4.2.3. Theory of accumulation of capital

Marx believed that the surplus value achieved can be used to finance total investment (replacement and additions)[2]. Marx considered that the profits capitalists earn from exploiting workers will be directed towards establishing investments (buildings and factories) to maximize their profits and compete with other producers. To maintain his existence and continuity, the capitalist will seek to reduce his production costs, which drives him to increase the use of machines and eliminate workers. The benefits of large-scale production can only be realized through the use of machines, which in turn require increased investments[3]. Thus, the gains from the increased productivity of the worker due to the introduction of machines go to the capitalist[4].

According to Marx, surplus value is transformed into capital, which Marx referred to as capital accumulation, remaining contingent upon the capitalist selling their goods and converting the financial returns from sales into capital. Indirectly, capital will create capital, and the labor used in creating surplus value will be transformed into capital[5].

4.2.4. Theory of concentration of capital

Marx believed that the large size of big enterprises will allow them to sell their products at a lower price, which excludes small enterprises and artisanal industries from competition, leading to a few enterprises monopolizing the market and hoarding

[1] Bouili Sakina, op.cit., pp. 388-389.

[2] Samir Amin, The Law of Global Value, translated by Saad Al-Tawil, 1st edition, National Center for Translation, Egypt, 2012, p. 25.

[3] Labib Shaqir, op.cit, pp. 135-136.

[4] Samir Amin, op.cit., p. 29.

[5] Karl Marx, Capital, Critique of Political Economy, Volume One, The Process of Capitalist Production, translated by Faleh Abdul-Jabbar, 1st edition, Dar Al-Farabi, Lebanon, 2013, p. 715.

the market gains resulting from price increases. Thus, the small capitalists who have been excluded become workers selling their labor to the large capitalists. In Marx's view, the capitalist system, in its development, tends towards the concentration of capital and the transformation of a significant proportion of small producers into workers who live by selling their labor power, which Marx referred to as the law of capital concentration[1].

4.2.5. The industrial reserve army

Marx and his followers believe that the introduction of machines and the increased concentration of capital will lead to the unemployment of workers, which Marx referred to as the Industrial Reserve Army. The expansion of this army will pose a continuous threat to active workers, forcing them to accept lower wages, thereby diminishing the likelihood of wage increases[2].

4.2.6. Theory of economic rent

Marx adopted Ricardo's theory on rent and developed a theory on land rent. Marx's theory on rent posits that the fertility of the land is not a natural attribute but is, in fact, the result of human labor, which he refers to as soil production. According to Marx, rent and profit are inversely related. The higher the rent, which is the value of renting and using the land, the lower the capitalist's profits. This will lead to another conflict where capitalists will fight against landowners to maximize profits by working to reduce the value of the land[3].

4.2.7. Theory of financial crises

Marx and followers of the socialist school believe that financial crises are inevitable under the capitalist system and are inherent in it due to the contradictions within it, which lead to its destruction and demise. Marx believed that capitalists have a tendency to exploit the working class by making them work longer hours for lower and decreasing wages, which leads to weak demand, an imbalance between production and consumption, and the emergence of crises. Marx adds that the pursuit of maximizing profits will drive capitalists, when given absolute freedom, to increase their investments in order to benefit from economies of scale and the concentration of capital among a small class of capitalists. This ultimately results in production exceeding consumption, which causes an economic imbalance between various economic functions, leading to the emergence of financial and economic crises and a rise in unemployment[4].

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[1] Labib Shaqir, op.cit, p. 136.
[2] Ibid, pp. 137-138.
[3] Samir Amin, op.cit., p. 73.
[4] Labib Shaqir, op.cit, pp. 129-133.

4.2.8. The fate of capitalism

Marx attempted to apply Hegel's dialectical materialism, known as dialectics, to predict the fate of capitalism, which he saw as destined for extinction. The accumulation and concentration of capital in the hands of a limited number of capitalists will lead to the division of society into two distinct classes and an increase in the gap between them: the numerous workers and the few capitalists. The capitalists' tendency to increase the use of machines leads to increased production, reduced need for labor, and decreased demand, resulting in the accumulation of unsold goods. This forces the capitalists to reduce the workforce and halt production, leading to crises and depressions accompanied by social chaos[1].

According to Marx's belief, economic crises in capitalist systems are crises of overproduction and are inevitable and unavoidable[2]. Thus, capitalism inadvertently generates the system that will replace it; within the factories, an organized proletariat class will emerge and revolt against the capitalists [3]. The core of Marxist criticism of capitalism is the view that the capitalist system is irrational, where the accumulation of capital and goods and the disappearance of the investment incentive are the fate of the competitive market that drives capitalists to increase investment, considering it the engine of capitalism. Over time, the capitalist system will enter a cycle of recession that will overthrow it and be replaced by socialism[4].

Marx believed that the increasing concentration of capital will lead to the spread of monopolies, the elimination of competition, and a rise in the unemployment rate among workers[5]. In light of the capitalists' tendency to exploit workers to maximize their profits and threaten them with relegation to the industrial reserve army, as well as the increased employment of children and women, the conflict between the two classes of the bourgeoisie (the monopolistic capitalists) and the proletariat (the workers) will intensify. This conflict will culminate in a workers' revolution against the capitalists, leading to the seizure of capital ownership from the capitalists and the establishment of socialism. The classes whose position is threatened will fight against the classes whose position is strong as the struggle between the classes for the division of social wealth continues, thus reorganizing the classes of society, which is inevitable. The class struggle occurs on an economic basis.

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[1] Labib Shaqir, op.cit, p.142.

[2] Nadia Lakoun, op.cit., p. 29.

[3] Robert Heilbroner, The Worldly Philosophers, translated by El-Braoui, Rashid, Al-Nahda Library, Egypt, 2011, pp. 164-165.

[4] Robert Gilpin, The Political Economy of International Relations, translated by the Gulf Research Center, Gulf Research Center, United Arab Emirates, 2004, p. 58.

[5] Omar Sakhri, Macroeconomic Analysis (Macroeconomics), 5th edition, University Publications Bureau, Algeria, 2005, p. 290.

Marx's socialist theories and ideas contributed to enriching economic thought, profoundly influencing the course of history and impacting the direction of modern economic policy. Currently, capitalist countries have begun to incorporate socialist ideas into shaping their economic policies to avoid the flaws of the capitalist system that Marx unveiled.

4.3. The Keynesian School

After a period of growth, prosperity, and industrial expansion in the industrialized countries, one of the most severe economic crises of the twentieth century emerged: the Great Depression of 1929. It originated in the United States and spread to capitalist Europe and the rest of the world, peaking in the United States in 1932 with an unprecedented and alarming unemployment rate of around 25%. The global economy began to slow down until it came to a halt. The crisis caused the disappearance of immense wealth, along with the evaporation of the economic gains achieved during the period of prosperity. Social unrest spread, with the most notable being demonstrations and marches by the unemployed demanding jobs and assistance. This compelled capitalist governments to defy the teachings of the capitalist school and dismantle some of the most important foundations of capitalism, such as neutrality. They intervened to save the struggling economies that had not yet recovered from the aftermath of World War I and to calm the turbulent social front[1].

Amidst those disturbances and crises, the Keynesian school emerged, known as the modern school of economics in the first quarter of the twentieth century. Its ideas influenced the course of history and guided the economic policies of countries around the world, and it continues to exert influence on decision-makers in various nations. The school was founded on the ideas of the English philosopher John Maynard Keynes, which were new ideas that formed a new economic school advocating for the reform of the capitalist system (sustainable capitalism) by abandoning absolute economic freedom and the necessity of state intervention to compensate for the shortcomings of the private sector and restore balance to the markets by eliminating demand deficiencies.

4.3.1. Theory of employment and economic equilibrium

The Keynesian theory is based on a set of principles, which are

- The focus on effective demand as a determinant of income and production for employment.

[1] Eric Rauchway, The Great Depression abilnd the New Deal, translated by Diaa Warad, 1st edition, Hindawi Foundation for Education and Culture, Egypt, 2015, p. 9.

- Economic instability, as it tends to expand and contract and even worsen due to the inherent volatility of planned investment, where changes in investment lead to greater fluctuations in national income and production.
- The inflexibility of prices and wages.
- Active monetary and fiscal policies are called for to intervene, stimulate full employment, maintain price stability, and achieve economic growth[1].

To address the phenomenon of unemployment, Keynes proposed his theory of employment, which states that actual aggregate demand is the main determining factor for the number of employed workers and the quantity of goods produced. As actual aggregate demand increases, producers' desire to increase production rises, leading to an increase in the demand for labor. Consequently, both production and employment rise together, and vice versa. Accordingly, the phenomenon of unemployment, according to Keynes, is linked to a decrease in the level of aggregate demand, and he used effective demand to express aggregate demand[2]. Keynes opposed the classical assumptions of the necessity of equilibrium at full employment, believing that equilibrium might find its way to application at a level of unemployment he termed "underemployment equilibrium." To achieve the equilibrium level and compensate for the shortcomings of market forces, Keynes advocated for government intervention to support demand through the use of sound fiscal measures during times of recession and recovery to avoid the repercussions of demand surplus or deficit[3].

Keynes divided effective demand into demand for consumer goods (demand by individual consumers) and demand for investment goods (demand by investors or organizers), in addition to the factors that determine the interest rate[4]. The demand for consumer goods depends on two factors, which are

a. Objective factors, which include:

- Current income: As current income increases, the proportion spent on goods and services also increases, with the rate of increase in spending diminishing as income rises, and vice versa. The increase in consumption resulting from an increase in income is known as the marginal propensity to consume. Keynes believed that this propensity is low among high-income earners and increases among low-income earners. In other words, the decrease in the marginal propensity to consume indicates an increase in the marginal propensity to save,

[1] Warda Chiban, The Causal Relationship Between the Money Supply and GDP in Algeria: An Econometric Study (1990-2011), PhD Thesis in Economic Sciences, Batna1 University, Algeria, 2015/2016, pp. 60-61.

[2] Khaled Saad Zaghloul Helmy, op.cit., pp. 44-45.

[3] Nizar Kazem Al-Khaikani & Haidar Younes Al-Moussawi, op.cit., p. 54.

[4] Mahmoud Hussein Al-Wadi & Hussein Mohammed Samhan & Suhail Ahmed Samhan, op.cit., p. 52.

which reduces the demand for producers' products and consequently diminishes the incentive to increase employment. Keynes called his theory of consumption the "absolute income theory," which posits that consumption is a function of current income[1].

- Changes in the time discount rate, which is the rate of exchange between present money and future money, primarily affected by the expected change in the value of money and changes in fiscal policy, such as tax increases (income taxes and profit taxes) or decreases[2].
- Expectations regarding future income.

b. Subjective or psychological factors that drive individuals to refrain from spending, which include several factors: building a reserve to face unexpected emergencies, preparing for any changes that may occur in the future, the desire to benefit from interest rates and preferring higher future consumption over lower current consumption, enjoying the gradual increase in spending and obtaining gradually increasing income, leaving wealth for children, stinginess, and others[3]. Thus, Keynes summarized the factors influencing consumption into income size, objective factors, and subjective factors.

As for the demand for investment goods, Keynes considers that the regulators are the demanders of investment goods. Therefore, the demand from the regulator for an additional unit of investment goods remains contingent on the propensity to invest, which is affected by the interest rate and what Keynes referred to as the marginal efficiency of capital (MEC), represented by the ratio between the expected profit from the machine during its lifespan after deducting costs, excluding interest, and the price of the machine itself. Keynes posits that this ratio ought to surpass the interest rate required to acquire the machine[4].

Regarding the factors that determine the interest rate, Keynes believed that the interest rate is determined by the supply of money (the quantity of money) set by monetary authorities and the demand for it (liquidity preference). As the supply of money increases, with demand remaining constant, the interest rate decreases, and vice versa. Similarly, as demand for money increases due to a greater preference for liquidity, the interest rate rises, and vice versa. Thus, the demand for investment goods depends on the balance between the interest rate and the marginal efficiency of capital[5]. Regulators increase investment spending when interest rates decline, leading to an

[1] Sami Khalil, Macroeconomic Theory, Vol 2, Al-Ahram Press, Egypt, 1994, pp. 1048-1049.
[2] Nabil Mahdi Al-Junaibi, Rational Expectations: The Modern Approach to Macroeconomic Theory, 1st edition, Ghaida Publishing and Distribution House, Jordan, 2017, p. 26.
[3] John Maynard Keynes, op.cit., pp. 146, 157, 158.
[4] Labib Shaqir, op.cit, pp. 154-155.
[5] Khaled Saad Zaghloul Helmy, op.cit., p. 54.

increase in production volume and employment levels. The decision to increase the money supply leads to higher investor expectations of a decrease in interest rates, resulting in increased investment. Through the investment multiplier effect, income will rise, and production and employment will increase[1].

In addition to consumer demand and investment demand, Keynes added government demand and net external demand. Government demand reflects the role that the government can play as the most important actor that compensates for the chaos characteristic of private capitalism through its intervention to better allocate available economic resources in society and distribute national output, which leads to satisfying human needs that the private sector cannot fulfill, such as defense, security, justice, education, and health; increasing employment and wages; stabilizing them; and influencing the consumption pattern in society to enhance societal welfare[2]. The government affects aggregate demand through fiscal policy, which is embodied in the state budget, consisting of two parts: the first part represents public expenditure, which is formed from government purchases of goods and services, along with wages and salaries, and transfer payments made by the government without receiving goods and services in return, such as social subsidies and the payment of public debt interest. As for the second part, it is represented by public revenues, which are primarily funded by tax and fee collections, the proceeds from the sale and rental of state-owned properties, borrowing, and other sources.

As for net external demand, it refers to the demand from the external world (non-residents) for national goods and services, and it equals the difference between exports and imports. The inclusion of external demand in the analysis of aggregate demand reflects the importance of international economic conditions and their impact on aggregate demand, and consequently on economic activity[3]. The addition of external balance to the general equilibrium model is an important contribution to Keynesian economic thought, as it highlighted the importance of a stable balance of payments. It has become one of the conditions for long-term economic stability to be achieved, in addition to price stability, full resource employment, and economic growth, namely, a stable balance of payments, which means achieving a surplus that ensures external balance[4].

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[1] Nabil Mahdi Al-Junaibi, op.cit., pp. 28-29.

[2] El-Morsi El-Sayed Higazi, The Economics of Public Projects: Theory and Application: Feasibility Studies, Pricing of Products, and Privatization, Al-Dar Al-Jamiya, Egypt, 2004, pp. 63-65. 63-65.

[3] Mahmoud Younes & Ahmed Mohamed Mandour & Mohamed Ahmed Al-Sariti, Principles of Macroeconomics, Alexandria University, Egypt, 2000, pp. 124-130.

[4] Massoud Miehoub & Youssef Berkan, Determinants of Macroeconomic Stability in Algeria in Light of Economic Reforms and Economic Recovery Programs for the Period (1990-2014), Journal of the Faculty of Economic Sciences, Management, and Commercial Sciences, University of M'sila, Algeria, Volume 10, N° 16, 2016, p. 15.

Based on the above, the level of employment according to Keynes depends on the actual aggregate demand for goods and services. The higher this demand exceeds the quantity of production (supply), the higher the profits for producers, leading to increased employment. Conversely, if demand is below the quantity of goods and services produced, this means there are unsold products, prompting producers to reduce their output to clear the inventory, lay off more workers, and push them into unemployment.

To achieve equilibrium and increase the level of employment, it is necessary to transform savings into investment, which creates demand for investment goods. If investment exceeds savings, this will encourage producers to increase production and employment. Conversely, if investment falls short of savings, production and employment will tend to decline due to the presence of unsold goods. Therefore, Keynes believed that hoarding or saving causes the imbalance [1], and he argued that for recovery to continue, investment must remain at a high level, which cannot be sustained for an extended period. Given that economic prosperity and recovery depend on investment, Keynes believed that maintaining economic balance requires state intervention and investment during periods when the private sector is unable to sustain high levels of investment. Therefore, Keynes advocated for increasing investment incentives in all possible ways, especially during times of recession[2]. With government intervention, either by injecting into the income cycle through government spending or withdrawing from income through taxes, balance will be restored by equalizing the withdrawals from the income cycle with the additions to it. And when exports are added as additions to aggregate demand and imports are considered as leakages from aggregate demand, equilibrium will be achieved according to the following equation:

Aggregate demand = consumption demand + investment demand + government demand + (exports - imports)

If we assume that aggregate demand equals total output, the equilibrium condition in this case will include that:

Investment demand + government demand + exports = savings + taxes + imports

Keynes opposed the classical assumptions that the economy tends to achieve automatic equilibrium at full employment, believing that equilibrium can be achieved at a level lower than full employment[3].

[1] Labib Shaqir, op.cit, pp. 155-159.

[2] Robert Heilbroner, op.cit., pp. 312-316.

[3] Majid Ali Hussein & Afaf Abdul Jabbar Said, Introduction to Macroeconomic Analysis, 1st edition, Dar Wael Publishing, Jordan, 2004, p. 210.

Keynes attacked the classical assumption that price flexibility would restore market equilibrium. He believed that prices tend to be inflexible during periods of depression or recession due to workers' resistance to wage cuts in order to preserve their purchasing power. Additionally, wage flexibility might not solve the problem either, as wage reductions during recessions would exacerbate the issue due to the decline in purchasing power, which leads to a decrease in aggregate demand and reduces the incentive for producers to increase production and employment[1].

4.3.2. Theory of Long-Term Stagnation

The followers of the Keynesian school presented the Theory of Secular Stagnation, which attempted to explain the stagnation in developing capitalist countries. The theory states that after a period of prosperity marked by population growth and increased demand for investment to industrialize the virgin areas of those countries and establish projects to produce goods that meet the needs of the growing population, a stage comes where the population growth rate declines after the industrialization of many areas in those countries. The demand for investment decreases to a level that cannot absorb the savings from full employment. The convergence of these conditions will cause capitalist economies to suffer from long-term stagnation and make them unable to achieve full employment, resulting in a persistent rate of unemployment even during the most prosperous periods[2].

The theory of secular stagnation differs from the Keynesian view of the business cycle in other capitalist economies. In those economies, economic prosperity will feed itself, as higher incomes will drive up consumption, prompting optimistic investors to increase their investments to keep up with this higher consumption, thereby raising aggregate demand (the multiplier effect). After a wave of expansion and prosperity, a period of recession follows, during which incomes decline and aggregate demand decreases, and market forces alone are unable to restore growth. To solve this problem and stimulate the economy to regain its activity, Keynes saw the possibility of government intervention (fiscal policy) by increasing its spending to boost aggregate demand and reducing taxes to increase disposable income, where the government can play a crucial role in achieving full employment[3].

4.3.3. Theory of Money

Keynes added another function to money, which is a store of value. He introduced a revolution in the appreciation of the role and function of money and demonstrated the significant impact of money on economic activity and, consequently, economic phenomena, thus presenting the liquidity preference theory. Keynes focused his

[1] James Gwartney & Richard Stroup, op.cit., p. 235.
[2] Labib Shaqir, op.cit, pp. 159-161.
[3] James Gwartney & Richard Stroup, op.cit., p. 292.

analysis on the demand for money, ignoring the supply of money, which he considered an independent variable beyond the influence of individuals (in the hands of monetary authorities). Money can be demanded for itself due to individuals' preference to hold money in liquid form to settle current transactions, speculation, future reserves, hoarding, and other purposes and goals[1].

The motive for transactions is the retention of money for the purpose of settling transactions or completing deals during the period between receiving two consecutive incomes. Its existence stems from the desire of individuals and institutions to retain a certain amount of money in liquid form to meet their current expenses due to the gap that occurs between receiving income and spending it for individuals, or between paying expenses and receiving sales revenue for institutions. As for the precautionary motive, it is due to the uncertainty of future conditions that individuals and institutions usually face, such as exposure to unemployment, illness, recession, or crises.

The speculative motive is considered the most complex and significant reason for the demand for money to be held as liquidity. Individuals and institutions may hold cash liquidity to buy and sell securities to benefit from price differences and achieve capital gains in a short period. Additionally, institutions may hold cash as barren assets that yield no return instead of investing it to avoid capital losses in case it is used to purchase assets whose prices may decline [2]. Keynes describes the demand for money for speculative purposes as highly volatile compared to the demand for transactions and precaution, which makes the speculative demand capable of causing daily and rapid fluctuations in the overall demand for money[3].

Keynes combined the three preferences for liquidity into an equation he called the liquidity preference equation, which takes into account real values and which he formulated as follows:

$$\frac{M^d}{P} = f(i, Y)$$

The above equation states that the real demand for money (M^d/P) is inversely related to the interest rate (i) while being positively related to real income (Y). Accordingly, Keynes differed from his predecessors of the marginalist and classical schools in that the demand for money is not constant but changes according to fluctuations in the interest rate. In other words, a rise in interest rates encourages

[1] Khaled Saad Zaghloul Helmy, op.cit., p .47.

[2] Diyaa Majid Al-Moussawi, Economic Theory: Macroeconomic Analysis, 3rd Edition, University Publications Bureau, Algeria, 2005, pp. 236, 250, 251.

[3] Ahmed Hani, Currency and Money, University Publications Bureau, Algeria, 2006, p. 129.

individuals to reduce their cash holdings and discourages the preference for liquidity regardless of the prevailing income level[1].

The liquidity trap is an important addition to Keynesian theory, as it attempted to draw the attention of monetary authorities to the ineffectiveness of monetary policy in overcoming recession in cases of lowering interest rates and increasing the money supply. A reduction in the interest rate to a certain level (2%) may drive economic agents to hoard their savings instead of investing them in bonds, as an increase in the money supply may lead to hoarding in the form of liquidity. To solve the liquidity trap problem, Keynes proposed adopting active monetary policies (tax cuts and increased government spending) instead of monetary policies[2].

4.3.4. Theory of inflation

Keynes believed that inflation is caused by an increase in demand to levels that exceed the available supply of goods and services due to increased investment or increased government spending, which leads to an increase in the available cash income. To address inflation, Keynes proposed that governments reduce public spending without specifying which sectors should be prioritized for cuts[3].

4.3.5. Theory of financial crises

Keynes presented his theory to explain crises based on the marginal efficiency of capital, which plays an important role in determining what investments are made. The demand for investment goods is characterized by its severe and frequent fluctuations, which cause an imbalance between investment and production on one hand and savings and consumer demand on the other, leading to economic crises. Keynes added that the imbalance between saving and investment is that an increase in income may not fully and automatically translate into consumer demand (effective demand) but can leak out in the form of uninvested savings (liquidity preference). Additionally, an increase in output, employment, and income will reduce consumption (marginal propensity to consume) and increase savings, creating a gap between savings that turn into investment and then production and consumption, where these previous imbalances lead to an economic crisis[4].

4.3.6. The fate of capitalism and interventionist policy

[1] Frederic S.Mishkin, The Economics of Money, Banking, and Financial Markets, 5th edition, Addison Wesley Longman, USA, 1998, pp. 537-538.
[2] Abdel Halim Ammar Gharbi, A Brief Guide to Monetary and Banking Economics, KIE Publications, 2018, p. 42.
[3] Bouili Sakina, op.cit., pp. 426-427.
[4] John Kenneth Galbraith, op.cit., pp. 249-252.

Keynes believed that eliminating unemployment was the only way to save capitalism. To eliminate unemployment, Keynes attacked the policy of absolute economic freedom and advocated for state intervention, as he believed that the unemployment he saw as permanent and rising could not be absorbed by market forces alone. Keynes believed that increasing employment could only be achieved by increasing actual aggregate demand. To increase consumption demand, Keynes advised redistributing income among individuals and reducing the disparity in wealth and income distribution. It is observed that the propensity to consume among high-income earners is usually weak, while their propensity to save is high compared to low-income earners, whose income, if not all, goes to consumption. Thus, distributing income to low-income earners would drive up consumption demand and reduce savings. To improve the chances of achieving equality in income distribution, Keynes saw the necessity of state intervention through the imposition of progressive taxes and the distribution of their proceeds to the poor classes by providing cash social subsidies or free services or at symbolic amounts, as offering these services would increase government consumer spending.

To increase demand for investment, Keynes advised interventionist measures to boost it, which are

- The state undertaking investment projects to employ unemployed workers.
- Reducing the interest rate, which has been dubbed the Cheap Money Policy, to encourage organizers to borrow to implement their investment projects.
- Eliminating monopolies on new inventions so that every organizer can implement a new invention as soon as it appears and establish investments with those new inventions
- Eliminating all forms of monopolies to avoid price increases that reduce demand for consumer goods and, consequently, a decrease in demand for investment goods[1].

4.4. The Chicago School of Economics

Milton Friedman led the Chicago School, where he attacked Keynesian ideas based on two points:

- That the economy is more stable than Keynesians believed, as the private economy is fundamentally stable due to the flexibility of prices and wages, which makes recessions tend to be short and mild. Moreover, active policies do more

[1] Labib Shaqir, op.cit, pp. 163.165.

harm than beneficial, and the best policies are those that leave the economy alone[1].

- Money holds great importance; it is considered one of the most significant economic variables. Money has a substantial impact on the inflation rate in the long term, allowing monetary authorities to maneuver due to their control over the money supply. Monetarists believe that the money supply is the main determinant of output and employment in the short term and the price level in the long term[2]. An increase in the money supply leads to a rise in aggregate demand, which increases output in the short term due to the concept of adaptive expectations, meaning expectations based on past events. As a result of the increase in output, it is expected that workers will adjust their wages to this increase, leading to a rise in production costs and a decline in output to the initial equilibrium level, but after a rise in prices[3].

Friedman and his followers believed that monetary policy is highly effective in the short term, while fiscal policy that is not accompanied by changes in the money supply is ineffective and has limited impact [4]. It is worth noting that monetary policy has been defined as a set of measures and actions taken by monetary authorities to manage the quantity of money and credit and regulate economic activity by influencing the money supply. It is considered one of the most important tools of economic policy adopted by countries, with the responsibility of managing it falling on central banks[5] to achieve monetary stability, which is crucial for maintaining the purchasing power of the currency both domestically and internationally[6].

Monetarists believe that an increase in the money supply will lead, in the short term, to a greater increase in production and employment than in the level of prices[7]. Monetarists believe that economic cycles and financial crises arise from adopting inappropriate monetary policies. The random increase in the money supply generates economic booms, higher interest rates, and inflation, which harm investment, encourage speculation, and lead to a decline in consumption and production over time.

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[1] Sami Khalil, Macroeconomic Theory, op.cit., p. 751.

[2] Michael Abdegeman, Macroeconomics: Theory and Policy, translated by Mohamed Ibrahim Mansour, Dar Al-Mareekh Publishing, Saudi Arabia, 2012, pp. 327, 331.

[3] Sami Khalil, Macroeconomic Theory, op.cit., pp. 751, 1084.

[4] Michael Abdegeman, op.cit., p. 333.

[5] Meherhera Madjida & Bouchama Mustapha, The Effectiveness of the Monetary Policy in Achieving Monetary Stability in Algeria for the Period of (200-2019), Al Bashaer Economic Journal, Université de Bechar, Algeria, Vol VII, N° 1, April 2021, pp. 854-855

[6] Adel Mokhtari & Mohamed Ben Elbar, The Economic Effects of Monetary Policy on Monetary Stability in Algeria - An Econometric Study for the Period 1990-2019, Journal of Economic Integration, University of Adrar, Algeria, Volume 9, N° 2, June 2021, pp. 5-6.

[7] Nabil Mahdi Al-Junaibi, op.cit., p. 33.

When confronting inflation by reducing the money supply, the economy will enter a recession. If monetary authorities reduce the money supply, the recession can continue until it reaches a depression. Therefore, the causes of economic crises, according to monetarists, are attributed to monetary factors related to money, interest rates, and state intervention through the adoption of inappropriate monetary policies[1]. These significant benefits of monetary stability have driven many countries to assign the responsibility of monetary stability and price stability to their central banks, which have enjoyed considerable independence from the influences of politics and government orientations that are usually volatile due to political, economic, and social factors[2].

The modern monetary theory is considered a crucial addition by Friedman, which focused on analyzing the demand for money, rather than production, monetary income, or price levels, to emphasize the importance of monetary policy in maintaining stability and mitigating the severity of crises. Friedman presented the modern monetary theory in a more comprehensive manner than classical and Keynesian analysis, introducing the concept of wealth as a fundamental determinant of the demand for money, which represents the capital value of all sources of income[3].

The following table summarizes the factors affecting the demand for money:

Table 1: Factors affecting the demand for money

Factors that increase the demand for money	**Factors that decrease the demand for money**
- Rise in price levels	- Decrease in the price level
- Real income growth	- Decrease in real income
- Decrease in interest rates	- Increase in interest rates
- Expectation of price decline	- Expectation of rising prices
- Increase in the ratio of physical capital to total wealth	- The decrease in the ratio of physical capital to total wealth
- Regulatory factors that reduce individuals' ability to achieve a balance between their income and expenses	- Regulatory factors that enhance people's ability to achieve a balance between income and expenditure
- The expected return from alternatives to cash is low.	- The high expected return from alternatives to cash

[1] Nadia Lakoun, op.cit., pp. 32-33.
[2] Meherhera Madjida & Bouchama Mustapha, op.cit., p. 854.
[3] Warda Chiban, op.cit., p. 73.

- Tastes and preferences of wealth holders - Development of banking services (development of the banking system)	- Tastes and preferences of wealth holders - The backwardness of banking services (the backwardness of the banking system)

Source: Author's preparation

Monetarists believe that adopting an expansionary monetary policy based on increasing the money supply will encourage individuals to increase their spending, thereby increasing the demand for money. This, in turn, will drive producers to increase their output and achieve full employment, making monetary policy effective[1].

[1] Frederic S.Mishkin, op.cit., pp. 545-546.

Summary

A careful examination of the evolution of economic thought reveals that economics is the culmination of the efforts and ideas of philosophers from diverse locations and periods who contributed to the field's founding and development. Furthermore, becoming acquainted with these concepts allows one to better comprehend and appreciate a wide range of economic phenomena. These ideas are critical in presenting decision-makers with a wide range of options and solutions for addressing economic issues and anticipating future changes.