

Chapter two:

Evolution of economic thought

Many economic thoughts emerged before any theory was formulated based on. Many economic terms, such as price, markets, profit, wages and interest, were very common in most human societies. In this context, it may be pointed out that the origin of the word "economy" is the word "Oikonomos", which is an old Greek word for housekeeping, i.e., provide adequate provision of food, drinking, clothing, distribution of tasks to members of the house according to their abilities and distribution of what they produce as needed. The meaning was subsequently extended to the State-city.

1. Economic thoughts in ancient times: Most economic thoughts came from ancient people in the context of religious teachings, legislative and moral orders and philosophical opinions. In the context of the organization of economic relations and State-building, the Greeks divided society into classes, Plato viewed with contempt the class of craftsmen, farmers and traders as well as slaves as acts that prompted its practitioners to strive for earning and distance them from participating in manifestations of public civil life, meanwhile he gave such importance to the warrior, politician and philosopher.

Plato called for collective ownership to be the general rule and considered the need for diversity of jobs (occupations) because of their role in improving the quality of things and achieving abundance, and Adam Smith later took this and called for specialty. Aristotle was more accurate, agreeing with Plato's contempt for economic activities, cash and interest lending, and that the money function should be limited to exchange rather than earning, accumulating profits and hoarding. However, he disagreed with Plato that collective ownership was impractical and contrary to individual tendencies.

The most important contributions of the Greek civilization came with Xenophone (Historian and Warrior) who authored the book housekeeping, which included some manifestations of capitalism in which he praised agriculture on the basis that it was economic wealth and favored trade and navigation and called for the extraction of gold and silver to increase public wealth and the development of

trade and the formation of joint venture companies. Contrary to the Greek, The Romans left little economic thoughts.

2. Economic thought in the Middle Ages (5th-15th century) : Following the devolution of the Roman Empire, Europe entered the stage of the feudal system (feudalism or landlordism). The new system tried to reconcile the the new economic order (the feudal system) with the existing social composition, where agriculture was the activity underpinning all manifestations of life. Due to the limitations of each feudal region relationship with the outside world, the importance of markets has declined, enabling the church to replace the supply and demand law, so it set prices and wages and reduced the use of money. The class of craftsmen and traders tended to conglomerate and formed trade unions that set levels of skill, price and remuneration for its affiliates.

The Church dominated Europe and worked hard to enforce its teachings, calling on Equinas (a church man and the preeminent thinkers of the age) to apply fair pay and price and denouncing the interest that was subsequently allowed to be dealt with on the basis that it was an opportunity lost to the lender or risk as a result of the debtor's possible inability to pay on time.

3. Economic thought in the Renaissance

3.1. Mercantilist current (mercantilism): Security prevailed in Europe during the feudal phase as a result of the need for agriculture, benefited the traders whose trade has expanded further away with the discovery of new low-cost maritime routes. The wealth flowed to them and they used it to support the emergence of modern nations and to support their armies at the expense of the feudalists who lost their influence and many of them went bankrupt. road traffic fees were eliminated, encouraged traders to remove monopolies, and supported emerging industries, and defended the need for States' intervention.

Thus, an economic system (the mineral system) was established that commensurate with the existing social composition, called on the intellectuals of that stage of the likes of **Niccolò di Bernardo dei Machiavelli** in Florence, **Budanvi** France, **Spira** in Italy and **Thomas** in Britain on trade, and contributed their views to supporting its growth and new capitalism. The aim of States' national policy at that point was to obtain gold and silver in various ways and to prevent their exit as a reservoir of wealth and an easy and quick way to increase the strength of emerging nations.

One of the most important contributions of the thinkers of the mercantilism is the provision of preliminary picture of what we call today the balance of payments and explain how to get a positive balance that allows to increase the amount of gold and silver. While Spain has taken the easy path of obtaining them by extracting them from the mines of its colonies mainly in Latin America, Britain and Italy intensified exports of industrial products to colonies and other markets and imposed the use of national wages and vessels in addition to reducing duties on exports.

The pursuit of gold and silver left victims, in addition to the inflation that swept into Europe as a result of the high amount of minerals, wages decreased significantly as exporters sought to reduce costs and increase sales in addition to the employment of women and children and exploitation of the colonial population and farmers' conditions have worsened as a result of the imposition of low prices and the prohibition of export of their products to reduce prices and the seizure of land by major owners to allocate them for the production of export crops.

3.2. Physiocrats: contrary to the mercantilists' views that did not rise to an economic school where their advocates were a group of politicians and traders who advocated policies for special interests, physiocrats is considered the first modern economic school established in France by Quesnay, followed by other economists who made natural law the basis of their thinking and initiated a policy of freedom to work, which is still in operation (the theory of absolute freedom).

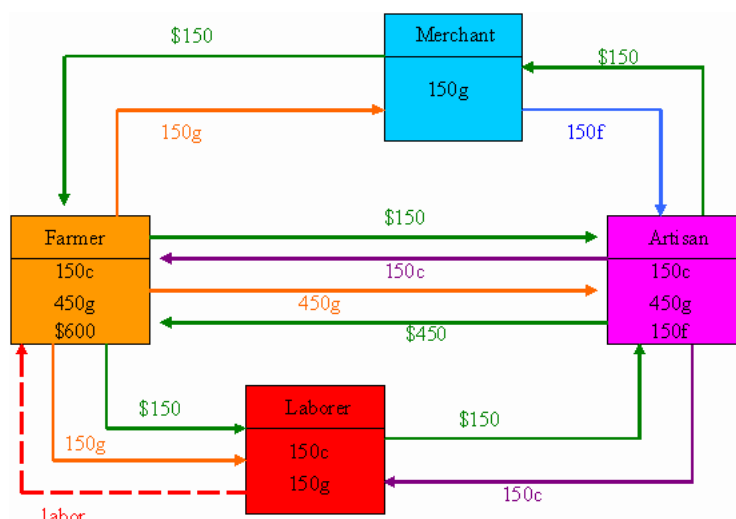
The physiocrats thought there was a "natural order" that allowed human beings to live together. Men had to discover the laws of the natural order that would allow individuals to live in society without losing significant freedoms.

The school launched its attack on trade policies and regarded agriculture as the only productive activity as what it is produced more than spent. Industry and trade were considered futile activities dependent on agriculture. Thus, farmers and landowners were glorified and made the productive class of economic surplus.

Physiocrats believed that any deviation from the natural system will cause turbulence and pain, and therefore must be eliminated, including encouraging industry and trade at the expense of agriculture that cause the withdrawal of labor from the agricultural sector and absorbing excess production resulting in widespread poverty and famine or starvation. Quesnay called for industrial

commodity prices to be as much as they consume the work in production, an idea that later Classic theory inferred. Quesnay's economic schedule is one of the most important contributions of the school, showing the income cycle in the country, i.e. national income.

Figure 1: The economic schedule



4. Modern economic schools

4.1. Classical political school: that school was founded by Adam Smith, and it had a broader effect and longer than any previous school. The industrial revolution that emerged in Britain required a new doctrine that establishes a new economic order that defends emerging industrialists and lifts restrictions on their work, which Classics did.

Contrary to previous opinions, Adam Smith and Classics have seen that the only source of wealth is output resulting from work and using resources, and that the way to increase production is division of labor, and the value of things depends on the value of the work devoted to their production. To achieve prosperity and increase wages, Smith saw the only way to do so is to exceed the ability to produce the increase in the population. Smith and Classic also called for the need to compete as a condition of the natural freedom system or the hidden hand he believed in, and called for the fight against monopoly and saw rent as a monopolistic price.

In addition to Smith, some thinkers contributed to enriching the classical school, most notably Malthus, the innovator of the Iron Law of Wages Theory, in which

he advocated fixing wages at the subsistence level to avoid increasing the population from the level of increasing available resources.

Malthus also contributed to an idea that enriched the economic theory of a law of diminishing returns. In France, Say developed a law whose conclusion was that supply created the same demand.

In addition to Smith and Malthus, David Ricardo is considered the most famous classical school flagship and the author of many of its theories. He provided an in-depth explanation of the rent in which he agreed to be a monopolistic price. He also defended the Iron Law of Wages and he called for the determination of the natural price of any commodity at the point the work required for the construction of buildings and machinery, and spoke frequently of the role of money and the effects of the change in its quantity.

The neutrality of the state (government) is one of the most important points agreed between Classics. The functions of the state are limited to the administration of justice, defense, internal security and diplomatic relations. These are important pillars that help to provide an environment conducive to economic activity and its expansion.

4.2. State Social school: The turmoil that engulfed Europe, culminating in the French Revolution, as well as the financial and social crises and the sharp deterioration in the working conditions that prevailed in capitalist countries, led to the launching of a set of ideas against the realities imposed by capitalism and called for the establishment of socialist societies in which collective ownership and the most prominent of those who led this counter-think were Saint-Simon and Fourier of France and Robert Owen of England and others.

Marx benefited from those ideas in the drafting of his book *The Capital* Which carried his Economic Theory that founded a new school known as socialism. Marx attributed the economic value of the goods to the amount of work done in their production, but he has stipulated that the work is necessary from a social point of view, meaning that what is produced must be of benefit to individuals and therefore the higher price paid goes to the pocket of a capitalist who pays a minimum living wage even if the worker's productivity doubles. Capitalists always tended to produce more goods than the market could absorb, leading to repeated crises, then layoffs and widespread poverty. He also saw that money was only a mediator.

His attack on capitalism was based on Hegel's philosophy of interpreting social development based on a dynamic process of class conflict within the capitalist system between employers and exploitative workers, which ended with the demise of capitalism and was replaced by socialism as the best and most just system.

4.3. Keynesian school: Amidst those disturbances and crises that appeared the 1920s, 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 (the 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.

The Keynesian school of economics addresses many issues. 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. 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.

Regarding 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 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. 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. 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.

Concerning inflation, Keynes believes 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.

In his efforts to explain crises, Keynes presented his theory 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 causes 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, as 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.

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.