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Lecture handout for the course of :

The history of economic thought

Prepared by: Dr. Marouf Djillali
Associate Professor, Class A

Nour El-Bachir University Center - El-Bayadh

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-History of Economic Thought Through the Words of the Greatest Economic Thinkers-

Adam Smith

“The real tragedy of the poor is the poverty of their aspirations.”

David Ricardo

“Under a system of perfectly free commerce, each country naturally devotes its capital and labor to such employments as are most beneficial.”

Thomas Robert Malthus

“Population, when unchecked, increases in a geometrical ratio.”

Karl Marx

“The history of all hitherto existing society is the history of class struggles.”

Alfred Marshall

“Economics is a study of mankind in the ordinary business of life.”

John Maynard Keynes

“The difficulty lies not so much in developing new ideas as in escaping from old ones.”

Milton Friedman

“Inflation is always and everywhere a monetary phenomenon.”

Friedrich Hayek

“The more the state ‘plans’ the more difficult planning becomes for the individual.”

Joseph Schumpeter

“Innovation is the specific instrument of entrepreneurship.”

Joseph Stiglitz

“Information is power.”

Introduction

General Introduction:

The history of economic thought constitutes one of the fundamental branches of economic studies, as it examines the evolution of ideas and theories that have attempted to explain economic phenomena throughout different historical periods. It is concerned not only with presenting economic doctrines in a chronological manner, but also with analyzing the intellectual, political, social, and cultural environments in which these theories emerged and developed. In this sense, the study of the history of economic thought provides a deeper understanding of the origins of modern economic science and the transformations that have shaped its concepts, methods, and objectives over time.

Economic thought did not emerge as an independent science from the outset. In ancient societies, economic ideas were closely connected to religion, philosophy, ethics, and political authority. Early civilizations such as those of Mesopotamia, Egypt, India, China, Greece, and Rome developed practical economic principles related to agriculture, trade, taxation, property, and labor organization. These early contributions reflected humanity's attempts to manage scarce resources and organize social and economic life in increasingly complex societies.

With the rise of Islamic civilization during the Middle Ages, economic thought acquired a broader moral and social dimension. Islamic teachings emphasized justice, moderation, lawful trade, social solidarity, and the protection of both individual rights and collective welfare. Muslim scholars made important contributions to economic analysis, particularly in areas such as taxation, public finance, market regulation, labor, and trade. Among the most prominent thinkers was Ibn Khaldun, whose analytical approach to labor, production, population, and economic development anticipated many ideas later explored in modern economics and sociology.

The transition to the modern period witnessed profound economic and social transformations associated with the expansion of commerce, the rise of nation-states, colonial expansion, and the Industrial Revolution. These developments contributed to the emergence of mercantilist ideas, followed by the classical school represented by thinkers such as Adam Smith, David Ricardo, and Thomas Robert Malthus. Classical economists sought to establish

economics as a scientific discipline governed by natural laws related to production, exchange, labor, and markets.

The nineteenth and twentieth centuries witnessed the emergence of diverse schools of thought in response to the transformations and crises generated by industrial capitalism. Socialist and Marxist thinkers criticized the inequalities and exploitation associated with capitalism, while the historical school emphasized the importance of historical and institutional contexts in economic analysis. Later, neoclassical economists introduced marginal analysis and mathematical methods, focusing on individual choice, utility, and market equilibrium. In the twentieth century, Keynesian economics revolutionized macroeconomic analysis by emphasizing the role of aggregate demand and government intervention, while monetarist and neoliberal schools revived confidence in market mechanisms and monetary stability.

The study of the history of economic thought is therefore essential for understanding how economic theories evolve in response to historical realities and societal challenges. It enables students and researchers to appreciate the diversity of economic perspectives and to recognize that economic theories are not static truths, but intellectual constructions shaped by changing historical conditions and human experiences. Furthermore, this field encourages critical thinking by exposing learners to competing approaches concerning the functioning of economies, the role of institutions, and the relationship between economic efficiency and social justice.

This pedagogical material aims to introduce students to the major stages in the development of economic thought, from ancient civilizations to contemporary theories. It seeks to provide a comprehensive and analytical understanding of the principal schools, concepts, and thinkers that have influenced the evolution of economic science. Through this exploration, students will be able to better understand the foundations of modern economic analysis and the continuing relevance of historical debates in addressing current economic issues and global challenges.

This pedagogical course material is organized into twelve chapters, arranged in accordance with the chronological emergence of the various schools of economic thought, as follows:

Chapter one: *The Origins of Economic Thinking in Ancient Eastern Societies*

Chapter two: *Economic Thought During the Islamic Civilization*

Chapter three: *Liberal Economic Thought and the Evolution of Capitalism*

Chapter four: *Socialist Economic Thought in France and the Emergence of Marxism*

Chapter five: *The German Historical School of Economic Thought*

Chapter six: *Mercantilism, An Origin Of Classical Economics*

Chapter seven: *Physiocracy, An Origin Of Classical Economics*

Chapter eight: *Classical Liberalism, An Origin Of Classical Economics*

Chapter nine: *Ricardian And Marxism School, An Origin Of Economic Thought*

Chapter ten: *Marshall And Neoclassical Economic Thought*

Chapter eleven: *Keynesian Thought and Modern Economic Theories*

Chapter twelve: *Modern Monetarist Thought and the Chicago School*

History of Economic Thought

PART01: THE HISTORY OF ECONOMIC THOUGHT IN- Ancient Eastern Societies, Islamic Civilization, French Socialist Thought, Marxism, and the German Historical School

① **Objectives :**

After going to this part you will be able:

- i.* To understand The Origins of Economic Thinking in Ancient Eastern Societies
- ii.* To understand The Origins of Economic Thinking in Islamic Civilization
- iii.* To understand the thoughts of German Historical School

② **General Introduction:**

The history of economic thought represents the gradual development of human ideas concerning production, exchange, wealth, labor, and the organization of economic life. Throughout history, societies attempted to understand the economic problems they faced and to propose solutions that would ensure stability, prosperity, and social justice. Economic thought did not emerge suddenly as an independent science; rather, it evolved progressively through religious teachings, philosophical reflections, political experiences, and social transformations.

In ancient Eastern societies, economic ideas were closely linked to religious beliefs, moral values, and political authority. Civilizations such as those of Mesopotamia, Egypt, India, and China developed early forms of economic organization based on agriculture, trade, state control, and social hierarchy. Their contributions laid the foundations for later economic systems and demonstrated an early awareness of issues related to property, labor, taxation, and commerce.

With the rise of Islamic civilization, economic thought acquired a more comprehensive and ethical dimension. Islam introduced principles aimed at achieving social justice, protecting private property, encouraging productive work, and regulating economic relations through moral and legal rules. Muslim scholars, particularly Ibn Khaldun, made significant contributions to economic

analysis by studying labor, taxation, trade, population, and the role of the state in economic development.

During the nineteenth century, the expansion of industrial capitalism and the social inequalities it produced led to the emergence of socialist thought in France. French socialist thinkers criticized the negative effects of capitalism and sought to establish more cooperative and equitable social systems. These ideas later influenced the development of Marxist thought¹, which provided a systematic critique of capitalism through theories of labor, surplus value, class struggle, and economic crises. Karl Marx became one of the most influential figures in modern economic and social thought².

At the same time, the German Historical School challenged the abstract and universal approach of classical economics. Its thinkers emphasized the importance of historical development, social institutions, and state intervention in economic life. They argued that economic systems differ according to historical and national circumstances, and therefore economic analysis must be connected to history, culture, and social evolution.

The study of these diverse schools and civilizations demonstrates that economic thought is not static, but rather a dynamic reflection of historical realities and societal needs. Understanding the evolution of economic ideas helps explain the foundations of modern economic theories and provides deeper insight into the intellectual development of human societies across different periods of history.

¹ Marx, Karl. *Capital: A Critique of Political Economy*, Vol. 1. Penguin Classics, 1990 , p :123.

² Hunt, E. K. *Property and Prophets: The Evolution of Economic Institutions and Ideologies*. M.E. Sharpe, 2002,p :54.

Chapter One: The Origins of Economic Thinking in Ancient Eastern Societies

① **Introduction**

Before the rise of modern economic theories, economic ideas were not treated as an independent science. In ancient times, economic thought was closely connected to religion, philosophy, ethics, and political authority. Human societies had limited control over nature and depended heavily on environmental conditions such as rivers, rainfall, and agricultural fertility. Because of this dependence, people often explained social and economic events through religious or spiritual beliefs rather than through scientific analysis.

Although ancient civilizations did not develop economics as a separate academic discipline, they introduced important principles related to trade, labor, property, taxation, and governance. These early ideas formed the first foundations of economic organization and reflected the growing awareness of how societies could manage resources and maintain stability. Furthermore, many ancient economic principles emphasized justice, fairness, and moral responsibility in economic activities, values that continued to influence later economic systems.

I- Features of Economic Organization in Ancient Eastern Civilizations

Ancient Eastern civilizations such as Egypt, Babylon, China, and Persia achieved remarkable levels of prosperity and social development. Their success was not accidental; rather, it was the result of carefully organized political, social, and economic systems. These societies managed to create stable administrations capable of controlling production, distributing resources, and maintaining social order¹.

One of the most significant characteristics of these civilizations was the strong central authority exercised by the state. Kings, emperors, or pharaohs held extensive power over economic life and supervised agriculture, trade, labor, and taxation. Economic activities were therefore highly centralized, with governments playing a decisive role in regulating production and organizing public works².

¹school of distance education *history of economic thought* ,university of calicut; school of distance education, 2011.

² Alessandro Roncaglia; *The Wealth of Ideas A History of Economic Thought*; Cambridge university press, 2005

Agriculture represented the backbone of most ancient Eastern economies. In regions such as Egypt and Mesopotamia, irrigation systems were essential because farming depended on the waters of major rivers like the Nile, Tigris, and Euphrates. Governments invested considerable effort in controlling irrigation canals and organizing agricultural labor to ensure food security and economic stability.

These civilizations also demonstrated an early understanding of the relationship between economic conditions and political stability. They recognized that poverty, food shortages, or unfair economic practices could threaten social order. As a result, rulers introduced regulations aimed at controlling markets, protecting property, and organizing labor relations¹.

However, economic concepts such as value, ownership, and wealth were still not clearly defined according to modern standards. Most surviving writings focused primarily on religion, governance, and philosophy rather than purely economic analysis. Nevertheless, these texts provide valuable insights into the administrative systems and economic practices that shaped ancient societies.

II- Economic Ideas in Mesopotamian Civilization

The civilization of Mesopotamia, particularly Babylon, played a major role in the evolution of economic thought. Located between the Tigris and Euphrates rivers, Babylon became an important center of trade, law, and political organization. One of its greatest achievements was the establishment of the famous Code of Hammurabi during the eighteenth century BCE. This legal code represented one of the earliest attempts to regulate economic and social life through written laws.

1. Legal Regulation of Economic Activities

The Code of Hammurabi contained numerous laws dealing with economic matters. It regulated commercial exchanges, established pricing rules, and defined punishments for fraud, theft, and other economic crimes. These laws aimed to create fairness and stability in economic relations while protecting both merchants and consumers.

The code also emphasized the protection of private property and the enforcement of contractual obligations. By introducing written legal rules,

¹ Lowry, S. Todd. *Ancient and Medieval Economic Ideas and Concepts of Social Justice*. Brill Academic Publishers, 2003, pp :16-27.

Babylonian society sought to reduce conflicts and increase trust in commercial transactions.

2. Commercial Contracts and Financial Relations

Babylonian economic thought demonstrated a sophisticated understanding of contracts and business agreements. Written contracts were commonly used in trade and financial activities, including loans, partnerships, and property exchanges. The laws regulated interest rates and clarified the responsibilities of debtors, creditors, and merchants.

This legal recognition of contracts contributed to the development of a more reliable and organized commercial environment. It also encouraged long-distance trade and economic cooperation between individuals and regions.

3. Agricultural Policies and Labor Organization

Agriculture occupied a central position in the Babylonian economy, which explains why many laws focused on land management and irrigation systems. The state established regulations concerning land cultivation, water distribution, and the responsibilities of farmers and laborers¹.

Labor laws were designed to ensure fairness between landowners and workers while preserving productivity and social stability. These regulations reflected the importance of agriculture as the foundation of economic prosperity in Mesopotamia.

4. Standardization of Weights and Measurements

Trade and commerce required accurate systems of measurement. The Babylonians developed standardized weights and measures to facilitate fair transactions and reduce fraud. This innovation represented a significant step toward the development of organized markets and commercial efficiency.

5. Government Intervention in Economic Affairs

Babylonian rulers believed that the state should play an active role in maintaining economic order. The government intervened to regulate markets, protect property rights, supervise trade, and enforce laws. Economic stability was viewed as essential for political authority and social harmony.

¹ Chan, Hok-lam. *The Economic Thought of Ancient China*. Harvard University Asia Center, 2000, pp:33-47.

Overall, Babylonian civilization introduced many principles that later became fundamental elements of economic administration and legal organization.

III- Economic Principles in Ancient Egyptian Civilization

Ancient Egypt developed one of the most stable and prosperous economies of the ancient world. The economic system of the Pharaonic civilization was deeply influenced by the Nile River, religious beliefs, and centralized political authority. The Pharaoh occupied a central position not only as a ruler but also as the protector of economic and social order.

1. Agriculture as the Foundation of the Economy

The fertility of the Nile Valley allowed ancient Egyptians to establish a highly productive agricultural economy. The annual flooding of the Nile deposited fertile soil that supported the cultivation of crops such as wheat, barley, and vegetables.

Economic thought in ancient Egypt focused on improving agricultural productivity through irrigation systems, land management, and organized labor. Ensuring a stable food supply was considered essential for the survival and prosperity of the kingdom.

2. Centralized Administration and Economic Planning

The Egyptian state exercised extensive control over economic resources and activities. The Pharaoh and his administration supervised land ownership, taxation, labor organization, and resource distribution¹.

Large-scale construction projects such as pyramids, temples, and irrigation canals were not only religious achievements but also major economic enterprises that employed thousands of workers and stimulated production.

3. Trade Networks and Commercial Exchange

Egypt's geographical location made it an important center for regional and international trade. Egyptians maintained commercial relations with neighboring civilizations in Africa, the Levant, and Mesopotamia.

¹ Screpanti, Ernesto & Zamagni, Stefano. *An Outline of the History of Economic Thought*. Oxford University Press, 2005.

Trade involved the exchange of goods such as gold, ivory, incense, copper, and luxury products. These commercial activities contributed significantly to Egypt's wealth and strengthened its political influence.

4. Exchange Systems and Economic Transactions

Although ancient Egypt did not develop coin-based monetary systems similar to those of later civilizations, economic exchanges were conducted through barter and commodity exchange. Agricultural products, livestock, and valuable goods often served as mediums of exchange.

This system reflected the practical and resource-based nature of the Egyptian economy.

5. Social Hierarchy and Labor Distribution

The economic structure of ancient Egypt was closely linked to its social hierarchy. Society was organized into different classes, including the Pharaoh, priests, nobles, scribes, craftsmen, farmers, and laborers.

Labor was carefully coordinated for both agricultural production and public works projects. Participation in these activities was often considered a social and religious obligation toward the state and the gods.

6. Resource Storage and Public Infrastructure

The Egyptian government adopted policies aimed at protecting society from economic crises and food shortages. Surplus agricultural products were stored in granaries to provide reserves during periods of famine or drought.

The state also invested heavily in public infrastructure projects such as canals, reservoirs, and irrigation systems to increase agricultural efficiency and support economic development.

In general, economic thought in ancient Egypt reflected a highly organized and centralized approach that successfully integrated political authority, religion, and economic management.

IV- Economic Contributions of Other Eastern Civilizations

Besides Egypt and Mesopotamia, several other Eastern civilizations developed important economic ideas that contributed to the history of economic thought.

1. Economic Philosophy in Ancient India

Ancient Indian economic ideas appeared in texts such as the “Arthashastra” and the “Manusmriti”; These writings addressed issues related to taxation, trade regulation, administration, and state responsibilities¹.

The “Arthashastra”, attributed to Chanakya, emphasized the importance of wise leadership and effective governance in achieving economic prosperity. Indian philosophy also connected economic behavior to ethical principles through the concept of “dharma,” which encouraged honesty, justice, and moral responsibility in commercial activities.

2. Economic Thought in Ancient China

Chinese civilization produced important philosophical ideas that influenced economic practices. Daoist philosophy promoted simplicity, moderation, and limited governmental interference in economic life. In contrast, Confucianism emphasized social harmony, ethical conduct, and responsible governance².

China also achieved remarkable economic progress by developing advanced systems of trade, paper money, and credit arrangements. These innovations facilitated commercial expansion and strengthened the Chinese economy³.

3. Economic Organization in Ancient Persia

The Persian Achaemenid Empire demonstrated a high level of administrative and economic sophistication. Persian rulers established extensive trade routes and transportation networks, including the famous Royal Road, which improved communication and commercial exchange throughout the empire.

The Persian government understood that economic stability was necessary for maintaining political unity and administrative efficiency across a vast multicultural empire.

¹ Blaug, Mark. *Economic Theory in Retrospect*. Cambridge University Press, 1997.

² Screpanti, Ernesto & Zamagni, Stefano. *An Outline of the History of Economic Thought*. Oxford University Press, 2005.

³ Ching, Julia. *Confucianism and Economic Ethics in China*. State University of New York Press, 1993.

- Conclusion

Ancient Eastern civilizations played a fundamental role in shaping the early foundations of economic thought. Although economic ideas during this period were closely connected to religion, philosophy, and political authority, these societies developed important principles related to trade, law, agriculture, labor organization, and state intervention.

Civilizations such as Babylon, Egypt, India, China, and Persia demonstrated remarkable administrative and economic sophistication. Their efforts to regulate markets, organize production, and maintain social stability contributed significantly to the evolution of human economic thinking¹.

Studying the economic thought of ancient Eastern civilizations allows us to better understand the origins of economic organization and highlights the diversity of intellectual traditions that influenced the development of global economic history.

¹ Ekelund, Robert B. & Hébert, Robert F. *A History of Economic Theory and Method*. Waveland Press, 2013, pp. 350–420.

Chapter two: Economic Thought During the Islamic Civilization

① **Introduction**

The emergence of Islam represented a major transformation in the social, moral, and economic organization of human societies. Islam did not merely introduce religious teachings related to worship and spirituality; rather, it established a comprehensive system that regulated the behavior of individuals and communities in all aspects of life, including economic relations. Islamic teachings sought to create a balanced society based on justice, cooperation, equality, and respect for human dignity.

The Islamic economic system emerged at a time when many societies were suffering from social injustice, economic exploitation, slavery, and inequality between social classes. Through its principles and legislation, Islam introduced reforms that aimed to protect human rights, encourage productive work, and establish fairness in economic transactions. Consequently, the rise of Islamic civilization marked an important stage in the development of economic thought during the medieval period.

I- Fundamental Principles of Economic Thought in Islam

Islamic economic thought was built upon moral and social foundations that aimed to achieve both material prosperity and social justice¹. Unlike purely materialistic systems, Islam viewed economic activity as part of a broader ethical framework that connected economic behavior with religious and moral responsibilities.

1. Abolition of Slavery and Human Exploitation

One of the most important reforms introduced by Islam was the gradual elimination of slavery and the promotion of human dignity. Islam encouraged the liberation of slaves and considered freedom a natural right of every human being. By reducing practices of enslavement and exploitation, Islamic teachings contributed to improving social and economic relations within society.

¹ Chapra, M. Umer. *The Future of Economics: An Islamic Perspective*. Islamic Foundation, 2000 ,p :27.

Islam also rejected all forms of economic oppression and exploitation that deprived individuals of their rights or transformed wealth into a tool of domination over weaker groups.

2. Improving the Social Position of Women

Islam introduced significant changes regarding the status of women in society. Women were granted legal and economic rights that were uncommon in many societies at that time. They obtained the right to own property, inherit wealth, conduct business activities, and participate in economic life independently¹.

These reforms contributed to raising the social and economic position of women and reflected the Islamic principle of justice and equality before the law.

3. Combating Economic Exploitation

Islam strongly opposed unjust economic practices and profits obtained without legitimate effort or productive activity. Economic relations were expected to be based on fairness, honesty, and mutual benefit rather than manipulation or exploitation.

The Islamic system encouraged lawful trade and productive investment while discouraging practices that harmed society or concentrated wealth unfairly in the hands of a small group.

4. Prohibition of Usury and the Importance of Zakat

One of the central principles of Islamic economics is the prohibition of usury (riba). Islam considered usury a form of exploitation because it allowed individuals to gain wealth without productive effort while placing heavy burdens on borrowers.

At the same time, Islam established zakat as a compulsory financial obligation designed to reduce poverty, redistribute wealth, and strengthen social solidarity. Zakat functioned not only as a religious duty but also as an economic mechanism aimed at supporting social welfare and reducing inequality.

5. Encouragement of Work and Productivity

Islam placed great importance on labor and productive activity. Work was considered both a right and a duty for every individual capable of contributing to

¹ Ghazanfar, Shaikh M. (ed.). *Medieval Islamic Economic Thought: Filling the Great Gap*. RoutledgeCurzon, 2003, p : 39 .

society. Muslims were encouraged to seek lawful earnings and participate actively in economic life while maintaining ethical conduct.

Unlike some earlier societies that undervalued manual labor, Islam honored workers and emphasized their dignity and rights. This recognition represented an important development in the history of labor relations and social justice¹.

6. Recognition of Private Property

Islam accepted the principle of private property and recognized the right of individuals to own wealth and resources legally. Ownership could be acquired through work, trade, inheritance, gifts, or wills.

However, Islam also imposed moral and social responsibilities on property owners. Wealth was not viewed as an unlimited right to dominate others but as a trust that should be used responsibly and fairly for the benefit of both individuals and society.

7. Opposition to Monopoly

Islam prohibited monopoly because monopolistic practices often lead to exploitation and artificial increases in prices. The Prophet Muhammad (peace be upon him) condemned monopolists and considered such practices harmful to society.

Muslim rulers later adopted measures to prevent monopolies and protect consumers from unfair market practices. This reflected the Islamic commitment to maintaining fairness and balance within economic markets.

II- Ibn Khaldun and the Development of Islamic Economic Analysis

Among the most influential scholars in the history of Islamic economic thought was Ibn Khaldun (1332–1406 AD). He is widely regarded as one of the earliest thinkers to analyze social and economic phenomena using scientific and rational methods rather than relying solely on religious explanations.

His most famous work, the “Muqaddimah” (The Introduction), is considered one of the greatest intellectual achievements of the medieval period. In this work, Ibn Khaldun developed innovative ideas about society, economics, politics, and history, which later influenced both sociology and economic theory.

III- Major Economic Ideas of Ibn Khaldun

¹ Ghazanfar, Shaikh M. (ed.). *Medieval Islamic Economic Thought: Filling the Great Gap*. RoutledgeCurzon, 2003,p :56.

1. Civilization and Social Organization

Ibn Khaldun believed that human society is a natural phenomenon resulting from cooperation among individuals. According to him, civilization develops because people cannot survive independently and must work together to satisfy their needs.

Urbanization and the growth of cities were therefore considered signs of social and economic progress. He explained how economic prosperity contributes to the expansion of urban life and cultural development¹.

2. The Importance of Division of Labor

One of Ibn Khaldun's most significant contributions was his explanation of the division of labor. He argued that no individual can fulfill all personal needs alone. As a result, people specialize in different occupations and exchange the products of their labor with others².

This specialization increases productivity, improves efficiency, and allows societies to produce greater wealth. Ibn Khaldun's analysis of labor specialization anticipated ideas that would later become central in classical economic theory.

3. Classification of Economic Activities

Ibn Khaldun identified several major forms of economic activity that contribute to the prosperity of society. These included³:

- ➡ Agricultural activity, which provides essential goods and food supplies.
- ➡ Industrial activity, which transforms raw materials into manufactured products.
- ➡ Commercial activity, which facilitates exchange and trade between regions and populations.

He considered these sectors interconnected and necessary for economic development and social stability.

4. Taxation and State Revenue

¹ Spengler, Joseph J. *Economic Thought of Islam: Ibn Khaldun. Comparative Studies in Society and History*, Cambridge University Press, 1964.

² Hunt, E. K. & Lautzenheiser, Mark. *History of Economic Thought: A Critical Perspective*. M.E. Sharpe, 2011.

³ Backhouse, Roger E. *The Penguin History of Economics*. Penguin Books, 2002, pp:48-49.

Ibn Khaldun demonstrated a remarkable understanding of the relationship between taxation and economic productivity. He observed that excessive taxation discourages work, investment, and production because individuals lose incentives to engage in economic activity.

On the other hand, moderate taxation encourages productivity and ultimately increases state revenues. This analysis resembles what modern economists describe as the relationship between tax rates and economic incentives.

5. Labor as the Source of Value

Ibn Khaldun considered labor to be the true source of wealth and value. Natural resources alone have limited usefulness unless human labor transforms them into valuable goods and services.

According to his theory, work creates economic value by combining human effort with natural resources. This idea represented an advanced understanding of production and wealth creation during the medieval period.

6. Human Needs and Population Growth

Ibn Khaldun classified human needs into two categories¹:

- Basic necessities, such as food, clothing, and shelter.
- Luxury goods and services, which emerge as societies become more prosperous and urbanized².

He explained that as urbanization expands and incomes increase, societies begin to demand more luxury products and recreational services. Economic growth therefore leads to changes in consumption patterns and living standards.

Furthermore, Ibn Khaldun emphasized the importance of population size in economic development. He argued that population growth increases labor supply, production capacity, and market demand, making it a driving force behind economic expansion and urban prosperity³.

¹ Islahi, Abdul Azim. *Economic Concepts of Ibn Khaldun*. Islamic Research and Training Institute, 1996.

² An Outline of the *History of Economic Thought* (2nd Edition), (2003) Ernesto Screpanti and Stefano Zamagni.

³ Backhouse, Roger E. *The Penguin History of Economics*. Penguin Books, 2002 ,pp :34 .

Conclusion:

Economic thought during the Islamic civilization represented a major stage in the historical development of economic ideas. Islam introduced principles based on justice, ethical behavior, social solidarity, and respect for human dignity. It encouraged productive work, protected private property, opposed exploitation, and sought to establish balance between individual interests and collective welfare.

The contributions of scholars such as Ibn Khaldun further enriched economic analysis by introducing scientific approaches to the study of labor, taxation, production, and social organization. His ideas demonstrated a deep understanding of the relationship between economic activity and the development of civilizations.

Overall, Islamic economic thought combined moral values with practical economic principles, creating a system that aimed to achieve both material prosperity and social justice.

Chapter Three: Liberal Economic Thought and the Evolution of Capitalism

① ***Introduction***

Liberal economic thought emerged as one of the most influential intellectual movements in modern history. It developed alongside the political, social, and economic transformations that Europe experienced from the seventeenth century onward. Liberalism promoted the principles of freedom, individual rights, and rational thinking, while capitalism became the practical economic system that translated these ideas into reality.

The rise of liberal capitalism marked a turning point in economic history because it shifted economic activity from state domination and feudal restrictions toward free markets, private ownership, and competition. Over time, capitalism evolved through several stages, each characterized by different economic structures and methods of wealth accumulation.

I- The Concept of Liberal Economic Thought

1. Meaning and Origins of Liberalism¹

The term “liberalism” originates from the English word *Liberalism* and the French term *Libéralisme*, both derived from the concept of liberty or freedom. Liberalism is therefore closely associated with the idea of individual freedom in political, social, and economic life.

As an intellectual doctrine, liberalism emphasizes rationality, personal initiative, and the right of individuals to make their own choices without excessive interference from the state or other authorities. Liberal thinkers believed that human beings are capable of managing their affairs through reason and free will.

Liberalism developed into several forms, including²:

- Political liberalism, which focuses on political rights and democratic participation.

¹ Douglas A. Irwin, *Against the Tide: An Intellectual History of Free Trade* (Princeton: Princeton University Press, 1996), pp. 27–58.

² William D. Grampp, *Economic Liberalism* (New York: Random House, 1965), pp. 17–53

- Religious liberalism, which supports freedom of belief and religious tolerance.
- Economic liberalism, which advocates economic freedom and free-market activity.

II- Economic Liberalism and the Capitalist System

Economic liberalism is based on the principle that individuals should enjoy broad economic freedom. According to this doctrine, the state's primary role is to protect individual rights rather than directly control economic activity.

These freedoms include¹:

- Freedom of thought and expression.
- Freedom of ownership and private property.
- Freedom of trade and movement of capital.
- Freedom of labor and enterprise.
- Freedom of contracts and economic exchange.

Economic liberalism adopted the famous slogan associated with the French liberal tradition: “*Laissez-faire, laissez-passer*” meaning “*let do, let pass*” This slogan reflected the belief that the economy functions more efficiently when individuals are free to pursue their own interests without heavy state intervention.

The most important economic system inspired by liberal thought is capitalism. Capitalism became systematically explained through the writings of Adam Smith, especially in his famous book “*The Wealth of Nations*”. Smith argued that economic prosperity results from free competition, specialization, and the pursuit of self-interest.

Capitalism can therefore be defined as an economic and social system based on:

- Private ownership of the means of production.
- Economic freedom.
- Market competition.
- The role of supply and demand in determining prices and production.

III- Philosophical Foundations of Capitalism

¹ Ronald Findlay and Kevin H. O'Rourke, *Power and Plenty: Trade, War, and the World Economy in the Second Millennium* (Princeton: Princeton University Press, 2007), pp. 227–280.

Capitalism rests upon several intellectual and philosophical principles that shaped its economic structure and social organization.

1. The Idea of the “Economic Man”

Capitalist thought assumes that individuals are rational beings who seek to maximize their personal benefits while minimizing costs. This assumption led economists to describe individuals within capitalism as “economic men,” motivated primarily by self-interest and profit.

According to liberal theorists, individual pursuit of personal gain eventually contributes to the prosperity of society as a whole.

2. The Legitimacy of Profit

Within capitalism, profit is considered both legitimate and necessary. Economic success is viewed as the reward for innovation, investment, risk-taking, and productive activity.

Adam Smith explained that when individuals pursue their own interests, an “invisible hand” guides economic activity toward achieving collective welfare and economic balance.

3. Protection of Private Property

Private property represents one of the central pillars of capitalism. Individuals have the right to own land, factories, businesses, and financial resources. The state’s role is mainly to provide legal protection for property rights and ensure that contracts and economic agreements are respected.

Capitalists considered secure property rights essential for encouraging investment, innovation, and economic growth.

4. Market Economy and Free Competition

Capitalism relies heavily on the market mechanism. Prices are determined through the interaction of supply and demand rather than through direct government planning¹.

Competition between individuals and firms is considered beneficial because it encourages efficiency, innovation, and lower prices. Free competition also

¹ Robert B. Ekelund Jr. and Robert D. Tollison, *Mercantilism as a Rent-Seeking Society*, *Economic Inquiry* 18, no. 4 (1980): 459–476

allows consumers to choose among different products and services according to their preferences.

5. Limited State Intervention

Classical capitalism advocated minimal state intervention in economic affairs. The government was expected to remain neutral and limit its role to maintaining security, enforcing laws, and protecting property rights.

According to liberal thinkers, excessive government interference disrupts market efficiency and restricts individual freedom.

IV- Historical Development of Capitalism

Capitalism did not emerge in its final form immediately. Instead, it evolved gradually through several major stages, each reflecting changes in production methods, trade relations, and financial systems.

1. The Era of Commercial Capitalism

Commercial capitalism developed between the fifteenth century and the eighteenth century. During this period, European powers expanded international trade and established global commercial networks.

The rise of nation-states and maritime exploration allowed European merchants to dominate world trade routes. Large monopoly companies emerged, such as the East India Company and the West India Company, which controlled trade with colonies and foreign territories.

These companies accumulated enormous wealth through overseas trade, colonial expansion, and the exploitation of raw materials. Commercial capitalism was therefore characterized by¹:

- Expansion of international trade.
- Growth of merchant capital.
- Colonial expansion.
- Accumulation of monetary wealth.

This stage laid the foundations for the later development of industrial capitalism.

¹ Steven G. Medema and Warren J. Samuels; *The History of Economic Thought: A Reader*; Routledge print. LONDON; 2004.

2. The Rise of Industrial Capitalism

Industrial capitalism began with the Industrial Revolution during the late eighteenth and nineteenth centuries. Technological innovations transformed production processes and shifted economic activity from manual labor to machine-based manufacturing.

Factories replaced traditional workshops, and industrial production expanded rapidly. This transformation created a clear separation between capital owners and workers.

The capitalist class owned factories, machines, and financial resources, while the working class possessed only its labor power. As a result, industrial society became increasingly divided into social classes.

Industrial capitalism also produced major economic and social changes, including:

- Rapid industrial growth.
- Urbanization and population concentration in cities.
- Expansion of wage labor.
- Development of transportation and communication systems.
- Intensification of class divisions between employers and workers.

Despite increasing production and wealth, industrial capitalism also generated difficult working conditions and social inequality, which later encouraged the emergence of socialist and labor movements.

3. The Emergence of Financial Capitalism

Financial capitalism developed during the second half of the nineteenth century when capitalism entered the monopoly stage. During this period, economic power became concentrated in large corporations and financial institutions.

Production and capital increasingly accumulated in the hands of powerful industrial and banking groups. Large enterprises gradually replaced small and medium-sized businesses, while banks became central actors in economic activity.

Britain was among the first countries to reach this advanced stage of capitalism, followed later by other European powers and the United States.

A- Expansion of Financial Institutions

Banks and financial institutions became the primary source of funding for industrial enterprises and large investment projects. Industrial sectors became increasingly dependent on financial markets and banking decisions.

For this reason, this phase became known as financial capitalism, as financial capital acquired enormous influence over economic development.

B- Growth of New Economic Sectors

The structure of industrial economies changed significantly during this period. While textiles and mining had dominated earlier industrial development, new sectors such as railways, automobile manufacturing, mechanical engineering, and chemical industries became the driving forces of economic growth.

Railways, in particular, contributed greatly to the expansion of domestic markets and the integration of national economies.

C- Colonial Expansion and International Competition

One of the defining characteristics of financial capitalism was the search for foreign markets and investment opportunities. Industrial capitalist countries sought access to raw materials, cheap labor, and new consumers in Africa, Asia, and Latin America.

This competition led to intense colonial expansion during the late nineteenth century. European powers occupied vast territories and transformed colonies into sources of raw materials and markets for industrial products.

Colonial rivalry also intensified tensions between major powers and contributed significantly to the outbreak of World War I.

Britain emerged as one of the largest colonial empires during this period, controlling extensive territories around the world.

Conclusion:

Liberal-capitalist thought played a central role in shaping the modern global economy. By emphasizing individual freedom, private property, market competition, and limited state intervention, liberalism established the intellectual foundations of capitalism.

Over time, capitalism evolved from commercial activity to industrial production and later to financial domination and global expansion. Each stage introduced important economic transformations that influenced production systems, social structures, and international relations.

Although capitalism contributed significantly to economic growth, technological progress, and global trade, it also generated challenges such as social inequality, monopolies, labor exploitation, and colonial competition. Consequently, the evolution of capitalism became one of the most important themes in the study of modern economic history and economic thought.

Chapter Four: Socialist Economic Thought in France and the Emergence of Marxism

① ***Introduction:***

The nineteenth century witnessed the emergence of new economic and social doctrines as reactions to the rapid expansion of capitalism and the social inequalities created by the Industrial Revolution. The concentration of wealth in the hands of factory owners, the difficult living conditions of workers, and the spread of poverty among the laboring classes encouraged many thinkers to search for alternative economic systems capable of achieving justice and social equality.

Among the most important intellectual trends that appeared during this period were French socialist thought and Marxist thought. French socialism attempted to reform society through moral cooperation and social organization, while Marxism developed a more comprehensive and scientific critique of capitalism based on economic analysis and class struggle. Together, these doctrines played a major role in shaping modern political and economic thought.

I- French Socialist Thought and Its Main Tendencies

French socialist thought is often described as “utopian socialism” because its thinkers attempted to imagine ideal social systems based on justice, equality, and cooperation. These thinkers criticized the negative consequences of capitalism but generally relied on peaceful reform and moral transformation rather than violent revolution¹.

French socialist thought developed into two major tendencies: the authoritarian or state-centered current and the cooperative current.

1. The State-Centered Socialist Current

One of the most important representatives of this tendency was Henri de Saint-Simon and his followers, commonly known as the Saint-Simonians.

¹ Paul Thomas, *Marxism and Scientific Socialism, From Engels to Althusser*, Routledge, Taylor & Francis Group, London and New York.

Saint-Simon believed that the state should play a central role in organizing economic and social life. According to his ideas, society could achieve prosperity only if economic activities were directed toward the public interest rather than individual selfishness. He argued that governments should encourage scientific progress, industrial development, and social planning in order to improve collective welfare.

Although Saint-Simon himself did not explicitly demand the abolition of private property, many of his followers strongly criticized the institution of inheritance. They believed that inherited wealth often placed economic resources in the hands of individuals who were not necessarily competent or productive. For this reason, some Saint-Simonians proposed that the state should become the principal heir to private fortunes so that wealth could be redistributed more effectively for the benefit of society¹.

This current therefore emphasized:

- Strong state intervention in economic affairs.
- Social organization based on efficiency and productivity.
- Reduction of inherited economic privileges.
- Promotion of public welfare over individual accumulation of wealth.

2. The Cooperative Socialist Current

The cooperative branch of French socialism sought to reform society through voluntary cooperation and collective organization rather than through state domination.

One of its most famous thinkers was Charles Fourier (1772–1837), who developed a social and economic theory associated with his name.

Fourier criticized the capitalist system because he believed it created competition, selfishness, and social inequality. However, unlike revolutionary socialists, he did not call for the complete abolition of private property. Instead, he proposed the creation of cooperative communities in which individuals would voluntarily work together for the common good.

According to Fourier's vision:

- Production should be organized collectively through cooperation.
- Individuals should be free to choose occupations that match their talents and interests.

¹ Mandel, Ernest. *Marxist Economic Theory*. Monthly Review Press, 1968, pp:21-29.

- Workers should have the possibility to change professions according to their abilities and preferences.
- Economic activity should serve social harmony rather than profit alone.

Fourier believed that such cooperative communities would reduce social conflict and create a more balanced and humane society.

II- The Emergence of Marxist Economic Thought

Among all socialist doctrines, Marxism became the most influential and scientifically developed critique of capitalism. The doctrine is associated with Karl Marx (1818–1883), whose ideas profoundly shaped modern political and economic debates¹.

Marx attempted to analyze capitalism scientifically by studying its internal mechanisms, contradictions, and long-term evolution. His most important work, “Capital” (“Das Kapital”), examined production, labor, profit, and class relations within capitalist societies.

In developing his theory, Marx borrowed several concepts from classical economists such as Adam Smith and David Ricardo, but he transformed these ideas into a revolutionary critique of capitalism.

III- Main Economic Theories of Marxism²

1. The Labor Theory of Value

Like many classical economists, Marx distinguished between two forms of value:

- Use value, which refers to the usefulness of a commodity in satisfying human needs.
- Exchange value, which refers to the ability of a commodity to be exchanged for another commodity in the market.

Marx asked an important question³: what is the common element that allows different commodities to be exchanged?

¹ Fourier, Charles. *The Theory of the Four Movements*. Cambridge University Press (translated edition), 1996,p:67.

²Marx, Karl. *Capital: A Critique of Political Economy, Vol. 1*. Penguin Classics, 1990,p:42.

³ Mandel, Ernest. *Marxist Economic Theory*. Monthly Review Press, 1968 ,p :113.

His answer was labor. According to Marx, the value of goods depends on the amount of “socially necessary labor time” required for their production. This means the average amount of labor needed to produce a commodity under normal production conditions and with average levels of skill and technology.

Therefore, labor became the foundation of value within Marxist analysis.

2. The Theory of Surplus Value

The concept of surplus value represents one of Marx’s most important contributions to economic thought¹.

According to Marx, workers sell their labor power to capitalists in exchange for wages. However, the value produced by workers during the production process is greater than the wages they receive. The difference between the value created by labor and the wages paid to workers is called surplus value.

Marx argued that this surplus value becomes profit for the capitalist and constitutes a form of exploitation because workers are not fully compensated for the wealth they create.

In this sense:

- Workers produce more value than they receive in wages.
- Capitalists appropriate the surplus generated by labor.
- Profit therefore originates from unpaid labor.

This theory formed the basis of Marx’s criticism of capitalist production.

3. Theory of Capital Accumulation

Marx believed that capitalism naturally tends toward the continuous accumulation of capital. Capitalists reinvest a significant portion of their profits in order to expand production and increase wealth.

He divided capital into two categories:

- Constant capital, which includes machines, tools, buildings, and raw materials.
- Variable capital, which refers to wages paid to workers.

¹ Sweezy, Paul M. *The Theory of Capitalist Development*. Monthly Review Press, 1999, p :87.

According to Marx, only variable capital creates surplus value because human labor is the true source of profit and economic value.

The process of accumulation therefore increases the power of capitalists while intensifying economic inequality within society.

4. Concentration of Capital

Marx argued that capitalist competition eventually leads to the concentration of economic power in the hands of a small number of large enterprises.

Large firms possess greater financial and technological advantages, allowing them to eliminate smaller competitors. Over time, this process creates monopolies and strengthens the dominance of major capitalist groups over markets and production.

As a consequence¹:

- Small producers and merchants gradually disappear.
- Wealth becomes concentrated among a limited capitalist elite.
- Many independent producers are transformed into wage laborers.

This tendency toward concentration represented, in Marx's view, one of the fundamental contradictions of capitalism.

5. The Theory of Increasing Poverty

Marx maintained that capitalist development ultimately worsens the conditions of the working class. Since capitalists seek to maximize profits, wages tend to remain low while wealth accumulates among owners of capital.

As surplus value increases, workers experience declining living standards, economic insecurity, and social inequality. Marx believed that capitalism creates a permanent conflict between labor and capital because the interests of workers and capitalists are fundamentally opposed.

6. Theory of Economic Crises

One of Marx's most influential ideas concerns the inevitability of economic crises within capitalism.

¹ Marx, Karl. *Capital: A Critique of Political Economy*, Vol. 1. Penguin Classics, 1990 ,p :104 .

According to Marx, the poverty of workers reduces their purchasing power, which eventually leads to insufficient consumer demand. At the same time, capitalist production continues to expand in search of profit.

This imbalance between production and consumption produces overproduction crises characterized by¹:

- Accumulation of unsold goods.
- Decline in profits.
- Closure of factories.
- Rising unemployment.
- Economic instability.

Marx argued that such crises would become increasingly severe until capitalism eventually collapsed under its own contradictions.

In his view, the fall of capitalism was not accidental but historically inevitable.

Conclusion:

French socialist thought and Marxist theory represented major reactions against the inequalities and social problems created by capitalist development during the nineteenth century.

French socialist thinkers sought to establish more cooperative and humane forms of social organization through state intervention or voluntary cooperation. Meanwhile, Karl Marx developed a systematic and scientific critique of capitalism based on labor, surplus value, class struggle, and economic crises.

The influence of these doctrines extended far beyond economics, shaping political movements, labor organizations, revolutions, and social reforms throughout the modern world. Even today, debates surrounding capitalism, social justice, inequality, and workers' rights continue to reflect the enduring impact of socialist and Marxist thought.

¹ Mandel, Ernest. *Marxist Economic Theory*. Monthly Review Press, 1968,p :76.

Chapter Five: The German Historical School of Economic Thought

① **Introduction:**

The German Historical School emerged in the nineteenth century as a major intellectual reaction against classical economic theory. It developed gradually from the 1840s with the writings of thinkers such as Friedrich List and Wilhelm Roscher, and continued its influence until the early twentieth century, ending symbolically with the death of Gustav Schmoller in 1917.

Unlike the classical school, which relied on universal laws and abstract reasoning, the German Historical School emphasized that economic systems are deeply influenced by history, culture, institutions, and stages of social development¹. It also reflected the specific economic reality of Germany in the nineteenth century, where the state played a central role in industrialization and national development.

At a time when Britain had already moved toward industrial capitalism and free trade policies, Germany was still undergoing structural transformation and relied heavily on state intervention and protectionist policies. This difference in historical experience strongly shaped German economic thinking and led to the development of an alternative approach to economic analysis.

I- Intellectual Foundations of the Historical Approach

1. Economic Systems as Evolving Historical Processes

One of the central ideas of the German Historical School is that economic life cannot be understood through fixed or universal laws. Instead, economies evolve gradually over time through different stages of development.

According to this view, societies pass through a natural historical cycle: they are born, grow, mature, decline, and eventually transform into new systems. Economic behavior, institutions, and policies therefore change depending on historical circumstances.

¹ Tribe, Keith. *The German Historical School of Economics: A Comparative Analysis*. Edward Elgar Publishing, 1995, p :12.

As a result, economic theories that may be valid for one country at a specific stage of development may not necessarily apply to another country or even to the same country at a different historical period. This idea strongly challenged the classical belief in universal economic principles.

2. The Role of the State in Economic Development

The German Historical School placed great importance on the role of the state in shaping economic progress¹. Unlike classical economists who advocated minimal government intervention, German thinkers argued that the state should actively participate in economic life.

They believed that individual interests do not always coincide with collective national interests. Therefore, government intervention is necessary to guide economic development, protect national industries, and ensure social stability.

In the German context, the state played a decisive role in:

- Promoting industrial development.
- Building transportation networks such as railways.
- Supporting economic modernization.
- Protecting emerging national industries from foreign competition.

This close relationship between the state and the economy was a defining feature of German economic thought during the nineteenth century.

3. The Historical-Empirical Method

Another key principle of the German Historical School is its emphasis on empirical and historical research. Instead of relying on abstract models and deductive reasoning, its scholars advocated the study of real economic history and concrete social data.

They argued that economic phenomena are deeply connected to other aspects of society, such as politics, law, culture, and religion. Therefore, economics should not be studied in isolation but as part of a broader social system.

This approach relied heavily on observation, historical comparison, and inductive reasoning. By analyzing real-world economic development across

¹ Tribe, Keith. *The German Historical School of Economics: A Comparative Analysis*. Edward Elgar Publishing, 1995, p :18.

different countries and periods, economists could better understand how economic systems actually function.

4. Critique of Classical Economic Theory

The German Historical School strongly criticized the classical and liberal economic traditions for their reliance on abstract and universal assumptions. Thinkers in this school rejected the idea that economic laws are fixed and applicable everywhere.

They also criticized the static nature of classical analysis, arguing that it failed to take into account historical change and institutional diversity. In their view, economic behavior cannot be understood without considering the social and historical context in which it occurs.

As a result, the German Historical School positioned itself as an alternative intellectual framework that emphasized realism, historical depth, and institutional analysis rather than theoretical abstraction.

Conclusion:

The German Historical School represented a major shift in economic thought by challenging the universality of classical economics and emphasizing the importance of history, institutions, and state intervention.

Through the contributions of thinkers such as Friedrich List, Wilhelm Roscher, and Gustav Schmoller, this school developed a more realistic and socially grounded approach to understanding economic systems.

Its legacy remains important in modern economics, particularly in fields such as institutional economics, development economics, and economic history, where context, structure, and historical evolution are essential for analysis.

PART02: HISTORY OF CLASSICAL ECONOMIC THOUGHT

① **Objectives :**

After going to this part you will be able:

- iv.** To understand the origin of Classical Economics
- v.** To understand the school of Mercantilism and Physiocracy
- vi.** To understand the thoughts of Adam Smith

② **General Introduction:**

The subject, the History of Economic Thought, may be defined as a critical account of the development of economic ideas, searching into their origins, interrelations, and, in some cases, their results. The history of economic thought concerns thinkers and theories in the field of political economy and economics from the ancient world right up to the present day. Economics was not considered a separate discipline until the nineteenth century. For example, *Aristotle*, the ancient Greek philosopher, in his works on politics and ethics have thought of '*art of wealth acquisition*'. He also considered the question whether property is best left in private or public hands. In medieval times, scholars like *Thomas Aquinas* argued that it was a moral obligation of businesses to sell goods at a just price. Economic thought evolved through feudalism in the middle Ages to mercantilist theory during the Renaissance (when people were concerned to orient trade policy to further the national interest). The modern political economy of *Adam Smith* appeared during the industrial revolution, when technological advancement, global exploration, and material opulence that had previously been unimaginable was becoming a reality. All these and further developments are subject matter of history of economic thought changes in economic thought have always accompanied changes in the economy, just as changes in economic thought can propel change in economic policy. Economic thought has at times focused on the aspects of human nature such as greed and selfishness that generally work against the good of all; at other times, economic behavior has been seen as self-regulating and working toward a common purpose. As contemporary economic thought deals with the issues of globalization and the emergence of a global economy, economists have turned to the multitude of other disciplines which, like economics, developed independently. Building on their discoveries, and united with them in pursuit of the common goal of benefiting human society, economic thought may be on the

road to achieving a new level of understanding. There are several ways to present the history of economic thought:

- (i) To analyze the changing nature of economic theory in conjunction with the social and economic development of society
- (ii) To emphasize economic thinking as part of the main currents of philosophical and political ideas
- (iii) To emphasize the internal dynamics of the science where new insights and results emerge as a consequence of economists' awareness of the shortcomings of the present state of the subject.

Observation:

▪ *Economic history is different from history of economic thought. Economic history is the study of the economic aspects of societies in the past; the history of the economic use of resources land, labor and capital; or the examination of the past performance of economies. It is concerned with how people lived most of their lives, how many were born and died, how they earned and spent, worked and played. Such variants, however, reveal little more than the definition which once said simply that it was the sort of history which required a knowledge of economics; though they are an advance on that which defined an economic historian as one who wrote as little history as possible for as much money as possible.*

▪ *Economic history asks economic questions be they about the demand and supply of goods and services, about costs of production, levels of income, the distribution of wealth, the volume and direction of investment, or the structure of overseas trade it inevitably deals with large numbers, with aggregates. A study of economic history is important because the historical economic phenomena to be examined in any given period have no existence independent of the social, political, cultural, religious and physical environment in which they occurred.*

- **Classical School:** The Classical School, which is regarded as the first school of economic thought, is associated with the 18th Century Scottish economist Adam Smith, and those British economists that followed, such as Robert Malthus and David Ricardo. The main idea of the Classical school was that markets work best when they are left alone, and that there is nothing but the smallest role for government. The approach is firmly one of *laissez-faire* and a strong belief in the efficiency of free markets to generate economic development. Markets should be left to work because the price mechanism acts as a powerful '*invisible hand*' to allocate resources to where they are best employed. In terms of explaining value, the focus of classical thinking was that it was determined mainly by scarcity and costs of production. In terms of the macro-economy, the Classical economists assumed that the economy would always return to full-employment level of real

output through an automatically self-adjustment mechanism. It is widely recognized that the Classical period lasted until 1870.

Classical economics refers to work done by a group of economists in the eighteenth and nineteenth centuries. They developed theories about the way markets and market economies work. The study was primarily concerned with the dynamics of economic growth. It stressed economic freedom and promoted ideas such as laissez-faire and free competition. Economic thought until the late 1800's. Adam Smith's *Wealth of Nations*, published in 1776 can be used as the formal beginning of Classical Economics but it actually it evolved over a period of time and was influenced by Mercantilist doctrines, Physiocracy, the enlightenment, classical liberalism and the early stages of the industrial revolution. Classical economics as the predominant school of mainstream economics ends with the '*Marginalist Revolution*' and the rise of Neoclassical Economics in the late 1800's. In the 1870's *William Stanley Jevons*' and *Carl Menger*'s concept of marginal utility and *Leon Walras*' general equilibrium theory provided the foundations. *Henry Sidgwick*, *F.Y. Edgeworth*, *Vilfredo Pareto* and *Alfred Marshall* provided the tools for neoclassical economics. Neoclassical economics is an extension of Classical economics but, the focus of the questions changed as well as the tools of analysis. In spite of the dominance of neoclassical thought, Classical Economics has persisted and influences modern economics, particularly the '*New Classical Economics*.' The belief in the efficacy of a '*free market*' is central to both classical and neoclassical ideology. Famous economists of this school of thought included *Adam Smith*, *David Ricardo*, *Thomas Malthus* and *John Stuart Mill*. While Adam Smith would be regarded as the originator and leader of the school, David Ricardo should be credited with establishing the form and methods of the school. The debates between Thomas Malthus and David Ricardo about policy issues such as the '*Corn Laws*' and the '*Poor Laws*' contributed to the focus and form of the school. Smith was concerned about the nature of economic growth. Malthus, Ricardo and other classical economists were concerned about the question of '*distribution*' One important debate among classical economists was whether there was or wasn't a '*surplus*' or '*glut*' *Jean Baptiste Say* and *Malthus* were the two major protagonists in the question about the existence of a surplus and its effects on a market economy.

Chapter six: Mercantilism, An Origin Of Classical Economics

① Introduction

Mercantilism is economic nationalism for the purpose of building a wealthy and powerful state. Adam Smith coined the term “mercantile system” to describe the system of political economy that sought to enrich the country by restraining imports and encouraging exports. This system dominated Western European economic thought and policies from the sixteenth to the late eighteenth centuries. The goal of these policies was, supposedly, to achieve a “favorable” balance of trade that would bring gold and silver into the country and also to maintain domestic employment. In contrast to the agricultural system of the physiocrats or the laissez-faire of the nineteenth and early twentieth century’s, the mercantile system served the interests of merchants and producers such as the British East India Company, whose activities were protected or encouraged by the state. The most important economic rationale for mercantilism in the sixteenth century was the consolidation of the regional power centers of the feudal era by large, competitive nation-states. Other contributing factors were the establishment of colonies outside Europe; the growth of European commerce and industry relative to agriculture; the increase in the volume and breadth of trade; and the increase in the use of metallic monetary systems, particularly gold and silver, relative to barter transactions. During the mercantilist period, military conflict between nation-states was both more frequent and more extensive than at any other time in history. The armies and navies of the main protagonists were no longer temporary forces raised to address a specific threat or objective, but were full-time professional forces. Each government’s primary economic objective was to command a sufficient quantity of hard currency to support a military that would deter attacks by other countries and aid its own territorial expansion. Most of the mercantilist policies were the outgrowth of the relationship between the governments of the nation-states and their mercantile classes. In exchange for paying levies and taxes to support the armies of the nation-states, the mercantile classes induced governments to enact policies that would protect their business interests against foreign competition.

② Meaning:

Alexander Gray observes that: “Mercantilism is a misleading and deceitful word”¹. Different writers have defined mercantilism differently. According to *Lekachman*: “Mercantilism was a battle against hampering medieval thought and practice”. It was revolt against medievalism resolve to reconstruct economic life to a more rational scheme. To *Edmund Whittaker*: “Mercantilism was the

¹ Blaug, Mark, *Economic Theory in Retrospect*, 4th Edition, Cambridge: Cambridge University Press. 2009.

economic counterpart of political nationalism”. *Heiman* described it as: the ideological justification of Commercial Capitalism. Thus mercantilist writers were essentially practical businessmen, merchants and administrators in various European countries like England, France, Italy, Germany, Scotland, and Spain etc. They left behind numerous works regarding contemporary national economic problems. They do not form a school of economists. So the ideas and policies which dominated the economic scene of England and a part of Europe between the close of the **16th** century and the middle of the **18th** century can rightly be called as mercantilism.

Observation:

- *Mercantilist* writers put emphasis on foreign trade as a means of accumulating treasure and building a strong nation.

③ **Important economic theories of mercantilism:**

Whereas the economic literature of scholasticism was written by medieval churchmen, the economic theory of mercantilism was the work of secular people, mostly merchant businessmen, who were privately engaged in selling and buying goods. The literature they produced focused on questions of economic policy and was usually related to a particular interest the merchant and writer (in one person) was trying to promote. For this reason, there was often considerable skepticism regarding the analytical merits of particular arguments and the validity of their conclusions. Few authors could claim to be sufficiently detached from their private issues and offer objective economic analysis. However, throughout the mercantilism, both the quantity (there were over **2000** economic works published in 16th and **17th** century) and quality of economic literature grew. The mercantilist literature from **1650** to **1750** was of distinctly higher quality, these writers created or touched on nearly all analytical concept on which Adam Smith based his *Wealth of Nations*, which was published in **1776**.

The age of mercantilism has been characterized as **one** in which every person was his own economist¹. Since the various writers between 1500 and 1750 held very diverse views, it is difficult to generalize about the resulting literature. Furthermore², each writer tended to concentrate on one topic, and no single writer was able to synthesize these contributions impressively enough to influence the subsequent development of economic theory³.

Secondly, mercantilism can best be understood as an intellectual reaction to the problems of the times. In this period of the decline of feudalism and the

¹ Lars Magnusson, *Mercantilism: The Shaping of an Economic Language* (London: Routledge, 1994), pp. 1–230

² Cosimo Perrotta, *Is the Mercantilist Theory of the Favorable Balance of Trade Really Erroneous?*, *History of Political Economy* 25, no. 2 (1993): 301–336.

³ Lars Magnusson (ed.), *Mercantilist Economics* (Boston: Kluwer Academic Publishers, 1993), pp. 1–320.

rise of the nation-states, the mercantilists tried to determine the best policies for promoting the power and wealth of the nation, the policies that would best consolidate and increase the power and prosperity of the developing economies. What is especially important here is the mercantilist assumption that the total wealth of the world was fixed and constant. These writers applied the assumption to trade between nations, concluding that any increase in the wealth and economic power of one nation occurred at the expense of other nations (the rest of the world). Thus, the mercantilists emphasized international trade as a mean of increasing the wealth and power of a nation. Using some modern game-theoretic language, we may say, that they perceived economic activity and international trade in particular as a zero-sum game that is a game, where it is impossible for both players to win. So according to mercantilists, it is impossible to increase a global wealth of the world in effect of international trade. It is a very sad assumption, and modern economists do not share it. The goal of economic activity, according to most mercantilists, was production, not consumption, as classical economists would later have it. They advocated increasing the nation's wealth by simultaneously encouraging production, increasing exports and holding down domestic consumption. Thus, in practice, the wealth of nation rested on the poverty of the many members of society¹.

Third general point about mercantilism is their insistence on the notion of balance of trade. Balance of trade figures, also called net exports, are the sum of the money gained by a given economy selling exports, minus the cost of buying imports. A positive balance of trade is known as a trade surplus and consists of exporting more than one imports. A negative balance of trade is known as a trade deficit and consists of importing more than one export². As we know today, neither positive nor negative balance of trade is necessarily dangerous in modern economies, although large trade surpluses or trade deficits may sometimes be a sign of other economic problems. According to mercantilists a country should increase exports and discourage imports by means of tariffs, quotas, subsidies, taxes and the like in order to achieve a so-called favorable or positive balance of trade. Production should be stimulated by government interference in the domestic economy and by the regulations of foreign trade. Protective duties should be placed on manufactured goods from abroad; and the state should encourage the import of cheap raw materials to be used in manufacturing goods for export.

④ **Criticisms of Mercantilism:**

The following criticisms were levelled against mercantilism by the opponents:

¹ Eric Roll, *A History of Economic Thought* (London: Faber and Faber, 1973), pp. 49–78

² Andrew S. Skinner, *A System of Social Science: Papers Relating to Adam Smith* (Oxford: Oxford University Press, 1996), pp. 85–130.

1. The mercantilists exaggerated the importance of Commerce to the extent of depressing agriculture and other branches of human industry.
2. Undue importance was attached to gold and silver.
3. They were under erroneous belief that a favorable balance of trade alone would bring prosperity to the country¹.
4. Their idea about value, utility capital and interest were vague and imperfect².
5. They are narrow minded nationalists and not cosmopolitans. They could not conceive the ideas of mutually advantageous trade. However, we cannot dismiss their ideas as useless or impractical³. The idea of nationalism, self-sufficiency and economic strength were the outcome of their policies. The mercantilist policy proved successful in France, England, Holland and Germany who were competing for colonial supremacy

Conclusion:

Mercantilism was an important economic doctrine that dominated Europe between the sixteenth and eighteenth centuries. It considered national wealth to be based mainly on the accumulation of gold and silver through a positive balance of trade. Mercantilist thinkers encouraged strong state intervention in the economy by promoting exports and limiting imports. This policy aimed to strengthen national power and support the growth of emerging industries. Mercantilism also played a major role in the expansion of colonial trade and international competition among European nations. Despite the criticism it later received from classical economists, it contributed significantly to the development of modern economic policies and international trade systems. Consequently, mercantilism remains a fundamental stage in the history of economic thought.

¹ Mark Blaug, *Economic Theory in Retrospect* (Cambridge: Cambridge University Press, 1997), pp. 10–38.

² Henry William Spiegel, *The Growth of Economic Thought* (Durham: Duke University Press, 1991), pp. 81–115

³ Terence W. Hutchison, *Before Adam Smith: The Emergence of Political Economy, 1662–1776* (Oxford: Basil Blackwell, 1988), pp. 1–210.

Chapter seven: Physiocracy, An Origin Of Classical Economics

① **Introduction**

The Physiocrats were a group of economists who believed that the wealth of nations was derived solely from agriculture. Their theories originated in France and were most popular during the second half of the 18th century. Physiocracy was perhaps the first well developed theory of economics. They called themselves *économistes* (*economists*) but are generally referred to as Physiocrats in order to distinguish them from the many schools of economic thought that followed them. *Physiocrat* is derived from the Greek for “*Government of Nature*”. The principles of Physiocracy were first put forward by *Richard Cantillon*, an Irish banker living in France, in his 1756 publication “*Essai sur la nature du commerce en général*” (Essay on the Nature of Commerce in General). The ideas were later developed by thinkers such as *François Quesnay* and *Jean Claude Marie; Vincent de Gournay* into a more systematic body of thought held by a united group of thinkers. The Physiocrats saw the true wealth of a nation as determined by the surplus of agricultural production over and above that needed to support agriculture (by feeding farm laborers and so forth). Other forms of economic activity, such as manufacturing, were viewed as taking this surplus agricultural production and transforming it into new products, by using the surplus agricultural production to feed the workers who produced the extra goods. While these manufacturers and other non-agricultural workers may be useful, they were seen as 'sterile' in that their income derives ultimately not from their own work, but from the surplus production of the agricultural sector. The Physiocrats strongly opposed mercantilism, which emphasized trade of goods between countries, as they pictured the peasant society as the economic foundation of a nation's wealth. The Physiocrats enjoyed some support from the French monarchy and frequently met at Versailles. *Adam Smith*, who visited France as a tutor and mentor to the Earl of Buccleigh's son's Grand Tour, was heavily influenced by the ideas of the Physiocrats, and *Karl Marx* cites them as a reference in *Das Kapital*; they popularized the modern version of the *labor theory of value*.

Physiocracy is a school of thought founded by *François Quesnay* (1694-1774),¹ a court physician to King Louis the 15th. At one point in time Physiocracy constituted a sort of religious movement that attracted a number of outstanding and extremely fervent believers, and exerted no small influence on real politics.

The history of the Physiocratic movement is thought to have begun in 1757, when Quesnay met Mirabeau the elder (1715-89), and come to an end in

¹ Craiutu, Aurelian. *Liberalism, the Happy Exception*. History of European Ideas, vol. 50, no. 4, 2024, pp. 675–681.

1776, with the fall of Turgot (1727-81). The actual members of the Physiocratic school referred to themselves not as Physiocrats but as *économistes*.

Observation:

- *The term “Physiocracy” apparently came into general use after having first appeared in 1767, with the appearance of a collection of Quesnay’s works published by Pierre du Pont under the title Physiocratie. The term is of course a combination of “physio” (nature) and “cracy” (rule), thus meaning the “rule of nature.” This expresses the school’s fundamental idea that there is a natural order, as opposed to artificial systems, and that the mission of scholarship and politics being to understand this natural order and bring it into existence, thereby bringing about this rule of nature.*

② **The Basic Principles of Physiocracy:**

The following are the fundamental principles and policies of Physiocracy:

1. Agriculture is the only productive occupation.
2. Industry and trade are sterile occupations.
3. Agriculture alone produces net product.
4. There is a natural order which makes life happy and meaningful.
5. There is harmony among all classes of people.
6. The individual should get maximum liberty.
7. State action should be limited to the minimum.
8. Trade is a necessary evil, and there should be free trade.
9. Value depends on utility. Wealth has value. Value and price are the same things.
10. The wage level is at the subsistence level.
11. There is interdependence in the economic system.
12. Real wealth lies in tangible and consumable goods.
13. Private initiative must be encouraged.
14. Distribution of products is very essential.
15. Money is a medium of exchange.
16. All that is bought is sold and all that is sold is bought.
17. Rent is a perfectly legitimate income of the landlords.
18. There should be a single and direct tax on land, as it is the only productive source.
19. Private property is essential.
20. There is the possibility of overpopulation on land.

② **Criticisms of Physiocracy:¹**

¹ Blackford, Russell. *How We Became Post-Liberal: The Rise and Fall of Toleration*. London: Bloomsbury Academic, 2024 , pp :414-427.

The important criticism levelled against physiocracy are as follows:

1. Their theory was drowned in normative statement. This is quite true of natural order concept.
2. The physiocrats failed to consider the laboring Class as a productive class. Moreover, their contention that manufacturing class is sterile is also subject to severe criticism.
3. The physiocrats do not have a clear-cut concept of value. They have confused value with utility. They held the view that value depend on utility.
4. Their conception of landlord as partly productive class is more based upon political motive¹.
5. Physiocrats placed too much emphasis on agriculture and have neglected the non-agricultural sector.
6. Hanex says that physiocratic doctrines are full of negative attitudes.

Conclusion:

Physiocracy was one of the earliest economic schools of thought that emphasized the importance of natural laws in economic life. The Physiocrats believed that agriculture was the main source of national wealth and that economic activities should operate freely without excessive government intervention. Led by François Quesnay, this school introduced important concepts such as the “Tableau Économique,” which explained the circulation of wealth within the economy. Physiocracy also contributed to the development of liberal economic ideas and influenced later classical economists like Adam Smith. Although some of its theories became outdated with industrial development, its emphasis on free trade and economic freedom remained influential in modern economic thought. Therefore, Physiocracy occupies an important place in the history of economic analysis and the evolution of liberal economic principles.

¹ Tsoulfidis, Lefteris, and Persefoni Tsaliki. *Classical Political Economics and Modern Capitalism: Theories of Value, Competition, Trade and Long Cycles*. Cham: Springer International Publishing, 2020

Chapter Eight: Classical Liberalism, An Origin Of Classical Economics

① **Introduction**

Classical liberalism developed in the late 18th and early 19th centuries as a response to the social, economic, and political changes brought on by the Industrial Revolution and urbanization in Europe and the United States. Based on a belief that social progress was best achieved through adherence to natural law and individualism, classical liberals drew on the economic ideas of **Adam Smith** in his classic 1776 book “*The Wealth of Nations.*” Classical liberals also agreed with Thomas Hobbes’ belief that governments were created by the people for the purpose of minimizing conflict between individuals and that financial incentive was the best way to motivate workers. They feared a welfare state as a danger to a free market economy

③ **Meaning:**

Classical liberalism is a political and economic ideology that advocates the protection of civil liberties and laissez-faire economic freedom by limiting the power of the central government. Developed in the early 19th century, the term is often used in contrast to the philosophy of modern social liberalism. Emphasizing individual economic freedom and the protection of civil liberties under the rule of law¹.

In essence, classical liberalism favors economic freedom, limited government, and protection of basic human rights, such as those in the U.S. Constitution’s Bill of Rights. These core tenets of classical liberalism can be seen in the areas of economics, government, politics, and sociology.

Economics:

On an equal footing with social and political freedom, classical liberals advocate a level of economic freedom that leaves individuals free to invent and produce new products and processes, create and maintain wealth, and trade freely with others. To the classical liberal, the essential goal of government is to facilitate an economy in which any person is allowed the greatest possible chance to achieve his or her life goals. Indeed, classical liberals view economic

¹ Kassens, Alice L., and Joshua C. Hall, eds. *Challenges in Classical Liberalism: Debating the Policies of Today Versus Tomorrow*. Cham: Palgrave Macmillan, 2023 .

freedom as the best, if not the only way to ensure a thriving and prosperous society.

Critics argue that classical liberalism's brand of economics is inherently evil, overemphasizing monetary profit through unchecked capitalism and simple greed. However, one of the key beliefs of classical liberalism is that the goals, activities, and behaviours of a healthy economy are ethically praiseworthy. Classical liberals believe that a healthy economy is one that allows a maximum degree of free exchange of goods and services between individuals. In such exchanges, they argue, both parties end up better off—clearly a virtuous rather than evil outcome. The last economic tenant of classical liberalism is that individuals should be allowed to decide how to dispose of the profits realized by their own effort free from government or political intervention.

Government:

Based on the ideas of Adam Smith, classical liberals believe that individuals should be free to pursue and protect their own economic self interest free from undue interference by the central government. To accomplish that, classical liberals advocated a minimal government, limited to only six functions:

- I. Protect individual rights and to provide services that cannot be provided in a free market.
- II. Defend the nation against foreign invasion.
- III. Enact laws to protect citizens from harms committed against them by other citizens, including protection of private property and enforcement of contracts.
- IV. Create and maintain public institutions, such as government agencies.
- V. Provide a stable currency and a standard of weights and measures.
- VI. Build and maintain public roads, canals, harbours, railways, communications systems, and postal services.

Classical liberalism holds that rather than granting the fundamental rights of the people, governments are formed by the people for the express purpose of protecting those rights.

Sociology :

Classical liberalism embraces a society in which the course of events is determined by the decisions of individuals rather than by the actions of an autonomous, aristocratically-controlled government structure.

Key to the classical liberal's approach to sociology is the principle of spontaneous order the theory that stable social order evolves and is maintained not by human design or government power, but by random events and processes seemingly beyond the control or understanding of humans. Adam Smith, in *The Wealth of Nations*, referred to this concept as the power of the "invisible hand. For example, classical liberalism argues that the long-term trends of market-

based economies are the result of the “invisible hand” of spontaneous order due to the volume and complexity of the information required to accurately predict and respond to market fluctuations. Classical liberals view spontaneous order as the result of allowing entrepreneurs, rather than governments, to recognize and provide for the needs of the society.

② Division of Labor :

The main focus of Adam Smith’s *The Wealth of Nations* lies in the concept of economic growth. Growth, according to Smith, is rooted in the increasing division of labor. This idea relates primarily to the specialization of the labor force, essentially the breaking down of large jobs into many tiny components. Under this regime each worker becomes an expert in one isolated area of production, thus increasing his efficiency¹.

The fact that laborer’s do not have to switch tasks during the day further saves time and money. Of course, this is exactly what allowed Victorian factories to grow throughout the nineteenth century. Assembly line technology made it necessary for a worker to focus his or her attention on one small part of the production process. Surprisingly, Smith recognized the potential problems of this development. He pointed out that forcing individuals to perform mundane and repetitious tasks would lead to an ignorant, dissatisfied work force. For this reason, he advanced the revolutionary belief that governments had an obligation to provide education to workers. This sprung from the hope that education could combat the deleterious effects of factory life. Division of labor also implies assigning each worker to the job that suits him best. Productive labor, to Smith, fulfils two important requirements. First, it must **‘lead to the production of tangible objects.’** Second, labor must **‘create a surplus’** which can be reinvested into production.

Observation:

- *Division of labor is the outcome of a tendency common to all men, the tendency to barter; and this tendency itself is spontaneously developed under the influence of personal interest, which acts simultaneously for the benefit of each and all. Smith in his *Wealth of Nations* (Book 1, Chapter 1) ‘Of the Division of Labor’ gives the example of a pin factory to explain the concept of division of labor.*

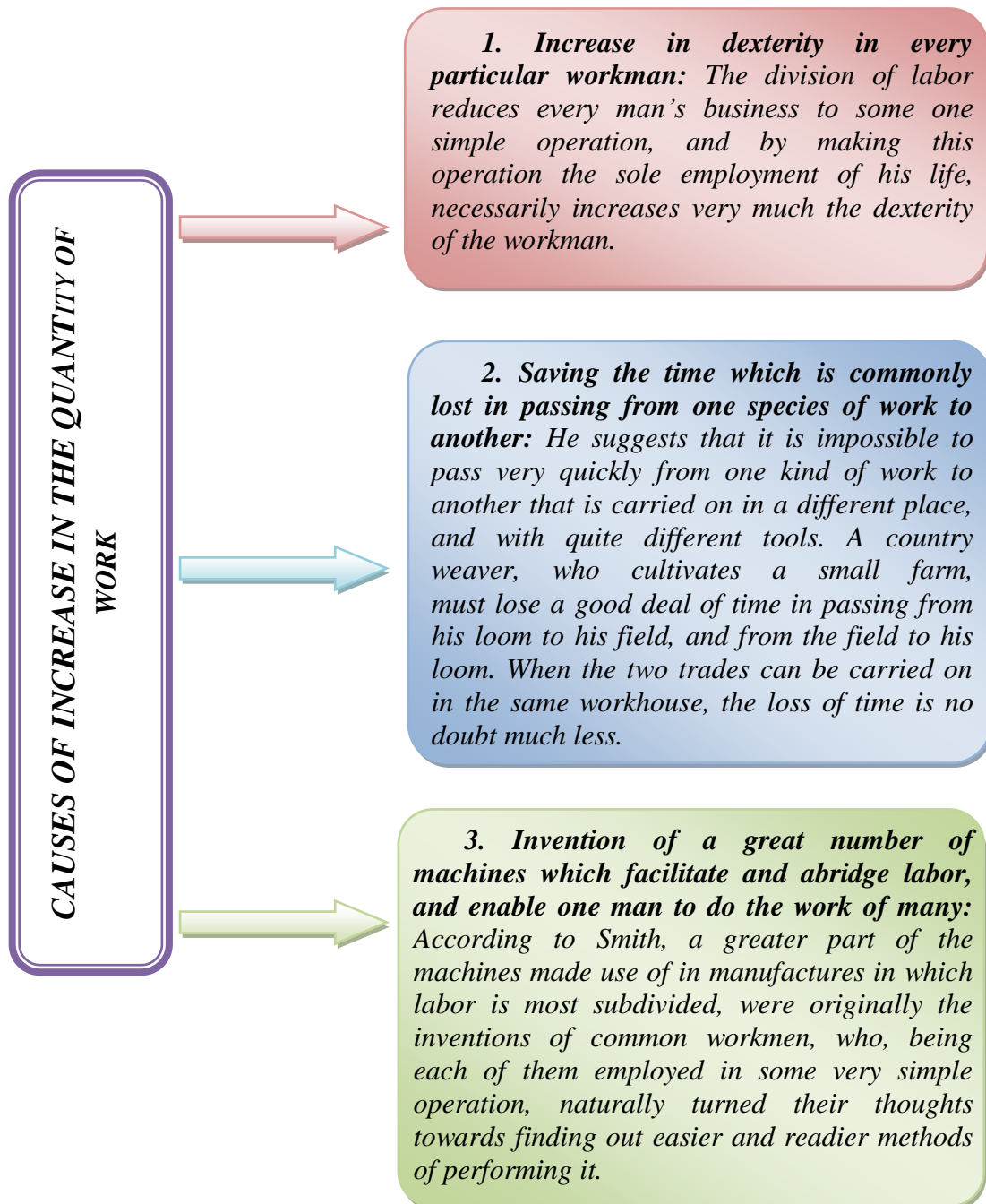
To take an example, therefore, from a very trifling manufacture; but one in which the division of labor has been very often taken notice of, the trade of the pin-maker; a workman not educated to this business (which the division of labor has rendered a distinct trade), nor acquainted with the use of the machinery

¹ Komlos, John. *Foundations of Real-World Economics: What Every Economics Student Needs to Know*. 3rd ed. London: Routledge, 2023, p : 129.

employed in it (to the invention of which the same division of labor has probably given occasion), could scarce, perhaps, with his utmost industry, make one pin in a day, and certainly could not make twenty. But in the way in which this business is now carried on, not only the whole work is a peculiar trade, but it is divided into a number of branches, of which the greater part are likewise peculiar trades. One man draws out the wire, another straightens it, a third cuts it, a fourth points it, a fifth grinds it at the top for receiving the head; to make the head requires two or three distinct operations; to put it on is a peculiar business, to whiten the pins is another; it is even a trade by itself to put them into the paper; and the important business of making a pin is, in this manner, divided into about eighteen distinct operations, which, in some manufactories, are all performed by distinct hands, though in others the same man will sometimes perform two or three of them. I have seen a small manufactory of this kind where ten men only were employed, and where some of them consequently performed two or three distinct operations¹. But though they were very poor, and therefore but indifferently accommodated with the necessary machinery, they could, when they exerted themselves, make among them about twelve pounds of pins in a day. There are in a pound upwards of four thousand pins of a middling size. Those ten persons, therefore, could make among them upwards of forty-eight thousand pins in a day. Each person, therefore, making a tenth part of forty-eight thousand pins, might be considered as making four thousand eight hundred pins in a day. But if they had all wrought separately and independently, and without any of them having been educated to this peculiar business, they certainly could not each of them have made twenty, perhaps not one pin in a day; that is, certainly, not the two hundred and fortieth, perhaps not the four thousand eight hundredth part of what they are at present capable of performing, in consequence of a proper division and combination of their different operations.’ Let us now interpret this.

Adam Smith explains the optimum organization of a pin factory. Traditional pin makers could produce only a few dozen pins a day. However, when organized in a factory with each worker performing a limited operation, they could produce tens of thousands a day. This was the reason why Smith favored division of labor. He suggests that there are three causes of increase in the quantity of work:

¹ Kurz, Heinz D. *David Ricardo: On the Art of Elucidating Economic Principles*. The European Journal of the History of Economic Thought, vol. 22, no. 5, 2015, pp. 818–851



④ Smith's Théorie of Value :

A main concern for Smith involved tracing the roots of value. He identified two different kinds of value, '**use value**' and '**exchange value**'. The concept of

exchange value interested Smith considerably¹. The diamond-water paradox, in particular, proved puzzling to him: Why is it that diamonds, which have very little practical use, command a higher price than water which is indispensable to life? By discovering the true source of value Smith hoped to find a benchmark for measuring economic growth. Eventually Smith settled on labor as the source of value: The number of hour's labor that a good can be exchanged for constitutes its inherent worth. (Note, this is not the same as saying that a good is worth the number of hours spent in its production.) The value of a good can also be referred to as the 'natural price.' The natural price need not function as the actual cost of a good in the marketplace. Competition, however, was expected to push the market price towards the natural price.

Smith believed that the word value has two different meanings, and sometimes expresses the utility of some particular object, and sometimes the power of purchasing other goods which the possession of that object conveys. The one may be called 'value in use'; the other, 'value in exchange.' The things which have the greatest value in use have frequently little or no value in exchange; and on the contrary, those which have the greatest value in exchange have frequently little or no value in use. Nothing is more useful than water: but it will purchase scarce anything; scarce anything can be had in exchange for it. A diamond, on the contrary, has scarce any value in use; but a very great quantity of other goods may frequently be had in exchange for it.

According to Smith, value in exchange is the power of a commodity to purchase other goods its price. This is an objective measure expressed in the market. His concept of value in use is ambiguous; it resulted in a good part of his difficulties in explaining relative prices. On the one hand, it has ethical connotations and is therefore a return to scholasticism. Smith's own puritanical standards are particularly noticeable in his statement that diamonds have hardly any value in use. On the other hand, value in use is the want-satisfying power of a commodity, the utility received by holding or consuming a good. Several kinds of utility are received when a commodity is consumed: *its total utility*, *its average utility*, and *its marginal utility*. Smith's focus was on total utility -the relationship between marginal utility and value was not understood by economists until one hundred years after Smith wrote and this obscured his understanding of how demand plays its role in price determination. It is clear that the total utility of water is greater than that of diamonds; this is what Smith was referring to when he pointed to the high use value of water as compared to the use value of diamonds. However, because a commodity's marginal utility often decreases as more of it is consumed, it is quite possible that another unit of water would give less marginal utility than another unit of diamonds. The price we are willing to pay for a commodity

¹ Gehrke, Christian, and Heinz D. Kurz. *Karl Marx on Physiocracy, Adam Smith, David Ricardo and Other Economists*. *The European Journal of the History of Economic Thought*, vol. 29, no. 1, 2022, pp. 1–25.

-the value we place on acquiring another unit - depends not on its total utility but on its marginal utility. Because Smith did not recognize this (nor did other economists until the 1870s), he could neither find a satisfactory solution to the diamond-water paradox nor see the relationship between use value and exchange value.

Smith's 'labor theory of value' stipulates that the value of a good or service is dependent upon the labor used in its production. It suggests that goods which take the same amount of time to produce should cost the same. This theory was an important concept in the philosophical ideals of Karl Marx. Opponents of the labor theory of value purport that it is not labor that determines the price of a good or service; rather, it is simply a function of supply and demand for a given good or service that determines its price. According to the theory, if the cost of purchasing something is greater than the amount that the purchaser values the time it would take to produce the good, then he will make it himself rather than buy it.

Conclusion:

Classical Liberalism is a political and economic philosophy that emphasizes individual freedom, private property, and limited government intervention in economic affairs. It emerged during the eighteenth and nineteenth centuries through the ideas of thinkers such as Adam Smith, John Locke, and David Ricardo. Classical liberals believed that free markets and competition were essential for economic growth and social progress. They also defended the principles of free trade, equality before the law, and protection of individual rights. This doctrine greatly influenced the development of capitalism and modern democratic systems. Although it has evolved over time, Classical Liberalism continues to shape contemporary debates on economic freedom and the role of the state in society.

Chapter Nine: Ricardian And Marxism School, An Origin Of Economic Thought

① **Introduction**

Ricardo added little to the economic knowledge gathered by Smith. As an analytical engine, economics provides an apparatus through which actual economic problems are analysed. Ricardo's greatest contribution to economics is the provision of engine of analysis. By using the technique of deductive or abstract reasoning¹, he constructed a rigorous model in which some selected economic variables were systematically placed to form logic. Such a theoretical model helps to understand how a system works and how the change in variables affects the working of the system.

Observation:

▪ *David Ricardo was born on 19 April 1772 in London. He was the third son of a Dutch Jew who had made a fortune on the London Stock Exchange.*

When he was 14, Ricardo joined his father's business and showed a good grasp of economic affairs. In 1793 he married a Quaker called Priscilla Anne Wilkinson; Ricardo then converted to Christianity, becoming a Unitarian. This caused a breach with his father and meant that Ricardo had to establish his own business. He continued as a member of the stock exchange, where his ability won him the support of an eminent banking house. He did so well that in a few years he acquired a fortune. This enabled him to pursue his interests in literature and science, particularly in mathematics, chemistry, and geology.

③ **Theory of Rent :**

David Ricardo, an English classical economist, first developed a theory in 1817 to explain the origin and nature of economic rent. Ricardo used the economic and rent to analyse a particular question. In the Napoleonic wars (1805-1815) there were large rise in corn and land prices. Did the rise in land prices force up the price of corn, or did the high price of corn increase the demand for land and so push up land prices. Ricardo defined rent as, "that portion of the produce of the earth which is paid to the landlord for the use of the original and indestructible powers of the soil." In his theory, rent is nothing but the producer's surplus or differential gain, and it is found in land only.

▪ **Assumptions :**

¹ Wood, John Cunningham, ed. *David Ricardo: Critical Assessments*. London: Routledge, 1985.

- i. Rent of land arises due to the differences in the fertility or situation of the different plots of land. It arises owing to the original and indestructible powers of the soil¹.
- ii. Ricardo assumes the operation of the law of diminishing marginal returns in the case of cultivation of land².
- iii. Ricardo looks at the supply of land from the standpoint of the society as a whole.
- iv. In the Ricardian theory it is assumed that land, being a gift of nature, has no supply price and no cost of production.

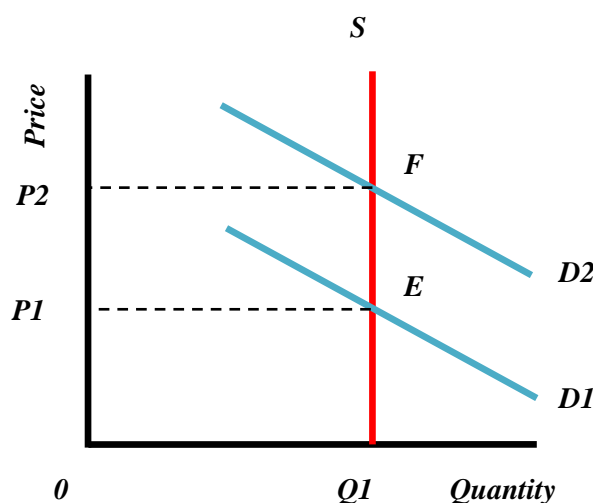
Observation:

- According to Ricardo rent arises for two main reasons:
 1. Scarcity of land as a factor and,
 2. Differences in the fertility of the soil.

1. Scarcity of land :

Ricardo assumed that land had only one use to grow corn. This meant that its supply was fixed, as shown in given figure below. Hence the price of land was totally determined by the demand for land. In other words, all the price of a factor of production in perfectly inelastic supply is economic rent it has no transfer earnings.

Figure n°: 01 Earning of a Factor in Fixed Supply



Source: Wood, John Cunningham, *David Ricardo: Critical Assessments*. London: Routledge, 1985, pp:98-100.

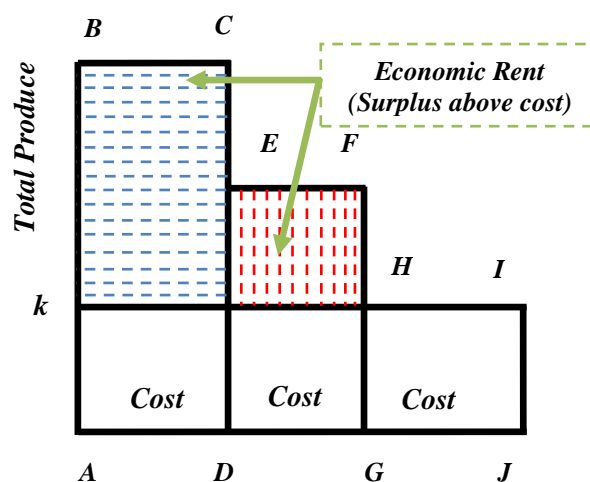
¹ Arrow, Kenneth J. *Ricardo's Work as Viewed by Later Economists*. *Journal of the History of Economic Thought*, vol. 13, no. 1, 1991, pp. 45–62.

² Kurz, Heinz D. *David Ricardo: On the Art of Elucidating Economic Principles*. *The European Journal of the History of Economic Thought*, vol. 22, no. 5, 2015, pp. 818–851.

2. Differences in the fertility of the soil :

Ricardo assumes that the different grades of lands are cultivated gradually in descending order the first-grade land being cultivated at first, then the second grade, after that the third grade and so on. With the increase in population and with the consequent increase in the demand for agricultural produce, inferior grades of lands are cultivated, creating a surplus or rent for the superior grades.

Figure n°: 02 Differential Rent



Source: Hollander, Samuel. *The Economics of David Ricardo*. London: Heinemann Educational Books, 1989, p:143.

Through figure 02, AD, DG and GJ are three separate plots of land of the same size, but of difference in fertility. The total produce of AD is ABCD, that of DG is DEFG and that of GJ is GHIJ. The first and second plots of land generate a surplus show by the shaded area, which represents the rent of the first two plots of land. Since the third plot GJ has no surplus, it is marginal land or no-rent land. Grade 4 (below-marginal) land will not be cultivated, because rent is negative¹.

② Theory of wage :

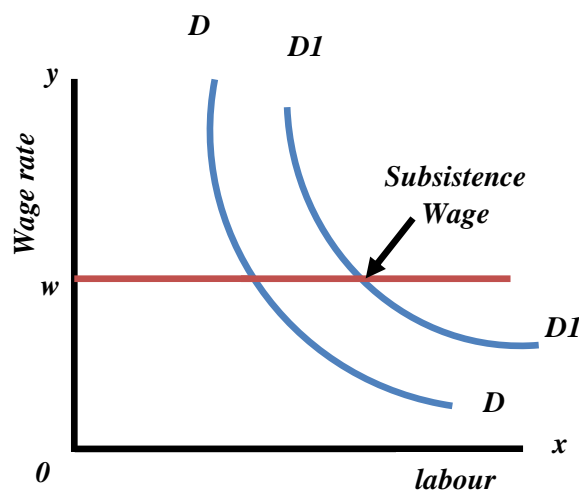
This theory was propounded by David Ricardo (1772-1823). According to this theory, “The labourers are paid to enable them to subsist and perpetuate the race without increase or diminution”. This payment is also called as ‘subsistence wages’. The basic assumption of this theory is that if workers are paid wages more than subsistence level, workers’ number will increase and, as a result wages will come down to the subsistence level.

On the contrary, if workers are paid less than subsistence wages, the number of workers will decrease as a result of starvation death; malnutrition,

¹ Hollander, Samuel. *The Economics of David Ricardo*. London: Heinemann Educational Books, 1989, p :143.

disease etc. and many would not marry. Then, wage rates would again go up to subsistence level. Since wage rate tends to be at, subsistence level at all cases, that is why this theory is also known as ‘Iron Law of Wages’. The subsistence wages refers to minimum wages. This theory can be discussed with the help of diagram.

Figure n°: 03 wage and labour



Source: Kurz, Heinz D. “David Ricardo: On the Art of Elucidating Economic Principles.” *The European Journal of the History of Economic Thought*, vol. 22, no. 5, 2015, pp. 818–851.

In given Figure demand and supply of labor has been measured on OX axis and wage rate on OY-axis. OW is the subsistence level of wages. At OW wage rate supply of labor is perfectly elastic. Since, supply of labor is perfectly elastic, wage rate neither can fall below OW nor can increase above the level of OW. Although demand increases from DD to D1D1 yet the wage rate remains the same at OW. Though this theory is criticized by many economists on various ground still it is one of the successful theory of wage¹.

④ Theory of Value :

Modern discussion of the validity of the economic system of David Ricardo has centered about the theory of value. The labor theory of value states that the relative price of two goods is determined by the ratio of the quantities of labor required in their production. His labor theory of value has the following assumptions:

1. Both sectors have the same wage rate and the same profit rate;
2. The capital employed in production is made up of wages only;

¹ Kurz, Heinz D. *David Ricardo: On the Art of Elucidating Economic Principles*. *The European Journal of the History of Economic Thought*, vol. 22, no. 5, 2015, pp. 818–851.

3. The period of production has the same length for both goods.

In the theory 'On Value and Riches,' Ricardo makes effort to illustrate that exchange value is not the same as 'value in use'. In this way one can factor two often contradictory results. the capital employed in production must be made up of wages only for his value theory to hold, is answered by this: that production may be made up of capital and machinery, but it doesn't change the principle (*which he attributes to Adam Smith*) that he tries to lay out in this chapter. Machinery may add to one measure of value beyond almost all measure without adding one penny to the other measure of value¹.

In this way, one is able, Ricardo seems to show, to factor out somewhat contradictory assumptions which if confounded lead to equally contradictory results.

③ Theory Surplus value :

The Marxian concept of surplus value, professed to explain the instability of the capitalist system. In Marxian economics, surplus value is the difference between the amount raised through a sale of a product and the amount it cost to the owner of that product to manufacture it: the amount raised through sale of the product minus the cost of the materials, plant and labour power. The concept originated in Ricardian socialism, with the term "surplus value" itself being coined by William Thompson in 1824; however, it was not consistently distinguished from the related concepts of surplus labour and surplus product. The concept was subsequently developed and popularized by Karl Marx. Marx's formulation is the standard sense and the primary basis for further developments, though how much of Marx's concept is original and distinct from the Ricardian concept is disputed. Marx's term is the German word "*Mehrwert*", which simply means value added (*sales revenue less the cost of materials used up*), and is cognate to English "*more worth*". It is a major concept in Karl Marx's critique of political economy. Conventionally, value-added is equal to the sum of gross wage income and gross profit income. However, Marx uses the term *Mehrwert* to describe the yield, profit or return on production capital invested

¹ Davis, John B. *Ricardo's Theory of Profit and the Third Edition of the Principles*. *Journal of the History of Economic Thought*, vol. 11, no. 2, 1999, pp. 165–179.

Observation:

▪ **Karl Heinrich Marx** (1818-1883) was born on May 5, 1818 in the city of Trier, Germany. His father was a lawyer, Karl Marx went to the University of Bonn to study law when he was 17 years old. Here he became engaged to Jenny von Westphalen, whose father, Baron von Westphalen, influenced Marx to read Romantic literature and Saint-Simonian politics. Only a year later, Marx was moved by his father to the University of Berlin where he studied Hegelianism, influenced by Ludwig Feurbach and other Hegelians.

Marx used the terms surplus and exploitation in a pejorative sense. He strongly believed that the income distribution at the time was unfair and that the institutions that led to this unfairness deserved to be called exploitative. Most modern economists see such judgments as going beyond the role of economists as economists. They try to separate normative judgments from positive analysis. But even in terms of normative judgments, they question the value of the exploitation concept. They see human nature as generally exploitative and see the market as based on the concept of mutual exploitation. Abba Lerner summarized this view nicely: in capitalism man exploits man; in socialism it is the other way around.

▪ **The Materialistic Interpretation of History :**

Marx's general ideas about society are known as his theory of historical materialism. Materialism is the basis of his sociological thought because for Marx material conditions or economic factors affect the structure and development of society. His theory is that material conditions essentially comprise technological means of production and human society is formed by the forces and relations of production¹.

Marx's theory of historical materialism is historical. It is historical because Marx has traced the evolution of human societies from one stage to another. It is called Materialistic because Marx has interpreted the evolution of societies in terms of their material or economic bases².

Materialism simply means that it is matter or material reality, which is the basis for any change. According to Friedrich Engels, the theory of historical materialism was discovered by Karl Marx, but Marx thought it was Engels who has conceived the materialist formulation of history independently. We shall

¹ O'Brien, Denis P. *The Classical Economists Revisited*. Princeton University Press, 2004.

² Kurz, Heinz D. *Revisiting Classical Economics: Studies in Long-Period Analysis*. London: Routledge, 2020.

say that both of them used this theory, to quote Marx, as the “guiding thread” of all their works.

Materialism means the materialist structure of society. It is how the super structure of society is based on economic infrastructure. Marx’s theory of historical materialism is the materialistic interpretation of the history of societies. All the societies have experienced similar pattern of history and every history is built upon its materialist foundations.

Marx has tried to suggest that all society passes through unilinear evolution, every society progresses stage by stage and every society has marched ahead. He has suggested about the history of society:

Figure n°: 04 The Society unilinear evolution of Marx



Source: Salvadori, Neri. *Ricardo’s Theory of Growth and Accumulation: A Modern View*. London: Routledge, 2020, p :342.

Marx’s theory sought to explain all social phenomena in terms of their place and function in the complex systems of society and nature. This was without recourse to what may be considered as metaphysical explanations clearly outlined in those early writings of Hegel and his followers. This eventually became a mature sociological conception of the making and development of human societies¹.

▪ **Assumptions:**

Historical materialism is based upon a philosophy of human history. But it is not strictly speaking, a philosophy of history. It is best understood as sociological theory of human progress. As a theory it provides a scientific and systematic research programme for empirical investigations. At the same time, it also claims to contain within it a revolutionary programme of intervention into society. It is this unique combination of scientific and revolutionary characters which is the hall mark of Marx’s original formulation.

▪ **The terms mentioned in Marx’s theory of Historical Materialism:**we can find four (04) terms.

1. **Social relations, over and above individuals:** -Marx says that as a general principle, the production of material requirements of life, which is a very basic necessity of all societies; compel individuals to enter into definite social relations that are independent of their will. This is the basic idea of Marx’s theory of society. He stresses that there are social relations which impinge upon individuals irrespective of their preferences. He

¹ Salvadori, Neri. *Ricardo’s Theory of Growth and Accumulation: A Modern View*. London: Routledge, 2020 , pp :323-327.

further elaborates that an understanding of the historical process depends on our awareness of these objective social relations¹.

2. **Infrastructure and Super-structure:** - According to Marx, every society has its infrastructure and superstructure. Social relations are defined in terms of material conditions which he called infrastructure. The economic base of a society forms its infrastructure. Any changes in material conditions also imply corresponding changes in social relations. Forces and relations of production came in the category of infrastructure. Within the superstructure figure the legal, educational and political institutions as well as values, cultural ways of thinking, religion, ideologies and philosophies².
3. **Forces and relations of production:** -The forces of production appear to be the capacity of a society to produce. This capacity to produce is essentially a function of scientific and technical knowledge, technological equipment and the organization of labour force. The relations of production arise out of the production process but essentially overlap with the relations in ownership of means of production.
4. **Social change in terms of social classes:** -Marx elaborates the significance of the infrastructure of society by tracing the formation of the principal social classes. He develops the idea of social change resulting from internal conflicts in a theory of class struggles. For Marx, social change displays a regular pattern. Marx constructs in broad terms, a historical sequence of the main types of society, proceeding from the simple, undifferentiated society of “primitive communism” to the complex class society of modern capitalism.

¹ Tsoulfidis, Lefteris, and Persefoni Tsaliki. *Classical Political Economics and Modern Capitalism: Theories of Value, Competition, Trade and Long Cycles*. Cham: Springer International Publishing, 2020, pp :290-297.

² Chatzarakis, Nikolaos, Persefoni Tsaliki, and Lefteris Tsoulfidis. *Economic Growth and Long Cycles: A Classical Political Economy Approach*. London: Routledge, 2024.

PART 3: HISTORY OF NEO-CLASSICAL ECONOMIC THOUGHT**① Objectives :**

After going to this part you will be able:

- i.** To understand the origin of neo-classical Economics
- ii.** To understand Alfred Marshall school
- iii.** To understand Alfred Marshall life's ideas and various theories in economics.

② General Introduction:

Neo-classical approach was adopted by **Alfred Marshall** and his followers to diverge from earlier economic theories and to formulate them in accordance with the changing situations. They paid more attention to the fact relating to the concrete economic realities. This approach was reconciliation between deductive and inductive methods of study. The Neo-classical approach believed that **“Inductive and Deductive reasoning are necessary for the science of economics just as the right and left feet are necessary for walking”**.

Joseph Schumpeter, who believed that an entrepreneur could earn economic profits by introducing successful innovations. He believes that a large firm needs short-run legal protection which would provide enough short-run market power to create an incentive to invest. Without any protection, Schumpeter feels that large firms would not be as likely to invest in innovative activities and there would be no technological change.

Whereas, the approach of **Pigou** was categorized as welfare approach, which contains a qualitative presentation. It aims at maximizing the welfare of the people. The welfare approach lays importance of utility, demand and consumption whereas classical approach stressed on cost, supply and production.

Chapter Ten: Marshall And Neoclassical Economic Thought

① **Introduction:**

Alfred Marshall was one of the most influential economists of the late 19th and early 20th centuries. His book, *Principles of Economics*, was published in 1890 and quickly became a dominant economic and mathematical textbook in England. It is still used today in classrooms around the world. Marshall is viewed as the founder of the neoclassical school of thought in economics and was the first to introduce many now-standard principles of the field. Neoclassical economists were interested in how agents, consumers, and producers maximize the function of scarce resources in a given market.² Marshall's articulation of the relationship between supply and demand was central to neoclassical economist foundations and his concepts endure today in many economic models and theories.

Observation:

▪ **Marshall** was born at Clapham, London on July 26, 1842. In 1861, he joined the Saint John's College (Cambridge University) from where he graduated with high honours in Mathematics. He taught Mathematics at Cambridge University for a period of 7 years. He began a serious study of Economics in 1867.

While a student at Cambridge he came into contact with eminent philosophers like Professor Sidgwick, T.H. Green and Maurice under whose able guidance he studied the works of Kant and Hegel which considerably shaped his ideas. He regarded Kant as his guide "the only man I ever worshipped." In order to study the original works of Kant he went to Germany in 1868 and 1870.

1. Economic ideas of Marshall:

In 1875, Marshall visited the USA for 4 months. At Harvard and Yale he had long talks with academic economists, but his main purpose was to study the problem of protection. On his return home, he delivered one lecture on November 17, 1875 at the Moral Science Club, Cambridge on the development of American industry and the other at Bristol in 1878 on the Economic condition of America. The American trip influenced and coloured all his future work.

2. Principles of Economics:

Marshall's Principles of Economics book was published by London based publisher Macmillan and Co in 1890. The eight edition was published in 1920 which has been reprinted 11 times. It's divided into 6 books;

- **Book-I:** deals with the preliminary survey;
- **Book-II:** examines some fundamental notions;
- **Book-III:** discusses wants and their satisfaction;
- **Book-IV:** describes and analyses the agents of production;
- **Book-V:** deals with the general relations of demand, supply and value;
- **Book-VI:** presents a discussion on the distribution of national income.

3. *Marshall's definition of Economics:*

“*Political Economy* or Economics is a study of mankind in the ordinary business of life; it examines the part of individual and social action which is most closely connected with the attainment and with the use of the material requisites of well-being. Thus, it is on the one side a study of wealth; and on the other, and more important side, a part of the study of man.” It's clear from his definition that he laid emphasis on two things – study of man and study of wealth. Whereas earlier economists had stressed upon wealth-getting and wealth-spending activities only. Marshall stated that although money or general purchasing power or command over material wealth “is the centre round which the economic science clusters” yet that was not the main aim of human activity. It was simply a convenient means of measuring human motives. For him, economics was concerned with individuals as members of a social organism. The aim of economic science, then is to contribute to the solution of existing social problems. It's concerned with well-being of human also. Although the study of economics is confined to those forces which can be measured in terms of money, yet besides selfishness, other factors like habits, love of family, work for pleasure, etc, also influence economic actions.

4. *Marshall's Theory Of Value And Time Element:*

For a very long time, there were different arguments regarding what determines the value of a product. The classical economists had an opinion that the cost of production and thereby the supply of the product determines its value. But the economists of the early *Marginalist* school said that demand based on marginal utility determines the value of a commodity. But Marshall was an opinion that both supply and demand determine the value of any product¹.

Marshall associated supply and demand with two blades of a pair of scissors. It is useless to ask which does cutting. In his own words, “We might as reasonably dispute, whether it is the upper or under a blade of a pair of scissors that cuts a piece of paper, as whether the value is governed

¹ Deleplace, Ghislain. *Time and Market Adjustment in Marshall's Theory of Value*. The European Journal of the History of Economic Thought, vol. 28, no. 3, 2021, pp. 355–378

by utility or cost of production. It is true that when one blade is held still, and the cutting is effected by moving the other, we may say with careless brevity that cutting is done by the second; but the statement is not strictly accurate, and is to be excused only so long as it claims to be merely a popular and not a strictly scientific account of what happens”.

Observation:

▪ **Marshall** did not try to demolish the economics of Smith, Ricardo and Mill, but he tried to supplement it. He sought a synthesis of the utility theory of the Austrian economists and the cost of production theory of classical economists.

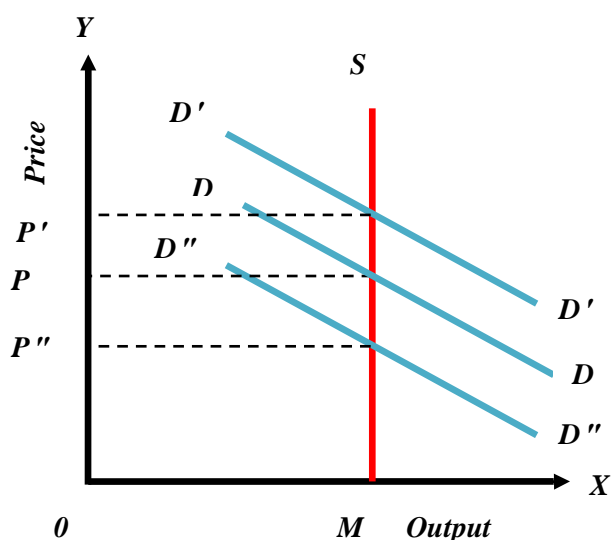
Marshallian theory of value, owing to its emphasis both on supply and demand as forces governing value, is known as the Dual theory of value. It is important to note that the theory emphasises the role of margin. Value is determined by the forces of supply and demand at the margin. It is marginal utility and marginal cost of production that govern value.

↳ **Types of value (on the basis of time):**

- Market value
- Short period value
- Long period value
- Secular value

The market price of a commodity may be defined as the price ruling at a particular period. In the case of market price, the supply is fixed and price depends mainly on demand.

Figure n°: 05 Types of value (on the basis of time)



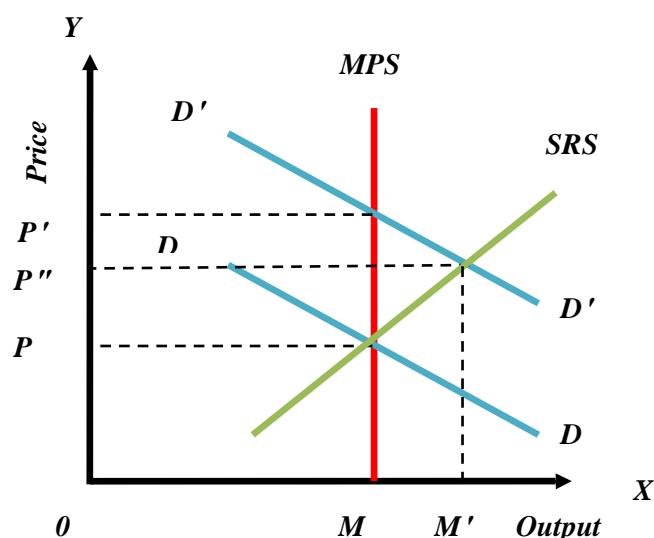
Source: Deleplace, Ghislain. *Time and Market Adjustment in Marshall’s Theory of Value*. *The European Journal of the History of Economic Thought*, vol. 28, no. 3, 2021, pp. 355–378

MS is the supply curve that is vertical because in the short period supply can’t change with a change in the price of the product. **DD** is the market

demand curve that is downward sloping. P is the equilibrium price level. If the demand increases to DD' , the price level will also increase to P' as the supply is fixed. If the demand decreases to $D'D''$, the price will also fall to P'' . However, the equilibrium level of output OM never changes in the short run.

In the case of a short period, we think of supply as the amount which can be produced at a given price, with a varying amount of labour and raw material. It can be defined as “that period during which the variable inputs can be increased or decreased but the fixed plant can’t be changed”. So in the case of short period price, both demand and supply determine the price.

Figure n°: 06 Types of value (on the basis of time)



Source: Arena, Richard. *Marshall's Time Period Analysis and the Evolution of Value Theory*. History of Political Economy, vol. 54, no. 2, 2022, pp. 201–229

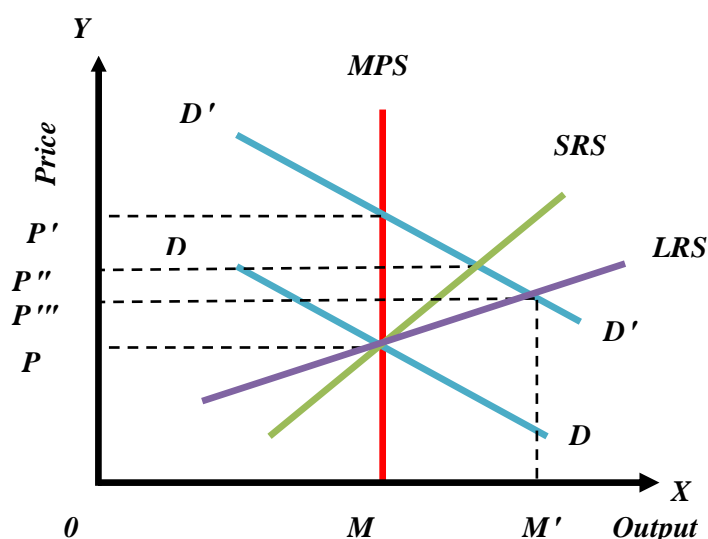
DD is the demand curve and MPS is the market period supply curve and SRS is the short-run supply curve. When there is an increase in demand, DD will shift to DD' and the short-run price will be OP'' at which new demand curve DD' intersects the SRS . The quantity supplied has also increased from OM to OM' . Therefore, in the short run, if demand increases, a more amount of the quantity is sold and the price is also not as high as in the market period

In the case of a long period, supply means “what can be produced by the plant which itself can be remuneratively produced and supplied within the given time”. In the long run, the cost of production is the most important determinant of price. So, when there is an increase in the demand for the product in the long-run more factories can be built, more machinery can

¹ Arena, Richard. *Marshall's Time Period Analysis and the Evolution of Value Theory*. History of Political Economy, vol. 54, no. 2, 2022, pp. 201–229.

be employed, more workers can be trained and more raw material can be utilised¹.

Figure n°: 07 Types of value (on the basis of time)



Source: Raffaelli, Tiziano, *The Time Element in Alfred Marshall's Economics*. Cambridge Journal of Economics, vol. 46, no. 4, 2022, pp. 789–812.

LRS is the long-run supply curve, which is relatively more elastic than the short-run supply curve. **MPS** is the market supply curve and **SRS** is the short-run supply curve. **DD'** is the market demand curve and **OP** is the price. If the demand increases to **DD'**, the market price will increase to **OP'**. Short period price will be **OP''** at which **SRS** intersects the **DD'** curve. But in the long-run, the price will be **OP'''** at which **LRS** intersects the **DD'** curve. Marshall defined long-run normal price as one which in the long-run would exactly balance supply and demand and which would be equal to long-run total cost of production. Marshall has also made the point market price will tend to fluctuate around normal price.

The secular period is very long. According to Marshall, it is a period of more than ten years in which changes in demand fully adjust themselves to supply. Since it is not possible to estimate the changes in demand due to changes in techniques of production, population, raw materials, etc. over a very long period, Marshall did not analyse pricing under the secular period.

Marshall has also conceived of gradual and secular changes in the normal value. The secular changes in the normal values are caused by the changes in the economic data like population, tastes and preferences of people, capital, organisation and so on.

¹ Harry Landreth and David C. Colander, *History of Economic Thought*, 4th Edition, Houghton Mifflin Company, Boston, Toronto.

Marshall's introduction of the time element in economic analysis was one of his many significant contributions to economic thinking. In conceiving of market broadly into the short and long period, his object was to *“trace a continuous thread running through and connecting the applications of the general theory of equilibrium of demand and supply of different periods of time.”*

5. Marshall's concept of representative firm:

According to Marshall, a representative firm as one which has had a fairly long life and fair success, which is managed with normal ability and which has normal access to the economies, external and internal, which belong to that aggregate volume of production the conditions of marketing them and the economic environment generally. His representative firm is in a sense an average firm. It is neither old nor new, neither very efficient nor inefficient. It is neither earning supernormal profits nor incurring losses. It is neither developing fast nor decaying.

Marshall says, *“the firms rise and fall but the representative firm remains always of the same size as does the representative tree of the virgin forest”.*

+ Features :

- i. *Representative firm will be an average firm. It has a fair amount of internal and external economies.*
- ii. *It is neither declining nor increasing.*
- iii. *Its management is neither very efficient nor inefficient.*
- iv. *It is neither old nor new.*
- v. *It is neither earning super normal profits nor incurring losses.*
- vi. *There can be more than one such firm.*

+ Criticisms :

- i. If the law of increasing returns operates in a firm then the firm will be enjoying profits. On the other hand, if the firm is subject to the operation of decreasing returns, it will be incurring losses.
- ii. Robbins has said that even the clearest statement given by Marshall for his so-called representative firm does not make it clear whether it is a representative plant or a technical production unit or a representative business unit.
- iii. Representative firm is also criticised as an illusory and unnecessary one.
- iv. Robertson has pointed out that in practice it is not so easy to locate a representative firm. A firm that may be representative now may not be in future.
- v. It is assumed that representative firm is neither increasing nor decaying. In practice, we cannot find firms that will be happy in that position.
- vi. Kaldor regards the representative firm as a state of mind rather than a concrete analysis.

Despite the above criticisms, some economists have tried to discover a representative firm. Chapman and Taussig have tried to locate a representative firm in 1914 in England.

6. Marshall's concept of consumer's surplus:

Another significant contribution of Marshall in the economic literature was the concept of consumer's surplus. According to Marshall, "The excess of price which he would be willing to pay rather than go without the thing, over that which he does pay, is the economic measure of this surplus satisfaction. And it may be called as consumer's surplus".

Consumers are generally prepared to pay a higher price for a commodity rather than go without it. But actually, they pay less for it. As a result, the consumer enjoys a surplus satisfaction and it is known as consumer's surplus. The concept of consumer's surplus has become the basis of welfare economics.

$$\text{Consumer's Surplus} = \text{The price a consumer is ready to pay} - \text{The price he actually pays}$$

The concept of consumer surplus is derived from the law of diminishing marginal utility. As per the law, as we purchase more of a commodity, its marginal utility reduces. Since the price is fixed, for all units of the goods we purchase, we get extra utility. This extra utility is consumer surplus¹.

↳ Example:

The consumer is in equilibrium when the marginal utility is equal to the price. That means, he purchases those many numbers of units of a good at which its marginal utility is equal to the price. Now, the price is fixed for all units. Hence, he gets a surplus for all units except the one at the margin. This extra utility is consumer surplus.

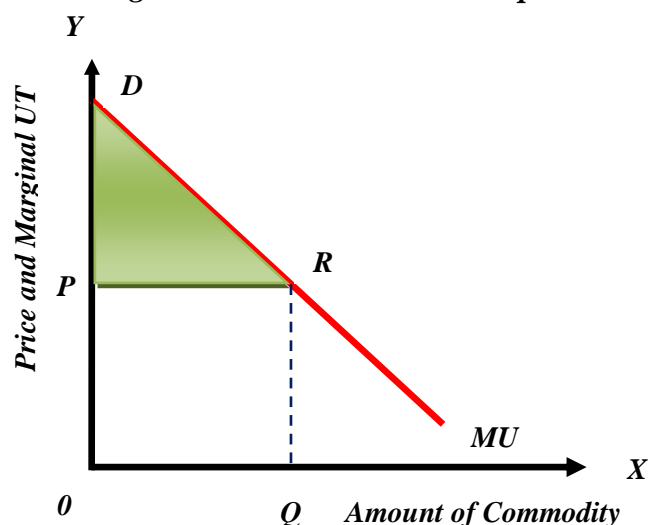
Table n°: 01 Consumer's Surplus

<i>Number of Units</i>	<i>Marginal Utility</i>	<i>Price (Rs)</i>	<i>Consumer's Surplus</i>
01	20	12	8
02	18	12	6
03	16	12	4
04	14	12	2
05	12	12	0
Total	80	60	20

As we can see from the above table, a first unit gives the 20 utility which gradually falls as there is an increase in the unit consumption. However, the price of the product has remained the same as Rs. 12. A rational consumer will consume 5 units as the marginal utility is equal to its price. Here the total utility is 80 units and the price he paid is Rs. 60, therefore he will have a 20 as consumer's surplus.

¹ Caldari, Katia. *Marshallian Competition and the Time Dimension in Economic Analysis*. Journal of the History of Economic Thought, vol. 45, no. 1, 2023, pp. 44–67

Figure n°: 08 Consumer's Surplus



Source: Caldari, Katia. *Marshallian Competition and the Time Dimension in Economic Analysis*. *Journal of the History of Economic Thought*, vol. 45, no. 1, 2023, pp. 44–67

In the above figure, the *X-axis* measures the amount of commodity, while the *Y-axis* measures the price and marginal utility. Further, *MU* represents the marginal utility curve, which is sloping downwards. This indicates that as the consumer consumes more units its marginal utility falls. However, the price of the commodity is fixed as *OP*. The total utility he derived here is *ODRQ* and total price paid is *OPRQ*. Therefore, consumer enjoys *DPR* as a consumer's surplus.

↳ **Criticism:**

1. The objective measurement of utility and therefore consumer's surplus is not possible.
2. For necessary goods, the marginal utilities of the first few units are infinitely large. Hence the consumer's surplus is infinite for such goods.
3. The availability of substitutes also affects the consumer's surplus.
4. Deriving the utility-scale for prestigious goods like diamonds is very difficult.
5. We cannot measure the consumer's surplus in terms of money. This is because the marginal utility of money changes as a consumer makes purchases and his stock of money diminishes.

7. Marshall's concept of economies of scale:

The Economies of scale are an important concept for any business in any industry and represent the cost-savings and competitive advantages larger businesses have over smaller ones.

In microeconomics, economies of scale are the cost advantages that enterprises obtain due to their scale of operation, and are typically measured by the amount of output produced. A decrease in cost per unit of output enables an increase in scale. At the basis of economies of scale, there may be technical, statistical, organizational or related factors to the degree of market control.

There are two types of economies of scale; internal and external.

1. Internal Economic of Scale:

Internal economies are borne from within the company. The vital sources of economies of scale are discussed below:

- **Purchasing:** A large firm can buy raw materials in bulk through long term contracts can save a lot of its money
- **Managerial:** A big firm can recruit specialized managers. By utilising their skills they can cut down the per-unit cost of production.
- **Financial:** For a large firm it is relatively easy to raise a fund. They can obtain funding at a lower interest when borrowing from banks. They are also having access to a greater range of financial instruments.
- **Marketing:** A large firm can spread the cost of advertising over a greater range of output in media markets.
- **Technological:** A large firm can afford machinery with the latest technology. That can be used to take advantage of returns to scale in the production function.

2. External Economies of Scale:

The external economies of scale, on the other hand, are achieved because of external factors, or factors that affect not a firm but an entire industry. That means no one company controls costs on its own. These occur when there is a highly-skilled labour pool, subsidies and/or tax reductions, and partnerships and joint ventures—anything that can cut down on costs to many companies in a specific industry.

External economies of scale are generally described as affecting the whole industry. So, when the industry grows, the average costs of business drop. External economies of scale can happen because of positive and negative externalities. Positive externalities include a trained or specialized workforce, relationships between suppliers, and/or more innovation. Negative ones happen at the industry levels and are often called external diseconomies.

There are several contributing factors behind external economies of scale. When competing companies set up shop in one area, specialized workers will seek employment. An example of this would be the IT industry in Silicon Valley, which has attracted a special set of skilled workers.

Secondly, certain industries may become so important; they can develop bargaining power with politicians and local governments. This, in turn, can lead to more favourable treatment in the form of subsidies or other concessions. The fertilizer industry has a long history of subsidies in India, which were

historically given to continue a steady flow of domestic supply of chemical fertilizers.

8. Marshall's concept of quasi rent:

Marshall introduced another term quasi-rent. Quasi meaning as if Distinguishing between rent and interest in relation to the element he remarked in the preface to the first edition of his book –“That which is rightly regarded as interest on free or floating capital or on new investment of capital, is more properly treated as a soft rent – a quasi-rent on old investment of capital.” Quasi-rent is a temporary differential gain or profit yielded by the agents of production other than land. It occurs to fixed capital – capital which is invested in machinery or factory, may yield for a short period, a return in excess of the current rate of interest¹.

According to Ricardo, the term rent is applied to income from land and other free gifts of nature, whereas quasi-rent is the income derived from man-made appliances and machines. The supply of these man-made producer goods cannot be increased in a short period even though the demand for them may increase. Marshall, therefore, coined the term quasi rent for the earnings of such capital goods in a short period.

In addition, Marshall gave an exposition of the Quantity Theory of Money-Value as part of the General Theory of Value, drew a distinction between the real rate of interest and the money rate of interest; and enunciated the Purchasing Power Parity theory, appended to his evidence given before the Gold and Silver Commission **1888**. Moreover, he introduced the chain method of index numbers, proposed paper currency based on gold and silver symmetallism and suggested an official tabular standard for optional use in the case of long contracts.

Durable factors like machines, ships, houses and even human skills are similar to the land whose supply is fixed in the short run. When the demand for them increases suddenly, their supply cannot be increased in the short run, therefore they earn a surplus which is not rent but is similar to rent.

▪ **Example:**

Due to the increase in urban population the demand for houses increases. But the supply cannot be increased because of the scarcity of land and building materials. This abnormal increase in their earnings is quasi-rent. It is not rent proper or pure rent because the supply of houses can be increased in the long-run.

▪ **Conclusion:**

➤ Economics as a science generalize about the working of economic system.

¹ Caldari, Katia. *Marshallian Competition and the Time Dimension in Economic Analysis*. *Journal of the History of Economic Thought*, vol. 45, no. 1, 2023, pp. 44–67.

- As an analytical engine, economics provides an apparatus through which actual economic problems are analyzed. Ricardo's greatest contribution to economics is the provision of engine of analysis.
- Marx questioned the idealism and abstract thought of philosophy and maintained his belief that reality lies in the material base of economics.
- Scientific Socialism has three principal divisions, namely, philosophy, economics, and politics.
- Commercial thought and natural thought had a great impact on building classical and modern economic thought
- Adam Smith and David Ricardo are considered the most important thinkers in classical thought
- Neoclassical economic thought arose on principles acquired from classical thought
- Marshall is the most important thinker in the neoclassical school through the theory of value and surplus

Questions for understanding:

Q1. Explain the following theories given by David Ricardo

- a) Theory of Rent*
- b) Theory of Wage*
- c) Theory of Value*

Q2. Elaborate the Theory of Surplus Value by Karl Marx.

Q3. Make a note on The Materialistic Interpretation of History.

Q4. What is Scientific Socialism? Elaborate.

Q5. Explain Marshall's theory of Representative Firm.

Q6. Write a note on Internal and External Economies of Scale.

Q7. Highlight the concept of Quasi Rent.

Q8. Discuss the Marshall's thoughts of Value.

Q9. Explain the Marshall's concept of Consumer's Surplus

PART 4: HISTORY OF KEYNESIAN THOUGHT AND MODERN MONETARIST THOUGHT

① Objectives :

After going to this part you will be able:

- iv.** To understand the origin of keynesian school
- v.** To understand Milton Friedman school
- vi.** To understand Chicago school ideas and various theories in economics.

② General Introduction:

The twentieth century marked a major turning point in the history of economic thought, as new schools of analysis emerged in response to the economic crises, structural changes, and policy challenges faced by modern capitalist economies. Among the most influential developments during this period were Keynesian economics and modern monetarist thought, particularly the Chicago School. These two approaches have played a central role in shaping contemporary macroeconomic theory and economic policy.

Keynesian thought emerged in response to the Great Depression of 1929, which revealed the inability of classical and neoclassical theories to explain prolonged unemployment and deep economic downturns. The work of John Maynard Keynes introduced a new macroeconomic framework centered on aggregate demand, emphasizing the importance of consumption, investment, and especially government intervention in stabilizing economic activity and achieving full employment.

In contrast, modern monetarist thought developed as a critique of Keynesian policies, particularly during periods of inflation and economic instability in the mid-twentieth century. Led by Milton Friedman and the Chicago School, monetarism reasserted the importance of monetary policy and the money supply in determining price levels and overall economic performance. It argued that excessive government intervention often creates distortions, and that markets are generally self-correcting when supported by stable monetary rules.

The Chicago School became a major intellectual center for monetarist ideas, promoting free-market principles, individual rationality, and limited government intervention. Its influence extended beyond academic theory to

practical economic policy, particularly in the late twentieth century, shaping debates on inflation control, monetary policy, and economic liberalization.

Together, Keynesian and monetarist theories represent two contrasting yet complementary approaches to understanding macroeconomic dynamics. Their debate continues to define much of modern economic thought, reflecting different perspectives on the role of the state, the behavior of markets, and the mechanisms that ensure economic stability and growth.

Chapter Eleven: Keynesian Thought and Modern Economic Theories

① **Introduction:**

The twentieth century witnessed a major transformation in economic thinking with the emergence of new theories that challenged both classical and neoclassical traditions. Among the most influential of these was Keynesian economics, which fundamentally changed the way economists understand unemployment, government intervention, and aggregate demand.

This intellectual shift was largely a response to the severe economic collapse of 1929, known as the Great Depression. The crisis exposed the inability of classical and neoclassical theories to explain persistent unemployment and prolonged economic stagnation. As a result, new approaches emerged that placed greater emphasis on macroeconomic stability and the active role of the state in managing economic activity.

I- Keynesian Economic Thought

1. Origins and General Framework

Keynesian economics is attributed to the British economist John Maynard Keynes, one of the most influential thinkers in modern economic theory. His ideas represented a radical departure from classical economics, particularly in relation to unemployment, demand, and the role of government¹.

Keynes developed his theory in response to the Great Depression, a period of severe global economic contraction characterized by mass unemployment and collapsing demand. Classical economics failed to provide an effective solution to this crisis, which led Keynes to propose a new theoretical framework centered on aggregate demand².

His most important work, “The General Theory of Employment, Interest and Money” (1936), laid the foundation for modern macroeconomics and introduced a new explanation of how economies function in the short run.

2. Keynes’s Critique of Classical Economics

¹ Kahn, Richard F. *The Relation of Home Investment to Unemployment*. The Economic Journal, Vol. 41, 1931, pp. 173–198. (Oxford University Press)

² Davidson, Paul. *Post Keynesian Macroeconomic Theory*. Edward Elgar Publishing, 1994, pp. 20–85

Keynes challenged several fundamental assumptions of classical economic theory¹:

a. Rejection of Say's Law

Classical economists believed in Say's Law, which states that "supply creates its own demand." Keynes rejected this idea and argued instead that demand creates supply. He emphasized the importance of aggregate demand, which includes²:

- ➔ Consumption
- ➔ Investment
- ➔ Government spending
- ➔ Net exports

According to Keynes, insufficient demand leads to unemployment and economic downturns.

b. Questioning Full Employment Equilibrium

Keynes rejected the idea that economies naturally operate at full employment. He argued that unemployment is not an abnormal condition but rather a normal feature of capitalist economies³.

He also emphasized that output is not determined solely by labor but also depends on capital, technology, and overall demand conditions.

c. Rigidity of Wages and Prices

Classical theory assumes that wages and prices are fully flexible. Keynes disagreed, arguing that wages tend to be rigid downward due to labor unions, contracts, and minimum wage laws. This rigidity prevents markets from quickly adjusting to restore full employment.

d. Imperfect Competition⁴

Keynes argued that perfect competition is rarely observed in real-world markets. Instead, many markets are characterized by monopolistic or imperfect competition, which affects pricing and output decisions.

¹ Keynes, John Maynard. *The General Theory of Employment, Interest and Money*. Macmillan, p :12, 1936.

² Minsky, Hyman P. *Stabilizing an Unstable Economy*. Yale University Press, 1986, pp. 10–60

³ Robinson, Joan. *The Accumulation of Capital*. Macmillan, 1956, pp. 1–45

⁴ Blinder, Alan S. *Keynesian Economics*. Penguin Books, pp :27-29, 1987.

e. Active Role of the State

One of Keynes's most important contributions was his argument for state intervention in the economy. He believed that during economic crises, private markets alone cannot restore equilibrium, and therefore government policies are necessary to stimulate demand and reduce unemployment¹.

*f. Role of Money and Interest Rates*²

Keynes rejected the classical idea that money is neutral. He argued that monetary policy has real effects on the economy. For example:

- An increase in money supply lowers interest rates
- Lower interest rates encourage investment
- Increased investment raises production and employment

Thus, money plays a crucial role in influencing economic activity.

g. Theory of Saving and Income

Unlike classical economists, Keynes argued that saving is primarily determined by income rather than interest rates. As income increases, saving increases, but individuals do not necessarily respond strongly to changes in interest rates.

II- Contemporary Economic Theories

Modern economic thought includes several schools that fall under the broader umbrella of neoliberalism. The most prominent among them are the Chicago School (monetarism), the Austrian School, and supply-side economics.

*1. The Monetarist School (Chicago School)*³

The monetarist school, often associated with the Chicago School, is one of the most influential modern liberal economic movements. Its most prominent figure is Milton Friedman⁴.

¹ Skidelsky, Robert. *John Maynard Keynes: Fighting for Britain 1937–1946*. Macmillan, 2000, p :33.

² Patinkin, Don. *Money, Interest, and Prices*. Harper & Row, p:17, 1965.

³ Friedman, Milton & Modigliani, Franco. *The Quantity Theory of Money: A Restatement*. *American Economic Review*, 1963, pp. 174–185

⁴ Brunner, Karl & Meltzer, Allan H. *The Explanation of the Great Depression: A Monetarist View*; *Journal of Monetary Economics*, 1981, pp. 1–30.

Friedman strongly defended free-market capitalism and advocated for minimal government intervention. He believed that markets are inherently efficient and that most economic problems arise from inappropriate government policies rather than from the market system itself.

According to monetarists, the primary role of government should be limited to maintaining monetary stability and protecting economic freedom¹.

↳ Main Principles of Monetarism

a. Rejection of Keynesian Intervention

Monetarists argue that the economy is naturally self-regulating. They believe that unemployment and inflation should be corrected through market forces rather than government intervention.

b. Rational Behavior and Individual Choice²

Monetarist theory is based on the assumption that individuals act rationally to maximize their utility or profit. Economic agents respond to incentives, and markets coordinate these individual decisions efficiently.

c. Central Role of Money³

Monetarists emphasize that changes in the money supply are the main drivers of economic fluctuations. According to this view, excessive money growth leads to inflation, while insufficient money supply leads to economic slowdown.

d. Stability of the Market System

Monetarists believe that capitalism is fundamentally stable and does not inherently produce long-term unemployment or stagnation. Economic problems arise mainly due to poor monetary policy.

e. Limited Government Role⁴

They argue that governments are often inefficient and may worsen economic problems. Therefore, state intervention should be minimal, limited to protecting property rights and ensuring monetary stability.

¹ Meltzer, Allan H. *A History of the Federal Reserve*. University of Chicago Press, 2003, pp. 200–260

² Fama, Eugene F. *Efficient Capital Markets: A Review of Theory and Empirical Work*. Journal of Finance, 1970, pp. 383–417.

³ Keynes, John Maynard. *The General Theory of Employment, Interest and Money*. Macmillan, p :24, 1936

⁴ Skidelsky, Robert. *John Maynard Keynes: The Economist as Saviour*. Penguin Books, p :76, 1992.

2. The Austrian School¹

The Austrian School is a liberal economic tradition that emphasizes individual behavior, market processes, and limited state intervention. One of its most influential modern thinkers is Friedrich Hayek.

Hayek played a key role in defending classical liberalism during the twentieth century and strongly opposed centralized economic planning.

Core Ideas of the Austrian School²:

- ➡ The free market is the most efficient mechanism for allocating resources.
- ➡ Prices reflect information and coordinate economic activity.
- ➡ Competition leads to innovation and efficiency.
- ➡ Economic stability is achieved through decentralized decision-making.

The Austrian School also emphasizes that capitalism rewards each factor of production according to its contribution to output, making it a fair and efficient system.

Additionally, Austrian economists place strong emphasis on microeconomic analysis, focusing on individual decision-making and subjective value.

3. Supply-Side Economics

Supply-side economics, sometimes called “Reaganomics,” became prominent during the presidency of Ronald Reagan, who implemented many of its policies in the 1980s.

This school of thought argues that economic growth is primarily driven by production (supply) rather than demand. Therefore, policies should focus on increasing the ability and incentives of producers.

↳ Key Principles of Supply-Side Economics

a. Tax Reduction

Lowering taxes on individuals and businesses increases incentives to save, invest, and produce, which in turn stimulates economic growth.

¹ Skidelsky, Robert. *John Maynard Keynes: The Economist as Saviour*. Penguin Books, p :77, 1992.

² Stigler, George J. *The Theory of Economic Regulation*. *Bell Journal of Economics*, 1971, pp. 3–21

b. Deregulation

Reducing government regulations allows businesses to operate more efficiently and encourages entrepreneurship and innovation.

c. Monetary Stability¹

Stable monetary policy is essential to maintain confidence in the economy and prevent inflationary pressures.

↳ Overall Objective

Supply-side economics focuses on long-term economic growth by enhancing productive capacity. It argues that higher production leads to:

- ➔ Increased income
- ➔ Higher employment
- ➔ Greater economic prosperity

In this view, producers are the central engine of economic development.

Conclusion:

Keynesian economics and modern economic theories represent different approaches to understanding how economies function. Keynesian thought, introduced by John Maynard Keynes, emphasized the importance of aggregate demand and active government intervention to stabilize the economy.

In contrast, contemporary schools such as monetarism, the Austrian School, and supply-side economics stress market efficiency, individual decision-making, and limited state intervention.

Together, these theories form the foundation of modern macroeconomic debate, shaping economic policy and academic discussion in contemporary economies worldwide.

¹ Lucas, Robert E. *Expectations and the Neutrality of Money.* "Journal of Economic Theory, 1972, pp. 103–124.

Chapter Twelve: Modern Monetarist Thought and the Chicago School

① **Introduction:**

Modern monetarist thought represents one of the most influential developments in twentieth-century economic theory, emerging as a direct response to Keynesian dominance after the Great Depression and World War II. While Keynesian economics emphasized the active role of government in managing aggregate demand, monetarism shifted attention back to the importance of money supply, price stability, and the self-regulating nature of markets¹.

The intellectual center of this movement was the University of Chicago, which became associated with a distinct economic approach known as the Chicago School. This school played a major role in reshaping economic policy debates during the second half of the twentieth century, especially through the work of Milton Friedman, one of the most influential economists of the modern era.

I- Origins and Intellectual Background of Monetarism

The rise of monetarist thought was closely linked to dissatisfaction with Keynesian policies, particularly during periods of high inflation combined with unemployment (stagflation)². Keynesian theory struggled to explain this phenomenon, which encouraged economists to reconsider the role of money in determining economic outcomes.

The Chicago School developed as a strong intellectual alternative, emphasizing empirical analysis, free markets, and limited government intervention. Monetarists argued that many economic fluctuations were the result of poor monetary management rather than inherent instability in capitalism.

II- Core Principles of the Chicago School

1. Central Role of Money Supply

¹ Stigler, George J. *Memoirs of an Unregulated Economist*. University of Chicago Press, 1988.

² Friedman, Milton. *Capitalism and Freedom*. University of Chicago Press, 1962.

Monetarists believe that changes in the money supply are the most important factor influencing economic activity. According to this view, inflation is always and everywhere a monetary phenomenon.

An excessive increase in money supply leads to inflation, while insufficient growth can cause recessions and unemployment.

2. Natural Stability of the Market Economy

Unlike Keynesian economists, monetarists argue that the capitalist system is inherently stable. Markets tend to return to equilibrium naturally without the need for large-scale government intervention.

Economic problems are usually temporary and result from policy mistakes rather than structural flaws in the market system.

3. Critique of Government Intervention¹

Monetarists strongly criticize excessive government intervention in the economy. They argue that public authorities often lack the necessary information and incentives to manage economic activity effectively.

Government policies may unintentionally create instability by distorting prices, wages, and market signals.

4. Rational Behavior of Economic Agents²

The Chicago School assumes that individuals behave rationally and respond to incentives in predictable ways. Consumers, firms, and workers make decisions based on available information to maximize their benefits.

This assumption supports the idea that markets, when left free, allocate resources efficiently.

5. Importance of Monetary Policy Rules³

One of the key contributions of monetarism is the argument that monetary policy should follow stable and predictable rules rather than discretionary decisions.

¹ Stigler, George J. *The Theory of Price*. Macmillan, 1987.

² Laidler, David. *The Demand for Money: Theories and Evidence*. Harper & Row, 1985, pp :98-101.

³ Friedman, Milton. *The Role of Monetary Policy*. American Economic Review, 1968, pp:117-123.

Milton Friedman proposed that central banks should aim for a steady and controlled growth of money supply in order to maintain price stability and avoid economic fluctuations¹.

III- The Quantity Theory of Money (Modern Form)

Monetarism is strongly based on a modern interpretation of the quantity theory of money, which links money supply directly to price levels and economic output².

According to this theory:

- ➡ If money supply grows faster than real output, inflation occurs.
- ➡ If money supply grows too slowly, economic contraction may result.

This relationship highlights the importance of controlling monetary expansion to ensure macroeconomic stability.

IV- Policy Implications of Monetarist Thought

Monetarist economics led to significant changes in economic policy, especially in the United States and the United Kingdom during the late twentieth century. Its main policy recommendations include³:

- ➡ Controlling inflation through strict monetary discipline.
- ➡ Reducing government spending and budget deficits.
- ➡ Limiting the role of central banks to controlling money supply growth.
- ➡ Promoting free markets and deregulation.
- ➡ Reducing state intervention in labor and product markets.

These policies were widely influential during the 1970s and 1980s, particularly under leaders who adopted market-oriented reforms.

V- The Chicago School and Economic Methodology⁴

The Chicago School is also known for its strong commitment to empirical research and data-based economic analysis. Unlike purely theoretical

¹ Medema, Steven G. *The Chicago School of Economics: A History of Ideas*. *Journal of the History of Economic Thought*, Cambridge University Press, 2023, pp. 169–200

² Blaug, Mark. *Economic Theory in Retrospect*. Cambridge University Press, 1997.

³ Tobin, James. *Money and Income: Post-Keynesian and Monetarist Debate*. *Journal of Economic Perspectives*, 1980, p:127.

⁴ Coase, Ronald H. *The Firm, the Market, and the Law*. University of Chicago Press, 1988.

approaches, Chicago economists emphasize testing economic theories using real-world data.

They believe that economic models should be evaluated based on their predictive power rather than their realism in assumptions¹.

This pragmatic approach strengthened the scientific status of economics and increased the influence of the Chicago School in academic and policy circles.

VI- Criticism of Keynesian Economics

Monetarists launched several important criticisms of Keynesian theory²:

- Keynesian policies may cause inflation if used excessively.
- Fiscal expansion is often inefficient and increases public debt.
- Government intervention can distort market signals.
- Short-term solutions may create long-term instability.

Monetarists argue that controlling money supply is a more effective and stable method of managing the economy than relying on fiscal stimulus.

VII- Legacy and Influence of Monetarism³

The ideas of the Chicago School had a major impact on global economic policy, especially during the late twentieth century. Many governments adopted monetarist-inspired policies focusing on inflation control, deregulation, and privatization.

The influence of Milton Friedman extended beyond academic economics into public policy, shaping debates on central banking, taxation, and market regulation.

Even though pure monetarism declined in its strict form, many of its principles remain integrated into modern macroeconomic frameworks.

¹ Snowdon, Brian & Vane, Howard. *Modern Macroeconomics: Its Origins, Development and Current State*. Edward Elgar Publishing, 2005, pp :11-15 .

² Snowdon, Brian & Vane, Howard. *Modern Macroeconomics: Its Origins, Development and Current State*. Edward Elgar Publishing, 2005, pp :76-79.

³ Modigliani, Franco. *The Monetarist Controversy*. American Economic Review, 1977.

Conclusion:

Modern monetarist thought and the Chicago School represent a major intellectual shift in contemporary economics. By emphasizing the role of money supply, market stability, and limited government intervention, this school challenged Keynesian dominance and reshaped economic policy in many countries.

Through the contributions of Milton Friedman and other Chicago economists, monetarism established itself as a key pillar of modern economic theory, leaving a lasting impact on both academic research and practical economic policymaking.

Conclusion

General Conclusion:

The history of economic thought represents a rich and evolving intellectual journey through which humanity has sought to understand the nature of economic activity, the organization of societies, and the mechanisms governing wealth, production, exchange, and distribution. Throughout different historical periods, economic ideas emerged as responses to concrete social, political, and economic realities. Consequently, economic thought has always reflected the aspirations, crises, transformations, and challenges experienced by human societies across civilizations and historical eras.

From the earliest economic practices observed in ancient Eastern civilizations, where economic organization was closely connected to religion, political authority, and social hierarchy, to the sophisticated analyses developed in modern economic theories, the evolution of economic thought illustrates the progressive transformation of economics into an independent scientific discipline. Ancient societies laid the foundations for economic organization through systems of trade, taxation, labor division, and state administration. Later, Islamic civilization introduced important ethical and social dimensions to economic activity by emphasizing justice, moderation, productive labor, and social solidarity. Muslim scholars contributed significantly to the understanding of economic and social phenomena, particularly through analytical approaches that connected economic activity with urbanization, population, labor, and governance.

The emergence of mercantilism and classical economics marked a decisive turning point in the development of economic analysis. Economic thinkers increasingly sought to formulate general laws governing production, markets, and wealth creation. Classical economists established the foundations of liberal economic theory and highlighted the importance of free markets, labor specialization, and competition. However, the profound social transformations generated by industrial capitalism also gave rise to socialist and Marxist critiques, which focused on inequality, exploitation, class conflict, and the concentration of wealth and capital.

Subsequently, the development of the neoclassical school introduced new analytical methods based on marginal utility, mathematical reasoning, and market equilibrium, further strengthening the scientific character of economics. In the twentieth century, the Great Depression and other economic crises

challenged previous theories and led to the emergence of Keynesian economics, which emphasized the necessity of state intervention in stabilizing economic activity and reducing unemployment. Later, monetarist and neoliberal schools, particularly the Chicago School, revived confidence in market mechanisms, monetary stability, and limited government intervention.

The study of these diverse schools and intellectual traditions demonstrates that economic thought is not fixed or absolute. Rather, it continuously evolves in response to historical circumstances, technological developments, institutional changes, and societal needs. Each school of thought contributed, in its own way, to enriching economic science and expanding humanity's understanding of the complex relationships between individuals, markets, institutions, and states.

This pedagogical document has sought to provide students with a broad and analytical overview of the principal stages in the development of economic thought, highlighting the most influential theories, schools, and thinkers that shaped the evolution of economics from ancient times to the contemporary period. Through this exploration, students are encouraged not only to acquire historical knowledge but also to develop critical thinking and analytical skills necessary for understanding current economic debates and future challenges.

Ultimately, the history of economic thought remains an indispensable field for anyone seeking a deeper comprehension of modern economics and its intellectual foundations. By studying the evolution of economic ideas, learners gain valuable insight into the diversity of human approaches to economic organization and the continuing search for solutions capable of promoting economic efficiency, social justice, and sustainable development in an increasingly interconnected world.

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List of Contents

Table of Contents :

N° :	Title	Page
	General Introduction	<i>a-c</i>
Part 01	<i>The History Of Economic Thought In- Ancient Eastern Societies, Islamic Civilization, French Socialist Thought, Marxism, And The German Historical School</i>	01
--	Objectives	01
--	General Introduction	01
Chapter One	<i>The Origins of Economic Thinking in Ancient Eastern Societies</i>	03
--	- Introduction	03
I-	<i>Features of Economic Organization in Ancient Eastern Civilizations</i>	03
II-	<i>Economic Ideas in Mesopotamian Civilization</i>	
1.	<i>Legal Regulation of Economic Activities</i>	04
2.	<i>Commercial Contracts and Financial Relations</i>	05
3.	<i>Agricultural Policies and Labor Organization</i>	05
4.	<i>Standardization of Weights and Measurements</i>	05
5.	<i>Government Intervention in Economic Affairs</i>	05
III-	<i>Economic Principles in Ancient Egyptian Civilization</i>	06
1.	<i>Agriculture as the Foundation of the Economy</i>	06
2.	<i>Centralized Administration and Economic Planning</i>	06
3.	<i>Trade Networks and Commercial Exchange</i>	06
4.	<i>Exchange Systems and Economic Transactions</i>	07
5.	<i>Social Hierarchy and Labor Distribution</i>	07
6.	<i>Resource Storage and Public Infrastructure</i>	07
IV-	<i>Economic Contributions of Other Eastern Civilizations</i>	07
1.	<i>Economic Philosophy in Ancient India</i>	08
2.	<i>Economic Thought in Ancient China</i>	08
3.	<i>Economic Organization in Ancient Persia</i>	08
--	- Conclusion	09
Chapter two	<i>Economic Thought During the Islamic Civilization</i>	10
--	- Introduction	
I-	<i>Fundamental Principles of Economic Thought in Islam</i>	10
1.	<i>Abolition of Slavery and Human Exploitation</i>	10
2.	<i>Improving the Social Position of Women</i>	11
3.	<i>Combating Economic Exploitation</i>	11
4.	<i>Prohibition of Usury and the Importance of Zakat</i>	11
5.	<i>Encouragement of Work and Productivity</i>	11
6.	<i>Recognition of Private Property</i>	12
7.	<i>Opposition to Monopoly</i>	12

II-	<i>Ibn Khaldun and the Development of Islamic Economic Analysis</i>	12
III-	<i>Major Economic Ideas of Ibn Khaldun</i>	12
1.	<i>Civilization and Social Organization</i>	13
2.	<i>The Importance of Division of Labor</i>	13
3.	<i>Classification of Economic Activities</i>	13
4.	<i>Taxation and State Revenue</i>	13
5.	<i>Labor as the Source of Value</i>	14
6.	<i>Human Needs and Population Growth</i>	14
--	<i>- Conclusion</i>	15
Chapter Three	<i>Liberal Economic Thought and the Evolution of Capitalism</i>	16
--	<i>- Introduction</i>	16
I-	<i>The Concept of Liberal Economic Thought</i>	16
1.	<i>Meaning and Origins of Liberalism</i>	16
II-	<i>Economic Liberalism and the Capitalist System</i>	17
III-	<i>Philosophical Foundations of Capitalism</i>	17
1.	<i>The Idea of the “Economic Man”</i>	18
2.	<i>The Legitimacy of Profit</i>	18
3.	<i>Protection of Private Property</i>	18
4.	<i>Market Economy and Free Competition</i>	18
5.	<i>Limited State Intervention</i>	19
IV-	<i>Historical Development of Capitalism</i>	19
1.	<i>The Era of Commercial Capitalism</i>	19
2.	<i>The Rise of Industrial Capitalism</i>	20
3.	<i>The Emergence of Financial Capitalism</i>	21
--	<i>- Conclusion</i>	21
Chapter Four	<i>Socialist Economic Thought in France and the Emergence of Marxism</i>	23
--	<i>- Introduction</i>	
I-	<i>French Socialist Thought and Its Main Tendencies</i>	23
1.	<i>The State-Centered Socialist Current</i>	23
2.	<i>The Cooperative Socialist Current</i>	24
II-	<i>The Emergence of Marxist Economic Thought</i>	25
III-	<i>Main Economic Theories of Marxism</i>	25
1.	<i>The Labor Theory of Value</i>	25
2.	<i>The Theory of Surplus Value</i>	26
3.	<i>Theory of Capital Accumulation</i>	26
4.	<i>Concentration of Capital</i>	27
5.	<i>The Theory of Increasing Poverty</i>	27
6.	<i>Theory of Economic Crises</i>	27
--	<i>- Conclusion</i>	27

Chapter Five	<i>The German Historical School of Economic Thought</i>	29
--	<i>- Introduction</i>	29
I-	<i>Intellectual Foundations of the Historical Approach</i>	29
1.	<i>Economic Systems as Evolving Historical Processes</i>	29
2.	<i>The Role of the State in Economic Development</i>	30
3.	<i>The Historical-Empirical Method</i>	30
4.	<i>Critique of Classical Economic Theory</i>	31
--	<i>- Conclusion</i>	31
Part02	<i>History Of Classical Economic Thought</i>	34
--	<i>Objectives</i>	34
--	<i>General Introduction</i>	34
Chapter six	<i>Mercantilism, An Origin Of Classical Economics</i>	35
I-	<i>Important economic theories of mercantilism:</i>	36
II-	<i>Criticisms of Mercantilism</i>	37
--	<i>- Conclusion</i>	38
Chapter seven	<i>Physiocracy, An Origin Of Classical Economics</i>	39
--	<i>- Introduction</i>	
I-	<i>The Basic Principles of Physiocracy</i>	40
II-	<i>Criticisms of Physiocracy</i>	40
--	<i>- Conclusion</i>	41
Chapter Eight	<i>Classical Liberalism, An Origin Of Classical Economics</i>	42
--	<i>- Introduction</i>	
1.	<i>Economics</i>	42
2.	<i>Government</i>	43
3.	<i>Sociology</i>	43
4.	<i>Division of Labor</i>	44
5.	<i>Smith's Théorie of Value</i>	45
--	<i>- Conclusion</i>	48
Chapter Nine	<i>Ricardian And Marxism School, An Origin Of Economic Thought</i>	49
--	<i>- Introduction</i>	49
1.	<i>Scarcity of land</i>	50
2.	<i>Differences in the fertility of the soil</i>	51
--	<i>- Conclusion</i>	56
Part 03	<i>History of neo-classical economic thought</i>	57
--	<i>Objectives</i>	57
--	<i>General Introduction</i>	57
Chapter Ten	<i>Marshall And Neoclassical Economic Thought</i>	58
--	<i>- Introduction</i>	58
1.	<i>Economic ideas of Marshall</i>	59
2.	<i>Principles of Economics</i>	59

3.	<i>Marshall's definition of Economics</i>	59
4.	<i>Marshall's Theory Of Value And Time Element</i>	59
5.	<i>Marshall's concept of representative firm</i>	63
6.	<i>Marshall's concept of consumer's surplus</i>	64
7.	<i>Marshall's concept of economies of scale</i>	65
8.	<i>Marshall's concept of quasi rent</i>	67
--	- Conclusion	68
Part 04	<i>History Of Keynesian Thought And Modern Monetarist Thought</i>	70
--	<i>Objectives</i>	70
--	<i>General Introduction</i>	70
Chapter Eleven	<i>Keynesian Thought and Modern Economic Theories</i>	72
--	- Introduction	72
I-	<i>Keynesian Economic Thought</i>	72
1.	<i>Origins and General Framework</i>	72
2.	<i>Keynes's Critique of Classical Economics</i>	72
II-	<i>Contemporary Economic Theories</i>	74
1.	<i>The Monetarist School (Chicago School)</i>	74
2.	<i>The Austrian School</i>	75
3.	<i>Supply-Side Economics</i>	76
--	- Conclusion	77
Chapter Twelve	<i>Modern Monetarist Thought and the Chicago School</i>	78
--	- Introduction	78
I-	<i>Origins and Intellectual Background of Monetarism</i>	78
II-	<i>Core Principles of the Chicago School</i>	78
1.	<i>Central Role of Money Supply</i>	78
2.	<i>Natural Stability of the Market Economy</i>	79
3.	<i>Critique of Government Intervention</i>	79
4.	<i>Rational Behavior of Economic Agents</i>	79
5.	<i>Importance of Monetary Policy Rules</i>	79
III-	<i>The Quantity Theory of Money (Modern Form)</i>	80
IV-	<i>Policy Implications of Monetarist Thought</i>	80
V-	<i>The Chicago School and Economic Methodology</i>	80
VI-	<i>Criticism of Keynesian Economics</i>	81
VII-	<i>Legacy and Influence of Monetarism</i>	81
--	- Conclusion	82
--	<i>General Conclsiion</i>	83
--	<i>List of referance</i>	85
--	<i>List of contents</i>	89-92