Economics as Way of thinking

Chapter 1

Oisín Moffatt

Leaving Cert 2025/2026

Learing Outcomes

In this chapter we will:

- appreciate the role of models, concepts and data for exploring economic behaviour, interactions, policy and outcomes
- differentiate between positive and normative economic statements; identify instances of their use in local, national or international media/economic commentary
- discuss and evaluate why solutions to economic problems may differ and how economic perspectives on solving economic challenges can change over time
- discuss how real world events such as the Great Depression, the Irish economic crises of the 1950s and the Great Recession (from 2007), have shaped our understanding of economics and the response of policy makers
- collect, organise, present, analyse and interpret data, with and without the use of technology, to come to an informed view and evaluate current economic issues/policies

Basic Economic Jargon

Economics – Definition

Economics is defined as a social science which studies, interprets and analyses human behavior – the way in which humans interact (buying, selling, working) is therefore central to the study of economics.

Needs & Wants

Needs are resources essential for human survival e.g. food
Wants are desires in excess of basic needs for survival e.g. iPhone

Choice: in economics, resources are scarce and have alternative uses however, human wants are unlimited so as a result, choices must be made, and these choices involve an opportunity cost

Opportunity Cost – Definition

Opportunity cost refers to the cost of forgone alternatives i.e. the cost of using your resources in one way rather than another.

An example of opportunity cost in government is choosing to spend tax revenue on building new highways (infrastructure) instead of funding more teachers and school renovations (education); the forgone education improvements represent the opportunity cost of the highway project, as resources (money, labor, materials) used for one cannot be used for the other.

Positive & Normative Economics

Positive Economics – Definition

Positive economics is economic analysis which is based on objective fact that can be prove either true or false.

Normative Economics – Definition

Normative economics is concerned with value judgements and opinion about what ought to occur, rather than factual information.

Consider the following – classify each statement as either positive or normative:

- The live register hits ten-year low
- Spending on health must be increased
- EU report highlights the need for capital investment
- There aren't enough public servants
- Germany's GDP growth reached a six-year high of 2.2% this year.

The Central Economic Question

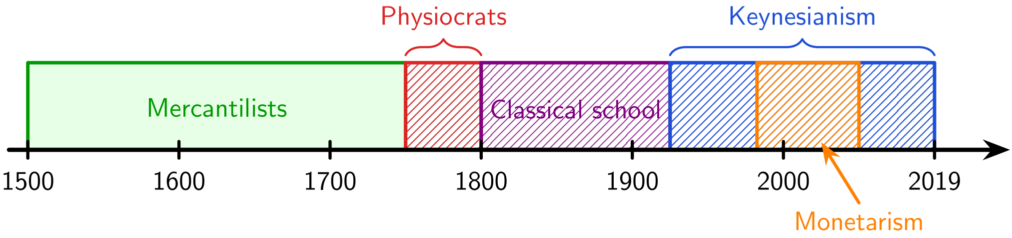
Before going any further, it's so important to have a really clear picture of the purpose of economics. It's essential purpose is to solve – or at least attempt to solve – the central economic question. But what is the central economic question??? We touched on it in the definition of opportunity costs.

In theory, we all have unlimited needs and wants. There's an infinite number of things we'd like to do, if only we had the resources to achieve them. However, we only have a limited amount of resources with which to achieve those needs and wants. For example, we all have a finite amount of time on earth, there's a finite space of habitable land and there's a limited amount of wealth (money) available. These are just some of the many, many limitations on the resources that we have.

So, it follows that we will have to make decisions about which needs and wants most need to be satisfied with our limited resources. The aim of the leaving cert economics course is to make you a better and more informed decision-maker around how we should get the best possible use of our limited resources. Always try to think critically and keep the central economic question in the back of your mind throughout your studies – the revised leaving cert syllabus will reward you for doing so.

Economic Philosophy Over Time

Approaches to solving the central economic question have evolved over time. The timeline below attempts to shed some light on this evolution. We will discuss each philosophy in the next few slides.



Mercantilists

Mercantilism was a very primitive and an extremely destructive view of economics which prevailed until the birth of modern day economic philosophy, following the publication of Adam Smith's book 'The Wealth of Nations'. Mercantilist theory essentially contended that there was a fixed amount of wealth on earth, so the only way of becoming richer was by invading another country and taking their resources.

Mercantilism also theorised that countries should aggressively pursue a balance of payments surplus. This meant taking goods in the invaded colonies and selling them abroad to boost exports, while also imposing protectionist policies to prevent importing and promote self-sufficiency.

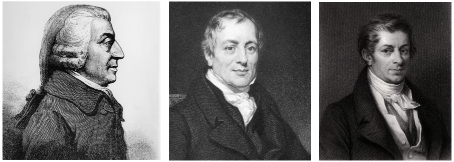
Not only were these deeply flawed views, they caused a massive amount of harm. European colonial endeavours to North and South America, Africa, Indonesia, India and Australia caused the genocides of tens, if not hundreds of millions of native peoples. In the 16^{TH} century alone, its estimated European settlers killed 54 million indigenous people in North, Central and South America. A piece of research carried out by University College London indicate native Americans as % of the global population fell from 14% in 1500 to 1% in 1600. You can access their research here.

Physiocrats & Economic Liberalism

Key beliefs of the physiocrats

- **Individualism and laissez-faire:** The physiocrats believed that self-interest was a motive for economic activity. Each individual is best suited to determine what goods they want and what work would provide such goods. While a person might work for benefit of others, they'll work harder for their own benefit.
- **Private property:** The physiocrats believed in the institution of private property. They saw property as a tree and its branches, as social institutions. They actually stated that landlords must enjoy $\frac{2}{5}$ on the land surpluses. They also advocated that landlords should be given dues, otherwise they would take the land away from the cultivators.
- **Diminishing returns:** Physiocrats put forward the theory of diminishing returns. This was a recognition that the productivity gains required to increase national wealth had an ultimate limit, and, therefore, wealth could not be infinite.
- **Investment capital:** Physiocrats recognised that capital was needed by farmers to start the production process, and were proponents of using some of each year's profits to increase productivity. Capital was also needed to sustain the laborers while they produced their product.

Classical Economists



Classical economists Smith, Ricardo and Say

Classical economists contributed massively to the modern theory of economics. Many of the concepts and theories we will discuss in this course were developed by classical economists.

1. Laissez - faire economic policies boosted economic growth so gov't involvement should be minimal.
2. Free trade (no protectionism) ensured a higher level of National Income.
3. The invisible hand: Adam Smith indicated prices should be determined by market forces
4. Utility Theory of Value: value of something in the short run is determined by it utility in the short run and its costs of production in the long run.
5. They thought the State should intervene to prevent the growth of monopolies as are market failure.
6. They introduced the idea of price elasticity which we will discuss in Chapter 5.
7. They promoted the theory around marginal revenue product of labour
8. Smith also developed the Canons of Taxation, see Chapter 12.

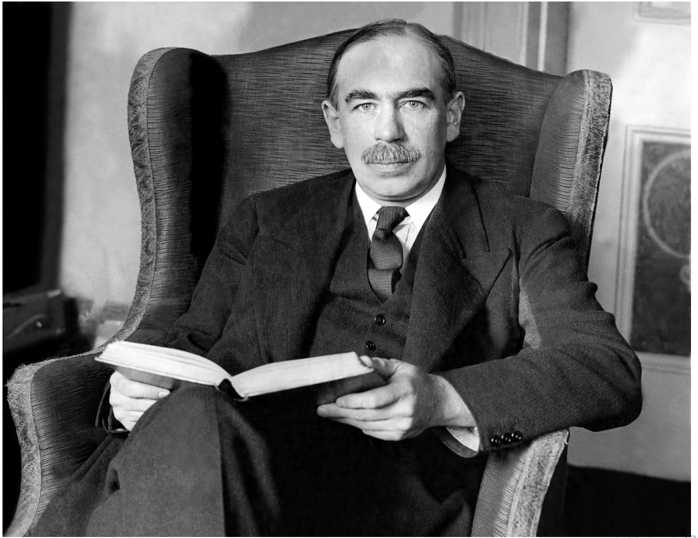
Keynesianism

Keynesianism as the name suggests, is a set of economic beliefs associated with John Maynard Keynes. Keynes rose to prominence following the Great Depression in 1929. Unlike classical and Austrian economists – who were focused on issues of supply – Keynes believed that boosting supply would be the best way to initiate an economic recovery.

Keynes favoured government intervention in the form of fiscal stimulus (lowering taxes and increase government spending) in order to try to stimulate demand. This became known as "spending your way out of a recession". Here are some of his other theories:

1. He suggested that national income could be in equilibrium (Aggregate Demand equals Aggregate Supply) without full employment
2. He opposed the Classical School idea that in a recession, wages would fall, the demand for labour would then rise and a recovery would follow. Keynes said that if wages fell, consumption would fall (as real income fell) leading to a worse recession, as was seen in the United States post 1929.
3. He was the one that introduced the idea of the Multiplier, see Chapter 11.
4. Keynes proposed that the level of investment was influenced more by the expectations of business people than the rate of interest.

John Maynard Keynes (1883 – 1946)



Monetarism

In the 1970's the widespread application of Keynesian economic policies, particularly in the UK and US, began to fail. Governments were becoming too big and too bureaucratic. Monetarism, a philosophy of American economist Milton Friedman, stood as a viable alternative. Monetarism was principally concerned with aggressive control of inflation and money supply. Like classical economists, Friedman concentrated on issues of supply, not demand. Here are some core beliefs:

1. Monetary Policy: should be the main instrument used by the State to manage the economy, NOT fiscal policy. Increased public spending would only lead to higher prices and not increased output and employment as advocated by Keynes.
2. Control of Money Supply: Monetarists suggest strict control of the money supply so as to control inflation. Limiting credit availability, keeping interest rates high would control consumer borrowing.
3. Inflation: Reduction in inflation increases competitiveness which may lead to relatively cheaper exports, increased exports and job creation in the long run. Companies should keep wage increases to a minimum in order to avoid cost-push inflation.
4. Friedman favoured a return to laissez faire principles, calling for minimal gov't intervention, deregulation and privatisation.

Friedman's beliefs became very popular in the West from the 1980s onwards. He was an economic advisor to US president Ronald Reagan and UK prime minister Maggie Thatcher.

Ronald Reagan and Maggie Thatcher at Camp David in Dec 1984

Keynesian vs. Monetarist Views

Policy Area	**Keynesian View**	**Monetarist View**
Fiscal policy	Expansionary fiscal policy in a recession can stimulate economic activity	Fiscal policy has no long-term effect on real output
Wage rigidity	Wages are sticky downwards, leading to unemployment	Wages are flexible in absence of trade unions or minimum wages
Unemployment	Caused mainly by demand deficiency	Emphasis on supply-side factors and natural rate
Phillips Curve	Long-run trade-off between unemployment and inflation	Trade-off only exists in the short run
Gov't borrowing	Governments should borrow during recessions to offset fall in private spending	Governments should maintain a balanced budget
Crowding out	No crowding out occurs during recessions	Borrowing by government increases crowding out

Wall Street Crash (1929)

The unemployed queueing outside soup kitchens,1930

Historical Context

- During The Roaring 20s, businesses expanded, earned higher profits.
- Confidence among consumers and investors led to rapid rise in prices for shares and property – cheap credit flowed through the economy.
- However, a marked change took place on 24 October 1929.
- Investors eventually became sceptical that prices were rising so high.
- Therefore they began selling their assets property and shares.
- The US economy contracted sharply, triggered by price collapse.

Wall Street Crash (1929)

Causes

- Fierce debate ensued as to the actual cause of the crash/collapse.
- Some blamed the increase in interest rates by the central bank shortly before the crash.
- Others critised the cheap credit (low interest rates) which allowed people to borrow excessively to purchase shares and inflate prices.
- People were buying shares with borrowed money which they had not earned.
- Companies on the stock market were overpriced and their market valuation didn't reflect the business' performance and profitability.

Irish Economic Malaise of The 1950s

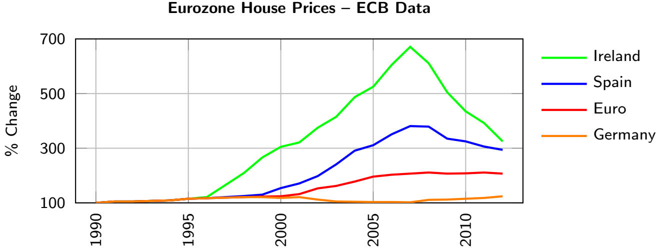
- In the 1950's Ireland was in a dark place economically – characterised by austerity (harsh state cutbacks and high taxes) and near poverty.
- Unemployment was very high so net outward (migration) was 4000 people annually.
- During this period, the Irish exchequer was following an economic policy of protectionism (imposing barriers to free trade) by putting high tariffs on UK imports.
- This policy aimed to build a sustainable domestic industrial base so that the Irish economy could support itself without financial support from the UK.
- However, as unemployment and austerity continued, it became clear that this protectionist approach was failing.

Economic Development Report - TK Whitaker

TK Whitaker

- In 1958, Irish economist Thomas Kenneth Whitaker introduced an economic proposal.
- He encouraged politicians to embrace free trade by rolling back the high import tariffs.
- This plan offered an alternative method to grow a sustainable industrial base by allowing Irish producers/suppliers to buy and sell in foreign markets.
- The plan was a success – Ireland became internationally competitive and the economy grew by around 4.5% annually by the 1970's.
- These policies and ideas will be explore in greater detail in the international trade chapter.

The Celtic Tiger



The policy roadmap laid out by Whitaker began to really take hold in the 1990's as exports became the main source of growth in the 90s. The expansion of enterprise boosted output, jobs and social prosperity. Improved access to education created a highly skilled workforce & attract foreign investment.

From 1994 to 2000, the booming economy was driven by exports. However, from 2000 to 2007, exports decreased as the economy relied more heavily on the property market as a source of economic growth. Similarly to the Wall Street Crash, public scepticism caused property prices to collapse and the economy was plunged into a deep recession. It became so severe The Irish State was nearly declared bankrupt.

Learnings

How can we avoid repeating past mistakes

Adopt prudent economic policies

The government should not spend more than it earns. High levels of national debt can seriously harm the exchequer's ability to deal with economic downturns.

Monitor credit supply

Many past economic crises have been caused by excessive cheap credit so governments and central banks must regulate and monitor lending practices to prevent this risk.

Invest in education

Ireland's dedication to a skilled labour force means that Irish workers are flexible, relevant and adaptable – this is because the Irish state and businesses contribute large sums of money to third-level institutions and training.

Brexit

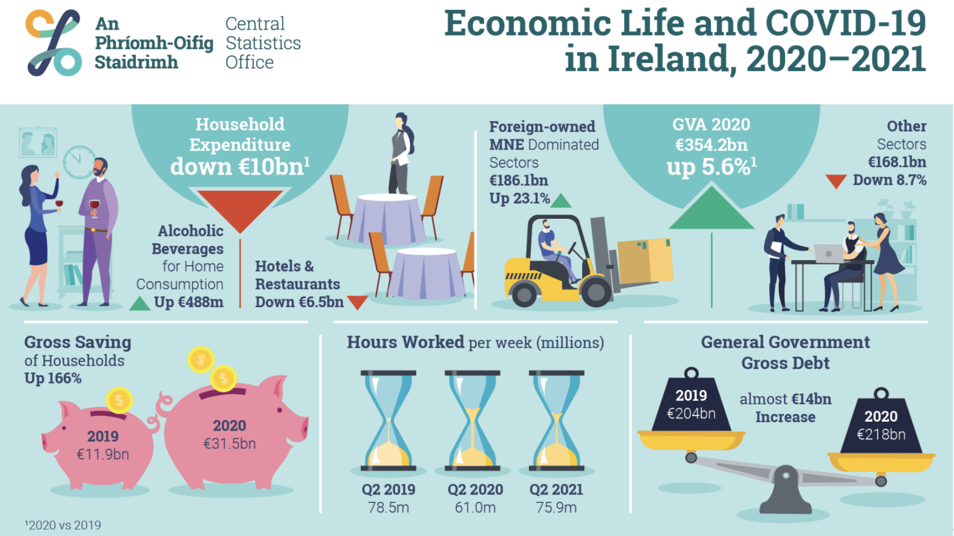
- In June 2016 the UK voted to leave the EU. Full customs checks began to take effect in Jan 2021.
- Irish exports to the UK fell by about 9% in 2021, while re-exports through Northern Ireland rose.
- Roughly 40% of Irish agri-food exports still go to the UK, making the sector highly exposed.
- Sterling fell from €1.42:£1 pre-vote to €1.10:£1 by late 2016, squeezing margins for Irish exporters.
- The EU launched a €5.4bn Brexit Adjustment Reserve in 2021 to help European SMEs cope with new trade barriers brought about by Brexit. Ireland received the largest share, roughly €800mn.

Take some time to analyse the graph shown above. You can find Brexit data on the CSO (click here).

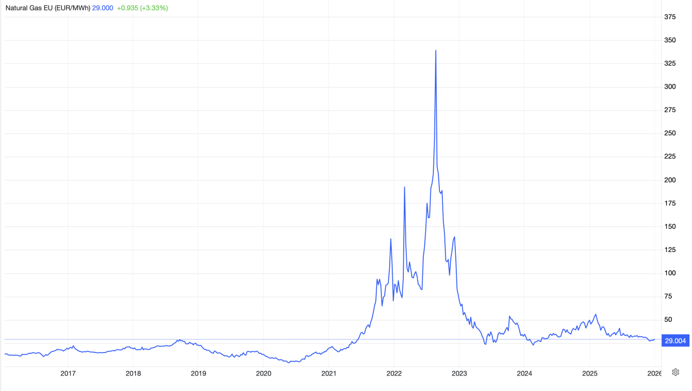
The Corona Virus

- In March 2020 Ireland imposed its first lockdown. Irish GDP contracted by 6.1% in Q2 2020.
- Unemployment (including recipients of the PUP) surged to almost 28% in April 2020 before easing.
- The Gov't introduced PUP and wage subsidies costing €18bn over 2020–2021.
- Household deposits rose by €16bn in 2020 due to curtailed spending (Central Bank of Ireland).
- CPI inflation was muted during lockdown but rose to 5.5% by end-2021 due to pent-up demand.

CSO Infographic on the Impact of The Corona Virus



Ukraine War



- Russia's invasion of Ukraine in Feb 2022 caused gas prices to spike on EU markets (see graph).
- Irish consumer electricity prices rose by over 60% between 2021 and 2022.
- Food input costs increased sharply; fertiliser prices more than doubled in 2022 (Teagasc).
- Government responded with €2.4bn of energy credits and excise duty cuts to cushion households.
- ECB raised policy rates from 0% in 2022 to 4% by 2023 to restore price stability.