

Methods of Economic Analysis

Economic analysis is the assessment of a topic from the perspective of an economist. There are two types of economic study - Deductive Method and Inductive Method.

Analysis refers to studying a given topic in detail. Economic analysis refers to the investigation of a particular topic from the perspective of an economist. It includes conducting an in-depth study of various processes such as production, consumption, consumer behaviour, national income, employment and others. It evaluates the given industry in detail with all the aspects associated with that particular industry.

Moreover, the primary aim of economic analysis is to determine the effectiveness of operations within an economy. There are two types of economic study or economic analysis: Deductive Method and Inductive Method. Here, we take a look at these methods and also present an overview of the process of making the hypothesis.

Deductive method

It is a method of economic investigation or economic analysis. It is also known as the analytical abstract priori method or the hypothetical method. In this method, a person is required to assume the factual information and then follow the phase of logical reasoning to arrive at a concrete result or conclusion. By including some assumptions and experiments, a theory is built in this method.

For instance, it is a common fact that businessmen strive for maximum profits. Therefore, assumptions such as businessmen buying materials at a cheaper cost and cutting labour costs are added to build an economic theory that offers solutions to qualitative and labour-related issues. Hence, the common rule to remember in the case of deductive methods is to move from general facts to particular assumptions and, eventually, constructive theories.

Moreover, in the deductive method, simple facts help in creating complex hypotheses. Therefore, three stages or phases are recognised in the deductive method:

1. Observation
2. Logical reasoning
3. Experimentation, instance and testing through observation.

Making the hypothesis is an important component of the deductive method of economic analysis.

Merits of the deductive method

Following are the merits of the deductive method:

1. **Simple and convenient:** This method is observation based and is fairly easy to practice. For example, in the Law of Diminishing Marginal Utility, after the increase in consumption, the consumer reaches the point of satiety, and the utility of the good begins to diminish.
2. **Removes the need for experimentation:** Experiments are vital in subjects like chemistry and physics but not mandatory in the case of economics. Deductive method is an alternative to experiments as far as economics as a subject is concerned.
3. **Accurate results:** Deductive method includes logical reasoning on the part of the economist or the analyst. Hence, logical thinking increases the chances of precision and sets high standards.

Demerits of deductive reasoning

The disadvantages of the deductive method are as follows:

1. **Assumption based:** Assumptions have a higher chance of going wrong and result in invalid solutions. This can lead to a serious economic crisis if done inappropriately.
2. **Imaginative:** There is a greater chance of the deductive method being far from reality since it works on the basis of imagination. Real-life problems cannot be solved by imaginative or utopic solutions.

Inductive method

In the inductive method, analysts or theorists progress from a practical outlook to a scientific problem in order to shorten the gap between theoretical knowledge and practical applications. The induction method is carried out in two forms, via statistics and experimentation. This method is classically associated with statistical forms of investigations. It involves a lot of numbers, quantities and formal terms.

Merits of inductive method

1. It is a very practical and applicable method, and it is simply descriptive.
2. It is totally verifiable since it deals with quantities.
3. Laws and theories under the inductive method may not be universal but are condition specific.

Demerits of inductive method

1. If in case the analysts or theorists do not possess a balanced and stable judgement, then this method is unhelpful as they will be extracting insufficient data.
2. Inductive method works on the basis of experiments, and experiments require materials and resources. It is often difficult to gather and access the facts required for experiments.
3. The Inductive method is an incomplete method alone. It can be used if combined with deductive methods or deductive reasoning.

Deductive method vs inductive method

BASIS	DEDUCTIVE METHOD	INDUCTIVE METHOD
ORIGIN	Used by those believing in classical theories.	Used by those who believe in Neo-classical theories.
TECHNIQUE	Abstract	Practical

OTHER NAMES	Analytical, priori or abstract method	Historical, empirical or posterior method
PROCEDURE	Facts are followed by logical reasoning	Practical scenario to scientific techniques
SCOPE	Works under the social science model.	Works under the science model.
APPLICATION	Universal	Situation specific
RESULTS	Confirmation of the making the hypothesis	Generalised results
STRUCTURE	Highly structured method	Less structured