



Methods of Economic Analysis

An economic theory derives laws or generalizations through two methods:

(1) Deductive Method of Economic Analysis

The **deductive method** is also named as **analytical, abstract** or **prior** method. The deductive method consists in deriving conclusions from general truths, takes few general principles and applies them to draw conclusions. **(GENERAL TO PARTICULAR)**

For instance, if we accept the general proposition that man is entirely motivated by self-interest. In applying the deductive method of **economic analysis**, we proceed from general to particular.

The classical and neo-classical school of economists notably, Ricardo, Senior, Cairnes, J.S. Mill, Malthus, Marshall, Pigou, applied the deductive method in their economic investigations.

Steps of Deductive Method:

The main steps involved in deductive logic are as under:

(i) Perception of the problem to be inquired into: In the process of deriving economic generalizations, the analyst must have a clear and precise idea of the problem to be inquired into.

(ii) Defining of terms: The next step in this direction is to define clearly the technical terms used in analysis. Further, assumptions made for a theory should also be precise.

(iii) Deducing hypothesis from the assumptions: The third step in deriving generalizations is deducing hypothesis from the assumptions taken.

(iv) Testing of hypothesis: Before establishing laws or generalizations, hypothesis should be verified through direct observations of events in the real world and through statistical methods. (Their inverse relationship between price and quantity demanded of a good is a well established generalization).

Merits of Deductive Method:

The main merits of deductive method are as under:

(i) This method is near to reality. It is less time consuming and less expensive.

(ii) The use of mathematical techniques in deducing theories of economics brings exactness and clarity in economic analysis.

(iii) There being limited scope of experimentation, the method helps in deriving economic theories.

(iv) The method is simple because it is analytical.

Demerits of Deductive Method:

It is true that deductive method is simple and precise, underlying assumptions are valid.

(i) The deductive method is simple and precise only if the underlying assumptions are valid.

More often the assumptions turn out to be based on half truths or have no relation to reality. The conclusions drawn from such assumptions will, therefore, be misleading.

(ii) In deductive method, the premises from which inferences are drawn may not hold good at all times, and places. As such **deductive reasoning is not applicable universally.**

(iii) The deductive method is highly abstract. **It requires a great deal of care to avoid bad logic or faulty economic reasoning.**



(2) Inductive Method of Economic Analysis:

Inductive method which also called **empirical method** was adopted by the "Historical School of Economists". It involves the process of reasoning from particular facts to general principle.

(PARTICULAR TO GENERAL)

This method derives economic generalizations on the basis of (i) Experimentations (ii) Observations and (iii) Statistical methods.

In this method, data is collected about a certain economic phenomenon. These are systematically arranged and the general conclusions are drawn from them.

For example, we observe 200 persons in the market. We find that nearly 195 persons buy from the cheapest shops, Out of the 5 which remains, 4 persons buy local products even at higher rate just to patronize their own products, while the fifth is a fool. From this observation, we can easily draw conclusions that people like to buy from a cheaper shop unless they are guided by patriotism or they are devoid of commonsense.

Steps of Inductive Method:

The main steps involved in the application of inductive method are:

- (i) Observation.
- (ii) Formation of hypothesis.
- (iii) Generalization.
- (iv) Verification.

Merits of Inductive Method:

- (i) It is based on facts as such the method is realistic.
- (ii) In order to test the economic principles, method makes statistical techniques. The inductive method is, therefore, more reliable.
- (iii) Inductive method is dynamic. The changing economic phenomenon are analyzed and on the basis of collected data, conclusions and solutions are drawn from them.
- (iv) Induction method also helps in future investigations.

Demerits of Inductive Method:

The main weaknesses of this method are as under:

- (i) If conclusions drawn from insufficient data, the generalizations obtained may be faulty.
- (ii) The collection of data itself is not an easy task. The sources and methods employed in the collection of data differ from investigator to investigator. The results, therefore, may differ even with the same problem.
- (iii) The inductive method is time-consuming and expensive.

Conclusion:

The above analysis reveals that both the methods have weaknesses. We cannot rely exclusively on any one of them. Modern economists are of the view that both these methods are complimentary. They partners and not rivals. **Alfred Marshall** has rightly remarked:

"Inductive and Deductive methods are both needed for scientific thought, as the right and left foot are both needed for walking".

We can apply any of them or both as the situation demands.