are specified and different economic units are expected to behave in a 'rational' manner. The outcome in this case is predictable, provided the assumptions made are satisfied. The assumptions themselves may be totally unrealistic or may be very close to reality but they are stated in a precise manner. In any case, this type of reasoning is called deductive reasoning. In this method, the generalisation or law is stated and the individual activities are expected to conform to it. A typical example of deductive reasoning is the law of demand which states that, other things being equal, the quantity of a product demanded varies inversely with its price. When price falls, demand expands and when price rises, demand contracts.

As against this deductive reasoning, some thinkers try to discover economic laws the other way round. Instead of laying down causes or conditions on a hypothetical basis, they collect the actual information regarding the behaviour of economic units under different conditions. In other words, empirical information is collected and generalisations regarding the behaviour of economic units under different conditions are worked out. This is called the method of inductive reasoning. A well-known example of the use of this method is the Engel's Law. Through a study of family budgets, Engel concluded that as the income of a family increases, the proportion of its expenditure on necessities decreases while that on comforts and luxuries goes up. Most business firms prefer this line of approach.

In economics, both inductive and deductive methods of reasoning are used to supplement our understanding of an economy and its working.

1.7.2 Equilibrium

The concept of equilibrium is an important tool of analysis in economics. It is very frequently used and one should become familiar with it. Usually, an economic variable (such as the price of a commodity) is subject to various forces trying to pull it in different directions. When these forces are in balance, the value of variable stops changing and it is said to be in equilibrium.

Concept of Equilibrium

Equilibrium means a state of rest, the attainment of a position from which there is no incentive nor opportunity to move.

- A consumer is in equilibrium when his expenditure on different goods and services yield maximum satisfaction. No move on his part can increase his satisfaction but, rather, will decrease it.
- A business firm is in equilibrium when its resource purchases and its output are such that it maximises its profits, if profit maximisation is its objective, any change on its part will cause profits to decrease.
- A resource owner is in equilibrium when the resources which he owns are placed in their highest paying employments and the income of the resource owners is maximised. Any transfer of resource units from one employment to another will cause his income to decrease.
- An economy is in equilibrium at the level of income (and employment) where aggregate demand equals aggregate supply.

Equilibrium concepts are important, not because equilibrium is ever in fact attained but because they show us the directions in which economic changes proceed. Economic units in disequilibrium usually move toward equilibrium positions.

Equilibrium can be analysed in two forms:

1) **Partial:** In partial equilibrium analysis we concentrate on a single market in isolation from the rest of the economy.

2) **General:** In general equilibrium analysis, we analyse simultaneously all the markets in the economy on the basic premise that everything depends on everything else.

1.8 POSITIVE VERSUS NORMATIVE ECONOMICS

The term **positive economics is concerned with only formulating economic laws and describing reality.** The economic laws may be derived from theoretical assumptions or from recorded facts. Either way, they only tell us what exists. They do not pass any judgement as to whether the findings of economic analysis are desirable or need a modification.

As against this, **normative economics realises the fact that an economy is never perfect. The outcome of its working can always be improved upon.** It is quite normal to find an economy faced with many problems requiring immediate attention. Such problems can be related to price changes, employment, scarcity of certain inputs, inequalities of Income and wealth, and so on. In normative economics, the knowledge gained is put to use for improving the working of the economy. Targets of improvement are laid down and policy measures are formulated by which the targets are to be achieved. Thus, normative economics is concerned with what ought to be.

A positive statement:

“An increase in price of petrol leads to a fall in its quantity demanded.”

A normative statement:

Government should take steps to cut the consumption of Petrol.

More generally, normative statement uses the verb “should”.

1.9 MICROECONOMICS AND MACROECONOMICS

The terms microeconomics and macroeconomics are used in connection with the level of aggregation, that is the extent to which economic units and variables are covered in economic analysis. At one end, the analysis may cover the behaviour and responses of a single economic unit and at the other extreme it may cover the entire economy. These two terms (micro and macro) are derived from Greece words **mikros** and **makros** which mean small and large respectively.