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POSITIVE VERSUS NORMATIVE ECONOMICS – AN EMPIRICAL STUDY

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Abstract

Positive and normative economic thought are two specific branches of economic reasoning. Although they are associated with one another, positive and no mative economic thought have different focuses when analyzing economic scenarios. Positive economics is a branch of economics that focuses on the description and explanation of phenomena, as well as their casual relationships. It focuses primarily on facts and cause-and-effect behavioral relationships, including developing and testing economic theories. As a science, positive economics focuses on analyzing economic behavior. It avoids economic value judgments. For example, positive economic theory would describe how money supply growth impacts inflation, but it does not provide any guidance on what policy should be followed. "The unemployment rate in France is higher than that in the United States" is a positive economic statement. It gives an overview of an economic situation without providing any guidance for necessary actions to address the issue. Normative economics is a branch of economics that expresses value or normative judgments about economic fairness. It focuses on what the outcome of the economy or goals of public policy should be. Many normative judgments are conditional. They are given up if facts or knowledge of facts change. In this instance, a change in values is seen as being purely scientific. Welfare economist Amartya Sen explained that basic (normative) judgments rely on knowledge of facts. An example of a normative economic statement is "The price of milk should be $6 a gallon to give dairy farmers a higher living standard and to save the family farm." It is a normative statement because it reflects value judgments. It states facts, but also explains what should be done. Normative economics has subfields that provide further scientific study including social choice theory, cooperative game theory, and mechanism design. This present study gives an overview of "Positive versus Normative Economics". The data used in this study is secondary data and by empirical study.

Key Words: *Economic Reasoning, Analyzing Economic Scenarios, Casual Relationships, Description & Explanation of Phenomena, Judgments about Economic Fairness and Outcome of the Economy.*

Introduction

Economics is the social science that studies economic activity to gain an understanding of the processes that govern the production, distribution and consumption of goods and services in an economy. The term economics comes from the Ancient Greek, hence "rules of the house (hold for good management)". 'Political economy' was the earlier name for the subject, but economists in the late 19th century suggested "economics" as a shorter term for "economic science" to establish itself as a separate discipline outside of political science and other social sciences. Economics focuses on the behavior and interactions of economic agents and how economies work. Consistent with this focus, primary textbooks often distinguish between microeconomics and macroeconomics.

Microeconomics examines the behavior of basic elements in the economy, including individual agents and markets, their interactions, and the outcomes of interactions. Individual agents may include, for example, households, firms, buyers, and sellers. Macroeconomics analyzes the entire economy (meaning aggregated production, consumption, savings, and investment) and issues affecting it, including unemployment of resources (labor, capital, and land), inflation, economic growth, and the public policies that address these issues (monetary, fiscal, and other policies). Other broad distinctions within economics include those between positive economics, describing "what is," and normative economics, advocating "what ought to be"; between economic theory and applied economics; between rational and behavioral economics; and between mainstream economics (more "orthodox" and dealing with the "rationality-individualism-equilibrium nexus") and heterodox economics (more "radical" and dealing with the "institutions-history-social structure nexus"). Besides the traditional concern in production, distribution, and consumption in an economy, economic analysis may be applied throughout society, as in business, finance, health care, and government. Economic analyses may also be applied to such diverse subjects as crime, education, the family, law, politics, religion, social institutions, war, and science; by considering the economic aspects of these subjects. Education, for example, requires time, effort, and expenses, plus the foregone income and experience, yet these losses can be weighed against future benefits education may bring to the agent or the economy. At the turn of the 21st century, the expanding domain of economics in the social sciences has been described as economic imperialism.

Objectives

The present study aimed with the following objectives:

1. To know about the Positive Economics and its statement in Economics
2. To know about the Normative Economics and its statement in Economics
3. To differentiate the Positive and Normative Economics
4. To study Positive and Normative Economics analysis

Operational Definitions

Alfred Marshall provides a still widely cited definition in his textbook “Principles of Economics (1890) that extends analysis beyond wealth and from the societal to the microeconomic level “Economics is a study of man in the ordinary business of life. It enquires how he gets his income and how he uses it. Thus, it is on the one side, the study of wealth and on the other and more important side, a part of the study of man”.

Positive Economics “..is the study of economics based on objective analysis. Most economists today focus on positive economic analysis, which uses what is and what has been occurring in an economy as the basis for any statements about the future. Positive economics stands in contrast to normative economics, which uses value judgments".

Normative Economics "..is a perspective on economics that incorporates subjectivity within its analyses. It is the study or presentation of "what ought to be" rather than what actually is. Normative economics deals heavily in value judgments and theoretical scenarios. It is the opposite of positive economics".

Positive Economics

Positive economics is a social science based on factual analysis and cause and effect that avoids value judgments, opinion or moral and ethical statements. Unlike normative economics that subjectively emphasizes what should be, positive economics states what is, what was or what likely will be in a way that can be tested for accuracy. For example, the statement "decreasing interest rates will encourage consumers to spend" could be considered as positive while "the government should regulate the cost of food to help feed the poor" is a normative economic statement. The former is a neutral statement based on fact that can be proven with observable evidence while the latter is a subjective statement presented as an emotional appeal. The reason why an economic situation has developed is a typical focus of positive economics. If the price of a commodity is proven to have suddenly decreased or increased significantly in a few months or a year, the positive economist would attempt to determine the factors that affected price. In contrast, a normative economist may suggest what policy should be enacted to reverse the effects of the price increase or decrease. Positive economists also help determine the likely consequences of a new economic policy or a policy change such as an increase in taxes. One of the most common tools used for such an assessment is called cost benefit analysis. Cost benefit analysis compares the total costs of an undertaking with its anticipated benefits. Additional related assessment tools include economic impact analysis, fiscal impact analysis and cost effectiveness analysis.

Although positive economics can aid in the prediction of the results of an economic policy via statistical methodology and theory, positive economists do not purposely seek policy changes or judge existing or former rules. Instead they try to objectively resolve economic issues by studying and testing evidence. Politicians and the general public are left to evaluate and choose what economic policies should be discarded, adopted or amended based on the results. The distinction between positive and normative economics was elaborated first by John Neville Keynes in the late 19th century and more recently in a 1953 essay by Milton Friedman. Friedman posited that as a science, positive economics should deal in objective and observable statements. The value of an economy theory, according to Friedman, is determined by its accuracy as a predictor of future economic events and consequences. A combination of positive and normative economic statements is commonly used in the media. Normative economic statements are preferred by political leaders who purpose solutions to economic problems or who wish to influence economic policy. Positive economists emphasize the scientific aspect of a specific field and limit themselves to questions that can be resolved with observable evidence.

Positive Economics concerns *what is*. To illustrate, an example of a positive economic statement is as follows: "The unemployment rate in France is higher than that in the United States."

The branch of economics that seeks to explain the way the economy actually operates. It is the application of the scientific method and the process of testing hypothesis to economic phenomena. A positive economic statement is one that can be refuted by looking at the real world--that is, by testing a hypothesis.

Positive economics results when the scientific method is applied to economic phenomena and issues related to the fundamental problem of scarcity. The scientific method is a systematic process of investigating the way the world works by verifying hypothesized relations against real world data. Those hypotheses that are satisfactorily verified become principles and are incorporated into scientific theories.

Science and Policy

The study of economics involves both scientific investigation and policy analysis. Economists first use science to explain the world and understand how the economy works, then they explore policies designed to improve the world. This means that economists practice both:

- Positive economics, which uses the scientific method to uncover the mechanism of the economy, seeks to describe the way this world IS.
- Normative economics, which recommends policies suggested by scientific knowledge to "fix" the world, seeks to prescribe the way the world SHOULD BE.

Description Versus Prescription

- Positive economics uses the scientific method to uncover the mechanism of the economy, to lay out the rules, to take it apart and see how it ticks. Positive economics seldom has room for debate. Either it is or it is not. Just the facts, facts which can be verified.
- This is not true for normative economics--the policy side of economics. While positive economics seeks to describe the way it is, normative economics seeks to prescribe the way it should be. Normative economics is used to recommend ways to change the world, to improve it, to make it a better place.
- There is a lot of room for debate over normative economics and what constitutes a better world. A better world for Pollyanna Pumpernickel, might not be a better one for Winston Smythe Kennsington III. In most markets. a better world for sellers is higher prices, while a better world for buyers is lower prices. There are no absolutely right or wrong normative actions.

Working Together

While some might choose to do either positive economics or normative economics, most economists do both. That is because both work together. The science of positive economics describes the mechanism of the economy. It lays out the options. If A happens, then B results. But does society really want B? Would society prefer to avoid B? The policies of normative economics then prescribes the best way to pursue A, or B, or something else.

Positive Economic Statements

Consider these examples of positive economic statements:

- An increase in the price of wheat to $5 a bushel gives farmers a higher living standard and helps save 1,000 family farms.
- The United States spends $10 billion more on national defense than on higher education.
- A market-based economy has less income inequality that other economic systems.

Each of these statements can be, in principle, verified by comparison with real world data.

- To verify statement (1) wheat prices can be checked to see if they did, in fact, increase to $5 a bushel. Farmers' living standards (measured with something like per capita income) can then be examined to see if they have increased and whether or not 1,000 family farms that might have gone out of business are still operating. Verifying this statement can be quite involved, requiring sophisticated statistical procedures. However, the fact that it can be verified, at least in principle, is what makes it a positive statement.
- Statement (2) is much more easily verified by checking how much was spent on national defense and how much was spent on education.
- Statement (3) can also be easily verified by examining measures of income inequality, such as the Gini coefficient, for a range of economic systems.

The key with each of these statements is that no value judgments are involved (as there would be the case for normative statements).

Normative Economics

Normative economics is an approach to analyzing economic events and factors in a manner that allows room for some degree or personal interpretation. This is in contrast to positive economics, where the rule of thumb is to focus on hard facts with little to no subjective opinion included in the presentation. Often, the format of normative statements regarding economic events is couched in verbiage that suggests possible future events resulting from current events, based on individual speculation and interpretation of the available data. Essentially, normative economics involves assessing current data and making a determination of how things should progress in the future, in order for a desired outcome to emerge. The subjective statements do not have to assume that the status quo will be maintained in the future, but that by pursuing one or more specified courses of action, a economic situation that is very different from the current one will come to pass. Often, statements of this type provide specific directives that, if implemented, have at least a chance of leading to outcome desired. The process of normative economics would involve making a statement of something that the speaker believes should take place in the future. For example, if a politician refers to current data regarding consumer spending within a given nation, and makes a statement that the government should reduce taxes by a certain percentage in order to provide more disposable income to taxpayers, that statement is based on projections of what could happen, rather than what is happening. By contrast, a positive or objective statement would involve noting that while tax cuts might be helpful, current data indicates that government agencies would have to reduce expenses before a tax cut would become feasible. The difference is that one statement focuses on the possible outcome of making a change, while the other has to do with what must happen before a chance can be made.

It is not unusual for normative economics to play a role in many statements made through the media. While those statements are subjective and sometimes considered impractical, that does not necessary mean they are without basis. In order for a comment to be truly based in a normative economics approach, that comment must have a foundation in currently verifiable facts, and provide a projection that at least some degree of logic in terms of how that proposed event would impact the economy. From this perspective, normative economics statements provide a valuable service, in that they can form the basis for new ideas and approaches, and aid in the establishment of workable goals for the future.

The branch of economics that seeks to recommend the way the economy should operate. It is the policy side of economics that is based on individual preferences and cannot be proven either right or wrong. A normative economic statement cannot be refuted by looking at the real world--that is, by testing hypotheses.

Normative economics depends on values, beliefs, preferences, self interests, and/or the pursuit of economic goals. It is the policy side of economics and the process of improving the economy by pursuing economic goals. However, what might constitute an improvement for one person might not be an improvement for another.

Normative Economic Statements

Consider these examples of normative economic statements:

- The price of wheat should be $5 a bushel to give farmers a higher living standard and to save the family farm.
- The United States would be better off spending $10 billion more on national defense than higher education.

- A market-based economy is clearly the best possible economic system.

These are all normative statements, the practice of normative economics, because they depend on value judgments and cannot be proven true or false by comparison against real world data.

- Statement (1) makes the judgment that farmers need a higher living standard and that family farms need to be saved. Maybe so, maybe not. Consumers who purchase more expensive wheat products (bread, tobuoli, snack cakes) might argue otherwise.
- Statement (2) makes the value judgment that national defense is more deserving of this $10 billion than education. Maybe it is, maybe it is not. Students, professors, and others in higher education who suffer from less funding might think otherwise.
- Lurking somewhere behind statement (3) is a hidden value about what constitutes the "best" economic system. Is it a system that achieves the economic goal of efficiency better than other systems? But what if society would rather achieve the goal of equity? Or stability? Maybe it is the best system, maybe it is not. The key with each of these statements is that value judgments are involved.

Positive Economics Versus Normative Economics

Positive economics is objective and fact based, while normative economics is subjective and value based. Positive economic statements do not have to be correct, but they must be able to be tested and proved or disproved. Normative economic statements are opinion based, so they cannot be proved or disproved. While this distinction seems simple, it is not always easy to differentiate between the positive and the normative. Many widely-accepted statements that people hold as fact are actually value based. For example, the statement, "government should provide basic healthcare to all citizens" is a normative economic statement. There is no way to prove whether government "should" provide healthcare; this statement is based on opinions about the role of government in individuals' lives, the importance of healthcare and who should pay for it. The statement, "government-provided healthcare increases public expenditures" is a positive economic statement, because it can be proved or disproved by examining healthcare spending data in countries like Canada and Britain where the government provides healthcare. Disagreements over public policies typically revolve around normative economic statements, and the disagreements persist because neither side can prove that it is correct or that its opponent is incorrect. A clear understanding of the difference between positive and normative economics should lead to better policy making, if policies are made based on facts (positive economics), not opinions (normative economics). Nonetheless, numerous policies on issues ranging from international trade to welfare are at least partially based on normative economics.

Economics is often split into two branches - positive and normative economics. Positive economics looks at economic issues that can be studied by looking at verifiable facts. Normative economics, on the other hand, looks at issues that involve value judgements or opinions. Thus normative economics means making a judgement based on an opinion which cannot be tested. Below we look in more detail at positive and normative statements.

Positive and Normative Statements

Economists often make statements. Some of these are positive and are attempts at statements of fact or testable hypotheses. At other times, economists may venture to say what is right or wrong and in so doing will express opinions or views. Thus economics is concerned with two main types of statements.

Positive Statements

These are statements of fact, or at least of a provable nature. Some examples:

- The retired population of Mexico has increased over the last 15 years.
- The Nigerian balance of payments deteriorated last month.
- Boys learn slower than girls.
- The moon is made of cheese.
- High mortgage interest rates encourage saving
- More African nations will qualify for the World Cup next time.

All of these are positive. They may not be true, but can be tested; i.e. they can be proved to be true or false.

Normative Statements

Normative statements, or value judgements as they are sometimes called, are matters of opinion or statements of value. They cannot be tested or proven. Some examples:

- University students should be funded from a new, higher rate of income tax.
- Nobody should have to pay for hospital treatment.
- Mobile phones should be banned in all public places.
- Girls should be given higher university loans than boys.
- The present level of income tax is unfair.
- Acts of terror by the state cannot be justified
- Workers should receive a greater share of capitalists profits

They tend to contain words such as *ought, should, fair*, and *inequitable*.

In economics, there is an important distinction between normative analysis and positive statements. Normative analysis deals with ideas/opinions/feelings or moral statements, and generally these statements begin with the word should. Positive analysis is a statement or hypothesis about the being or current state of something, and can be tested to be either true or false. For example,

Here are some positive statements:

- The temperate is 85 degrees today (this can be tested, and found to be true or false)
- The sky is blue (if we know what "blue" is, this can be tested)
- More people will buy homes if the price of homes goes down (again, can be tested)
- Raising the minimum wage causes unemployment (again, look at the data and see if it is true or not)

Here are some similar statements that are normative in nature:

- It is too hot today (how can we test this? It is an opinion)
- We should take a picture of the blue sky (again, a recommendation or opinion)
- We should lower the price of homes (can't test this, it is how someone feels)
- To be fair, minimum wage should go up (what is fair? There is no real definition in economics about fairness so this cannot be tested)

Sometimes textbooks or teachers will discuss normative analysis and positive analysis as well, but this generally involves answering the normative or positive statements or questions. Being able to recognize the difference between the two is the trick, and this trick involves the ability to test the statement or not.

Positive and Normative Analysis

Economics uses two types of analysis: positive and normative. **Positive analysis** describes the world the way it is. It is based on facts. **Normative analysis** describes the world the way it should be. It is based upon opinions. Economists use both types of analysis when examining social issues and advising policymakers.

Positive analysis of economic growth includes the calculation of the value of the goods and services produced and available to satisfy our needs and wants. The value of output, if measured accurately, is a fact. Positive analysis also includes discussions of ways to increase economic growth, such as increased specialization and trade or investment in physical capital, education, and technology. Simple economic models, such as those discussed in Chapter 3, illustrate these facts. Normative analysis of economic growth might suggest that taxes should be increased to provide additional funding for public schools. Economists demonstrate that increases in education usually increase productivity. Skilled workers produce more output than unskilled workers. Since this is factual information, this is positive analysis. People differ, however, in their opinions about how to achieve a better-educated workforce. Normative analysis might suggest that property taxes should be increased to provide more funding for public schools. This is an opinion about how to improve education. If society chooses to devote more resources to the public school system, property taxes are not the only way to generate the necessary funds. Others might prefer a different tax structure. An alternative normative analysis might disagree with the presumption that increased spending on public schools will automatically improve the quality of education. This is the basis behind President George W. Bush's initiatives that require students to pass competency examinations before promotion to the next school grade level. Since this part of the analysis is based on opinions about the best way to improve education, it is normative.

A similar distinction between positive and normative analysis can be made when discussing the macroeconomic policy goal of low unemployment. Economists at the U.S. Bureau of Labor Statistics (BLS)regularly report on the condition of the U.S. labor market. Their calculations of the number of adults who are unemployed and the percentage of the labor force that wants a job but is unable to find one is examples of positive economic analysis since they are based on facts. Normative analysis might suggest that the current unemployment rate is too high and that the government should take steps to reduce unemployment. Whether the current unemployment rate is too high is a matter of opinion. Similarly, positive analysis of inflation includes the calculation of the rate at which prices are rising, while normative analysis might suggest that the inflation rate is too high and the government should attempt to correct it. Positive analysis of monetary policy includes a discussion of the ways the Federal Reserve System affects the economy by influencing the amount of money banks create when they issue loans. Normative analysis might suggest the Fed should do more to stimulate overall spending in the economy. Positive analysis of fiscal policy includes a discussion of the various taxes that are used to generate revenue for the government and the ways that money is spent to provide goods and services for the public. Normative analysis might suggest that the current tax system is inefficient or unfair or proclaim that the government spends too much money on certain programs and too little on others.

Politicians often use economists as hired guns. Rather than asking economists to provide an independent analysis of a policy issue, they instead tell the economists their position on a social issue and ask economists to provide them with supporting research. This frequently results in the public being given a partial analysis, with unfavorable aspects ignored or downplayed. Politicians may also hire economists to present opinions as if they were facts. Thus it is important to be able to distinguish between positive and normative analysis when evaluating economic arguments.

Summary in Points

- Positive economics deals with what is while normative economics deals with what should be.
- Positive economics deals with facts while normative economics deals with opinions on what a desirable economy should be.

- Positive economics is also called descriptive economics while normative economics is called policy economics.
- Positive economic statements can be tested using scientific methods while normative economics cannot be tested.

Conclusion

Each of us must have an understanding on how the economy works. It will allow us to see if our policy makers are making the right economic decisions for us. We should be able to know how our behavior and spending habits affect the economy. It is important therefore to know what economics is and learn about its different features and dimensions. Economics is a social science that deals with the production, distribution, and consumption of goods and services. Its purpose is to explain how economies work and the interaction between its various agents. Positive economic statements are always based on what is actually going on in the economy and they can either be accepted or rejected depending on the facts presented. Normative economic statements cannot be tested and proved right or wrong through direct experience or observation because they are based on an individual’s opinion. Although these two are distinct from each other, they complement each other because one must first know about economic facts before he can pass judgment or opinion on whether an economic policy is good or bad.

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