
1 Introduction

1.1 About Econometrics

Economists are frequently interested in relationships between different quantities, for example between individual wages and the level of schooling. The most important job of econometrics is to quantify these relationships on the basis of available data and using statistical techniques, and to interpret, use or exploit the resulting outcomes appropriately. Consequently, econometrics is the interaction of economic theory, observed data and statistical methods. It is the interaction of these three that makes econometrics interesting, challenging and, perhaps, difficult. In the words of a seminar speaker, several years ago: ‘Econometrics is much easier without data’.

Traditionally econometrics has focused upon aggregate economic relationships. Macro-economic models consisting of several up to many hundreds equations were specified, estimated and used for policy evaluation and forecasting. The recent theoretical developments in this area, most importantly the concept of cointegration, have generated increased attention to the modelling of macro-economic relationships and their dynamics, although typically focusing on particular aspects of the economy. Since the 1970s econometric methods are increasingly employed in micro-economic models describing individual, household or firm behaviour, stimulated by the development of appropriate econometric models and estimators which take into account problems like discrete dependent variables and sample selection, by the availability of large survey data sets, and by the increasing computational possibilities. More recently, the empirical analysis of financial markets has required and stimulated many theoretical developments in econometrics. Currently econometrics plays a major role in empirical work in all fields of economics, almost without exception, and in most cases it is no longer sufficient to be able to run a few regressions and interpret the results. As a result, introductory econometrics textbooks usually provide insufficient coverage for applied researchers. On the other hand, the more advanced econometrics textbooks are often too technical or too detailed for the average economist to grasp the essential ideas and to extract the information that is needed. Thus there is a need for an accessible textbook that discusses the recent and relatively more advanced developments.