CHAPTER 1 - INTRODUCTION

Because the textbook stresses economic analysis as it applies to the labor market, students must understand the ways economic analyses are used. The basic purpose of Chapter 1 is to introduce students to the two major modes of economic analysis: positive and normative. Because both modes of analysis rest on some very fundamental assumptions, Chapter 1 discusses the bases of each mode in some detail.

In our treatment of positive economics, the concept of rationality is defined and discussed, as is the underlying concept of scarcity. There is, in addition, a lengthy discussion of what an economic model is, and an example of the behavioral predictions flowing from such a model is presented. The discussion of normative economics emphasizes its philosophical underpinnings and includes a discussion of the conditions under which a market would fail to produce results consistent with the normative criteria. Labor market examples of governmental remedies are provided.

The appendix to Chapter 1 introduces the student to ordinary least squares regression analysis. It begins with univariate analysis, introduced in a graphical context, explaining the concepts of dependent and independent variables, the "intercept" and "slope" parameters, the "error term," and the t statistic. The analysis then moves to multivariate analysis and the problem of omitted variables.

List of Major Concepts

1. The essential features of a market include the facilitation of contact between buyers and sellers, the exchange of information, and the execution of contracts.

2. The uniqueness of labor services affects the characteristics of the labor market.

3. Positive economics is the study of economic behavior, and underlying this theory of behavior are the basic assumptions of scarcity and rationality.

4. Normative economics is the study of what "should be," and theories of social optimality are based in part on the underlying philosophical principle of "mutual benefit. "

5. A market "fails" when it does not permit all mutually beneficial trades to take place, and there are three common reasons for such failure.

6. A governmental policy is "Pareto-improving" if it encourages additional mutually beneficial transactions. At times, though, the goal of improving Pareto efficiency conflicts with one of generating more equity.

7. The concept that governmental intervention in a market may be justified on grounds other than the principle of mutual benefit is discussed (for example, government

intervention may be justified on the grounds that income redistribution is a desirable social objective).

8. (Appendix) The relationship between two economic variables (e.g., wages and quit rates) can be plotted graphically; this visual relationship can also be summarized algebraically.

9. (Appendix) A way to summarize a linear relationship between two variables is through ordinary least squares regression analysis -- a procedure that plots the "best" line (the one that minimizes the sum of squared deviations) through the various data points. The parameters describing this line are *estimated,* and the uncertainty surrounding these estimates are summarized by the *standard error* of the estimate.

10. (Appendix) Multivariate procedures for summarizing the relationship between a dependent and two or more independent variables is a generalization of the univariate procedure, and each coefficient can be interpreted as the effect on the dependent variable of a one-unit change in the relevant independent variable, *holding the other variables constant.*

11. (Appendix) If an independent variable that should be in an estimating equation is left out, estimates of the other coefficients may be biased away from their true values.