xthst: Testing slope homogeneity in Stata

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Tore Bersvendsen\textsuperscript{1}, Jan Ditzen\textsuperscript{2}

\textsuperscript{1}Kristiansand Municipality, Norway

\textsuperscript{2}Heriot-Watt University, Edinburgh, UK
Center for Energy Economics Research and Policy (CEERP)
www.jan.ditzen.net, j.ditzen@hw.ac.uk

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Motivation

- Different econometric methods are available if the parameter of interest (slope) is homogeneous or heterogeneous.
- Huge literature on homogeneous slopes. Examples: fixed effects, random effects, GMM, ...
- Methods for models with heterogeneous effects are available as well. Examples: SURE, mean group estimator, ...
- Incorrectly ignoring slope heterogeneity leads to biased results (Pesaran and Smith, 1995).
- Establishing slope homogeneity/heterogeneity key for model selection.
- This presentation: introducing the Delta test (Pesaran and Yamagata, 2008; Blomquist and Westerlund, 2013) for testing slope homogeneity in large panels using \texttt{xthst} (Bersvendsen and Ditzen (2020) and forthcoming in \textit{The Stata Journal}).
Econometric Model

- Large panel data model with \( N_g \to \infty \) cross-sectional units and \( T \to \infty \) time periods.
- Slope coefficients can be heterogeneous:

\[
y_{i,t} = \mu_i + \beta_1' x_{1i,t} + \beta_2' x_{2i,t} + \epsilon_{i,t},
\]

(1)

- Effect of \( x_{1i,t} \) and \( x_{2i,t} \) on \( y_{i,t} \) of main interest.
- We want to test if the effect of \( x_{2i,t} \) is the same across all cross-sectional units, namely if \( \beta_2' = \beta_2' \forall i \).
- Assumption \( \beta_1 \) heterogeneous and \( \epsilon_{i,t} \) has heteroskedastic errors.
Testing slope homogeneity

Overview

- **Hypothesis:**
  
  \[ H_0 : \beta_{2i} = \beta_2 \text{ for all } i, \]

  against the alternative:

  \[ H_A : \beta_{2i} \neq \beta_2 \text{ for some } i. \]

- **Tests available**
  
  - F-Test requires homoskedasticity assumption, fixed \( N \) and requires \( T > N \).
  
  - Hausman style tests valid only if \( N > T \) and require strongly exogenous regressors (Pesaran et al., 1996; Pesaran and Yamagata, 2008).
  
  - Bootstrap approaches (Blomquist and Westerlund, 2016)
  
  - Delta Test (Pesaran and Yamagata, 2008) and HAC robust version (Blomquist and Westerlund, 2013).
Testing for slope homogeneity

Delta Test (Pesaran and Yamagata, 2008)

- Based on a standardised version of Swamy’s test (Swamy, 1970).
- Compares the weighted difference between the cross-sectional unit specific estimate ($\beta_{2,i}$) and a weighted pooled estimate ($\beta_{2WFE}$):

$$\tilde{\Delta} = \frac{1}{\sqrt{N}} \left( \frac{\sum_{i=1}^{N} \tilde{d}_i - k_2}{\sqrt{2k_2}} \right)$$

with

$$\tilde{d}_i = (\hat{\beta}_{2i} - \tilde{\beta}_{2WFE})' \frac{X'_{2i} M_{1i} X_{2i}}{\tilde{\sigma}_i^2} (\hat{\beta}_{2i} - \tilde{\beta}_{2WFE})$$

$$M_{1i} = I_{T_i} - Z_{1i} (Z'_{1i} Z_{1i})^{-1} Z'_{1i}, Z_{1i} = (\tau_{T_i}, X_{1i})$$

- $\beta_{2WFE}$ is weighted by the cross-section unit specific variances.
- Under $H_0$, $\tilde{\Delta} \sim \mathcal{N}(0, 1)$. 

$\tilde{\Delta}$ is approximately standard normal under the null hypothesis.
Testing for slope homogeneity

HAC Robust Delta Test (Blomquist and Westerlund, 2013)

- Standard delta test requires error not to be autocorrelated.
- Blomquist and Westerlund (2013) derive a HAC robust version.

\[ \hat{\Delta}_{HAC} = \sqrt{N} \left( \frac{N^{-1} S_{HAC} - k_2}{\sqrt{2k_2}} \right) \]  \hspace{2cm} (3)

\[ S_{HAC} = \sum_{i=1}^{N} T_i (\hat{\beta}_{2i} - \hat{\beta}_{2HAC})' (\hat{Q}_{i,T_i} \hat{V}_{i,T_i}^{-1} \hat{Q}_{i,T_i}) (\hat{\beta}_{2i} - \hat{\beta}_{2HAC}) \]

- where
  - \( \hat{\beta}_{2HAC} \) is a HAC robust estimator of the pooled coefficients \( \beta_2 \)
  - \( \hat{Q}_{i,T_i} \) is a projection matrix to partial the heterogeneous variables out,
  - and \( \hat{V}_{i,T_i} \) a robust variance estimator with kernel \( \kappa() \) and bandwidth \( B_{i,T_i} \).
- Under \( H_0 \), \( \hat{\Delta}_{HAC} \sim \mathcal{N}(0, 1) \).
Testing for slope homogeneity

Cross-Sectional Dependence Robust version

- In large panels cross-sectional units likely to be correlated with each other, often modelled by common factor structure:

\[ y_{i,t} = \mu_i + \beta'_1 i x_{1i,t} + \beta'_2 i x_{2i,t} + u_{i,t}, \]
\[ u_{i,t} = \gamma'_i f_t + \varepsilon_{i,t}, \]

- Following Pesaran (2006); Chudik and Pesaran (2015) the common factors \( f_t \) can be approximated by cross-sectional averages.
- We propose to defactor \( y_{i,}, X_{1i} \) and \( X_{2i} \) by using cross-sectional averages to remove strong cross-sectional dependence.
- Then use the defactored variables and construct the test statistic following (2) and (3).
- No formal derivation available so far, Monte Carlo results are encouraging.
**xthst**

**Syntax**

```
xthst depvar indepvars [ if ] [ partial(varlist_p) noconstant
  crosssectional(varlist_cr [, cr_lags(numlist)]) ] ar hac bw(integer)
  whitening kernel(kernel_options) nooutput comparehac ]
```

- *depvar* is the dependent variable of the model to be tested, *indepvars* the independent variables
- *varlist_p* are the variables to be partialled out ($X_1$)
- *varlist_cr* are variables added as cross-sectional averages
- *hac* uses the HAC robust Delta test and *bw()* sets the bandwidth.
- *kernel_options* can be *qs*, *bartlett* or *truncated*.
- *ar* for pure autoregressive model.
**xthst - HAC and kernel options**

- *xthst* supports several kernel estimators for the variance/covariance estimator when using the HAC robust Delta test.

\[
\hat{\Sigma}_{i,T} = \hat{\Omega}_i(0) + \sum_{j=1}^{T_i-1} \kappa(j/B_{i,T})[\hat{\Phi}_i(j) + \hat{\Phi}_i(j)'],
\]  \hspace{1cm} (4)

- Possible kernel estimator for \( \kappa() \) are: *Bartlett* (default), *Quadratic spectral* (QS) and the *Truncated*.

- If bandwidth is not manually chosen, *xthst* opts for a data-dependent selection based on the chosen kernel:

\[
B_{i,T} = \left[ c(\alpha_i(q)^2 T_i)^{1/(2q+1)} \right],
\]  \hspace{1cm} (5)

where scalars \( c \) and \( q \) depend on the type of kernel (Andrews and Monahan, 1992; Newey and West, 1994; Bersvendsen and Ditzen, 2020).

- To reduce small sample bias, residuals for the variance estimator can be pre-whitened (Blomquist and Westerlund, 2013).
Monte Carlo Results

Overview

- Following Pesaran and Yamagata (2008) and Blomquist and Westerlund (2013):

\[
y_{i,t} = \mu_i + \sum_{l=1}^{k} \beta_{l,i} x_{i,l,t} + u_{i,t}
\]

\[
x_{i,l,t} = \mu_i (1 - \rho_{x,i,l}) + \rho_{x,i,l} x_{i,l,t-1} + (1 - \rho_{x,i,l})^{1/2} v_{i,l,t}
\]

\[
u_{i,t} = \rho_{u,i} u_{i,t-1} + \sqrt{1 - \rho_{u,i}^2} (\gamma_{u,i} f_t + e_{i,t})
\]

- \(x\) and \(u\) are allowed to independent or autocorrelated and have no cross-sectional dependence and strong cross-sectional dependence.

- Power and Size are compared for standard Delta test, HAC with QS kernel and prewhitening, CSD robust Delta test and a mix of all.

- Graphs generated by `resultplot` (coming soon on SSC by Wursten and Ditzen).
Monte Carlo Results

Size

Graph showing Monte Carlo results with various data points and lines indicating different conditions or methods.
Empirical Examples

• Growth model with GDP per capita growth in logarithms, log rgdpo and explanatory variables are human capital, log hc, physical capital, log ck, and population growth added with break even investments of 5%, log ngd.

• Data from Penn World Tables 8.0 (Feenstra et al., 2015).

• 93 countries ($N_g$) and $T = 48$ years between 1960 and 2007.
Empirical Examples

Delta Test

- Dynamic model and test if any of the slope coefficients are homo- or heterogeneous

```
.xthst d.log rgdp L.d.log rgdp log hc log ck log ngd
```

Testing for slope heterogeneity


H0: slope coefficients are homogenous

<table>
<thead>
<tr>
<th>Delta</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.957</td>
<td>0.003</td>
</tr>
<tr>
<td>adj.</td>
<td>3.171</td>
</tr>
</tbody>
</table>

Variables partialled out: constant

- `xthst` assumes a heterogeneous constant and partials it out.
- The null of slope homogeneity and an estimator allowing for heterogeneous slopes, such as the mean group estimator should be used.
Empirical Examples

Testing a subset

- Assume we want to test if only the lag of the dependent variable is heterogeneous.
- `partial()` is used to remove all other variables:

  ```stata
  . xthst d.log_rgdp L.d.log_rgdp log_hc log_ck log_ngd, \
  > partial(log_hc log_ck log_ngd)
  ```

Testing for slope heterogeneity
H0: slope coefficients are homogenous

<table>
<thead>
<tr>
<th>Delta</th>
<th>p-value</th>
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<tbody>
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<td>adj.</td>
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<tr>
<td></td>
<td>0.016</td>
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</table>

Variables partialled out: log_hc log_ck log_ngd constant
Empirical Examples

HAC robust Test

- Option `hac` can be employed to use the HAC robust standard errors.
- Default is to use `bartlett` kernel with data driven bandwidth.

```stata
.xthst d.log_rgdpl d.log_rgdpl log_hc log_ck log_ngd, hac
```

Testing for slope heterogeneity
(Blomquist, Westerlund. 2013. Economic Letters)
H0: slope coefficients are homogenous

<table>
<thead>
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<th>p-value</th>
</tr>
</thead>
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</tr>
<tr>
<td>adj.</td>
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<td>0.000</td>
</tr>
</tbody>
</table>

HAC Kernel: bartlett
with average bandwidth 3
Variables partialled out: constant
Empirical Examples

Option `comparehac`

- `xthst` should be used for model selection, comparison of results next to each other useful.
- Option `comparehac` compares the standard and HAC robust delta test.
- It also tests for cross-sectional dependence using `xtcd2` (Ditzen, 2018).

```
. xthst d.log_rgdpo L.d.log_rgdpo ///
   log_hc log_ck log_ngd, comparehac
Testing for slope heterogeneity
HO: slope coefficients are homogenous

<table>
<thead>
<tr>
<th></th>
<th>Delta</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2.957</td>
<td>0.003</td>
</tr>
<tr>
<td>adj.</td>
<td>3.171</td>
<td>0.002</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Delta (HAC)</th>
<th>p-value</th>
</tr>
</thead>
<tbody>
<tr>
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<td>0.593</td>
</tr>
<tr>
<td>adj.</td>
<td>-0.573</td>
<td>0.567</td>
</tr>
</tbody>
</table>
```

Tests disagree. Autocorrelation might occur. See helpfile for further info.

HAC Settings:
- Kernel: quadratic spectral (QS)
- with average bandwidth 45

Variables partialled out: constant

Cross Sectional dependence in base variables detected:
- `D.log_rgdpo LD.log_rgdpo log_hc log_ck log_ngd`

See helpfile for `xthst` and `xtcd2` for further info.
Testing for slope homogeneity important for selection of appropriate econometric method.

`xthst` introduces two such tests in panels with large number of observations over time and cross-sectional units.

Options involve:
- HAC robust tests with different bandwidth and kernels
- Cross-sectional dependence robust
- Pure autoregressive model

Empirical examples and results of Monte Carlo given.

Left for further research:
- Error correction models.
- Improve cross-sectional dependence robust test.
References I


References


References III


noconstant suppresses the individual heterogeneous constant, $\mu_i$.

partial(varlist_p) requests exogenous regressors in varlist_p to be partialled out. The constant is automatically partialled out, if included in the model. Regressors in varlist will be included in $z_{it}$ and are assumed to have heterogeneous slopes.

ar allows for an AR(p) model. The degree of freedom of $\tilde{\sigma}^2$ is adjusted. May not be combined with hac.

hac implements the HAC consistent test by Blomquist and Westerlund (2013). If kernel and bw are not specified, kernel is set to bartlett the data driven bandwidth selection is used. May not be combined with ar.

kernel(kernel) specifies the kernel function used in calculating the HAC consistent test statistic. Available kernels are bartlett, qs (quadratic spectral) and truncated. Is only required in combination with hac.
Options

- `bw(#)` sets the bandwidth equal to `#` for the HAC consistent test statistic, where `#` is an integer greater than zero. Is only required in combination with `hac`. Default is the data driven bandwidth selection.

- `whitening` performs pre-whitening to reduce small-sample bias in HAC estimation. Is only required in combination with `hac`.

- `crosssectional(varlist_cr [,cr_lags(numlist)])` defines the variables to be added as cross-sectional averages to approximate strong cross-sectional dependence. Variables in `varlist_cr` are partialled out. `cr_lags(numlist)` sets the number of lags of the cross-sectional averages. If not defined, but `crosssectional()` contains a `varlist`, then only contemporaneous cross sectional averages are added but no lags. `cr_lags(0)` is the equivalent. The number of lags can be variable specific, where the order is the same as defined in `cr()`. For example if `cr(y x)` and only contemporaneous cross-sectional averages of `y` but 2 lags of `x` are added, then `cr_lags(0 2)`.
• nooutput omits output.

• comparehac compares the standard delta test to the HAC robust version. First the standard delta test is run, then the HAC robust version. Results for both tests are displayed. If the tests disagree a message is posted. In addition the base of all variables are tested for cross-sectional dependence using xtdc2 (Ditzen, 2018). If cross-sectional dependence is found, a message is posted. The options crosssectional(), partial() and noconstant are hold constant across both tests. All HAC related options only apply to the HAC robust run. This option is only for testing purposes and should not replace further testing.
Stored Values

Scalars
\( r(bw) \) bandwidth

Macros
\( r(\text{cross-sectional}) \) variables of which cross-sectional averages are added
\( r(\text{partial}) \) variables partialled out
\( r(\text{kernel}) \) used kernel

Matrices
\( r(\delta) \) delta and adjusted delta
\( r(\delta_p) \) p-values of the above