A more powerful subvector Anderson and Rubin test in linear instrumental variables regression

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University of Konstanz, 4th KoLa workshop

July 30-31, 2018

Overview

- Robust inference on a slope coefficient(s) in a linear IV regression

- "Robust" means uniform control of null rejection probability over all "empirically relevant" parameter constellations

- "Weak instruments"

  - pervasive in applied research (Angrist and Krueger, 1991)

  - adverse effect on estimation and inference (Dufour, 1997; Staiger and Stock 1997)

- Large literature on "robust inference" for the full parameter vector

- Here: Consider **subvector inference in the linear IV model**, allowing for **weak instruments**

- First assume (almost) **conditional homoskedasticity**

  – then relax to general **Kronecker-Product** structure

  – then allow for arbitrary forms of **conditional heteroskedasticity**

- Presentation based on two papers; one being "A more powerful subvector Anderson and Rubin test in linear instrumental variables regression under conditional homoskedasticity"

- Focus on the **Anderson and Rubin (AR, 1949) subvector test statistic**:
  - **"History of critical values":**
  - Projection of AR test (Dufour and Taamouti, 2005)
  - Guggenberger, Kleibergen, Mavroeidis, and Chen (2012, GKMC) provide power improvement:

    Using $\chi^2_{k-m_W,1-\alpha}$ as critical value, rather than $\chi^2_{k,1-\alpha}$ still controls asymptotic size

    "Worst case" occurs under strong identification

- **HERE:** consider a **data-dependent critical value** that adapts to strength of identification

- Show: controls **finite sample/asymptotic size** & has uniformly **higher power** than method in GKMC

- One additional main contribution : **computational ease**

- Implication: Test in GKMC is "inadmissible"

Presentation

- Introduction: ✓

- finite sample case

  a) $m_W = 1$: motivation, correct size, power analysis (near optimality result)

  b) $m_W > 1$: correct size, uniform power improvement over GKMC

  c) refinement

- asymptotic case:

  a) (almost) conditional homoskedasticity

  b) general Kronecker-Product structure

  c) general case (arbitrary forms of conditional heteroskedasticity)

Model and Objective (finite sample case)

$$
\begin{aligned}
y &= Y\beta + W\gamma + \varepsilon, \\
Y &= Z\Pi_Y + V_Y, \\
W &= Z\Pi_W + V_W,
\end{aligned}
$$

$$
y \in R^n, Y \in R^{n\times m_Y} \text{ (end or ex)}, W \in R^{n\times m_W} \text{ (end)},\ \ Z \in R^{n\times k} \text{ (IVs)}
$$

- **Reduced form:**

$$
(y \vdots Y \vdots W) = Z\,(\Pi_Y \vdots \Pi_W)\begin{pmatrix}\beta & I_{m_Y} & 0 \\ \gamma & 0 & I_{m_W}\end{pmatrix} + \underbrace{(v_y \vdots V_Y \vdots V_W)}_{V},
$$

where $v_y := \varepsilon + V_Y\beta + V_W\gamma$.

- **Objective:** test

$$
H_0 : \beta = \beta_0 \text{ versus } H_1 : \beta \neq \beta_0.
$$

s.t. size bounded by nominal size & "good" power

Parameter space:

1. The reduced form error satisfies:

$$V_i \sim \text{i.i.d. } N\left(0, \Omega\right), \; i = 1, ..., n,$$

   where $\Omega \in R^{(m+1)\times(m+1)}$ is assumed to be known and positive definite.

2. $Z \in R^{n\times k}$ fixed, and $Z'Z > 0$ $k \times k$ matrix.

- **Note:** no restrictions on reduced form parameters Π_Y and Π_W $\rightarrow$ allow for weak IV

- Several robust tests available for **full vector inference**

$$H_0 : \beta = \beta_0, \gamma = \gamma_0 \text{ vs } H_1 : \text{not } H_0$$

including AR (Anderson and Rubin, 1949), LM, and CLR tests, see Kleibergen (2002), Moreira (2003, 2009).

- **Optimality properties:** Andrews, Moreira, and Stock (2006), Andrews, Marmer, and Yu (2018), and Chernozhukov, Hansen, and Jansson (2009)

Subvector procedures

- **Projection:** "inf" test statistic over parameter not under test, same critical value $\rightarrow$ "computationally hard" and "uninformative"

- **Bonferroni and related techniques:** Staiger and Stock (1997), Chaudhuri and Zivot (2011), McCloskey (2012), Zhu (2015), Andrews (2017), ...; often computationally hard, power ranking with projection unclear

- **Plug-in approach:** Kleibergen (2004), Guggenberger and Smith (2005)...Requires strong identification of parameters not under test.

- GMM models: Andrews, I. and Mikusheva (2016)

- Models defined by moment inequalities: Gafarov (2016), Kaido, Molinari, and Stoye (2016), Bugni, Canay, and Shi (2017), ...

The Anderson and Rubin (1949) test

- **AR test stat** for **full vector hypothesis**

$$H_0 : \beta = \beta_0, \gamma = \gamma_0 \ vs \ H_1 : \text{not } H_0$$

- AR statistic exploits $EZ_i\varepsilon_i = 0$

- **AR test stat:**

$$AR_n(\beta_0, \gamma_0) = \frac{(y - Y\beta_0 - W\gamma_0)' P_Z (y - Y\beta_0 - W\gamma_0)}{\left(1 \vdots -\beta_0' \vdots -\gamma_0'\right) \Omega \left(1 \vdots -\beta_0' \vdots -\gamma_0'\right)'}$$

- AR stat is distri. as χ^2_k under null hypothesis; critical value $\chi^2_{k,1-\alpha}$

- **Subvector AR statistic** for testing H_0 is given by

$$AR_n(\beta_0) = \min_{\gamma \in R^{m_W}} \frac{(\overline{Y}_0 - W\gamma)' P_Z (\overline{Y}_0 - W\gamma)}{(1 \vdots -\beta_0' \vdots -\gamma')\, \Omega\, (1 \vdots -\beta_0' \vdots -\gamma')'},$$

where $\overline{Y}_0 = y - Y\beta_0$.

- Alternative representation (using $\kappa_{\min}(A) = \min_{x, ||x||=1} x'Ax$):

$$AR_n(\beta_0) = \hat{\kappa}_p,$$

where $\hat{\kappa}_i$ for $i = 1, ..., p = 1 + m_W$ be roots of characteristic polynomial in κ

$$\left| \kappa I_p - \Omega(\beta_0)^{-1/2} \left(\overline{Y}_0 \vdots W\right)' P_Z \left(\overline{Y}_0 \vdots W\right) \Omega(\beta_0)^{-1/2} \right| = 0,$$

ordered non-increasingly, where we define variance matrix of $(\overline{Y}_{0i}, V'_{Wi})'$ as

$$\Omega(\beta_0) = \begin{pmatrix} 1 & 0 \\ -\beta_0 & 0 \\ 0 & I_{m_W} \end{pmatrix}' \Omega \begin{pmatrix} 1 & 0 \\ -\beta_0 & 0 \\ 0 & I_{m_W} \end{pmatrix}.$$

- When using $\chi^2_{k,1-\alpha}$ critical values, as for projection, trivially, test has correct size;

  GKMC show that this is also true for $\chi^2_{k-m_W,1-\alpha}$ critical values

- **Next show:** AR statistic is the minimum eigenvalue of a non-central Wishart matrix

- For par space above, the roots $\hat{\kappa}_i$ solve

$$0 = \left|\hat{\kappa}_i I_{1+m_W} - \Xi'\Xi\right|, \quad i = 1, ..., p = 1 + m_W,$$

where

$$\Xi \sim N\left(M, I_k \otimes I_p\right),$$

and M is a $k \times p$.

- Under H_0, the noncentrality matrix becomes $M = \left(0^k, \Theta_W\right)$, where

$$\Theta_W = \left(Z'Z\right)^{1/2} \Pi_W \Sigma_{V_W V_W . \varepsilon}^{-1/2},$$
$$\Sigma_{V_W V_W . \varepsilon} = \Sigma_{V_W V_W} - \Sigma'_{\varepsilon V_W} \sigma_{\varepsilon\varepsilon}^{-1} \Sigma_{\varepsilon V_W}$$

and

$$\begin{pmatrix} \sigma_{\varepsilon\varepsilon} & \Sigma_{\varepsilon V_W} \\ \Sigma'_{\varepsilon V_W} & \Sigma_{V_W V_W} \end{pmatrix} = \begin{pmatrix} 1 & 0 \\ -\beta_0 & 0 \\ -\gamma & I_{m_W} \end{pmatrix}' \Omega \begin{pmatrix} 1 & 0 \\ -\beta_0 & 0 \\ -\gamma & I_{m_W} \end{pmatrix}$$

- **Summarizing**, under H_0 the $p \times p$ matrix

$$\Xi'\Xi \sim W\left(k, I_p, M'M\right),$$

has non-central Wishart with noncentrality matrix

$$M'M = \begin{pmatrix} 0 & 0 \\ 0 & \Theta'_W \Theta_W \end{pmatrix}$$

and

$$AR_n(\beta_0) = \kappa_{\min}(\Xi'\Xi)$$

- The distribution of the eigenvalues of a noncentral Wishart matrix only depends on the eigenvalues of the noncentrality matrix $M'M$.

- Hence, distribution of $\hat{\kappa}_i$ only depends on the eigenvalues of $\Theta_W'\Theta_W$, κ_i say, $i = 1, \ldots, m_W$ and $\kappa = (\kappa_1, ..., \kappa_{m_W})'$

- When $m_W = 1$, $\kappa = \kappa_1 = \Theta_W'\Theta_W$ is scalar.

Theorem: Suppose $m_W = 1$. Then, under the null hypothesis $H_0 : \beta = \beta_0$, the distribution function of the subvector AR statistic, $AR_n(\beta_0)$, is monotonically decreasing in the parameter κ_1.

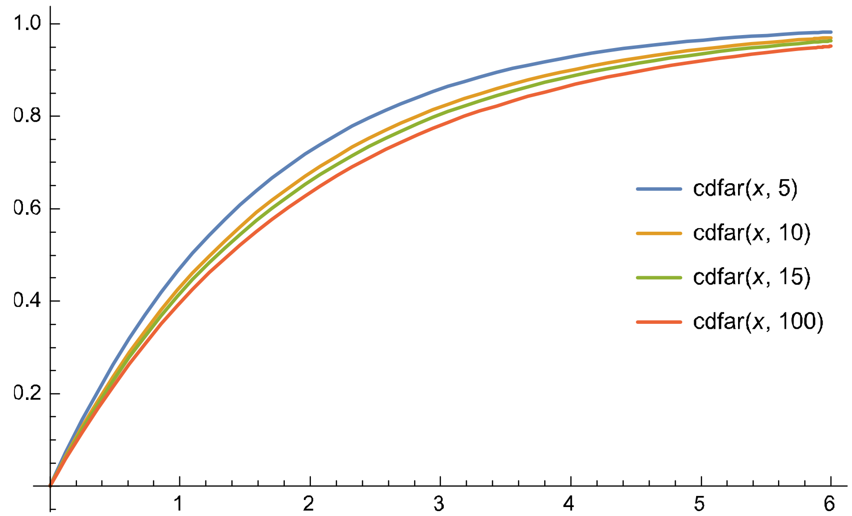


Figure 1: The cdf of the subset AR statistic with $k = 3$ instruments, for different values of $\kappa_1 = 5, 10, 15, 100$

New critical value for subvector Anderson and Rubin test: $m_W = 1$

- **Relevance:** If we knew κ_1 we could implement the subvector AR test with a smaller critical value than $\chi^2_{k-m_W,1-\alpha}$ which is the critical value in the case when κ_1 is "large".

- Muirhead (1978): Under null, when κ_1 "is large", the larger root $\widehat{\kappa}_1$ (which measures strength of identification) is a sufficient statistic for κ_1

- More precisely: the conditional density of $AR_n(\beta_0) = \hat{\kappa}_2$ given $\hat{\kappa}_1$ can be approximated by

$$f_{\hat{\kappa}_2|\hat{\kappa}_1}(x) \sim f_{\chi^2_{k-1}}(x)\left(\hat{\kappa}_1 - x\right)^{1/2} g\left(\hat{\kappa}_1\right),$$

where $f_{\chi^2_{k-1}}$ is the density of a χ^2_{k-1} and g is a function that does not depend on κ_1.

- Analytical formula for g

- The **new critical value** for the subvector AR-test at significance level $1-\alpha$ is given by

$$1 - \alpha \text{ quantile of (approximation of } AR_n \text{ given } \widehat{\kappa}_1)$$

- Denote cv by

$$c_{1-\alpha}(\hat{\kappa}_1, k - m_W)$$

Depends only on $\alpha, k - m_W$, and $\hat{\kappa}_1$

- Conditional quantiles can be computed by numerical integration

- Conditional critical values can be tabulated $\longrightarrow$ implementation of new test is trivial and fast

- They are increasing in $\hat{\kappa}_1$ and converging to quantiles of χ^2_{k-1}

- We find, by simulations over fine grid of values of κ_1, that new test

$$1(AR_n(\beta_0) > c_{1-\alpha}(\hat{\kappa}_1, k - m_W))$$

  controls size

- It improves on the GKMC procedure in terms of power

- **Theorem:** Suppose $m_W = 1$. The new conditional subvector Anderson Rubin test has correct size under the assumptions above.

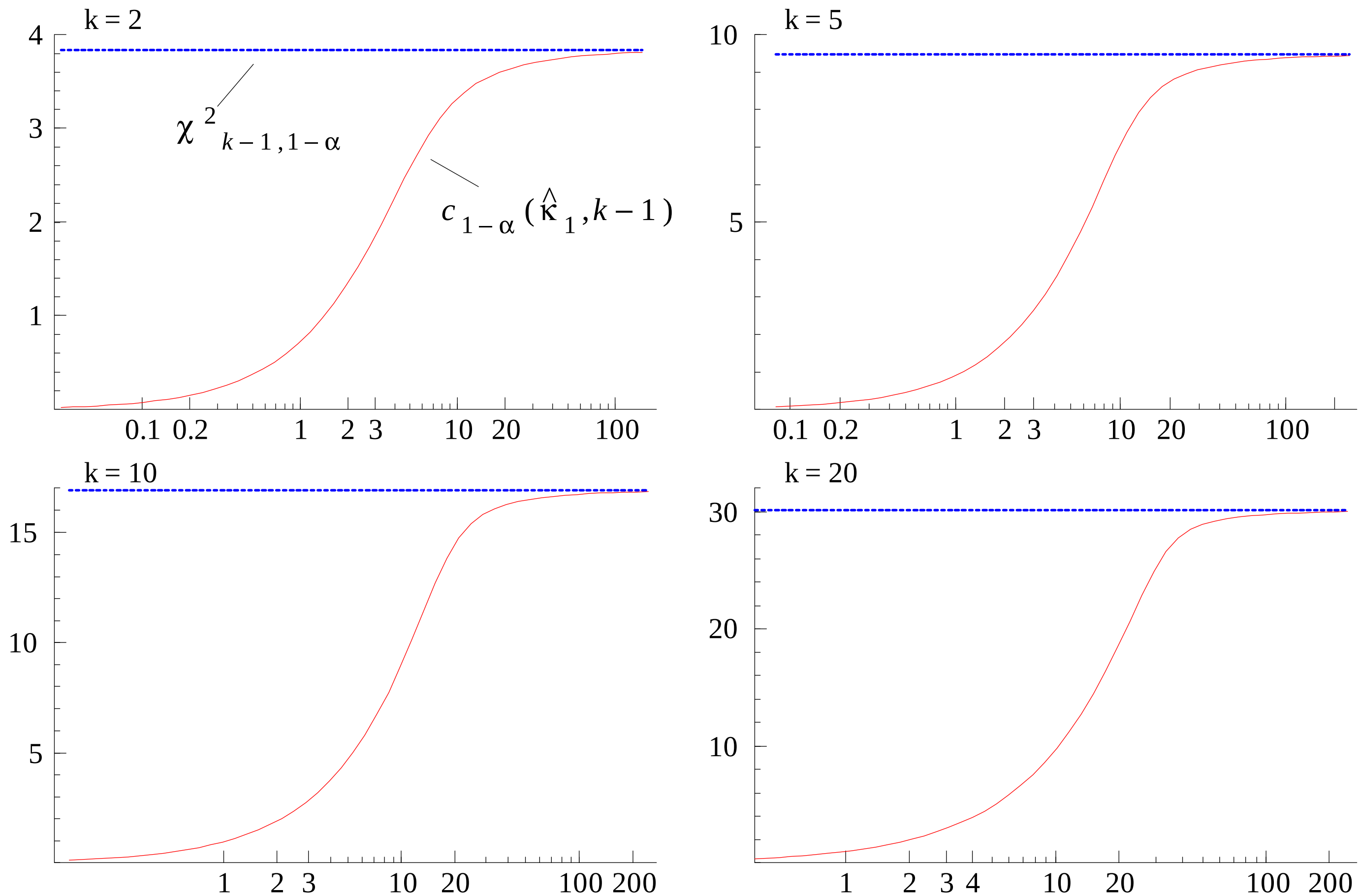
- Proof partly based on simulations; Verified for e.g. $\alpha \in \{1\%, 5\%, 10\%\}$ and $k - m_W \in \{1, ..., 20\}$.

- **Summary $m_W = 1$:** the cond'l test rejects when

$$\hat{\kappa}_2 > c_{1-\alpha}(\hat{\kappa}_1, k-1),$$

where $(\hat{\kappa}_1, \hat{\kappa}_2)$ are the eigenvalues of 2×2 matrix $\Xi'\Xi \sim W(k, I_p, M'M)$;

Under the null $M'M$ is of rank 1; **test has size α**

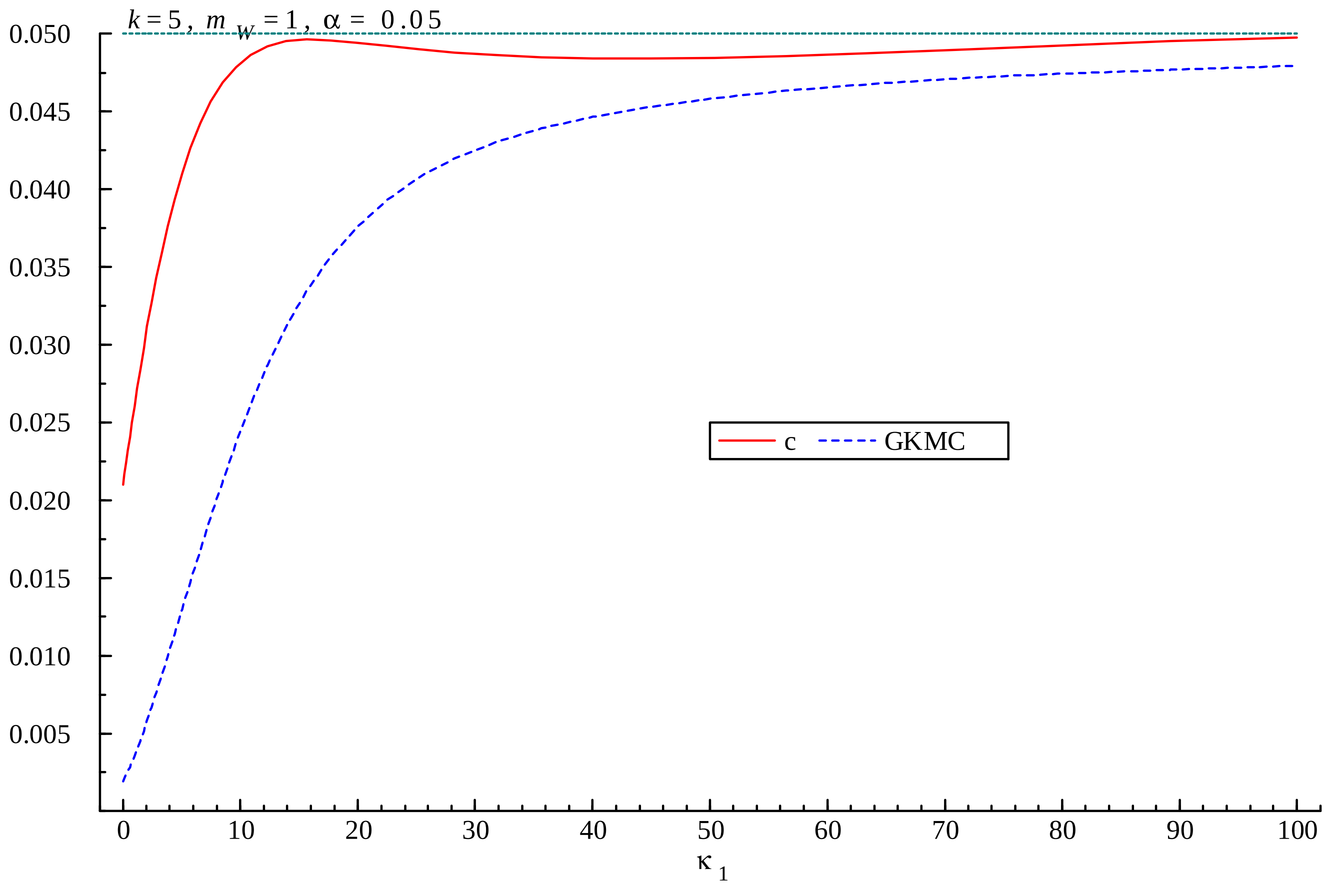


Critical value function $c_{1-\alpha}(\widehat{\kappa}_1, k-1)$ for $\alpha = 0.05$.

Table of conditional critical values cv=$c_{1-\alpha}(\hat{\kappa}_1, k - m_W)$

$\alpha = 5\%, \quad k - m_W = 4$											
$\hat{\kappa}_1$	cv	$\hat{\kappa}_1$	cv	$\hat{\kappa}_1$	cv	$\hat{\kappa}_1$	cv	$\hat{\kappa}_1$	cv	$\hat{\kappa}_1$	cv
0.22	0.2	2.00	1.8	3.92	3.4	6.10	5.0	8.95	6.6	14.46	8.2
0.44	0.4	2.23	2.0	4.17	3.6	6.41	5.2	9.40	6.8	15.88	8.4
0.65	0.6	2.46	2.2	4.43	3.8	6.73	5.4	9.89	7.0	17.85	8.6
0.87	0.8	2.70	2.4	4.69	4.0	7.05	5.6	10.42	7.2	20.89	8.8
1.10	1.0	2.94	2.6	4.96	4.2	7.39	5.8	11.01	7.4	26.42	9.0
1.32	1.2	3.18	2.8	5.24	4.4	7.75	6.0	11.68	7.6	39.82	9.2
1.54	1.4	3.42	3.0	5.52	4.6	8.13	6.2	12.44	7.8	114.76	9.4
1.77	1.6	3.67	3.2	5.81	4.8	8.52	6.4	13.35	8.0	$+$.Inf	9.5

* For simplicity of implementation we suggest linear interpolation of tabulated cvs; we verify resulting test has correct size



Null rejection frequency of subset AR test based on conditional (red) and χ^2_{k-1} (blue) critical values, as function of κ_1.

Extension to $m_W > 1$

We define a new subvector Anderson Rubin test that rejects when

$$AR_n(\beta_0) > c_{1-\alpha}(\kappa_{\max}\left(\Xi'\Xi\right), k - m_W).$$

Note: We condition on the LARGEST eigenvalue of the Wishart matrix.

Theorem: The test above has i) correct size and ii) has uniformly larger power than the test in GKMC.

Lemma: Under the null $H_0 : \beta = \beta_0$, there exists a random matrix $O \in O(p)$, such that for

$$\tilde{\Xi} := \Xi O \in R^{k\times p}, \text{ and its upper left submatrix } \tilde{\Xi}_{11} \in R^{k-m_W+1\times 2}$$

$\tilde{\tilde{\Xi}}_{11}'\tilde{\tilde{\Xi}}_{11}$ is a non-central Wishart 2×2 matrix of order $k - m_W + 1$ (cond'l on O), whose noncentrality matrix, $\tilde{M}_1'\tilde{M}_1$ say, is of rank 1;

Proof of Theorem:

(i) Note that

$$\begin{aligned} AR_n(\beta_0) &= \kappa_{\min}\left(\Xi'\Xi\right) = \kappa_{\min}\left(\tilde{\tilde{\Xi}}'\tilde{\tilde{\Xi}}\right) \\ &\leq \kappa_{\min}\left(\tilde{\tilde{\Xi}}_{11}'\tilde{\tilde{\Xi}}_{11}\right) \leq \kappa_{\max}\left(\tilde{\tilde{\Xi}}_{11}'\tilde{\tilde{\Xi}}_{11}\right) \\ &\leq \kappa_{\max}\left(\tilde{\tilde{\Xi}}'\tilde{\tilde{\Xi}}\right) = \kappa_{\max}\left(\Xi'\Xi\right) \end{aligned} \tag{1}$$

and thus

$$\begin{aligned} & P(AR_n(\beta_0) > c_{1-\alpha}(\kappa_{\max}\left(\Xi'\Xi\right), k - m_W)) \\ \leq\ & P(\kappa_{\min}\left(\tilde{\tilde{\Xi}}_{11}'\tilde{\tilde{\Xi}}_{11}\right) > c_{1-\alpha}(\kappa_{\max}\left(\tilde{\tilde{\Xi}}_{11}'\tilde{\tilde{\Xi}}_{11}\right), k - m_W)) \\ =\ & P(\kappa_2\left(\tilde{\tilde{\Xi}}_{11}'\tilde{\tilde{\Xi}}_{11}\right) > c_{1-\alpha}(\kappa_1\left(\tilde{\tilde{\Xi}}_{11}'\tilde{\tilde{\Xi}}_{11}\right), k - m_W)) \\ \leq\ & \alpha, \end{aligned}$$

where first inequality follows from (1) and last inequality from correct size for $m_W = 1$ (by conditionning on O) and the lemma

Recall summary when $m_W = 1$: new test rejects when

$$\hat{\kappa}_2 > c_{1-\alpha}(\hat{\kappa}_1, k-1)$$

where $(\hat{\kappa}_1, \hat{\kappa}_2)$ are the eigenvalues of $\Xi'\Xi \sim W\left(k, I_2, M'M\right)$ and $M'M$ is of rank 1 under the null

(ii) new conditional test is uniformly more powerful than test in GKMC (because $c_{1-\alpha}(\cdot, k - m_W)$) is increasing and converging to $\chi^2_{k-m_W,1-\alpha}$ as argument goes to infinity), i.e. the test in GKMC is inadmissible

Power analysis of tests based on $(\hat{\kappa}_1, ..., \hat{\kappa}_p)$

- For $A = E\left[Z'\left(y - Y\beta_0 \vdots W\right)\right] \in R^{k\times p}$, consider

$$H_0' : \rho\left(A\right) \leq m_W \text{ versus } H_1' : \rho\left(A\right) = p = m_W + 1$$

- $H_0 : \beta = \beta_0$ implies H_0' but the converse is not true:
  - H_0' holds iff $[\rho\left(\Pi_W\right) < m_W$ or $\Pi_Y\left(\beta - \beta_0\right) \in span(\Pi_W)]$

- Under H_0', $(\hat{\kappa}_1, ..., \hat{\kappa}_p)$ are distributed as eigenvalues of Wishart $W\left(k, I_p, M'M\right)$ with rank deficient noncentrality matrix - a distribution that appears also under H_0

- Thus, every test $\varphi(\hat{\kappa}_1, ..., \hat{\kappa}_p) \in [0, 1]$ that has size α under H_0 must also have size α under H_0' - so cannot have power exceeding size under alternatives $H_0' \backslash H_0$.

- In other words, size α tests $\varphi(\hat{\kappa}_1, ..., \hat{\kappa}_p)$ under H_0 can only have nontrivial power under alternatives $\rho\left(A\right) = p$.

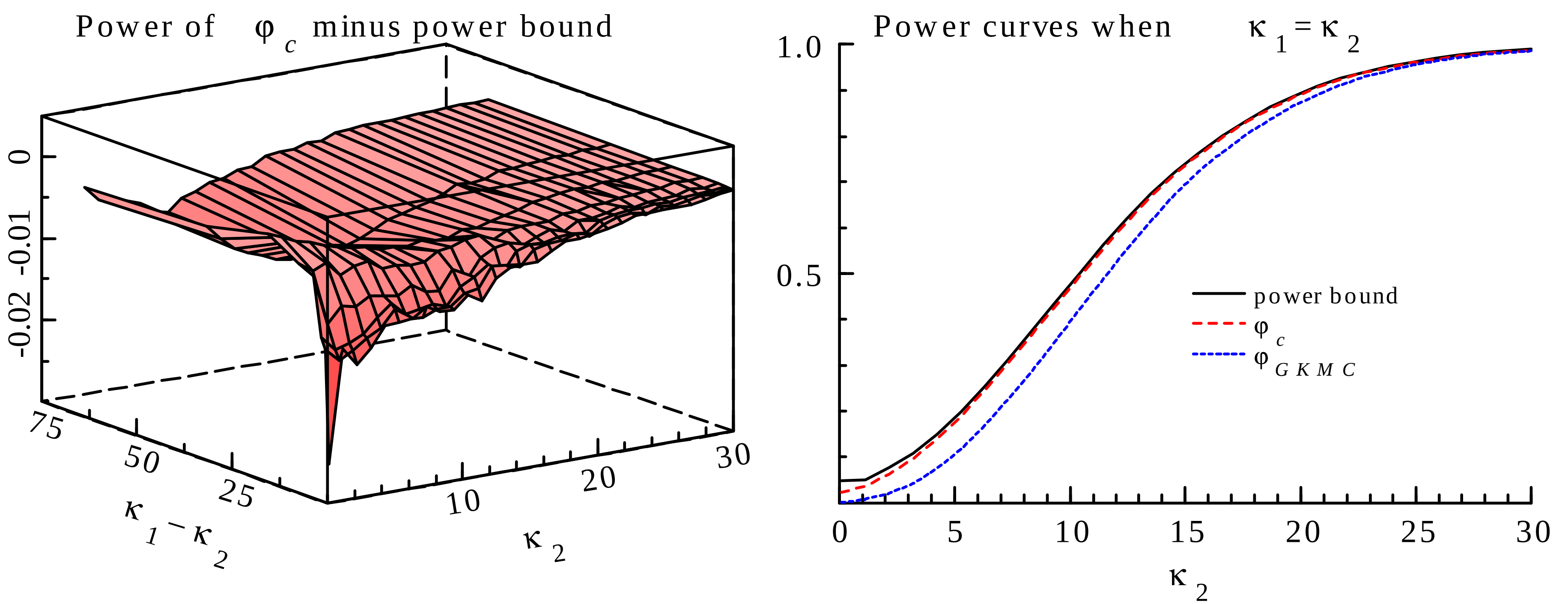
- We use this insight to derive a power envelope for tests of the form $\varphi\left(\hat{\kappa}_1, ..., \hat{\kappa}_p\right)$.

Power bounds

- Consider only the case $m_W = 1$.

- Equivalently, $H_0' : \kappa_2 = 0$, $\kappa_1 \geq \kappa_2$ against $H_1' : \kappa_2 > 0, \kappa_1 \geq \kappa_2$.

- Obtain point-optimal power bounds using approximately least favorable distribution Λ^{LF} over nuisance parameter κ_1 based on algorithm in Elliott, Müller, and Watson (2015)



Power of conditional subvector AR test $\varphi_c(\hat{\kappa}) = \mathbf{1}_{\{\hat{\kappa}_2 > c_{1-\alpha}(\hat{\kappa}_1, k-1)\}}$ relative to power bound (left) and power of φ_c, $\varphi_{GKMC}(\hat{\kappa}) = \mathbf{1}_{\left\{\hat{\kappa}_2 > \chi^2_{k-1,1-\alpha}\right\}} = \mathbf{1}_{\{\hat{\kappa}_2 > c_{1-\alpha}(\infty, k-1)\}}$ and bound at $\kappa_1 = \kappa_2$ (right) for $k = 5$. Computed using 10000 MC replications.

- Little scope for power improvement over proposed test. But not zero scope...:

Refinement: For the case $k = 5$, $m_W = 1$, and $\alpha = 5\%$, let φ_{adj} be the test that uses the critical values in Table above where the smallest 8 critical values are divided by 5

Asymptotic case: a) almost "conditional homoskedasticity"

- Define **parameter space** $\mathcal{F}$ under the null hypothesis $H_0 : \beta = \beta_0$.

  Let $U_i = (\varepsilon_i, V'_{W,i})'$ and F distribution of (U_i, V_{Yi}, Z_i)

  $\mathcal{F}$ is set of all $(\gamma, \Pi_W, \Pi_Y, F)$ s.t.

  $$\begin{aligned}
  &\gamma \in R^{m_W}, \Pi_W \in R^{k\times m_W}, \Pi_Y \in R^{k\times m_Y},\\
  &E_F(||T_i||^{2+\delta}) \leq M, \text{ for } T_i \in \{Z_i\varepsilon_i, vec(Z_i V'_{W,i}), V_{W,i}\varepsilon_i, \varepsilon_i, V_{W,i}, Z_i\},\\
  &E_F(Z_i(\varepsilon_i, V'_{Wi}, V'_{Yi})) = 0,\\
  &E_F(vec(Z_i U'_i)(vec(Z_i U'_i))') = (E_F(U_i U'_i) \otimes E_F(Z_i Z'_i)),\\
  &\kappa_{\min}(A) \geq \delta \text{ for } A \in \{E_F(Z_i Z'_i), E_F(U_i U'_i)\}
  \end{aligned}$$

  for some $\delta > 0$, $M < \infty$

- Note: no restriction is imposed on the variance matrix of $vec(Z_i V'_{Yi})$

- **subvector AR stat** equals smallest solution of

$$\left| \widehat{\kappa} I_{1+m_W} - \left(\frac{\overline{Y}' M_Z \overline{Y}}{n-k}\right)^{-1/2} (\overline{Y}' P_Z \overline{Y}) \left(\frac{\overline{Y}' M_Z \overline{Y}}{n-k}\right)^{-1/2} \right| = 0$$

  where

$$\overline{Y} := (y - Y\beta_0 \vdots W) \in R^{n \times (1+m_W)}$$

- **Note:** Same as in finite sample case with $\Omega(\beta_0)$ replaced by $\frac{\overline{Y}' M_Z \overline{Y}}{n-k}$

- **critical value** is again

$$c_{1-\alpha}(\hat{\kappa}_1, k - m_W)$$

  the $1-\alpha$ quantile of (the approximation of) AR_n given $\widehat{\kappa}_1$

- **Theorem:** The new subvector AR test has correct asymptotic size for parameter space $\mathcal{F}$.

- Again, part of the proof is based on simulations.

Asymptotic case: b) general Kronecker Product Structure

- For $U_i := (\varepsilon_i + V'_{W,i}\gamma, V'_{W,i})'$, $p := 1 + m_W$, and $m := m_Y + m_W$ let

$$\mathcal{F}_{KP} = \{(\gamma, \Pi_W, \Pi_Y, F) : \gamma \in \Re^{m_W}, \Pi_W \in \Re^{k\times m_W}, \Pi_Y \in \Re^{k\times m_Y},$$
$$E_F(||T_i||^{2+\delta_1}) \leq B, \text{ for } T_i \in \{vec(Z_i U_i'), vec(Z_i Z_i')\},$$
$$E_F(Z_i V_i') = 0^{k\times(m+1)}, \ \mathbf{E}_F(\mathbf{vec}(\mathbf{Z}_i\mathbf{U}_i')(\mathbf{vec}(\mathbf{Z}_i\mathbf{U}_i'))') = \mathbf{G}_1 \otimes \mathbf{G}_2,$$
$$\kappa_{\min}(A) \geq \delta_2 \text{ for } A \in \{E_F\left(Z_i Z_i'\right), G_1, G_2\}\}$$

for pd $G_1 \in \Re^{p\times p}$ (whose upper left element is normalized to 1) and $G_2 \in \Re^{k\times k}$ and $\delta_1, \delta_2 > 0$, $B < \infty$

- Covers conditional homoskedasticity, but also cases of cond hetero

Example. Take $(\widetilde{\varepsilon}_i, \widetilde{V}'_{Wi})' \in \Re^p$ i.i.d. zero mean with pd variance matrix, independent of Z_i, and

$$(\varepsilon_i, V'_{Wi})' := f(Z_i)(\widetilde{\varepsilon}_i, \widetilde{V}'_{Wi})'$$

for some scalar valued function f of Z, e.g. $f(Z_i) = ||Z_i||/k^{1/2}$. Then

$$\begin{aligned}
&E_F(vec(Z_iU'_i)(vec(Z_iU'_i))') \\
&= E_F\left(U_iU'_i \otimes Z_iZ'_i\right) \\
&= E_F\left((\varepsilon_i + V'_{W,i}\gamma, V'_{W,i})'(\varepsilon_i + V'_{W,i}\gamma, V'_{W,i}) \otimes Z_iZ'_i\right) \\
&= E_F\left((\widetilde{\varepsilon}_i + \widetilde{V}'_{W,i}\gamma, \widetilde{V}'_{W,i})'(\widetilde{\varepsilon}_i + \widetilde{V}'_{W,i}\gamma, \widetilde{V}'_{W,i})\right) \otimes E_F\left(f(Z_i)^2 Z_iZ'_i\right)
\end{aligned}$$

has KP structure even though

$$E_F(U_iU'_i|Z_i) = f(Z_i)^2 E_F(\widetilde{\varepsilon}_i + \widetilde{V}'_{W,i}\gamma, \widetilde{V}'_{W,i})'(\widetilde{\varepsilon}_i + \widetilde{V}'_{W,i}\gamma, \widetilde{V}'_{W,i})$$

depends on Z_i.

- **Modified AR subvector statistic**. Estimate $E_F(U_iU_i' \otimes Z_iZ_i')$ by

$$\widehat{R}_n := n^{-1}\sum_{i=1}^{n} f_if_i' \in \Re^{kp\times kp}, \text{ where}$$
$$f_i := ((M_Z(y - Y\beta_0))_i, (M_ZW)_i')' \otimes Z_i \in \Re^{kp}.$$

- Let

$$(\widehat{G}_1, \widehat{G}_2) = \arg\min ||\overline{G}_1 \otimes \overline{G}_2 - \widehat{R}_n||_F,$$

where the minimum is taken over $(\overline{G}_1, \overline{G}_2)$ for $\overline{G}_1 \in \Re^{p\times p}$, $\overline{G}_2 \in \Re^{k\times k}$ being pd, symmetric matrices, normalized such that the upper left element of $\overline{G}_1$ equals 1. Estimators are unique and given in closed form.

- The subvector AR statistic, $AR_{KP,n}(\beta_0)$ is defined it as the smallest root $\hat{\kappa}_{pn}$ of the roots $\hat{\kappa}_{in}$, $i = 1, ..., p$ (ordered nonincreasingly) of the characteristic polynomial

$$\left|\hat{\kappa} I_p - n^{-1} \widehat{G}_1^{-1/2} \left(\overline{Y}_0, W\right)' Z \widehat{G}_2^{-1} Z' \left(\overline{Y}_0, W\right) \widehat{G}_1^{-1/2}\right| = 0.$$

- Note: Relative to previous definition,

  $\widehat{G}_1$ replaces $\frac{\overline{Y}' M_Z \overline{Y}}{n-k}$ and $\widehat{G}_2$ replaces $\frac{Z'Z}{n}$

- The conditional subvector AR$_{KP}$ test rejects H_0 at nominal size α if

$$AR_{KP,n}(\beta_0) > c_{1-\alpha}(\hat{\kappa}_{1n}, k - m_W),$$

  where $c_{1-\alpha}(\cdot, \cdot)$ is defined as above.

Theorem: The conditional subvector AR_{KP} test implemented at nominal size α has asymptotic size, i.e.

$$\lim \sup_{n\to\infty} \sup_{(\gamma,\Pi_W,\Pi_Y,F)\in\mathcal{F}_{KP}} P_{(\beta_0,\gamma,\Pi_W,\Pi_Y,F)}(AR_{AKP,n}(\beta_0) > c_{1-\alpha}(\hat{\kappa}_{1n}, k-m_W))$$

equal to α.

Asymptotic case: c) General forms of Cond Hetero

- Perform a Wald type pretest based on $\widehat{G}_1 \otimes \widehat{G}_2 - \widehat{R}_n$ to test the null of Kronecker Product structure

- If pretest rejects continue with a robust (to cond hetero and weak IV) subvector procedure, like the AR type tests proposed in Andrews (2017)

- Otherwise, continue with the test AR$_{KP}$ test

- Resulting test has correct asymptotic size no matter what the pretest nominal size is

- Reasons:
  - pretest is consistent against deviations from null for which
  $$n^{1/2}\min||\overline{G}_1\otimes\overline{G}_2 - E_F(U_iU_i'\otimes Z_iZ_i')|| \to \infty$$
  and the AR type tests in Andrews (2017) have correct asymptotic size
  - when
  $$n^{1/2}\min||\overline{G}_1\otimes\overline{G}_2 - E_F(U_iU_i'\otimes Z_iZ_i')|| = O(1)$$
  the conditional subvector AR_{KP} test has correct asymptotic size and rejects whenever the AR type test in Andrews (2017) rejects.

Asymptotic Size: General theory

- Distinction between pointwise (asymptotic) null rejection probability and (asymptotic) size

"Discontinuity" in limiting distribution of test statistic

Staiger and Stock (1997): simplified version of linear IV model with one IV

$$\begin{aligned} y_1 &= y_2\theta + u, \\ y_2 &= Z\pi + v \end{aligned}$$

Let $\lambda_n = (\lambda_{1n}, \lambda_{2n}, \lambda_{3n})$ be sequence of parameters s.t. $\lambda_{3n} = (F_n, \pi_n)$

$$\lambda_{1n} = (EZ_i^2)^{1/2}\pi/\sigma_v \text{ and } \lambda_{2n} = corr(u_i, v_i)$$

satisfies

$$h_{n,1}(\lambda_n) = n^{1/2}\lambda_{1n} \to h_1 < \infty \text{ and } h_{n,2}(\lambda_n) = \lambda_{2n} \to h_2.$$

We will denote such a sequence λ_n by $\lambda_{n,h}$.

Work out limiting distribution of 2SLS under $\lambda_{n,h}$:

$$\begin{aligned}
\frac{\sigma_v}{\sigma_u}(\widehat{\theta}_{2SLS} - \theta) &= \frac{\sigma_v}{\sigma_u}\frac{y_2' P_Z u}{y_2' P_Z y_2} = \frac{(n^{-1}Z'Z)^{-1/2} n^{-1/2} Z'u/\sigma_u}{(n^{-1}Z'Z)^{-1/2} n^{-1/2} Z'y_2/\sigma_v} \\
&= \frac{(n^{-1}Z'Z)^{-1/2} n^{-1/2} Z'u/\sigma_u}{(n^{-1}Z'Z)^{1/2} n^{1/2}\pi/\sigma_v + (n^{-1}Z'Z)^{-1/2} n^{-1/2} Z'v/\sigma_v} \\
&\to_d \frac{z_{u,h_2}}{h_1 + z_{v,h_2}}, \text{ where}
\end{aligned}$$

$$\begin{pmatrix} z_{u,h_2} \\ z_{v,h_2} \end{pmatrix} \sim N(0, \Sigma_{h_2}) \text{ and } \Sigma_{h_2} = \begin{pmatrix} 1 & h_2 \\ h_2 & 1 \end{pmatrix}$$

- Similarly for t test statistic $T_n(\theta_0)$:

$$T_n(\theta_0) \rightarrow_d J_h$$

  for $h = (h_1, h_2)$ under the parameter sequence $\lambda_{n,h}$.

- So, to implement the test, we should take the $1 - \alpha$-quantile $c_h(1 - \alpha)$ of J_h as the critical value

- If we implement a test using a Wald statistics with chi-square critical values, the asymptotic size is 1, see Dufour (1997)

- Problem: we cannot consistently estimate h; we can only estimate consistently λ_{1n}

- (h_1, h_2) takes on values in $H = (R \cup \{\pm\infty\}) \times [-1, 1]$

- We say the limit distribution of $T_n(\theta_0)$ "**depends discontinuously** on nuisance parameter λ_1" and **continuously** on λ_2

  Continuity: when $x \to x_0$ then $f(x) \to f(x_0)$

  Here $(EZ_i^2)^{1/2}\pi/\sigma_v \to 0$, but limit of $T_n(\theta_0)$ does not just depend on 0

- Situation arises frequently in applied econometrics and leads to size distortion for various "classical" inference procedures:

  weak IVs/identification, use of pretests, moment inequalities, (nuisance) parameters on boundary, inference in (V)ARs with unit root(s)

General Theory: Asymptotic Size of Tests

- $\{\varphi_n : n \geq 1\}$ sequence of tests for null hypothesis H_0
- λ indexes the true null distribution of the observations
- Parameter space for λ is some space Λ
- $RP_n(\lambda)$ denotes rejection probability of φ_n under λ
- The asymptotic size of φ_n for the parameter space Λ is defined as:

$$AsySz = \limsup_{n \to \infty} \sup_{\lambda \in \Lambda} RP_n(\lambda)$$

Formula for Calculation of AsySz

Recall relevance of limits of $h_{n,1}(\lambda_n) = n^{1/2}\lambda_{1n} = n^{1/2}(EZ_i^2)^{1/2}\pi/\sigma_v$ and $h_{n,2}(\lambda_n) = \lambda_{2n} = corr(u_i, v_i)$ for limit distributions of test statistics in weak IV example

Generalizing, let

$$\{h_n(\lambda) = (h_{n,1}(\lambda), ..., h_{n,J}(\lambda))' \in R^J : n \geq 1\}$$

be a sequence of functions on Λ, where $h_{n,j}(\lambda) \in R\ \forall j = 1, ..., J$.

For any subsequence $\{p_n\}$ of $\{n\}$ and $h \in (R \cup \{\pm\infty\})^J$ denote a sequence $\{\lambda_{p_n} \in \Lambda : n \geq 1\}$ such that $h_{p_n}(\lambda_{p_n}) \to h$ by

$$\lambda_{p_n,h}$$

Define

$H = \{h \in (R \cup \{\pm\infty\})^J :$ there is subsequence $\{p_n\}$ and sequence $\lambda_{p_n,h}\}$.

Theorem, Andrews, Cheng, and Guggenberger (2011)

Assume that under any sequence $\lambda_{p_n,h}$

$$RP_{p_n}(\lambda_{p_n,h}) \to RP(h)$$

for some $RP(h) \in [0, 1]$. Then:

$$AsySz = \sup_{h \in H} RP(h).$$

Proof. i) Let $h \in H$. To show $AsySz \geq RP(h)$. By definition of H, there is $\lambda_{p_n,h}$. Then

$$\begin{aligned} AsySz &= \limsup_{n \to \infty} \sup_{\lambda \in \Lambda} RP_n(\lambda) \\ &\geq \limsup_{n \to \infty} RP_{p_n}(\lambda_{p_n,h}) \\ &= RP(h) \end{aligned}$$

Proof. (continued)

ii) To show $AsySz \leq \sup_{h \in H} RP(h)$. Let $\{\lambda_n \in \Lambda : n \geq 1\}$ be a sequence such that

$$\limsup_{n \to \infty} RP_n(\lambda_n) = AsySz.$$

Let $\{p_n : n \geq 1\}$ be a subsequence of $\{n\}$ such that $\lim_{n \to \infty} RP_{p_n}(\lambda_{p_n})$ exists and equals $AsySz$ and $h_{p_n}(\lambda_{p_n}) \to h$. Therefore this sequence is of type $\lambda_{p_n,h}$, and thus, by assumption, $RP_{p_n}(\lambda_{p_n}) \to RP(h)$. Because also $RP_{p_n}(\lambda_{p_n}) \to AsySz$, it follows that $AsySz = RP(h)$. $\square$

Specification of λ for subvector Anderson and Rubin test

- Given F let

$$W_F := (E_F Z_i Z_i')^{1/2} \text{ and } U_F := \Omega(\beta_0)^{-1/2}.$$

- Consider a singular value decomposition

$$C_F \Lambda_F B_F'$$

of

$$W_F(\Pi_W \gamma, \Pi_W) U_F$$

- i.e. B_F denote a $p \times p$ orthogonal matrix of eigenvectors of

$$U_F'(\Pi_W \gamma, \Pi_W)' W_F' W_F (\Pi_W \gamma, \Pi_W) U_F$$

and C_F denote a $k \times k$ orthogonal matrix of eigenvectors of

$$W_F(\Pi_W \gamma, \Pi_W) U_F U_F' (\Pi_W \gamma, \Pi_W)' W_F'$$

- Λ_F denotes a $k \times p$ diagonal matrix with singular values $(\tau_{1F}, ..., \tau_{pF})$ on diagonal, ordered nonincreasingly

- Note $\tau_{pF} = 0$

- Define the elements of λ_F to be

$$\begin{aligned}
\lambda_{1,F} &:= (\tau_{1F}, ..., \tau_{pF})' \in R^p, \\
\lambda_{2,F} &:= B_F \in R^{p \times p}, \\
\lambda_{3,F} &:= C_F \in R^{k \times k}, \\
\lambda_{4,F} &:= W_F \in R^{k \times k}, \\
\lambda_{5,F} &:= U_F \in R^{p \times p}, \\
\lambda_{6,F} &:= F, \\
\lambda_F &:= (\lambda_{1,F}, ..., \lambda_{9,F}).
\end{aligned}$$

- A sequence $\lambda_{n,h}$ denotes a sequence λ_{F_n} such that $(n^{1/2}\lambda_{1,F_n}, ..., \lambda_{5,F_n}) \to h = (h_1, ..., h_5)$

- Let $q = q_h \in \{0, ..., p-1\}$ be such that

$$h_{1,j} = \infty \text{ for } 1 \leq j \leq q_h \text{ and } h_{1,j} < \infty \text{ for } q_h + 1 \leq j \leq p - 1$$

- Roughly speaking, need to compute asy null rej probs under seq's with (i) strong ident'n,(ii) semi-strong ident'n, (iii) std weak ident'n (all parameters weakly ident'd) & (iv) nonstd weak ident'n

- **strong identification:** $\lim_{n\to\infty} \tau_{m_W,F_n} > 0$

- **semi-strong ident'n:** $\lim_{n\to\infty} \tau_{m_W,F_n} = 0$ & $\lim_{n\to\infty} n^{1/2}\tau_{m_W,F_n} = \infty$

- **weak ident'n:** $\lim_{n\to\infty} n^{1/2}\tau_{m_W,F_n} < \infty$

  - **standard** (of all parameters): $\lim_{n\to\infty} n^{1/2}\tau_{1,F_n} < \infty$ as in Staiger & Stock (1997)

  - **nonstandard:** $\lim_{n\to\infty} n^{1/2}\tau_{m_W,F_n} < \infty$ & $\lim_{n\to\infty} n^{1/2}\tau_{1,F_n} = \infty$ includes some weakly/some strongly ident'd parameters, as in Stock & Wright (2000); also includes **joint weak ident'n**

Andrews and Guggenberger (2014): Limit distribution of eigenvalues of quadratic forms

- Consider a singular value decomposition $C_F \Lambda_F B_F'$ of $W_F D_F U_F$
- Define $\lambda_F, h, \lambda_{n,h}...$ as above

Let $\widehat{\kappa}_{jn}$ $\forall j = 1, ..., p$ denote jth eigenval of

$$n\widehat{U}_n' \widehat{D}_n' \widehat{W}_n' \widehat{W}_n \widehat{D}_n \widehat{U}_n,$$

where under $\lambda_{n,h}$

$$\begin{aligned} n^{1/2}(\widehat{D}_n - D_{F_n}) &\to {}_d\overline{D}_h \in R^{k\times p}, \\ \widehat{W}_n - W_{F_n} &\to {}_p 0^{k\times k}, \\ \widehat{U}_n - U_{F_n} &\to {}_p 0^{p\times p}, \\ W_{F_n} &\to h_4,\ U_{F_n} \to h_5 \end{aligned}$$

with h_4, h_5 nonsingular

Theorem (AG, 2014): under $\{\lambda_{n,h} : n \geq 1\}$,

(a) $\widehat{\kappa}_{jn} \to_p \infty$ for all $j \leq q$

(b) vector of smallest $p-q$ eigenvals of $n\widehat{U}_n'\widehat{D}_n'\widehat{W}_n'\widehat{W}_n\widehat{D}_n\widehat{U}_n$, i.e., $(\widehat{\kappa}_{(q+1)n}, ..., \widehat{\kappa}_{pn})'$, converges in dist'n to $p-q$ vector of eigenvals of random matrix $M(h, \overline{D}_h) \in R^{(p-q)\times(p-q)}$

- complicated proof;
  - eigenvalues can diverge at any rate or converge to any number
  - can become close to each other or close to 0 as $n \longrightarrow \infty$

- We apply this result with

$$
\begin{aligned}
W_F &= (E_F Z_i Z_i')^{1/2}, \widehat{W}_n = (n^{-1} \sum Z_i Z_i')^{1/2}, \\
U_F &= \Omega(\beta_0)^{-1/2}, \widehat{U}_n = \left(\frac{\overline{Y}' M_Z \overline{Y}}{n-k} \right)^{-1/2}, \\
D_F &= (\Pi_W \gamma, \Pi_W), \widehat{D}_n = (Z'Z)^{-1} Z' \overline{Y}
\end{aligned}
$$

to obtain the joint limiting distribution of all eigenvalues

Joint asymptotic dist'n of eigenvalues

- Recall: test statistic and critical value are functions of $p = 1 + m_W$ roots of

$$\left| \widehat{\kappa} I_{1+m_W} - \left(\frac{\overline{Y}' M_Z \overline{Y}}{n-k}\right)^{-1/2} (\overline{Y}' P_Z \overline{Y}) \left(\frac{\overline{Y}' M_Z \overline{Y}}{n-k}\right)^{-1/2} \right| = 0$$

- To obtain joint limiting distribution of eigenvalues, we use general result in Andrews and Guggenberger (2014) about joint limiting distribution of eigenvalues of quadratic forms

  Results:

- the joint limit depends only on localization parameters $h_{1,1}, ..., h_{1,m_W}$

- asymptotic cases replicate finite sample, normal, fixed IV, known variance matrix setup

- together with above proposition, correct asymptotic size then follows from correct finite sample size