Microeconometrics: Alternative Distributions

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1 Poisson, Geometric and Negative Binomial Distributions

• Start with a Bernoulli Distribution: an event happens with probability \((p, 1 - p)\)

  - Mean: \(p \cdot 1 + (1 - p) \cdot 0 = p\)

  - Variance: \(p (1 - p)^2 + (1 - p) (0 - p)^2 = p (1 - p)\)
  
  SD: \(SD = \sqrt{p (1 - p)}\)

• Generalized Binomial:

  - Random Variable = \(X\)

  - With \(n\) trials: \(P (X = k) = \binom{n}{k} p^k (1 - p)^{n-k}\)

  - Mean: \(np\)

  - Variance: \(np (1 - p)\); SD: \(\sqrt{np (1 - p)}\)
• Poisson: Count variable ("law of rare events")

\[ \lim_{n \to \infty} \binom{n}{k} p^k (1 - p)^{n-k} = \frac{e^{-\mu} \mu^k}{k!} \text{ with fixed } np = \mu \ (\implies p \to 0) \]

- Mean: \( E(N) = \sum_{k=0}^{\infty} kP(N = k) = \sum_{k=1}^{\infty} ke^{-\mu} \frac{\mu^k}{k!} \)

\[ \begin{align*}
\text{but } \sum_{k=1}^{\infty} ke^{-\mu} \frac{\mu^k}{k!} &= \mu \\
\text{Variance: } V(N) &= \mu; \text{ SD: } SD(N) = \sqrt{\mu} 
\end{align*} \]

• Geometric Distribution: Waiting Time (First Event)

- Realization Probability: \( P(T = n) = (1 - p)^{n-1} p \)

- Mean: \( E(T) = \sum_{n=1}^{\infty} nP(T = n) = \frac{1}{p} \)

- Variance: \( V(T) = \frac{(1-p)}{p^2}; \text{ SD: } SD(T) = \frac{\sqrt{1-p}}{p} \)
• Negative Binomial: (Generalized Geometric Dist.)

- $P(T_r = t) =$Joint prob. of $r - 1$ successes in first $t - 1$ trials and trial $t$ success

- Therefore: $P(T_r = t) = \binom{t-1}{r-1} p^{r-1} (1 - p)^{t-r} p$
  but $\binom{t-1}{r-1} p^{r-1} (1 - p)^{t-r} p = \binom{t-1}{r-1} p^r (1 - p)^{t-r}$

- Mean: $E(T_r) = \frac{r}{p}$

- Variance: $V(T_r) = \frac{r(1-p)}{p^2}$; SD: $SD(T_r) = \sqrt{\frac{r(1-p)}{p^2}}$
2 Estimation of Poisson and Negative Binomial Distributions

- Why Poisson or Negative Binomial?
  - Only positive numbers (but can use lognormal distribution)
  - Can improve on SEs
    * In general, binomial distribution has $\lim_{p \to \infty} V(\hat{p}) = 0$
    * Case of $p = 0$ or $p = 1$, can reject based upon one observation.
    * Can improve SEs by using binomial structure for all binomial family derivatives
  - Lowers under-estimation of zeros (allows for right skewness)
• Why not Poisson or Negative Binomial

  – Overdispersion: SEs too low if not bernoulli and with essentially zero probability

    * In Poisson, \( V_{Data}(N) > E(N) = V(N) \)

  – Still too few zeros?

  – Especially true with Poisson
3 Poisson Regression

- What is being estimated?
  - The determinants of the expected number of counts
    
    \[ e^{-\mu_i \mu_i^k} \frac{k!}{k!} \text{ where } \ln \mu_i = X_i' \beta \]

    \[ e - e^{X_i' \beta} \left( e^{X_i' \beta} \right)^k \]

    \[ E(Y_i|X_i) = V(Y_i|X_i) = \mu_i \]

- Estimation Methods

  - NLS: \[ \min_\beta \sum_{i=1}^{N} \left[ y_i - e^{X_i' \beta} \frac{\left( e^{X_i' \beta} \right)^{y_i}}{y_i!} \right]^2 \]

  - Maximum Likelihood:
\[
* \min_\beta \ln L = \min_\beta \sum_{i=1}^N \ln \frac{e^{-e^{X_i'\beta}}(e^{X_i'\beta})^{y_i}}{y_i!} \\
* = \min_\beta \sum_{i=1}^N \left[ y_i X_i'\beta - e^{X_i'\beta} - \ln y_i! \right] \\
* \text{Moment Conditions} \\
\quad \sum_{i=1}^N \left[ k_i - e^{X_i'\beta} \right] X_i' = 0 \\
* \text{Variance of Estimate: } V \left( \hat{\beta}_P \right) = \left( \sum_{i=1}^N \mu_i x_i x_i' \right)^{-1} \\
\bullet \text{Test for overdispersion:} \\
- \text{Model variance: } V \left( y_i | X_i \right) = \mu_i + \alpha g \left( \mu_i \right) \\
- g \left( \mu_i \right) \text{ usually } = \mu_i \text{ or } \mu_i^2
– Run OLS

\[
\frac{(y_i - \hat{\mu}_i)^2 - y_i}{\hat{\mu}_i} = \alpha \frac{g(\hat{\mu}_i)}{\hat{\mu}_i} + u_i
\]

– Test \( \alpha = 0 \)

• Robust Standard Errors (overdispersion correction)

– Define \( \hat{\alpha} = (n - k)^{-1} \sum_{i=1}^{N} \frac{(y_i - \hat{\mu}_i)^2}{\hat{\mu}_i} \)

– Then \( V(y_i|X_i) = \hat{\alpha} E(y_i|X_i) = \hat{\alpha} e^{x_i'\beta} \)

• Compute marginal effects: \( \frac{\partial E(y_i|X_i)}{\partial X_i} = \beta_i e^{x_i'\beta} \)

– Note that marginal effects depend upon \( X_i \).
4 Negative Binomial Regression

- Now suppose that $\mu_i$ is random as in specification error

\[- \ln \mu = x_i' \beta + \epsilon_i = \ln \lambda_i + \ln u_i\]

- The conditional distribution of $f$ then is:

\[- f (y_i | x_i, \lambda_i) = \frac{e^{-\mu_i \lambda_i} (\lambda_i \mu_i)^{y_i}}{y_i!}\]

- Integrating, we get:

\[- f (y_i | x_i) = \int_0^\infty \frac{e^{-\mu_i \lambda_i} (\lambda_i \mu_i)^{y_i}}{y_i!} g (u_i) du_i\]

- We now assume a distribution for $g$:

\[- g (\lambda_i) = \frac{\theta^\theta}{\Gamma (\theta)} e^{-\theta \mu_i \mu_i^{\theta-1}}\]
• We can now solve for $f$:

$$ f(y_i|x_i) = \frac{\Gamma(\theta+y_i)}{\Gamma(y_i+1)\Gamma(\theta)} r_i^y_i (1 - r_i)^\theta $$

- where $r_i = \frac{\lambda_i}{\lambda_i + \theta}$

• This can be estimated with MLE or NLLS

• The mean is $E(y_i|x_i) = \lambda_i$

• The variance is $V(y_i|x_i) = \lambda_i \left(1 + \frac{1}{\theta} \lambda_i\right)$
  - Remember that $\theta$ is estimated so this decouples the mean and variance
  - The Poisson Model is the restriction of $\frac{1}{\theta} = 0$
  - This can be tested using a Wald or LRT Test
Regression (OLS, Poisson, Negative Binomial) of numbers of donors to presidential, senate and house of representative campaigns during 2000 electoral cycle on population and presence of Fox News in 2000:

- Spec. A includes just a constant, log population, and a dummy for Fox News

- Spec. B adds number of donors in 1996:

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<td>124.5</td>
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Regression of numbers of donors to presidential, senate and house of representative campaigns during 2000 electoral cycle on population and presence of Fox News in 2000 (robust standard errors):

- Spec. A includes just a constant, log population, and a dummy for Fox News

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