

EE325 Introductory Econometrics (Section 1 semester 1/2020)

Assignment 4

Instruction: Write your answer in either paper or digital paper. However, if you write on paper, please scan it and save as a PDF file. Submission is via BE-Moodle as a PDF file for both cases. (Please keep the file below 10MB as that is the maximum per file capacity for student.)

Due date: Friday, November 6, 2020 (Before 10 P.M.)

1. From the data for 46 states in the United States for 1992, results of the regression are displayed as follows.

$$\begin{aligned} \ln C_i &= 4.30 - 1.34 \ln P_i + 0.17 \ln Y_i \\ se &= (0.91) \quad (0.32) \quad (0.20) \\ \bar{R}^2 &= 0.27 \end{aligned}$$

where C_i = cigarette consumption, packs per year

P_i = real price per pack, \$ per pack

Y_i = real disposable income per capita, \$ per week

1.1) Do the estimation results follow the law of demand?

1.2) What is the elasticity of demand for cigarettes with respect to price? Is it statistically significant? If so, is it statistically different from 1?

1.3) What is the income elasticity of demand for cigarettes? Is it statistically significant? If not, what might be the reasons for it?

2. From estimating the regression equation on net financial wealth (nettfa), age of the survey respondent (age), and annual family income (inc) for people in the United States. The wealth and income variables are both recorded in thousands of dollars. The OLS estimation results for the model are given by

$$nettfa_i = \beta_1 + \beta_2 inc_i + \beta_3 age_i + u_i$$

reg nettfa inc age

Source	SS	df	MS	Number of obs	=	9,275
Model	6414618.8	2	3207309.4	F(2, 9272)	=	943.21
Residual	31528770.7	9,272	3400.42825	Prob > F	=	0.0000
				R-squared	=	0.1691
				Adj R-squared	=	0.1689
Total	37943389.5	9,274	4091.3726	Root MSE	=	58.313

nettfa	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]
inc	.9533566	.0252775	37.72	0.000	.9038072 1.002906
age	1.030777	.0591226	17.43	0.000	.9148838 1.14667
_cons	-60.69654	2.596333	-23.38	0.000	-65.78592 -55.60715

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reg nettfba inc age agesq
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Source	SS	df	MS	Number of obs	=	9,275
Model	6567017.15	3	2189005.72	F(3, 9271)	=	646.80
Residual	31376372.3	9,271	3384.35685	Prob > F	=	0.0000
Total	37943389.5	9,274	4091.3726	R-squared	=	0.1731
				Adj R-squared	=	0.1728
				Root MSE	=	58.175

nettfba	Coef.	Std. Err.	t	P> t	[95% Conf. Interval]	
inc	.9782522	.0254891	38.38	0.000	.928288	1.028216
age	-2.231489	.4897118	-4.56	0.000	-3.191432	-1.271547
agesq	.0377221	.0056214	6.71	0.000	.026703	.0487413
_cons	4.680388	10.08099	0.46	0.642	-15.08056	24.44134

2.1) Test the coefficient, in the first model, $\beta_3 < 1$ in the first model or not?

2.2) Due to estimation result by adding the age² variable or agesq. Perform the test whether we should include the quadratic term of the age variable or not? (Test for both t-test and F-test.) Also, interpret the meaning of this coefficient.

3. You are conducting an empirical investigation into the median prices of houses in 506 communities of a large metropolitan area. The sample data consist of 506 observations on the following observable variables:

P_i : the median house price in community i , in dollars;

NOX_i : the level of nitrous oxide in the air of community i , in parts per 100 million;

$DIST_i$: the weighted distance of community i from municipal area, in miles;

$ROOM_i$: the average number of rooms per house in community i ;

$STRAT_i$: the average student-teacher ratio of schools in community i .

Researcher estimates the following model of median house price. The OLS estimation results for the model are given by

$$\ln(P_i) = 11.08 - 0.9535 \ln(NOX_i) - 0.1343 \ln(DIST_i) + 0.2545 ROOM_i - 0.05245 STRAT_i$$

$$se = (0.3181) \quad (0.1167) \quad (0.04310) \quad (0.01853) \quad (0.005897)$$

$$RSS = 35.1835 \quad TSS = 84.5822$$

3.1) Interpret each of the coefficient estimates in regression equation.

3.2) Test the individual significance of each of the slope coefficient estimates for $\ln(NOX_i)$ and $ROOM_i$.

3.3) Find the R-squared, adjusted R-squared, and test the joint significance of all the slope coefficient estimates.

3.4) If researcher would like to test the proposition that the marginal effect of $\ln(NOX_i)$ on $\ln(P_i)$ equals the marginal effect of $\ln(DIST_i)$ on $\ln(P_i)$, write the restricted model and

perform the test comparing restricted and unrestricted model, given that OLS estimation of this restricted regression equation yields a Residual Sum of Squares value = 41.9532.

4. Production function (Y) of the industrial sector in Thailand. It depends on the capital factor (K) and labor factor (L) in the years 1980-2010 with the following estimation.

Model 1:

$$\ln Y_t = 18.27 + 0.536 \ln L_t + 0.024 \ln K_t$$

$$R^2 = 0.9389, RSS = 0.0124$$

Model 2:

$$\ln \left(\frac{Y}{L} \right)_t = 2.13 + 1.12 \ln \left(\frac{K}{L} \right)_t$$

$$R^2 = 0.8087, RSS = 0.0153$$

4.1) Interpret the coefficients of the independent variables in models 1 and 2.

4.2) Test the hypothesis. Is the industrial production function characterized by constant return to scale? (Hint: you can perform any type of test that you see fit.)

4.3) Can we compare the R^2 value between the two regression models? Why?

$$\textcircled{1} \quad \ln C_i = 4.30 - 1.34 \ln P_i + 0.17 \ln Y_i \quad n=46$$

$$se = (0.91) \quad (0.32) \quad (0.20)$$

$$\bar{R}^2 = 0.27$$

1.1) According to the estimation result, the consumption and price is negatively related. The law of demand is that the quantity demanded and price is negatively related, thus the increase in price will make people demand less, finally consumption falls. So this estimation goes with the law of demand.

1.2) Elasticity of demand with respect to price is β_2 which is -1.34

$$\textcircled{1} \quad H_0: \beta_2 = 1$$

$$H_1: \beta_2 \neq 1$$

$$\textcircled{2} \quad t_{cal}(\beta_2) = \frac{\hat{\beta}_2 - \beta_2}{\sigma_{\hat{\beta}_2}} \sim t_{n-3}$$

$$= \frac{-1.34 - 1}{0.32} = -7.3125$$

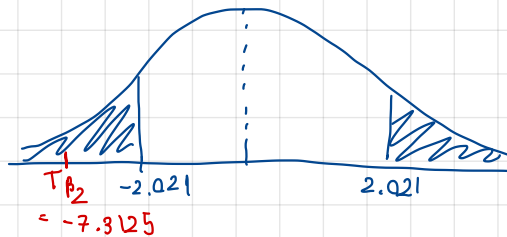
$$\textcircled{3} \quad \alpha = 0.05; \quad t_{0.025, 43} = 2.021$$

$$n = 46$$

$$n - k = 43$$

$$t_{upper} = 2.021$$

$$t_{lower} = -2.021$$



④ t_{β_2} lies beyond the boundaries so reject H_0 , so it is different from 1 at the 95% confidence interval.

1.3) Income elasticity demand for cigarettes is β_3 which equals to 0.17

$$\textcircled{1} \quad H_0: \beta_3 = 0$$

$$H_1: \beta_3 \neq 0$$

$$\textcircled{2} \quad t_{cal}(\beta_3) = \frac{\hat{\beta}_3 - \beta_3}{\sigma_{\hat{\beta}_3}} = \frac{0.17 - 0}{0.2} = 0.85$$

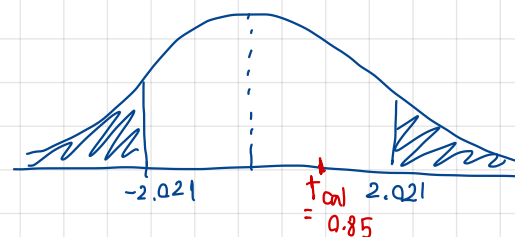
$$\textcircled{3} \quad \alpha = 0.05; \quad t_{0.025, 43} = 2.021$$

$$n = 46$$

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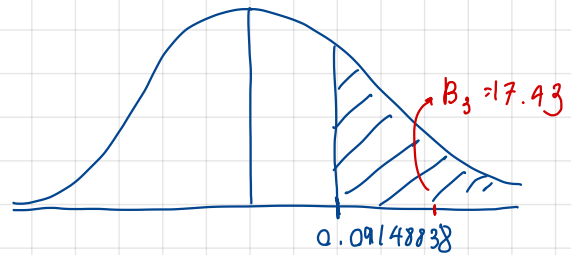
④ t_{β_3} lies within the boundaries, so we cannot reject H_0 , as the result we cannot conclude that β_3 is significant at 95% confidence interval

② $nettf a_i = \beta_1 + \beta_2 inc_i + \beta_3 age_i + u_i$

2.1) ① $H_0 : \beta_3 < 1$
 $H_1 : \beta_3 \geq 1$

② $t_{cal}(\beta_3) = \frac{\hat{\beta}_3 - \beta_3}{\hat{\sigma}_{\beta_3}} = 17.43 \sim t_{9, 272}$

③ $\alpha = 0.005$; $t_{upper} = 0.9148838$



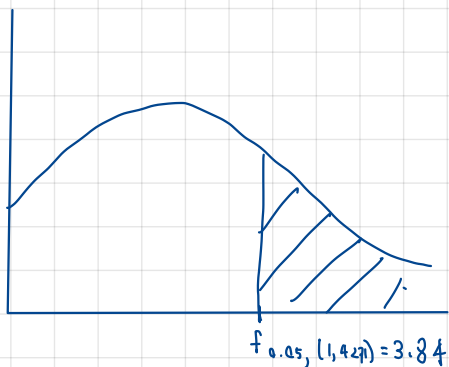
④ t_{β_3} lies beyond the boundaries, so we can reject H_0 , so β_3 is significant at 95% confidence interval

2.2)
$$f_{cal} = \frac{RSS_R - RSS_{UR}/m}{RSS_{UR}/n-k}$$

$$= \frac{R_{UR}^2 - R_R^2/m}{(1 - R_{UR}^2/n-k)}$$

$$= \frac{(3,528,770.7 - 31,376,372.3)/1}{313,763.3/9.275 - 4}$$

$$= 45.03024_{**}$$



$\therefore$ Reject H_0 if $f_{cal} > 3.84$ find that $45.03 > 3.82$

$\therefore$ Reject H_0

There is enough evidence to say that the addition of age^2 to the model is significant at 95% confidence interval

3

$$\ln(P_i) = 11.08 - 0.9535 \ln(NOX_i) - 0.1343 \ln(DIST_i) + 0.2545 ROOM_i - 0.05245 STRAT_i$$

$$se = (0.3181) (0.1167) \quad (0.04310) \quad (0.01853) \quad (0.005897)$$

$$RSS = 35.1835 \quad TSS = 84.5822$$

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3.1) $\hat{\beta}_1 = 11.08$; if $\ln(NOX_i) = 0$, $\ln(DIST_i) = 0$, $ROOM_i = 0$, and $STRAT_i = 0$
 , on average the median house price would be equal to $\$e^{11.08} = \$4,860,483.49$

$\hat{\beta}_2 = -0.9535$; When the level of NOX increase by 1%, the median house price decrease by 0.9535% , when other variables remain constant.

$\hat{\beta}_3 = -0.1343$; When the distance increase by 1% , the median house price will decrease by 0.1343% , when other variables remain constant.

$\hat{\beta}_4 = 0.2545$; When the average # Rooms per house increase by 1 unit, the median house price will increase by 25.45% , when other variables remain constant.

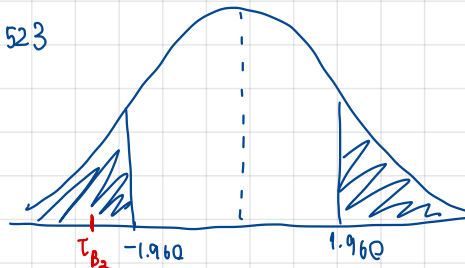
$\hat{\beta}_5 = -0.05245$; As the average student-teacher ratio increase by 1 student-teacher, the median house price will increase by 5.245% , when other variables remain constant.

3.2) $\ln(NOX_i)$

① $H_0 : \beta_2 = 0$
 $H_1 : \beta_2 \neq 0$

② $t_{cal}(\beta_2) = \frac{\hat{\beta}_2 - \beta_2}{\sigma_{\hat{\beta}_2}} = \frac{-0.9535 - 0}{0.1167} = -8.170523$

③ $\alpha = 0.05$; $t_{upper} = 1.960$
 $d.f. = 506 - 5 = 501$ $t_{lower} = -1.960$



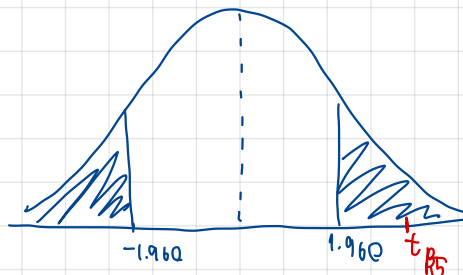
④ We can reject H_0 , so β_2 is significant

$ROOM_i$

① $H_0 : \beta_5 = 0$
 $H_1 : \beta_5 \neq 0$

② $t_{cal}(\beta_5) = \frac{\hat{\beta}_5 - \beta_5}{\sigma_{\hat{\beta}_5}} = \frac{-0.2545 - 0}{0.01853} = -13.7345$

③ $\alpha = 0.05$; $t_{upper} = 1.960$
 $d.f. = 506 - 5 = 501$ $t_{lower} = -1.960$



④ We can reject H_0 , so β_5 is significant

$$3.3) ESS = TSS - RSS = 84.5822 - 35.189 = 49.3937_*$$

$$R^2 = ESS / TSS = 84.5822 / 49.3937 = 1.7122353_*$$

$$\text{adjust } R^2 = \frac{1 - RSS / (n - k)}{TSS / (n - 1)} = \frac{1 - 35.183 / 501}{84.5822 / 506} = \frac{-0.06822}{0.167158} = -0.408116_*$$

$$① H_0 : \beta_2 = \beta_3 = \beta_4 = \beta_5 = 0$$

H_1 : Not all slope coefficient are simultaneously zero.

$$② F_{cal} = \frac{ESS / (k - 1)}{RSS / (n - k)} = \frac{R^2 / (k - 1)}{(1 - R^2) / (n - k)}$$

$$= \frac{49.3937 / 4}{35.1835 / 501}$$

$$= \frac{49.3937}{4} = \frac{49.3937}{4} \times \frac{501}{35.1835} = 175.8441$$

$$③ F_{0.05, (4, 501)} = 2.37$$

$\therefore$ We can reject H_0 , So we can say that at least one parameter is not equal to zero at 95% confidence interval

$$3.4) H_0 : \beta_2 = \beta_3$$

$$H_1 : \beta_2 \neq \beta_3$$

$$\ln(\beta_1) = \beta_1 + \beta_2 \ln(NDX_i) + \beta_3 \ln(DIST_i) + \beta_4 ROOM_i + \beta_5 STRAT_i + u_i$$

$$= \beta_1 + \beta_2 \ln(NOX_i) - (DIST_i) + \beta_4 ROOM_i + \beta_5 STRAT_i + u_i \text{ (restricted)}$$

$$② F_{cal} = \frac{41.9532 - 35.1835 / 1}{35.1835 / 501} = 96.34801$$

$$③ F_{(1, 501)} = 3.84 < \begin{matrix} F_{upper} = 3.84 \\ F_{lower} = -3.84 \end{matrix}$$

$\therefore$ We can reject H_0 , β_2 is not equal to β_3

④

Model 1:

$$\ln Y_t = \beta_1 + \beta_2 \ln L_t + \beta_3 \ln K_t$$

$$R^2 = 0.9389, RSS = 0.0124$$

Model 2:

$$\ln \left(\frac{Y}{L} \right)_t = \beta_1 + \beta_2 \ln \left(\frac{K}{L} \right)_t$$

$$R^2 = 0.8087, RSS = 0.0153$$

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4.1) Model 1 : $\beta_1 = 18.27$ means that if $\ln L$ and $\ln K_t$ is equal to zero we will produce at $e^{18.27}$ unit

$\beta_2 = 0.536$; if the labor factor increase by 1%, the product will increase by 0.536%.

$\beta_3 = 0.024$; if the capital factor increase by 1%, the product will increase by 0.024%.

Model 2 : $\beta_1 = 2.13$, if $\ln \left(\frac{K}{L} \right)_t = 0$ then the average product per labour is $e^{2.13} = 8.415$ unit

$\beta_2 = 1.12$, if $\ln \left(\frac{K}{L} \right)_t$ increase by 1%, the $\ln \left(\frac{Y}{L} \right)_t$ will increase by 1.12%.

4.2) Model 1 is unrestricted, Model 2 is restricted ; $\beta_2 + \beta_3 = 1$

① $H_0 : \beta_2 + \beta_3 = 1$

$H_1 : \beta_2 + \beta_3 \neq 1$

$$\begin{aligned} \textcircled{2} F_{\text{cal}} &= \frac{(R_{UR}^2 - R_R^2) / m}{(1 - R_{UR}^2) / (n - k_{UR})} \\ &= \frac{(0.9389 - 0.8087) / 1}{(1 - 0.9389) / 27} = 57.535 \end{aligned}$$

③ $F_{0.05, 1, 27} = 4.23 < \begin{cases} F_{\text{upper}} = 4.23 \\ F_{\text{lower}} = -4.23 \end{cases}$

④ We can reject H_0 , so the function does not yield constant return to scale at $\alpha = 0.05$.

4.3) We cannot use R^2 to compare between two model since both models have different variables (model 1 : $\ln Y_t$, model 2 : $\ln \left(\frac{Y}{L} \right)_t$), despite equal number of data.