Economics 103 – Statistics for Economists

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Lecture # 10

Definition of Conditional PMF

How does the distribution of y change with x?

$$\boxed{p_{Y|X}(y|x) = P(Y = y|X = x)}$$

Which of these is the formula for $p_{Y|X}(y|x)$?

You can figure this out from what you already know about probability, using the definition $p_{Y|X}(y|x) = P(Y = y|X = x)$

(a) $p_X(x)/p_Y(y)$

(b) $p_{XY}(x, y)/p_X(x)$

(c) $p_X(x)p_{XY}(x, y)$

(d) $p_{XY}(x, y)/p_Y(y)$

(e) $p_Y(y)/p_X(x)$

Conditional PMF from Joint and Marginal

$$p_{Y|X}(y|x) = P(Y = y|X = x) = \frac{P(Y = y \cap X = x)}{P(X = x)} = \frac{p_{XY}(x, y)}{p_X(x)}$$

Hence,

$$\boxed{p_{Y|X}(y|x) = \frac{p_{XY}(x, y)}{p_X(x)}}$$

and similarly,

$$\boxed{p_{X|Y}(x|y) = \frac{p_{XY}(x, y)}{p_Y(y)}}$$

Conditional PMF of Y given $X = 2$

		Y			
		1	2	3	
X	0	1/8	0	0	1/8
	1	0	1/4	1/8	3/8
	2	0	1/4	1/8	3/8
	3	1/8	0	0	1/8

$$p_{Y|X}(1|2) \quad =$$

Conditional PMF of Y given $X = 2$

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$$p_{Y|X}(1|2) \quad = \quad \frac{p_{XY}(2,1)}{p_X(2)} =$$

Conditional PMF of Y given $X = 2$

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$$p_{Y|X}(1|2) = \frac{p_{XY}(2,1)}{p_X(2)} = \frac{0}{3/8} = 0$$

Conditional PMF of Y given $X = 2$

		Y			
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What is $p_{X|Y}(1|2)$?

			Y		
		1	2	3	
X	0	1/8	0	0	
	1	0	1/4	1/8	
	2	0	1/4	1/8	
	3	1/8	0	0	
		1/4	1/2	1/4	

What is $p_{X|Y}(1|2)$?

		Y			
		1	2	3	
X	0	$1/8$	0	0	
	1	0	$1/4$	$1/8$	
	2	0	$1/4$	$1/8$	
	3	$1/8$	0	0	
		$1/4$	$1/2$	$1/4$	

$$p_{X|Y}(0|2) = \frac{p_{XY}(0,2)}{p_Y(2)} = \frac{0}{1/2} = 0$$

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$$
\begin{aligned}
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$$p_{X|Y}(2|2) = \frac{p_{XY}(2,2)}{p_Y(2)} = \frac{1/4}{1/2} = 1/2$$

What is $p_{X|Y}(1|2)$?

		Y			
		1	2	3	
X	0	$1/8$	0	0	
	1	0	$1/4$	$1/8$	
	2	0	$1/4$	$1/8$	
	3	$1/8$	0	0	
		$1/4$	$1/2$	$1/4$	

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p_{X|Y}(2|2) &= \frac{p_{XY}(2,2)}{p_Y(2)} = \frac{1/4}{1/2} = 1/2 \\
p_{X|Y}(3|2) &= \frac{p_{XY}(3,2)}{p_Y(2)} = \frac{0}{1/2} = 0
\end{aligned}
$$

Independent RVs

Definition

We say that two discrete RVs are independent if and only if their joint pmf equals the product of their marginal pmfs:

$$p_{XY}(x,y) = p_X(x)p_Y(y)$$

for all pairs (x,y) in the support.

In Terms of Conditional PMF

From the previous slide, it follows that an equivalent definition of independence is that both conditional pmfs equal the corresponding marginal pmfs: $p_{Y|X}(y|x) = p_Y(y)$ and $p_{X|Y}(x|y) = p_X(x)$ for all (x,y) in the support.

Are X and Y Independent?

(A = YES, B = NO)

		Y			
		1	2	3	
X	0	1/8	0	0	1/8
	1	0	1/4	1/8	3/8
	2	0	1/4	1/8	3/8
	3	1/8	0	0	1/8
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	2	0	1/4	1/8	3/8
	3	1/8	0	0	1/8
		1/4	1/2	1/4	

$$p_{XY}(2,1) = 0$$

Are X and Y Independent?

(A = YES, B = NO)

		Y 1	2	3	
X	0	1/8	0	0	1/8
	1	0	1/4	1/8	3/8
	2	0	1/4	1/8	3/8
	3	1/8	0	0	1/8
		1/4	1/2	1/4	

$$
\begin{aligned}
p_{XY}(2,1) &= 0 \\
p_X(2) \times p_Y(1) &=
\end{aligned}
$$

Are X and Y Independent?

(A = YES, B = NO)

		Y = 1	2	3	
X	0	1/8	0	0	1/8
	1	0	1/4	1/8	3/8
	2	0	1/4	1/8	3/8
	3	1/8	0	0	1/8
		1/4	1/2	1/4	

$$\begin{aligned} p_{XY}(2,1) &= 0 \\ p_X(2) \times p_Y(1) &= (3/8) \times (1/4) \neq 0 \end{aligned}$$

Therefore X and Y are *not* independent.

Conditional Expectation

Intuition

$E[Y|X]$ is our "best guess" of the realization that Y will take on having observed the realization of X.

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Calculating $E[Y|X = x]$

Take the mean of the conditional pmf of Y given $X = x$.

Conditional Expectation: $E[Y|X=2]$

		Y 1	2	3	
X	0	1/8	0	0	1/8
	1	0	1/4	1/8	3/8
	2	0	1/4	1/8	3/8
	3	1/8	0	0	1/8
		1/4	1/2	1/4	

We showed above that the conditional pmf of $Y|X=2$ is:

$$\boxed{p_{Y|X}(1|2)=0 \qquad p_{Y|X}(2|2)=2/3 \qquad p_{Y|X}(3|2)=1/3}$$

Hence

$$E[Y|X=2]=2\times 2/3+3\times 1/3=7/3$$

Conditional Expectation: $E[Y|X = 0]$

		Y			
		1	2	3	
X	0	1/8	0	0	1/8
	1	0	1/4	1/8	3/8
	2	0	1/4	1/8	3/8
	3	1/8	0	0	1/8
		1/4	1/2	1/4	

The conditional pmf of $Y|X = 0$ is

$$\boxed{p_{Y|X}(1|0) = 1 \qquad p_{Y|X}(2|0) = 0 \qquad p_{Y|X}(3|0) = 0}$$

Hence $E[Y|X = 0] = 1$

Calculate $E[Y|X=3]$

		Y 1	2	3	
X	0	1/8	0	0	1/8
	1	0	1/4	1/8	3/8
	2	0	1/4	1/8	3/8
	3	1/8	0	0	1/8
		1/4	1/2	1/4	

The conditional pmf of $Y|X=3$ is

$$\boxed{p_{Y|X}(1|3) = 1 \qquad p_{Y|X}(2|3) = 0 \qquad p_{Y|X}(3|3) = 0}$$

Hence $E[Y|X=3] = 1$

Calculate $E[Y|X = 1]$

		Y			
		1	2	3	
X	0	1/8	0	0	1/8
	1	0	1/4	1/8	3/8
	2	0	1/4	1/8	3/8
	3	1/8	0	0	1/8
		1/4	1/2	1/4	

Calculate $E[Y|X=1]$

		Y			
		1	2	3	
X	0	1/8	0	0	1/8
	1	0	1/4	1/8	3/8
	2	0	1/4	1/8	3/8
	3	1/8	0	0	1/8
		1/4	1/2	1/4	

The conditional pmf of $Y|X=1$ is

$$\boxed{p_{Y|X}(1|1)=0 \qquad p_{Y|X}(2|1)=2/3 \qquad p_{Y|X}(3|1)=1/3}$$

Hence

$$E[Y|X=1]=2\times 2/3+3\times 1/3=7/3$$

$E[Y|X]$ is a Random Variable

In this particular example we have seen that:

$$E[Y|X] = \begin{cases} 1 & X = 0 \\ 7/3 & X = 1 \\ 7/3 & X = 2 \\ 1 & X = 3 \end{cases}$$

But from above we know the marginal distribution of X :

$$P(X = 0) = 1/8 \qquad P(X = 1) = 3/8$$
$$P(X = 2) = 3/8 \qquad P(X = 3) = 1/8$$

$E[Y|X]$ is a Random Variable

In this particular example we have seen that:

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But from above we know the marginal distribution of X :

$$P(X = 0) = 1/8 \qquad P(X = 1) = 3/8$$
$$P(X = 2) = 3/8 \qquad P(X = 3) = 1/8$$

Therefore, $E[Y|X]$ is a RV that takes on the value 1 with probability $1/4$ and the value $7/3$ with probability $3/4$.

The Law of Iterated Expectations

Since $E[Y|X]$ is a random variable, we can ask what its expectation is. It turns out that, for any RVs X and Y

$$\boxed{E\left[E\left[Y|X\right]\right] = E[Y]}$$

and this is called the Law of Iterated Expectations. I've posted a proof HERE for those who are interested.

This will be helpful in Econ 104...

Law of Iterated Expectations for Our Example

Marginal pmf of Y

$$
\begin{aligned}
P(Y = 1) &= 1/4 \\
P(Y = 2) &= 1/2 \\
P(Y = 3) &= 1/4
\end{aligned}
$$

Law of Iterated Expectations for Our Example

Marginal pmf of Y

$$\begin{aligned} P(Y=1) &= 1/4 \\ P(Y=2) &= 1/2 \\ P(Y=3) &= 1/4 \end{aligned}$$

$$\begin{aligned} E[Y] &= 1 \times 1/4 + 2 \times 1/2 + 3 \times 1/4 \\ &= 2 \end{aligned}$$

Law of Iterated Expectations for Our Example

Marginal pmf of Y

$$
\begin{aligned}
P(Y=1) &= 1/4 \\
P(Y=2) &= 1/2 \\
P(Y=3) &= 1/4
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$$

$$
\begin{aligned}
E[Y] &= 1 \times 1/4 + 2 \times 1/2 + 3 \times 1/4 \\
&= 2
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$$

$E[Y|X]$

$$
E[Y|X] = \begin{cases} 1 & \text{w/ prob. } 1/4 \\ 7/3 & \text{w/ prob. } 3/4 \end{cases}
$$

Law of Iterated Expectations for Our Example

Marginal pmf of Y

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\begin{aligned}
P(Y=1) &= 1/4 \\
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$E[Y|X]$

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E[Y|X] = \begin{cases} 1 & \text{w/ prob. } 1/4 \\ 7/3 & \text{w/ prob. } 3/4 \end{cases}
$$

$$
\begin{aligned}
E\left[E\left[Y|X\right]\right] &= 1 \times 1/4 + 7/3 \times 3/4 \\
&= 2
\end{aligned}
$$

Expectation of Function of Two Discrete RVs

$$\boxed{E[g(X,Y)] = \sum_x \sum_y g(x,y)p_{XY}(x,y)}$$

Some Extremely Important Examples

Same For Continuous Random Variables

Let $\mu_X = E[X], \mu_Y = E[Y]$

Covariance

$$\sigma_{XY} = Cov(X, Y) = E[(X - \mu_X)(Y - \mu_Y)]$$

Correlation

$$\rho_{XY} = Corr(X, Y) = \frac{\sigma_{XY}}{\sigma_X \sigma_Y}$$

Shortcut Formula for Covariance

Much easier for calculating:

$$\boxed{Cov(X, Y) = E[XY] - E[X]E[Y]}$$

We'll talk more about this in an upcoming lecture...

Calculating $Cov(X, Y)$

		Y			
		1	2	3	
X	0	1/8	0	0	1/8
	1	0	1/4	1/8	3/8
	2	0	1/4	1/8	3/8
	3	1/8	0	0	1/8
		1/4	1/2	1/4	

$$E[X] = 3/8 + 2 \times 3/8 + 3 \times 1/8 = 3/2$$

$$E[Y] = 1/4 + 2 \times 1/2 + 3 \times 1/4 = 2$$

Calculating $Cov(X, Y)$

		Y			
		1	2	3	
X	0	1/8	0	0	1/8
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$$E[X] = 3/8 + 2 \times 3/8 + 3 \times 1/8 = 3/2$$

$$E[Y] = 1/4 + 2 \times 1/2 + 3 \times 1/4 = 2$$

$$\begin{aligned} E[XY] &= 1/4 \times (2+4) + 1/8 \times (3+6+3) \\ &= 3 \end{aligned}$$

Calculating $Cov(X, Y)$

		Y			
		1	2	3	
X	0	1/8	0	0	1/8
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$$E[X] = 3/8 + 2 \times 3/8 + 3 \times 1/8 = 3/2$$

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$$\begin{aligned} E[XY] &= 1/4 \times (2 + 4) + 1/8 \times (3 + 6 + 3) \\ &= 3 \end{aligned}$$

$$Cov(X, Y) = E[XY] - E[X]E[Y]$$

Calculating $Cov(X, Y)$

		Y			
		1	2	3	
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$$E[X] = 3/8 + 2 \times 3/8 + 3 \times 1/8 = 3/2$$

$$E[Y] = 1/4 + 2 \times 1/2 + 3 \times 1/4 = 2$$

$$\begin{aligned} E[XY] &= 1/4 \times (2+4) + 1/8 \times (3+6+3) \\ &= 3 \end{aligned}$$

$$\begin{aligned} Cov(X, Y) &= E[XY] - E[X]E[Y] \\ &= 3 - 3/2 \times 2 = 0 \end{aligned}$$

Calculating $Cov(X, Y)$

		Y			
		1	2	3	
X	0	1/8	0	0	1/8
	1	0	1/4	1/8	3/8
	2	0	1/4	1/8	3/8
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$$E[X] = 3/8 + 2 \times 3/8 + 3 \times 1/8 = 3/2$$

$$E[Y] = 1/4 + 2 \times 1/2 + 3 \times 1/4 = 2$$

$$\begin{aligned} E[XY] &= 1/4 \times (2 + 4) + 1/8 \times (3 + 6 + 3) \\ &= 3 \end{aligned}$$

$$\begin{aligned} Cov(X, Y) &= E[XY] - E[X]E[Y] \\ &= 3 - 3/2 \times 2 = 0 \end{aligned}$$

$$Corr(X, Y) = Cov(X, Y)/[SD(X)SD(Y)] = 0$$

Hence, zero covariance (correlation) does *not* imply independence!

However, independence *does* imply zero covariance (correlation)

I've posted a proof HERE for those who are interested.

Linearity of Expectation, Again

Holds for Continuous RVs as well, but different proof.

In general, $E[g(X, Y)] \neq g(E[X], E[Y])$. The key exception is when g is a linear function:

$$\boxed{E[aX + bY + c] = aE[X] + bE[Y] + c}$$

where X, Y are random variables and a, b, c are constants. I've posted a proof HERE for those who are interested.

Application: Shortcut Formula for Variance

By the Linearity of Expectation,

$$Var(X) \;=\; E[(X-\mu)^2] =$$

Application: Shortcut Formula for Variance

By the Linearity of Expectation,

$$\begin{aligned} Var(X) &= E[(X-\mu)^2] = E[X^2 - 2\mu X + \mu^2] \\ &= \end{aligned}$$

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Application: Shortcut Formula for Variance

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Application: Shortcut Formula for Variance

By the Linearity of Expectation,

$$
\begin{aligned}
Var(X) &= E[(X-\mu)^2] = E[X^2 - 2\mu X + \mu^2] \\
&= E[X^2] - 2\mu E[X] + \mu^2 \\
&= E[X^2] - 2\mu^2 + \mu^2 \\
&= E[X^2] - \mu^2
\end{aligned}
$$

We saw in a previous lecture that it's typically much easier to calculate variances using the shortcut formula.

Another Application: Shortcut Formula for Covariance

Similar to Shortcut for Variance: in fact $Var(X) = Cov(X, X)$

$$
\begin{aligned}
Cov(X,Y) &= E[(X-\mu_X)(Y-\mu_Y)] \\
&= E[XY - \mu_X Y - \mu_Y X + \mu_X \mu_Y] \\
&\vdots \\
&= E[XY] - E[X]E[Y]
\end{aligned}
$$

You'll fill in the details for homework...

Expected Value of Sum = Sum of Expected Values

Repeatedly applying the linearity of expectation,

$$E[X_1 + X_2 + \ldots + X_n] = E[X_1] + E[X_2] + \ldots + E[X_n]$$

regardless of how the RVs $X_1, \ldots, X_n$ are related to each other. In particular it doesn't matter if they're dependent or independent.

Independent and Identically Distributed (iid) RVs

Example

$X_1, X_2, \ldots X_n \sim$ iid Bernoulli(p)

Independent

Joint pmf equals product of marginal pmfs (see last lecture): Knowing the realization of one of the RVs gives no information about the others.

Identically Distributed

Each X_i is the same kind of RV, with the same values for any parameters. (Hence same pmf, cdf, mean, variance, etc.)

Binomial(n, p) Random Variable

Definition

Sum of n independent Bernoulli RVs, each with probability of "success," i.e. 1, equal to p

Parameters

$p =$ probability of "success," $n = \#$ of trials

Support

$\{0, 1, 2, \ldots, n\}$

Using Our New Notation

Let $X_1, X_2, \ldots, X_n \sim$ iid Bernoulli(p), $Y = X_1 + X_2 + \ldots + X_n$.
Then $Y \sim$ Binomial(n, p).

Which of these is the PMF of a Binomial(n, p) RV?

(a) $p(x) = p^x(1-p)^{n-x}$

(b) $p(x) = \binom{n}{x} p^x(1-p)^{n-x}$

(c) $p(x) = \binom{x}{n} p^x$

(d) $p(x) = \binom{n}{x} p^{n-x}(1-p)^x$

(e) $p(x) = p^n(1-p)^x$

Which of these is the PMF of a Binomial(n, p) RV?

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(b) $p(x) = \binom{n}{x} p^x(1-p)^{n-x}$

(c) $p(x) = \binom{x}{n} p^x$

(d) $p(x) = \binom{n}{x} p^{n-x}(1-p)^x$

(e) $p(x) = p^n(1-p)^x$

$$p(x) = \binom{n}{x} p^x(1-p)^{n-x}$$

Expected Value of Binomial RV

Use the fact that a Binomial(n, p) RV is defined as the sum of n iid Bernoulli(p) Random Variables and the Linearity of Expectation:

$$E[Y] = E[X_1 + X_2 + \ldots + X_n] =$$

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&= p + p + \ldots + p \\
&= np
\end{aligned}
$$

Extremely Important:

Variance of Sum $\neq$ Sum of Variances!

Variance of a Sum

$$Var(aX + bY) = E\left[\{(aX + bY) - E[aX + bY]\}^2\right]$$

Variance of a Sum

$$
\begin{aligned}
Var(aX + bY) &= E\left[\{(aX + bY) - E[aX + bY]\}^2\right] \\
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\end{aligned}
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&= E\left[a^2(X - \mu_X)^2 + b^2(Y - \mu_Y)^2 + 2ab(X - \mu_X)(Y - \mu_Y)\right]
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&= a^2E[(X - \mu_X)^2] + b^2E[(Y - \mu_Y)^2] + 2abE[(X - \mu_X)(Y - \mu_Y)] \\
&= a^2Var(X) + b^2Var(Y) + 2abCov(X, Y)
\end{aligned}
$$

Since $\sigma_{XY} = \rho\sigma_X\sigma_Y$, this is sometimes written as:

$$\boxed{Var(aX + bY) = a^2\sigma_X^2 + b^2\sigma_Y^2 + 2ab\rho\sigma_X\sigma_Y}$$

Independence $\Rightarrow Var(X+Y) = Var(X) + Var(Y)$

As explained above, if X and Y are independent, $Cov(X, Y) = 0$.

Hence, independence implies

$$\begin{aligned} Var(X+Y) &= Var(X) + Var(Y) + 2Cov(X, Y) \\ &= Var(X) + Var(Y) \end{aligned}$$

This is also true for more than two RVs

If $X_1, X_2, \ldots, X_n$ are independent, then

$$Var(X_1 + X_2 + \ldots X_n) = Var(X_1) + Var(X_2) + \ldots + Var(X_n)$$

Crucial Distinction

Expected Value

It is always true that

$$E[X_1 + X_2 + \ldots + X_n] = E[X_1] + E[X_2] + \ldots + E[X_n]$$

Variance

It is not true in general that

$$Var[X_1 + X_2 + \ldots + X_n] = Var[X_1] + Var[X_2] + \ldots + Var[X_n]$$

but it is true in the special case where $X_1, \ldots X_n$ are independent.

Variance of Binomial Random Variable

Definition from Sequence of Bernoulli Trials

If $X_1, X_2, \ldots, X_n \sim$ iid Bernoulli(p) then

$$Y = X_1 + X_2 + \ldots + X_n \sim \text{Binomial}(n, p)$$

Using Independence

$$\begin{aligned} Var[Y] &= Var[X_1 + X_2 + \ldots + X_n] \\ &= Var[X_1] + Var[X_2] + \ldots + Var[X_n] \\ &= \end{aligned}$$

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$$\begin{aligned}
Var[Y] &= Var[X_1 + X_2 + \ldots + X_n] \\
&= Var[X_1] + Var[X_2] + \ldots + Var[X_n] \\
&= p(1-p) + p(1-p) + \ldots + p(1-p) \\
&=
\end{aligned}$$

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$$\begin{aligned} Var[Y] &= Var[X_1 + X_2 + \ldots + X_n] \\ &= Var[X_1] + Var[X_2] + \ldots + Var[X_n] \\ &= p(1-p) + p(1-p) + \ldots + p(1-p) \\ &= np(1-p) \end{aligned}$$