

Selection of Heterogeneous Instruments in Partially Linear Fixed Effects Panel Regression

Working Paper

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Introduction

Given a linear in parameters fixed effects panel data model, suppose that for all cross-sections and time periods a known subset of regressors is correlated with the error term. This endogeneity problem will be resolved using the control function approach of Newey, Powell, and Vella (1999), with the additional complication of having the set of instrumental variables which are appropriate/available for at least one cross-section not identical to those available/appropriate for a non empty subset of other cross-sections. Suppose that for each time period $t \in \{1, 2, \dots, T\}$, component of Z_{1jt} $d \in \{1, 2, \dots, p_1\}$, and cross-section $j \in \{1, 2, \dots, q\}$ where $\{q, T\} \in \mathbb{N}$,

$$Y_{jt} = \beta_0 + [Z'_{1jt} \ Z'_{2jt}] \beta_1 + e_j + \varepsilon_{jt} \quad (1)$$

$$Z_{1jdt} = \alpha_{jd0} + Z'_{2jt} \alpha_{1jd} + W'_{jt} \alpha_{2jd} + V_{jdt} \quad (2d)$$

$$E(\varepsilon_{jt} | Z_{1jt}, Z_{2jt}) = E(\varepsilon_{jt} | Z_{1jt}) \neq 0 \quad (3)$$

$$E(V_{jdt} | Z_{2jt}, W_{jt}) = 0 \quad (4)$$

Where for $\{p_1, p_2, c, w, w_1, w_2, \dots, w_q\} \subset \mathbb{N}$, Y_{jt} , and ε_{jt} are scalar random variables, Z_{2jt} is a p_2 dimension vector of exogenous random variables, Z_{1jt} is a vector of endogenous random variables having dimension p_1 . e_j is a scalar fixed effect, ε_{jt} is a scalar error term, V_{jdt} is a scalar error term. $W_t = [W_{1t} \ W_{2t} \ \dots \ W_{wt}]'$ is vector of instrumental variables of dimension w , $W_{jt} = [W_{j1t} \ W_{j2t} \ \dots \ W_{jw_{jt}}]'$ is a vector of instrumental variables of dimension w_j where $\{W_{jit}\}_{i=1}^{w_j} \subset \{W_{it}\}_{i=1}^w$ and there exists at least one pair $j, j' \in \{1, 2, \dots, p\}$, where $j \neq j'$, such that $\{W_{jit}\}_{i=1}^{w_j} \neq \{W_{j'it}\}_{i=1}^{w_{j'}}$. β_0 and α_{d0} are scalars, β_1 , α_{1d} , α_{2d} are $p_1 + p_2 = p$, p_2 , and w_j dimensional vectors of real numbers respectively. Lastly for notational convenience let define the following equivalences,

$$Z_{jt} = [Z'_{1jt} \ Z'_{2jt}]' \quad \text{and} \quad V_{jt} = [V_{j1t} \ V_{j2t} \ \dots \ V_{jp_1t}]'$$

Remarks :

- a.) We have in equation (1) a linear in parameters function of primary interest having endogenous random variable Z_{1jt} . The focus of this proposal is the identification and estimation of finite dimensional

parameter β_1 .

As mentioned above $E(\varepsilon_{jt}|Z_{1jt}) \neq 0$ means that the error term ε_{jt} is not orthogonal to the space of functions of Z_{1jt} . Following the control function approach of Newey, Powell, and Vella (1999), I assume that there exists a random variable u_{jt} and unknown function $f_j(\cdot)$ such that;

$$\varepsilon_{jt} = f_j(V_{jt}) + u_{jt} \quad \text{where} \quad E(u_{jt}|\{Z_{jk}, W_{jk}, X_{jk}, V_{jk}\}_{k=1}^t) = 0$$

Furthermore I assume that all unknown functions heretofore define are additive, that is, $f_j(V_{jt}) = \sum_{d=1}^{p_1} f_{jd}(V_{jdt})$ Where each $f_{jd}(\cdot)$ is a unknown function. Now where $t > 1$, we can rewrite (1) as;

$$Y_{jt} - Y_{j(t-1)} = [Z'_{jt} - Z'_{j(t-1)}]\beta_1 + \sum_{d=1}^{p_1} [f_{jd}(V_{jdt}) - f_{jd}(V_{jd(t-1)})] + u_{jt} - u_{j(t-1)}$$

Adopting the notation that for any finite dimensional random vector A_{jt} define $\Delta A_{jt} \equiv A_{jt} - A_{j(t-1)}$ we can further rewrite (1) as;

$$\Delta Y_{jt} = \Delta Z'_{jt}\beta_1 + \sum_{l=1}^{p_1} \Delta f_{jl}(V_{jlt}) + \Delta u_{jt}$$

As a result of the foregoing assumptions and definitions, we can rewrite the model as the following,

$$\Delta Y_{jt} = \Delta Z'_{jt}\beta_1 + \sum_{d=1}^{p_1} \Delta f_{jd}(V_{jdt}) + \Delta u_{jt} \tag{5}$$

$$Z_{1jdt} = \alpha_{d0} + Z'_{2jt}\alpha_{1jd} + W'_{jt}\alpha_{2jd} + V_{jdt} \tag{2d}$$

$$E(\Delta u_{jt}|\{Z_{jk}, W_{jk}, X_{jk}, V_{jk}\}_{k=1}^t) = 0 \tag{6}$$

$$E(V_{jt}|Z_{2jt}, W_{jt}) = 0 \tag{7}$$

Remarks :

- a.) In equation (5), by differencing equation (1), including the control function, and imposing additivity, we have eliminated fixed effect e_j , but in return we now have a collection of equations $\{f_{j1}(\cdot), f_{j2}(\cdot), \dots, f_{jp_1}(\cdot)\}$ unique to each cross-section j , a fate seemingly even worse than the presence of fixed effects.
- b.) In the following I will show that using a variation on the identification technique of Manzan and Zerom (2005) SaPL, it is possible under mild conditions to identify and estimate finite dimensional parameter β_1 and hopefully achieve \sqrt{n} asymptotic normality without having to jointly estimate $f_j(V_{jt})$,

Next in preparation for the following lemma regarding the identification of parameter vector β_1 I define the following density ratios,

$$\phi_{jt} = \frac{\prod_{d=1}^{p_1} p(V_{jdt}, V_{jd(t-1)})}{p(V_{jt}, V_{j(t-1)})}$$

where for any random vector A_j , $p(A_j)$ is the joint density of that vector. Define following conditional expectations,

$$\begin{aligned} H_{jd}(\Delta Z_{jt}) &= E[\phi_{jt} \Delta Z_{jt} | V_{jdt}, V_{jd(t-1)}] & H_{jd}(\Delta Y_{jt}) &= E[\phi_{jt} \Delta Y_{jt} | V_{jdt}, V_{jd(t-1)}] \\ H_j(\Delta Z_{jt}) &= \sum_{d=1}^{p_1} H_{jd}(\Delta Z_{jt}) & H_j(\Delta Y_{jt}) &= \sum_{d=1}^{p_1} H_{jd}(\Delta Y_{jt}) \end{aligned}$$

Lastly, define the following collection of vectors,

$$\begin{aligned} H(\Delta Y_t) &= [H_1(\Delta Y_{1t}) \ H_2(\Delta Y_{2t}) \ \cdots \ H_q(\Delta Y_{qt})]' & H(\Delta Z_t) &= [H_1(\Delta Z_{1t}) \ H_2(\Delta Z_{2t}) \ \cdots \ H_q(\Delta Z_{qt})]' \\ \Delta Y_t &= [\Delta Y_{1t} \ \Delta Y_{2t} \ \cdots \ \Delta Y_{qt}]' & \Delta Z_t &= [\Delta Z_{1t} \ \Delta Z_{2t} \ \cdots \ \Delta Z_{qt}]' & \Delta u_t &= [\Delta u_{1t} \ \Delta u_{2t} \ \cdots \ \Delta u_{qt}]' \end{aligned}$$

Now that all necessary definitions have been made, the following lemma gives the sufficient conditions for the identification of parameter β_1 ,

Lemma 1. *Letting $\phi_t = \text{diag}(\{\phi_{jt}\}_{j=1}^q)$, if*

- i.) $E[f_{jd}(V_{jdt})] = E[f_{jd}(V_{jd(t-1)})]$ for all $d \in \{1, 2, \dots, p_1\}$, $j \in \{1, 2, \dots, q\}$, and $t \in \{2, \dots, T\}$
- ii.) $E\left([\Delta Z_t - H(\Delta Z_t)]' [\Delta Z_t - H(\Delta Z_t)]\right)$ is positive semi definite,

Then β_1 is identified, in particular,

$$\beta_1 = E\left([\Delta Z_t - H(\Delta Z_t)]' \phi_t [\Delta Z_t - H(\Delta Z_t)]\right)^{-1} E\left([\Delta Z_t - H(\Delta Z_t)]' \phi_t [\Delta Y_t - H(\Delta Y_t)]\right)$$

Proof. I begin with a series of preliminary results, which combine to show the main result. First for $d \neq k$ consider,

$$\begin{aligned} E[\phi_{jt} \Delta f_{jk}(V_{jkt}) | V_{jdt}, V_{jd(t-1)}] &= \int \phi_{jt} \Delta f_{jk}(V_{jkt}) p(V_{jdt}, V_{jd(t-1)}) p(V_{jdt}, V_{jd(t-1)})^{-1} dV_{j-dt} V_{j-d(t-1)} \\ &= \int \Delta f_{jk}(V_{jkt}) p(V_{jkt}, V_{jk(t-1)}) dV_{jkt} V_{jk(t-1)} \prod_{a \notin \{d, k\}} \int p(V_{jat}, V_{ja(t-1)}) dV_{jat} V_{ja(t-1)} \\ &= E[\Delta f_{jk}(V_{jkt})] = E[f_{jk}(V_{jkt})] - E[f_{jk}(V_{jk(t-1)})] = 0 \end{aligned}$$

Next consider

$$\begin{aligned} E[\phi_{jt}|V_{jdt}, V_{jd(t-1)}] &= \int \phi_{jt} p(V_{jt}, V_{j(t-1)}) p(V_{jdt}, V_{jd(t-1)})^{-1} dV_{j-dt} V_{j-d(t-1)} \\ &= \prod_{a \neq d} \int p(V_{jat}, V_{ja(t-1)}) dV_{jat} V_{ja(t-1)} = 1 \end{aligned}$$

Consequently,

$$\begin{aligned} H_{jd}(\Delta Y_{jt}) &= E[\phi_{jt} \Delta Y_{jt} | V_{jdt}, V_{jd(t-1)}] \\ &= E[\phi_{jt} \Delta Z'_{jt} | V_{jdt}, V_{jd(t-1)}] \beta_1 + \Delta f_{jd}(V_{jdt}) E[\phi_{jt} | V_{jdt}, V_{jd(t-1)}] \\ &\quad + \sum_{k \neq d}^{p_1} E[\phi_{jt} \Delta f_{jk}(V_{jkt}) | V_{jdt}, V_{jd(t-1)}] + E[\phi_{jt} \Delta u_{jt} | V_{jdt}, V_{jd(t-1)}] \\ &= H_{jd}(\Delta Z'_{jt}) \beta_1 + \Delta f_{jd}(V_{jdt}) + E[\phi_{jt} E(\Delta u_{jt} | \{Z_{jk}, W_{jk}, V_{jk}\}_{k=1}^t) | V_{jdt}, V_{jd(t-1)}] \\ &= H_{jd}(\Delta Z'_{jt}) \beta_1 + \Delta f_{jd}(V_{jdt}) \end{aligned}$$

Furthermore

$$H_j(\Delta Y_{jt}) = \sum_{d=1}^{p_1} H_{jd}(\Delta Y_{jt}) = \sum_{d=1}^{p_1} H_{jd}(\Delta Z'_{jt}) \beta_1 + \sum_{d=1}^{p_1} \Delta f_{jd}(V_{jdt}) = H_j(\Delta Z_{jt}) \beta_1 + \sum_{d=1}^{p_1} \Delta f_{jd}(V_{jdt})$$

Consequently

$$\sqrt{\phi_{jt}}[\Delta Y_{jt} - H_j(\Delta Y_{jt})] = \sqrt{\phi_{jt}}[\Delta Z_{jt} - H_j(\Delta Z_{jt})] \beta_1 + \sqrt{\phi_{jt}} \Delta u_{jt}$$

and stacking these equations into a vector,

$$\sqrt{\phi_t}[\Delta Y_t - H(\Delta Y_t)] = \sqrt{\phi_t}[\Delta Z_t - H(\Delta Z_t)] \beta_1 + \sqrt{\phi_t} \Delta u_t$$

The result follows since $E[\sqrt{\phi_t} E(\Delta u_t | \{Z_{jk}, W_{jk}, V_{jk}\}_{k=1}^t)] = 0$ □

Estimation of Secondary Equations

The specification of equation (2d) is quite general where; intercepts α_{0jd} , and coefficients on exogenous regressors α_{1jd} are unique to each cross-section. Furthermore, although instruments W_{jt} are shared across cross-sections their coefficients α_{2jd} are unique, and as yet there is no sense in which error terms V_{jdt} are correlated across cross-section. As a result there are a number of restrictions on the regressors and parameters of equation (2d) which can be imposed and have a substantial effect on the manner in

which V_{jdt} will be estimated.

Note: For all vectors of dimension greater than two, I reference the individual elements of each vector by including a comma followed by a scalar value in the subscript. I reference the entire vector whenever the comma is omitted. For example,

$$W_{jt} = \begin{bmatrix} W_{jt,1} & W_{jt,2} & \cdots & W_{jt,w_j} \end{bmatrix}'$$

Case 1: W_{jt} is an known subset of W_t .

If so, estimation is comprised of q separate OLS regressions.

$$(\hat{\alpha}_{0jd}, \hat{\alpha}_{1jd}, \hat{\alpha}_{2jd}) = \arg \min \sum_{t=1}^T (Z_{1jdt} - \alpha_0 - Z'_{2jt}\alpha_1 - W'_{jt}\alpha_2)^2$$

where $\alpha_0 \in \mathbb{R}$, $\alpha_1 \in \mathbb{R}^{p_2}$, and $\alpha_3 \in \mathbb{R}^{w_j}$. So that

$$\hat{V}_{jdt} = Z_{1jdt} - \hat{\alpha}_{0jd} - Z'_{2jt}\hat{\alpha}_{1jd} - W'_{jt}\hat{\alpha}_{2jd}$$

Case 2: W_{jt} is an unknown subset of W_t .

If so, estimation is comprised of q separate regressions, each of which will incorporate a subset selection routine. Let $\alpha_{2jd} = [\alpha_{2jd,1} \ \alpha_{2jd,2} \ \cdots \ \alpha_{2jd,w}]$ where $\alpha_{2jd,l} = 0$ whenever $W_{t,l} \notin W_{jt}$. To facilitate subset selection I apply the lasso estimator by imposing an ℓ^1 penalty on estimated coefficients $\hat{\alpha}_{2jd}$.

$$(\hat{\alpha}_{0jd}, \hat{\alpha}_{1jd}, \hat{\alpha}_{2jd}) = \arg \min \sum_{t=1}^T (Z_{1jdt} - \alpha_0 - Z'_{2jt}\alpha_1 - W'_t\alpha_2)^2 \quad \text{subject to} \quad \sum_{l=1}^w |a_{2,l}| \leq \lambda$$

where $\alpha_0 \in \mathbb{R}$, $\alpha_1 \in \mathbb{R}^{p_2}$, and $\alpha_2 \in \mathbb{R}^w$. So that again,

$$\hat{V}_{jdt} = Z_{1jdt} - \hat{\alpha}_{0jd} - Z'_{2jt}\hat{\alpha}_{1jd} - W'_t\hat{\alpha}_{2jd}$$

Case 3: W_{jt} is an known subset of W_t , $\alpha_{1jd} = \alpha_{1j'd} \equiv \alpha_{1d}$ for all $j, j' \in \{1, 2, \dots, q\}$, and $\alpha_{2jd,l} = \alpha_{2j'd,l} \equiv \alpha_{2d,l}$ whenever $W_{t,l} \in W_{jt}$ and $W_{t,l} \in W_{j't}$. Let

$$1[W_{t,l} \in W_{tj}] = \begin{cases} 1 & \text{if } W_{t,l} \in W_{tj} \\ 0 & \text{otherwise} \end{cases}$$

and $M_j = \text{diag}(\{1[W_{tl} \in W_{jt}]\}_{l=1}^w)$ so that,

$$\begin{aligned} Z_{1jdt} &= \alpha_{0jd} + Z'_{2jt}\alpha_{1jd} + W'_{jt}\alpha_{2jd} + V_{jdt} \\ &= \alpha_{0jd} + Z'_{2jt}\alpha_{1d} + W'_t M_j \alpha_{2d} + V_{jdt} \end{aligned}$$

Now let $\Delta Z_{1jdt} = Z_{1jdt} - Z_{1jd(t-1)}$, $\Delta Z_{2jdt} = Z_{2jdt} - Z_{2jd(t-1)}$, $\Delta W_t = W_t - W_{t-1}$, and $\Delta V_{jdt} = V_{jdt} - V_{jd(t-1)}$ so that,

$$\Delta Z_{1jdt} = \Delta Z'_{2jt}\alpha_{1d} + \Delta W'_t M_j \alpha_{2d} + \Delta V_{jdt}$$

As a result,

$$(\hat{\alpha}_{1d}, \hat{\alpha}_{2d}) = \arg \min \sum_{j=1}^q \sum_{t=1}^T (\Delta Z_{1jdt} - \Delta Z'_{2jt}\alpha_1 - \Delta W'_t M_j \alpha_2)^2$$

so that given

$$\alpha_{0jd} = E(V_{jdt} + \alpha_{0jd}) = E(Z_{1jdt} - Z'_{2jt}\alpha_{1d} - W'_t M_j \alpha_{2d})$$

we have

$$\hat{V}_{jdt} = Z_{1jdt} - Z'_{2jt}\hat{\alpha}_{1d} - W'_t M_j \hat{\alpha}_{2d} - T^{-1} \sum_{t=1}^T (Z_{1jdt} - Z'_{2jt}\hat{\alpha}_{1d} - W'_t M_j \hat{\alpha}_{2d})$$

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Case 4: W_{jt} is an unknown subset of W_t , $\alpha_{1jd} = \alpha_{1j'd} \equiv \alpha_{1d}$ for all $j, j' \in \{1, 2, \dots, q\}$, and $\alpha_{2jd,l} = \alpha_{2j'd,l} \equiv \alpha_{2d,l}$ whenever $W_{t,l} \in W_{jt}$ and $W_{t,l} \in W_{j't}$. Inheriting notation from case 3 we again have,

$$\Delta Z_{1jdt} = \Delta Z'_{2jt}\alpha_{1d} + \Delta W'_t M_j \alpha_{2d} + \Delta V_{jdt}$$

In order to introduce our selection procedure we will estimate the coefficients on W_t as if that are not identical, then average the non zero estimates to construct a single estimate. Consider,

$$(\hat{\alpha}_{1d}, \hat{\alpha}_{2d}) = \arg \min \sum_{j=1}^q \sum_{t=2}^T (\Delta Z_{1jdt} - \Delta Z'_{2jt}\alpha_1 - \Delta W'_t \alpha_{2j})^2 \quad \text{subject to} \quad \sum_{l=1}^w |\alpha_{2j,l}| \leq \lambda \quad \text{for all } 1 \leq j \leq q$$

Consequently define for some $\varepsilon > 0$

$$\tilde{\alpha}_{2d,l} = \frac{\sum_{l=1}^q \hat{\alpha}_{2jd,l} 1[\hat{\alpha}_{2jd,l} > \varepsilon]}{\sum_{l=1}^q 1[\hat{\alpha}_{2jd,l} > \varepsilon]}$$

Now let $\tilde{\alpha}_{2d} = [\tilde{\alpha}_{2d,1} \ \tilde{\alpha}_{2d,2} \ \cdots \ \tilde{\alpha}_{2d,w}]'$ and $\tilde{M}_{jd} = \text{diag}(\{1[\hat{\alpha}_{2jd,l} > \varepsilon]\}_{l=1}^w)$ so that,

$$\hat{V}_{jdt} = Z_{1jdt} - Z'_{2jt}\hat{\alpha}_{1d} - W'_t\tilde{M}_{jd}\tilde{\alpha}_{2d} - T^{-1} \sum_{t=1}^T (Z_{1jdt} - Z'_{2jt}\hat{\alpha}_{1d} - W'_t\tilde{M}_{jd}\tilde{\alpha}_{2d})$$

Estimation of the Primary Equation

Now having estimates of all error terms, I construct the following estimates of the primary equation coefficients in the following way.

Density Estimation:

Obtain Rosenblatt Kernel Density Estimates of, $p(V_{jdt}, V_{jdc})$, and $p(V_{jdt}, V_{jct})$ using $\{\hat{V}_{jdt}, \hat{V}_{jct}\}_{t=2}^T$.

$$\begin{aligned} \hat{p}(\hat{V}_{jdt,l}, \hat{V}_{jd(t-1),l}) &= (nh_1h_2)^{-1} \sum_{i=2}^T k_1[h_1^{-1}(\hat{V}_{jdi,l} - \hat{V}_{jdt,l})]k_2[h_2^{-1}(\hat{V}_{jdi,l} - \hat{V}_{jd(t-1),l})] \\ \hat{p}(\hat{V}_{jdt,l}, \hat{V}_{j(t-1),l}) &= (nh_1^{p_1}h_2^{p_1})^{-1} \sum_{i=2}^T \prod_{d=1}^{p_1} k_1[h_1^{-1}(\hat{V}_{jdi,l} - \hat{V}_{jdt,l})]k_2[h_2^{-1}(\hat{V}_{jdi,l} - \hat{V}_{jd(t-1),l})] \end{aligned}$$

Form estimated density ratio $\hat{\phi}_{jt}$ with densities estimated in previous step.

$$\hat{\phi}_{jt} = \frac{\prod_{d=1}^{p_1} \hat{p}(\hat{V}_{jdt,d}, \hat{V}_{j(t-1),d})}{\hat{p}(\hat{V}_{jdt}, \hat{V}_{j(t-1)})} \quad \hat{\theta}_{jt,d} = \frac{\prod_{l \neq d}^{p_1} \hat{p}(\hat{V}_{jdt,l}, \hat{V}_{j(t-1),l})}{\hat{p}(\hat{V}_{jdt}, \hat{V}_{j(t-1)})}$$

H Function Estimation:

Now estimate the conditional expectation functions by a variation on a Nadaraya Watson estimation.

$$\hat{H}_{j,d}(\Delta Z_{jt,a}) = [(T-1)b_1b_2]^{-1} \sum_{l \neq t, l' > 1}^T k_1[b_1^{-1}(V_{jlt,d} - V_{jdt,d})]k_2[b_2^{-1}(V_{j(l-1),d} - V_{j(t-1),d})]\hat{\theta}_{jl,d}\Delta Z_{jl,a}$$

then construct

$$\hat{H}_j(\Delta Z_{jt}) = \sum_{d=1}^{p_1} \hat{H}_{jd}(\Delta Z_{jt}) \quad \hat{H}_j(\Delta Y_{jt}) = \sum_{d=1}^{p_1} \hat{H}_{jd}(\Delta Y_{jt})$$

where $\Delta Z_{jt} = [\Delta Z_{jt,1} \ \Delta Z_{jt,2} \ \cdots \ \Delta Z_{jt,(p_1+p_2)}]'$. Then construct the following vectors.

$$\begin{aligned} \hat{H}(\Delta Y_t) &= [\hat{H}_1(\Delta Y_{1t}) \ \hat{H}_2(\Delta Y_{2t}) \ \cdots \ \hat{H}_q(\Delta Y_{qt})]' \\ \hat{H}(\Delta Z_t) &= [\hat{H}_1(\Delta Z_{1t}) \ \hat{H}_2(\Delta Z_{2t}) \ \cdots \ \hat{H}_q(\Delta Z_{qt})]' \\ \Delta Z &= [\Delta Z'_2 \ \Delta Z'_3 \ \cdots \ \Delta Z'_T]' \\ \Delta Y &= [\Delta Y_2 \ \Delta Y_3 \ \cdots \ \Delta Y_T]' \\ \hat{H}(\Delta Z) &= [\hat{H}(\Delta Z_2)' \ \hat{H}(\Delta Z_3)' \ \cdots \ \hat{H}(\Delta Z_T)'] \end{aligned}$$

$$\hat{H}(\Delta Y) = [\hat{H}(\Delta Y_2) \ \hat{H}(\Delta Y_3) \ \cdots \ \hat{H}(\Delta Y_T)]$$

β_1 **Coefficient Estimation:**

Let $\hat{\phi} = \text{diag}(\{\hat{\phi}_t\}_{c+1}^T)$ and calculate $\hat{\beta}_1$ as follows,

$$\hat{\beta}_1 = \left([\Delta Z - \hat{H}(\Delta Z)]' \hat{\phi} [\Delta Z - \hat{H}(\Delta Z)] \right)^{-1} \left([\Delta Z - \hat{H}(\Delta Z)]' \hat{\phi} [\Delta Y - \hat{H}(\Delta Y)] \right)$$