

Econ 722 – Advanced Econometrics IV

Francis J. DiTraglia

University of Pennsylvania

Lecture #1 – Decision Theory

Statistical Decision Theory

The James-Stein Estimator

Decision Theoretic Preliminaries

Parameter $\theta \in \Theta$

Unknown state of nature, from parameter space Θ

Observed Data

Observe X with distribution F_θ from a sample space \mathcal{X}

Estimator $\hat{\theta}$

An estimator (aka a decision rule) is a function from \mathcal{X} to Θ

Loss Function $L(\theta, \hat{\theta})$

A function from $\Theta \times \Theta$ to \mathbb{R} that gives the cost we incur if we report $\hat{\theta}$ when the true state of nature is θ .

Examples of Loss Functions

$$L(\theta, \hat{\theta}) = (\theta - \hat{\theta})^2$$

squared error loss

$$L(\theta, \hat{\theta}) = |\theta - \hat{\theta}|$$

absolute error loss

$$L(\theta, \hat{\theta}) = 0 \text{ if } \theta = \hat{\theta}, 1 \text{ otherwise}$$

zero-one loss

$$L(\theta, \hat{\theta}) = \int \log \left[\frac{f(x|\theta)}{f(x|\hat{\theta})} \right] f(x|\theta) dx$$

Kullback–Leibler loss

(Frequentist) Risk of an Estimator $\hat{\theta}$

$$R(\theta, \hat{\theta}) = \mathbb{E}_{\theta} [L(\theta, \hat{\theta})] = \int L(\theta, \hat{\theta}(x)) dF_{\theta}(x)$$

The frequentist decision theorist seeks to evaluate, for each θ , how much he would “expect” to lose if he used $\hat{\theta}(X)$ repeatedly with varying X in the problem.

(Berger, 1985)

Example: Squared Error Loss

$$R(\theta, \hat{\theta}) = \mathbb{E}_{\theta} [(\theta - \hat{\theta})^2] = \text{MSE} = \text{Var}(\hat{\theta}) + \text{Bias}_{\theta}^2(\hat{\theta})$$

Bayes Risk and Maximum Risk

Comparing Risk

$R(\theta, \hat{\theta})$ is a *function* of θ rather than a single number. We want an estimator with low risk, but how can we compare?

Maximum Risk

$$\bar{R}(\hat{\theta}) = \sup_{\theta \in \Theta} R(\theta, \hat{\theta})$$

Bayes Risk

$$r(\pi, \hat{\theta}) = \mathbb{E}_{\pi} \left[R(\theta, \hat{\theta}) \right], \text{ where } \pi \text{ is a prior for } \theta$$

Bayes and Minimax Rules

Minimize the Maximum or Bayes risk over all estimators $\tilde{\theta}$

Minimax Rule/Estimator

$\hat{\theta}$ is **minimax** if

$$\sup_{\theta \in \Theta} R(\theta, \hat{\theta}) = \inf_{\tilde{\theta}} \sup_{\theta \in \Theta} R(\theta, \tilde{\theta})$$

Bayes Rule/Estimator

$\hat{\theta}$ is a **Bayes rule** with respect to prior π if

$$r(\pi, \hat{\theta}) = \inf_{\tilde{\theta}} r(\pi, \tilde{\theta})$$

Recall: Bayes' Theorem and Marginal Likelihood

Let π be a prior for θ . By Bayes' theorem, the **posterior** $\pi(\theta|\mathbf{x})$ is

$$\pi(\theta|\mathbf{x}) = \frac{f(\mathbf{x}|\theta)\pi(\theta)}{m(\mathbf{x})}$$

where the **marginal likelihood** $m(\mathbf{x})$ is given by

$$m(\mathbf{x}) = \int f(\mathbf{x}|\theta)\pi(\theta) d\theta$$

Posterior Expected Loss

Posterior Expected Loss

$$\rho(\pi(\theta|\mathbf{x}), \hat{\theta}) = \int L(\theta, \hat{\theta}) \pi(\theta|\mathbf{x}) d\theta$$

Bayesian Decision Theory

Choose an estimator that minimizes posterior expected loss.

Easier Calculation

Since $m(\mathbf{x})$ does not depend on θ , to minimize $\rho(\pi(\theta|\mathbf{x}), \hat{\theta})$ it suffices to minimize $\int L(\theta, \hat{\theta}) f(\mathbf{x}|\theta) \pi(\theta) d\theta$.

Question

Is there a relationship between Bayes risk, $r(\pi, \hat{\theta}) \equiv \mathbb{E}_{\pi}[R(\theta, \hat{\theta})]$, and posterior expected loss?

Bayes Risk vs. Posterior Expected Loss

Theorem

$$r(\pi, \hat{\theta}) = \int \rho(\pi(\theta|\mathbf{x}), \hat{\theta}(\mathbf{x})) m(\mathbf{x}) d\mathbf{x}$$

Proof

$$\begin{aligned} r(\pi, \hat{\theta}) &= \int R(\theta, \hat{\theta}) \pi(\theta) d\theta = \int \left[\int L(\theta, \hat{\theta}(\mathbf{x})) f(\mathbf{x}|\theta) d\mathbf{x} \right] \pi(\theta) d\theta \\ &= \int \int L(\theta, \hat{\theta}(\mathbf{x})) [f(\mathbf{x}|\theta) \pi(\theta)] d\mathbf{x} d\theta \\ &= \int \int L(\theta, \hat{\theta}(\mathbf{x})) [\pi(\theta|\mathbf{x}) m(\mathbf{x})] d\mathbf{x} d\theta \\ &= \int \left[\int L(\theta, \hat{\theta}(\mathbf{x})) \pi(\theta|\mathbf{x}) d\theta \right] m(\mathbf{x}) d\mathbf{x} \\ &= \int \rho(\pi(\theta|\mathbf{x}), \hat{\theta}(\mathbf{x})) m(\mathbf{x}) d\mathbf{x} \end{aligned}$$

Finding a Bayes Estimator

Hard Problem

Find the **function** $\hat{\theta}(\mathbf{x})$ that minimizes $r(\pi, \hat{\theta})$.

Easy Problem

Find the **number** $\hat{\theta}$ that minimizes $\rho(\pi(\theta|\mathbf{x}), \hat{\theta})$

Punchline

Since $r(\pi, \hat{\theta}) = \int \rho(\pi(\theta|\mathbf{x}), \hat{\theta}(\mathbf{x})) m(\mathbf{x}) d\mathbf{x}$, to minimize $r(\pi, \hat{\theta})$ we can set $\hat{\theta}(\mathbf{x})$ to be the value $\hat{\theta}$ that minimizes $\rho(\pi(\theta|\mathbf{x}), \hat{\theta})$.

Bayes Estimators for Common Loss Functions

Zero-one Loss

For zero-one loss, the Bayes estimator is the posterior mode.

Absolute Error Loss: $L(\theta, \hat{\theta}) = |\theta - \hat{\theta}|$

For absolute error loss, the Bayes estimator is the posterior median.

Squared Error Loss: $L(\theta, \hat{\theta}) = (\theta - \hat{\theta})^2$

For squared error loss, the Bayes estimator is the posterior mean.

Derivation of Bayes Estimator for Squared Error Loss

By definition,

$$\hat{\theta} \equiv \arg \min_{a \in \Theta} \int (\theta - a)^2 \pi(\theta | \mathbf{x}) d\theta$$

Differentiating with respect to a , we have

$$\begin{aligned} 2 \int (\theta - a) \pi(\theta | \mathbf{x}) d\theta &= 0 \\ \int \theta \pi(\theta | \mathbf{x}) d\theta &= a \end{aligned}$$

Example: Bayes Estimator for a Normal Mean

Suppose $X \sim N(\mu, 1)$ and π is a $N(a, b^2)$ prior. Then,

$$\begin{aligned}\pi(\mu|x) &\propto f(x|\mu) \times \pi(\mu) \\ &\propto \exp \left\{ -\frac{1}{2} \left[(x - \mu)^2 + \frac{1}{b^2} (\mu - a)^2 \right] \right\} \\ &\propto \exp \left\{ -\frac{1}{2} \left[\left(1 + \frac{1}{b^2} \right) \mu^2 - 2 \left(x + \frac{a}{b^2} \right) \mu \right] \right\} \\ &\propto \exp \left\{ -\frac{1}{2} \left(\frac{b^2 + 1}{b^2} \right) \left[\mu - \left(\frac{b^2 x + a}{b^2 + 1} \right) \right]^2 \right\}\end{aligned}$$

So $\pi(\mu|x)$ is $N(m, \omega^2)$ with $\omega^2 = \frac{b^2}{1+b^2}$ and $m = \omega^2 x + (1 - \omega^2)a$.

Hence the Bayes estimator for μ under squared error loss is

$$\hat{\theta}(X) = \frac{b^2 X + a}{1 + b^2}$$

Minimax Analysis

Wasserman (2004)

The advantage of using maximum risk, despite its problems, is that it does not require one to choose a prior.

Berger (1986)

Perhaps the greatest use of the minimax principle is in situations for which no prior information is available . . . but two notes of caution should be sounded. First, the minimax principle can lead to bad decision rules. . . Second, the minimax approach can be devilishly hard to implement.

Methods for Finding a Minimax Estimator

1. Direct Calculation
2. Guess a “Least Favorable” Prior
3. Search for an “Equalizer Rule”

Method 1 rarely applicable so focus on 2 and 3. . .

The Bayes Rule for a Least Favorable Prior is Minimax

Theorem

Let $\hat{\theta}$ be a Bayes rule with respect to π and suppose that for all $\theta \in \Theta$ we have $R(\theta, \hat{\theta}) \leq r(\pi, \hat{\theta})$. Then $\hat{\theta}$ is a **minimax estimator**, and π is called a **least favorable prior**.

Proof

Suppose that $\hat{\theta}$ is not minimax. Then there exists another estimator $\tilde{\theta}$ with $\sup_{\theta \in \Theta} R(\theta, \tilde{\theta}) < \sup_{\theta \in \Theta} R(\theta, \hat{\theta})$. But since

$$r(\pi, \tilde{\theta}) \equiv \mathbb{E}_{\pi} [R(\theta, \tilde{\theta})] \leq \mathbb{E}_{\pi} \left[\sup_{\theta \in \Theta} R(\theta, \tilde{\theta}) \right] = \sup_{\theta \in \Theta} R(\theta, \tilde{\theta})$$

but this implies that $\tilde{\theta}$ is *not* Bayes with respect to π since

$$r(\pi, \tilde{\theta}) \leq \sup_{\theta \in \Theta} R(\theta, \tilde{\theta}) < \sup_{\theta \in \Theta} R(\theta, \hat{\theta}) \leq r(\pi, \hat{\theta})$$

Example of Least Favorable Prior

Bounded Normal Mean

- ▶ $X \sim N(\theta, 1)$
- ▶ Squared error loss
- ▶ $\Theta = [-m, m]$ for $0 < m < 1$

Least Favorable Prior

$\pi(\theta) = 1/2$ for $\theta \in \{-m, m\}$, zero otherwise.

Resulting Bayes Rule is Minimax

$$\hat{\theta}(X) = m \tanh(mX) = m \left[\frac{\exp\{mX\} - \exp\{-mX\}}{\exp\{mX\} + \exp\{-mX\}} \right]$$

Equalizer Rules

Definition

An estimator $\hat{\theta}$ is called an **equalizer rule** if its risk function is constant: $R(\theta, \hat{\theta}) = C$ for some C .

Theorem

If $\hat{\theta}$ is an equalizer rule and is Bayes with respect to π , then $\hat{\theta}$ is **minimax** and π is **least favorable**.

Proof

$$r(\pi, \hat{\theta}) = \int R(\theta, \hat{\theta}) \pi(\theta) d\theta = \int C \pi(\theta) d\theta = C$$

Hence, $R(\theta, \hat{\theta}) \leq r(\pi, \hat{\theta})$ for all θ so we can apply the preceding theorem.

Example: $X_1, \dots, X_n \sim \text{iid Bernoulli}(p)$

Under a $\text{Beta}(\alpha, \beta)$ prior with $\alpha = \beta = \sqrt{n}/2$,

$$\hat{p}(\mathbf{x}) = \frac{n\bar{X} + \sqrt{n}/2}{n + \sqrt{n}}$$

is the Bayesian posterior mean, hence the Bayes rule under squared error loss. The risk function of \hat{p} is,

$$R(p, \hat{p}) = \frac{n}{4(n + \sqrt{n})^2}$$

which is constant in p . Hence, \hat{p} is an equalizer rule, and by the preceding theorem is minimax.

Problems with the Minimax Principle



In the left panel, $\tilde{\theta}$ is preferred by the minimax principle; in the right panel $\hat{\theta}$ is preferred. But the only difference between them is that the right panel adds an additional *fixed* loss of 1 for $1 \leq \theta \leq 2$.

Problems with the Minimax Principle

Suppose that $\Theta = \{\theta_1, \theta_2\}$, $\mathcal{A} = \{a_1, a_2\}$ and the loss function is:

	a_1	a_2
θ_1	10	10.01
θ_2	8	-8

- ▶ Minimax principle: choose a_1
- ▶ Bayes: Choose a_2 unless $\pi(\theta_1) > 0.9994$

Minimax ignores the fact that under θ_1 we can never do better than a loss of 10, and tries to prevent us from incurring a tiny additional loss of 0.01

Dominance and Admissibility

Dominance

$\hat{\theta}$ **dominates** $\tilde{\theta}$ with respect to R if $R(\theta, \hat{\theta}) \leq R(\theta, \tilde{\theta})$ for all $\theta \in \Theta$ and the inequality is strict for at least one value of θ .

Admissibility

$\hat{\theta}$ is **admissible** if no other estimator dominates it.

Inadmissibility

$\hat{\theta}$ is **inadmissible** if there is an estimator that dominates it.

Example of an Admissible Estimator

Say we want to estimate θ from $X \sim N(\theta, 1)$ under squared error loss. Is the estimator $\hat{\theta}(X) = 3$ admissible?

If not, then there is a $\tilde{\theta}$ with $R(\theta, \tilde{\theta}) \leq R(\theta, \hat{\theta})$ for all θ . Hence:

$$R(3, \tilde{\theta}) \leq R(3, \hat{\theta}) = \left\{ \mathbb{E} [\hat{\theta} - 3] \right\}^2 + \text{Var}(\hat{\theta}) = 0$$

Since R cannot be negative for squared error loss,

$$0 = R(3, \tilde{\theta}) = \left\{ \mathbb{E} [\tilde{\theta} - 3] \right\}^2 + \text{Var}(\tilde{\theta})$$

Therefore $\hat{\theta} = \tilde{\theta}$, so $\hat{\theta}$ is admissible, although very silly!

Bayes Rules are Admissible

Theorem A-1

Suppose that Θ is a discrete set and π gives strictly positive probability to each element of Θ . Then, if $\hat{\theta}$ is a Bayes rule with respect to π , it is admissible.

Theorem A-2

If a Bayes rule is unique, it is admissible.

Theorem A-3

Suppose that $R(\theta, \hat{\theta})$ is continuous in θ for all $\hat{\theta}$ and that π gives strictly positive probability to any open subset of Θ . Then if $\hat{\theta}$ is a Bayes rule with respect to π , it is admissible.

Admissible Equalizer Rules are Minimax

Theorem

Let $\hat{\theta}$ be an equalizer rule. Then if $\hat{\theta}$ is admissible, it is minimax.

Proof

Since $\hat{\theta}$ is an equalizer rule, $R(\theta, \hat{\theta}) = C$. Suppose that $\hat{\theta}$ is not minimax. Then there is a $\tilde{\theta}$ such that

$$\sup_{\theta \in \Theta} R(\theta, \tilde{\theta}) < \sup_{\theta \in \Theta} R(\theta, \hat{\theta}) = C$$

But for any θ , $R(\theta, \tilde{\theta}) \leq \sup_{\theta \in \Theta} R(\theta, \tilde{\theta})$. Thus we have shown that $\tilde{\theta}$ dominates $\hat{\theta}$, so that $\hat{\theta}$ cannot be admissible.

Minimax Implies “Nearly” Admissible

Strong Inadmissibility

We say that $\hat{\theta}$ is **strongly inadmissible** if there exists an estimator $\tilde{\theta}$ and an $\varepsilon > 0$ such that $R(\theta, \tilde{\theta}) < R(\theta, \hat{\theta}) - \varepsilon$ for all θ .

Theorem

If $\hat{\theta}$ is minimax, then it is **not** strongly inadmissible.

Example: Sample Mean, Unbounded Parameter Space

Theorem

Suppose that $X_1, \dots, X_n \sim N(\theta, 1)$ with $\Theta = \mathbb{R}$. Under squared error loss, one can show that $\hat{\theta} = \bar{X}$ is admissible.

Intuition

The proof is complicated, but effectively we view this estimator as a **limit** of a of Bayes estimator with prior $N(a, b^2)$, as $b^2 \rightarrow \infty$.

Minimaxity

Since $R(\theta, \bar{X}) = \text{Var}(\bar{X}) = 1/n$, we see that \bar{X} is an equalizer rule. Since it is admissible, it is therefore minimax.

Recall: Gauss-Markov Theorem

Linear Regression Model

$$\mathbf{y} = X\beta + \epsilon, \quad \mathbb{E}[\epsilon|X] = \mathbf{0}$$

Best Linear Unbiased Estimator

- ▶ $\text{Var}(\epsilon|X) = \sigma^2 I \Rightarrow$ then OLS has lowest variance among linear, unbiased estimators of β .
- ▶ $\text{Var}(\epsilon|X) \neq \sigma^2 I \Rightarrow$ then GLS gives a lower variance estimator.

What if we consider biased estimators and squared error loss?

Multiple Normal Means: $X \sim N(\theta, I)$

Goal

Estimate the p -vector θ using X with $L(\theta, \hat{\theta}) = \|\hat{\theta} - \theta\|^2$.

Maximum Likelihood Estimator $\hat{\theta}$

MLE = sample mean, but only one observation: $\hat{\theta} = X$.

Risk of $\hat{\theta}$

$$(\hat{\theta} - \theta)' (\hat{\theta} - \theta) = (X - \theta)' (X - \theta) = \sum_{i=1}^p (X_i - \theta_i)^2 \sim \chi_p^2$$

Since $\mathbb{E}[\chi_p^2] = p$, we have $R(\theta, \hat{\theta}) = p$.

Multiple Normal Means: $X \sim N(\theta, I)$

James-Stein Estimator

$$\hat{\theta}^{JS} = \hat{\theta} \left(1 - \frac{p-2}{\hat{\theta}'\hat{\theta}} \right) = X - \frac{(p-2)X}{X'X}$$

- ▶ Shrinks components of sample mean vector towards zero
- ▶ More elements in $\theta \Rightarrow$ more shrinkage
- ▶ MLE close to zero ($\hat{\theta}'\hat{\theta}$ small) gives more shrinkage

MSE of James-Stein Estimator

$$\begin{aligned}R(\theta, \hat{\theta}^{JS}) &= \mathbb{E} \left[(\hat{\theta}^{JS} - \theta)' (\hat{\theta}^{JS} - \theta) \right] \\&= \mathbb{E} \left[\left\{ (X - \theta) - \frac{(p-2)X}{X'X} \right\}' \left\{ (X - \theta) - \frac{(p-2)X}{X'X} \right\} \right] \\&= \mathbb{E} [(X - \theta)' (X - \theta)] - 2(p-2) \mathbb{E} \left[\frac{X'(X - \theta)}{X'X} \right] \\&\quad + (p-2)^2 \mathbb{E} \left[\frac{1}{X'X} \right] \\&= p - 2(p-2) \mathbb{E} \left[\frac{X'(X - \theta)}{X'X} \right] + (p-2)^2 \mathbb{E} \left[\frac{1}{X'X} \right]\end{aligned}$$

Using fact that $R(\theta, \hat{\theta}) = p$

Simplifying the Second Term

Writing Numerator as a Sum

$$\mathbb{E} \left[\frac{X'(X - \theta)}{X'X} \right] = \mathbb{E} \left[\frac{\sum_{i=1}^p X_i (X_i - \theta_i)}{X'X} \right] = \sum_{i=1}^p \mathbb{E} \left[\frac{X_i (X_i - \theta_i)}{X'X} \right]$$

For $i = 1, \dots, p$

$$\mathbb{E} \left[\frac{X_i (X_i - \theta_i)}{X'X} \right] = \mathbb{E} \left[\frac{X'X - 2X_i^2}{(X'X)^2} \right]$$

Not obvious: integration by parts, expectation as a p -fold integral, $X \sim N(\theta, I)$

Combining

$$\begin{aligned} \mathbb{E} \left[\frac{X'(X - \theta)}{X'X} \right] &= \sum_{i=1}^p \mathbb{E} \left[\frac{X'X - 2X_i^2}{(X'X)^2} \right] = p \mathbb{E} \left[\frac{1}{X'X} \right] - 2 \mathbb{E} \left[\frac{\sum_{i=1}^p X_i^2}{(X'X)^2} \right] \\ &= p \mathbb{E} \left[\frac{1}{X'X} \right] - 2 \mathbb{E} \left[\frac{X'X}{(X'X)^2} \right] = (p - 2) \mathbb{E} \left[\frac{1}{X'X} \right] \end{aligned}$$

The MLE is Inadmissible when $p \geq 3$

$$\begin{aligned} R\left(\theta, \hat{\theta}^{JS}\right) &= p - 2(p-2) \left\{ (p-2) \mathbb{E} \left[\frac{1}{X'X} \right] \right\} + (p-2)^2 \mathbb{E} \left[\frac{1}{X'X} \right] \\ &= p - (p-2)^2 \mathbb{E} \left[\frac{1}{X'X} \right] \end{aligned}$$

- ▶ $\mathbb{E}[1/(X'X)]$ exists and is positive whenever $p \geq 3$
- ▶ $(p-2)^2$ is always positive
- ▶ Hence, second term in the MSE expression is *negative*
- ▶ First term is MSE of the MLE

Therefore James-Stein strictly dominates MLE whenever $p \geq 3$!

James-Stein More Generally

- ▶ Our example was specific, but the result is general:
 - ▶ MLE is inadmissible under quadratic loss in regression model with at least three regressors.
 - ▶ Note, however, that this is MSE for the *full parameter vector*
- ▶ James-Stein estimator is also inadmissible!
 - ▶ Dominated by “positive-part” James-Stein estimator:

$$\hat{\beta}^{JS} = \hat{\beta} \left[1 - \frac{(p-2)\hat{\sigma}^2}{\hat{\beta}'X'X\hat{\beta}} \right]_+$$

- ▶ $\hat{\beta} = \text{OLS}$, $(x)_+ = \max(x, 0)$, $\hat{\sigma}^2 = \text{usual OLS-based estimator}$
- ▶ Stops us from shrinking *past* zero to get a negative estimate for an element of β with a small OLS estimate.
- ▶ Positive-part James-Stein isn't admissible either!

Lecture #2 – Model Selection I

Kullback-Leibler Divergence

Bias of Maximized Sample Log-Likelihood

Review of Asymptotics for Mis-specified MLE

Deriving AIC and TIC

Corrected AIC (AIC_c)

Mallow's C_p

Kullback-Leibler (KL) Divergence

Motivation

How well does a given density $f(y)$ approximate an unknown true density $g(y)$? Use this to select between parametric models.

Definition

$$\text{KL}(g; f) = \underbrace{\mathbb{E}_G \left[\log \left\{ \frac{g(Y)}{f(Y)} \right\} \right]}_{\text{True density on top}} = \underbrace{\mathbb{E}_G [\log g(Y)]}_{\substack{\text{Depends only on truth} \\ \text{Fixed across models}}} - \underbrace{\mathbb{E}_G [\log f(Y)]}_{\text{Expected log-likelihood}}$$

Properties

- ▶ Not symmetric: $\text{KL}(g; f) \neq \text{KL}(f; g)$
- ▶ By Jensen's Inequality: $\text{KL}(g; f) \geq 0$ (strict iff $g = f$ a.e.)
- ▶ Minimize KL \iff Maximize Expected log-likelihood

KL Divergence and Mis-specified MLE

Pseudo-true Parameter Value θ_0

$$\hat{\theta}_{MLE} \xrightarrow{P} \theta_0 \equiv \arg \min_{\theta \in \Theta} \text{KL}(g; f_{\theta}) = \arg \max_{\theta \in \Theta} \mathbb{E}_G[\log f(Y|\theta)]$$

What if f_{θ} is correctly specified?

If $g = f_{\theta}$ for some θ then $\text{KL}(g; f_{\theta})$ is minimized at zero.

Goal: Compare Mis-specified Models

$$\mathbb{E}_G [\log f(Y|\theta_0)] \quad \text{versus} \quad \mathbb{E}_G [\log h(Y|\gamma_0)]$$

where θ_0 is the pseudo-true parameter value for f_{θ} and γ_0 is the pseudo-true parameter value for h_{γ} .

How to Estimate Expected Log Likelihood?

For simplicity: $Y_1, \dots, Y_n \sim \text{iid } g(y)$

Unbiased but Infeasible

$$\mathbb{E}_G \left[\frac{1}{T} \ell(\theta_0) \right] = \mathbb{E}_G \left[\frac{1}{T} \sum_{t=1}^T \log f(Y_t | \theta_0) \right] = \mathbb{E}_G [\log f(Y | \theta_0)]$$

Biased but Feasible

$T^{-1} \ell(\hat{\theta}_{MLE})$ is a **biased** estimator of $\mathbb{E}_G[\log f(Y | \theta_0)]$.

Intuition for the Bias

$T^{-1} \ell(\hat{\theta}_{MLE}) > T^{-1} \ell(\theta_0)$ unless $\hat{\theta}_{MLE} = \theta_0$. Maximized sample log-like. is an **overly optimistic** estimator of expected log-like.

What to do about this bias?

1. General-purpose asymptotic approximation of “degree of over-optimism” of maximized sample log-likelihood.
 - ▶ Takeuchi's Information Criterion (TIC)
 - ▶ Akaike's Information Criterion (AIC)
2. Problem-specific finite sample approach, assuming $g \in f_\theta$.
 - ▶ Corrected AIC (AIC_c) of Hurvich and Tsai (1989)

Tradeoffs

TIC is most general and makes weakest assumptions, but requires very large T to work well. AIC is a good approximation to TIC that requires less data. Both AIC and TIC perform poorly when T is small relative to the number of parameters, hence AIC_c .

Recall: Asymptotics for Mis-specified ML Estimation

Model $f(y|\theta)$, pseudo-true parameter θ_0 . For simplicity $Y_1, \dots, Y_T \sim \text{iid } g(y)$.

Fundamental Expansion

$$\sqrt{T}(\hat{\theta} - \theta_0) = J^{-1} \left(\sqrt{T} \bar{U}_T \right) + o_p(1)$$

$$J = -\mathbb{E}_G \left[\frac{\partial \log f(Y|\theta_0)}{\partial \theta \partial \theta'} \right], \quad \bar{U}_T = \frac{1}{T} \sum_{t=1}^T \frac{\partial \log f(Y_t|\theta_0)}{\partial \theta}$$

Central Limit Theorem

$$\sqrt{T} \bar{U}_T \rightarrow_d U \sim N_p(0, K), \quad K = \text{Var}_G \left[\frac{\partial \log f(Y|\theta_0)}{\partial \theta} \right]$$

$$\sqrt{T}(\hat{\theta} - \theta_0) \rightarrow_d J^{-1} U \sim N_p(0, J^{-1} K J^{-1})$$

Information Matrix Equality

If $g = f_\theta$ for some $\theta \in \Theta$ then $K = J \implies \text{AVAR}(\hat{\theta}) = J^{-1}$

Bias Relative to Infeasible Plug-in Estimator

Definition of Bias Term B

$$B = \underbrace{\frac{1}{T} \ell(\hat{\theta})}_{\text{feasible over-optimistic}} - \underbrace{\int g(y) \log f(y|\hat{\theta}) dy}_{\text{uses data only once infeas. not over-optimistic}}$$

Question to Answer

On average, over the sampling distribution of $\hat{\theta}$, how large is B ?

AIC and TIC construct an asymptotic approximation of $\mathbb{E}[B]$.

Derivation of AIC/TIC

Step 1: Taylor Expansion

$$B = \bar{Z}_T + (\hat{\theta} - \theta_0)' J(\hat{\theta} - \theta_0) + o_p(T^{-1})$$

$$\bar{Z}_T = \frac{1}{T} \sum_{t=1}^T \{\log f(Y_t|\theta_0) - \mathbb{E}_G[\log f(Y|\theta_0)]\}$$

Step 2: $\mathbb{E}[\bar{Z}_T] = 0$

$$\mathbb{E}[B] \approx \mathbb{E} \left[(\hat{\theta} - \theta_0)' J(\hat{\theta} - \theta_0) \right]$$

Step 3: $\sqrt{T}(\hat{\theta} - \theta_0) \rightarrow_d J^{-1}U$

$$T(\hat{\theta} - \theta_0)' J(\hat{\theta} - \theta_0) \rightarrow_d U' J^{-1}U$$

Derivation of AIC/TIC Continued...

Step 3: $\sqrt{T}(\hat{\theta} - \theta_0) \rightarrow_d J^{-1}U$

$$T(\hat{\theta} - \theta_0)'J(\hat{\theta} - \theta_0) \rightarrow_d U'J^{-1}U$$

Step 4: $U \sim N_p(0, K)$

$$\mathbb{E}[B] \approx \frac{1}{T}\mathbb{E}[U'J^{-1}U] = \frac{1}{T}\text{tr}\{J^{-1}K\}$$

Final Result:

$T^{-1}\text{tr}\{J^{-1}K\}$ is an asymp. unbiased estimator of the over-optimism of $T^{-1}\ell(\hat{\theta})$ relative to $\int g(y) \log f(y|\hat{\theta}) dy$.

TIC and AIC

Takeuchi's Information Criterion

Multiply by $2T$, estimate $J, K \Rightarrow \text{TIC} = 2 \left[\ell(\hat{\theta}) - \text{tr} \left\{ \hat{J}^{-1} \hat{K} \right\} \right]$

Akaike's Information Criterion

If $g = f_{\theta}$ then $J = K \Rightarrow \text{tr} \{ J^{-1} K \} = p \Rightarrow \text{AIC} = 2 \left[\ell(\hat{\theta}) - p \right]$

Contrasting AIC and TIC

Technically, AIC requires that all models under consideration are at least correctly specified while TIC doesn't. But $J^{-1}K$ is hard to estimate, and if a model is badly mis-specified, $\ell(\hat{\theta})$ dominates.

Corrected AIC (AIC_c) – Hurvich & Tsai (1989)

Idea Behind AIC_c

Asymptotic approximation used for AIC/TIC works poorly if p is too large relative to T . Try exact, finite-sample approach instead.

Assumption: True DGP

$$\mathbf{y} = \mathbf{X}\beta_0 + \varepsilon, \quad \varepsilon \sim N(\mathbf{0}, \sigma_0^2 \mathbf{I}_T), \quad k \text{ Regressors}$$

Can Show That

$$KL(g, f) = \frac{T}{2} \left[\frac{\sigma_0^2}{\sigma_1^2} - \log \left(\frac{\sigma_0^2}{\sigma_1^2} \right) - 1 \right] + \left(\frac{1}{2\sigma_1^2} \right) (\beta_0 - \beta_1)' \mathbf{X}' \mathbf{X} (\beta_0 - \beta_1)$$

Where f is a normal regression model with parameters (β_1, σ_1^2) that might not be the true parameters.

But how can we use this?

$$KL(g, f) = \frac{T}{2} \left[\frac{\sigma_0^2}{\sigma_1^2} - \log \left(\frac{\sigma_0^2}{\sigma_1^2} \right) - 1 \right] + \left(\frac{1}{2\sigma_1^2} \right) (\beta_0 - \beta_1)' \mathbf{X}' \mathbf{X} (\beta_0 - \beta_1)$$

1. Would need to know (β_1, σ_1^2) for **candidate model**.
 - ▶ Easy: just use MLE $(\hat{\beta}_1, \hat{\sigma}_1^2)$
2. Would need to know (β_0, σ_0^2) for **true model**.
 - ▶ Very hard! The whole problem is that we don't know these!

Hurvich & Tsai (1989) Assume:

- ▶ Every candidate model is **at least correctly specified**
- ▶ Implies any candidate estimator $(\hat{\beta}, \hat{\sigma}^2)$ is consistent for truth.

Deriving the Corrected AIC

Since $(\hat{\beta}, \hat{\sigma}^2)$ are random, look at $\mathbb{E}[\widehat{KL}]$, where

$$\widehat{KL} = \frac{T}{2} \left[\frac{\sigma_0^2}{\hat{\sigma}^2} - \log \left(\frac{\sigma_0^2}{\hat{\sigma}^2} \right) - 1 \right] + \left(\frac{1}{2\hat{\sigma}^2} \right) (\hat{\beta} - \beta_0)' \mathbf{X}' \mathbf{X} (\hat{\beta} - \beta_0)$$

Finite-sample theory for correctly spec. normal regression model:

$$\mathbb{E}[\widehat{KL}] = \frac{T}{2} \left\{ \frac{T+k}{T-k-2} - \log(\sigma_0^2) + \mathbb{E}[\log \hat{\sigma}^2] - 1 \right\}$$

Eliminate constants and scaling, unbiased estimator of $\mathbb{E}[\log \hat{\sigma}^2]$:

$$\text{AIC}_c = \log \hat{\sigma}^2 + \frac{T+k}{T-k-2}$$

a finite-sample unbiased estimator of KL for model comparison

Motivation: Predict \mathbf{y} from \mathbf{x} via Linear Regression

$$\underset{(T \times 1)}{\mathbf{y}} = \underset{(T \times K)}{\mathbf{X}} \underset{(K \times 1)}{\boldsymbol{\beta}} + \boldsymbol{\epsilon}$$

$$\mathbb{E}[\boldsymbol{\epsilon}|\mathbf{X}] = 0, \quad \text{Var}(\boldsymbol{\epsilon}|\mathbf{X}) = \sigma^2 \mathbf{I}$$

- ▶ If $\boldsymbol{\beta}$ were known, could never achieve lower MSE than by using all regressors to predict.
- ▶ But $\boldsymbol{\beta}$ is unknown so we have to estimate it from data \Rightarrow bias-variance tradeoff.
- ▶ Could make sense to exclude regressors with small coefficients: add small bias but reduce variance.

Operationalizing the Bias-Variance Tradeoff Idea

Mallow's C_p

Approximate the predictive MSE of each model relative to the infeasible optimum in which β is known.

Notation

- ▶ Model index m and regressor matrix \mathbf{X}_m
- ▶ Corresponding OLS estimator $\hat{\beta}_m$ padded out with zeros
- ▶ $\mathbf{X}\hat{\beta}_m = \mathbf{X}_{(-m)}\mathbf{0} + \mathbf{X}_m [(\mathbf{X}_m'\mathbf{X}_m)^{-1}\mathbf{X}_m'\mathbf{y}] = \mathbf{P}_m\mathbf{y}$

In-sample versus Out-of-sample Prediction Error

Why not compare $RSS(m)$?

In-sample prediction error: $RSS(m) = (\mathbf{y} - \mathbf{X}\hat{\boldsymbol{\beta}}_m)'(\mathbf{y} - \mathbf{X}\hat{\boldsymbol{\beta}}_m)$

From your Problem Set

RSS cannot decrease even if we add irrelevant regressors. Thus in-sample prediction error is an **overly optimistic** estimate of out-of-sample prediction error.

Bias-Variance Tradeoff

Out-of-sample performance of full model (using all regressors) could be very poor if there is a lot of estimation uncertainty associated with regressors that aren't very predictive.

Predictive MSE of $\mathbf{X}\hat{\boldsymbol{\beta}}_m$ relative to infeasible optimum $\mathbf{X}\boldsymbol{\beta}$

Step 1: Algebra

$$\begin{aligned}\mathbf{X}\hat{\boldsymbol{\beta}}_m - \mathbf{X}\boldsymbol{\beta} &= \mathbf{P}_m\mathbf{y} - \mathbf{X}\boldsymbol{\beta} = \mathbf{P}_m(\mathbf{y} - \mathbf{X}\boldsymbol{\beta}) - (\mathbf{I} - \mathbf{P}_m)\mathbf{X}\boldsymbol{\beta} \\ &= \mathbf{P}_m\boldsymbol{\epsilon} - (\mathbf{I} - \mathbf{P}_m)\mathbf{X}\boldsymbol{\beta}\end{aligned}$$

Step 2: \mathbf{P}_m and $(\mathbf{I} - \mathbf{P}_m)$ are both symmetric and idempotent, and orthogonal to each other

$$\begin{aligned}\left\|\mathbf{X}\hat{\boldsymbol{\beta}}_m - \mathbf{X}\boldsymbol{\beta}\right\|^2 &= \{\mathbf{P}_m\boldsymbol{\epsilon} - (\mathbf{I} - \mathbf{P}_m)\mathbf{X}\boldsymbol{\beta}\}' \{\mathbf{P}_m\boldsymbol{\epsilon} + (\mathbf{I} - \mathbf{P}_m)\mathbf{X}\boldsymbol{\beta}\} \\ &= \boldsymbol{\epsilon}'\mathbf{P}_m'\mathbf{P}_m\boldsymbol{\epsilon} - \boldsymbol{\beta}'\mathbf{X}'(\mathbf{I} - \mathbf{P}_m)'\mathbf{P}_m\boldsymbol{\epsilon} - \boldsymbol{\epsilon}'\mathbf{P}_m'(\mathbf{I} - \mathbf{P}_m)\mathbf{X}\boldsymbol{\beta} \\ &\quad + \boldsymbol{\beta}'\mathbf{X}'(\mathbf{I} - \mathbf{P}_m)(\mathbf{I} - \mathbf{P}_m)\mathbf{X}\boldsymbol{\beta} \\ &= \boldsymbol{\epsilon}'\mathbf{P}_m\boldsymbol{\epsilon} + \boldsymbol{\beta}'\mathbf{X}'(\mathbf{I} - \mathbf{P}_m)\mathbf{X}\boldsymbol{\beta}\end{aligned}$$

Predictive MSE of $\mathbf{X}\hat{\boldsymbol{\beta}}_m$ relative to infeasible optimum $\mathbf{X}\boldsymbol{\beta}$

Step 3: Expectation of Step 2 conditional on \mathbf{X}

$$\begin{aligned}\text{MSE}(m|\mathbf{X}) &= \mathbb{E} \left[(\mathbf{X}\hat{\boldsymbol{\beta}}_m - \mathbf{X}\boldsymbol{\beta})' (\mathbf{X}\hat{\boldsymbol{\beta}}_m - \mathbf{X}\boldsymbol{\beta}) | \mathbf{X} \right] \\ &= \mathbb{E} \left[\boldsymbol{\epsilon}' \mathbf{P}_m \boldsymbol{\epsilon} | \mathbf{X} \right] + \mathbb{E} \left[\boldsymbol{\beta}' \mathbf{X}' (\mathbf{I} - \mathbf{P}_m) \mathbf{X} \boldsymbol{\beta} | \mathbf{X} \right] \\ &= \mathbb{E} \left[\text{tr} \left\{ \boldsymbol{\epsilon}' \mathbf{P}_m \boldsymbol{\epsilon} \right\} | \mathbf{X} \right] + \boldsymbol{\beta}' \mathbf{X}' (\mathbf{I} - \mathbf{P}_m) \mathbf{X} \boldsymbol{\beta} \\ &= \text{tr} \left\{ \mathbb{E} [\boldsymbol{\epsilon} \boldsymbol{\epsilon}' | \mathbf{X}] \mathbf{P}_m \right\} + \boldsymbol{\beta}' \mathbf{X}' (\mathbf{I} - \mathbf{P}_m) \mathbf{X} \boldsymbol{\beta} \\ &= \text{tr} \left\{ \sigma^2 \mathbf{P}_m \right\} + \boldsymbol{\beta}' \mathbf{X}' (\mathbf{I} - \mathbf{P}_m) \mathbf{X} \boldsymbol{\beta} \\ &= \sigma^2 k_m + \boldsymbol{\beta}' \mathbf{X}' (\mathbf{I} - \mathbf{P}_m) \mathbf{X} \boldsymbol{\beta}\end{aligned}$$

where k_m denotes the number of regressors in \mathbf{X}_m and

$$\text{tr}(\mathbf{P}_m) = \text{tr} \left\{ \mathbf{X}_m (\mathbf{X}_m' \mathbf{X}_m)^{-1} \mathbf{X}_m' \right\} = \text{tr} \left\{ \mathbf{X}_m' \mathbf{X}_m (\mathbf{X}_m' \mathbf{X}_m)^{-1} \right\} = \text{tr}(\mathbf{I}_m)$$

Now we know the MSE of a given model...

$$\text{MSE}(m|\mathbf{X}) = \sigma^2 k_m + \beta' \mathbf{X}' (\mathbf{I} - \mathbf{P}_m) \mathbf{X} \beta$$

Bias-Variance Tradeoff

- ▶ Smaller Model $\Rightarrow \sigma^2 k_m$ smaller: less estimation uncertainty.
- ▶ Bigger Model $\Rightarrow \mathbf{X}' (\mathbf{I} - \mathbf{P}_m) \mathbf{X} = \|(\mathbf{I} - \mathbf{P}_m) \mathbf{X}\|^2$ is in general smaller: less (squared) bias.

Mallow's C_p

- ▶ Problem: MSE formula is infeasible since it involves β and σ^2 .
- ▶ Solution: Mallow's C_p constructs an unbiased estimator.
- ▶ Idea: what about plugging in $\hat{\beta}$ to estimate second term?

What if we plug in $\hat{\beta}$ to estimate the second term?

For the missing algebra in Step 4, see the lecture notes.

Notation

Let $\hat{\beta}$ denote the full model estimator and \mathbf{P} be the corresponding projection matrix: $\mathbf{X}\hat{\beta} = \mathbf{P}\mathbf{y}$.

Crucial Fact

$\text{span}(\mathbf{X}_m)$ is a subspace of $\text{span}(\mathbf{X})$, so $\mathbf{P}_m\mathbf{P} = \mathbf{P}\mathbf{P}_m = \mathbf{P}_m$.

Step 4: Algebra using the preceding fact

$$\mathbb{E} \left[\hat{\beta}' \mathbf{X}' (\mathbf{I} - \mathbf{P}_m) \mathbf{X} \hat{\beta} | \mathbf{X} \right] = \dots = \beta' \mathbf{X}' (\mathbf{I} - \mathbf{P}_m) \mathbf{X} \beta + \mathbb{E} \left[\epsilon' (\mathbf{P} - \mathbf{P}_m) \epsilon | \mathbf{X} \right]$$

Substituting $\hat{\beta}$ doesn't work...

Step 5: Use “Trace Trick” on second term from Step 4

$$\begin{aligned}\mathbb{E}[\epsilon'(\mathbf{P} - \mathbf{P}_m)\epsilon|\mathbf{X}] &= \mathbb{E}[\text{tr}\{\epsilon'(\mathbf{P} - \mathbf{P}_m)\epsilon\}|\mathbf{X}] \\&= \text{tr}\{\mathbb{E}[\epsilon\epsilon'|\mathbf{X}](\mathbf{P} - \mathbf{P}_m)\} \\&= \text{tr}\{\sigma^2(\mathbf{P} - \mathbf{P}_m)\} \\&= \sigma^2(\text{trace}\{\mathbf{P}\} - \text{trace}\{\mathbf{P}_m\}) \\&= \sigma^2(K - k_m)\end{aligned}$$

where K is the total number of regressors in \mathbf{X}

Bias of Plug-in Estimator

$$\mathbb{E}\left[\hat{\beta}'\mathbf{X}'(\mathbf{I} - \mathbf{P}_m)\mathbf{X}\hat{\beta}|\mathbf{X}\right] = \underbrace{\beta'\mathbf{X}'(\mathbf{I} - \mathbf{P}_m)\mathbf{X}\beta}_{\text{Truth}} + \underbrace{\sigma^2(K - k_m)}_{\text{Bias}}$$

Putting Everything Together: Mallows's C_p

Want An Unbiased Estimator of This:

$$\text{MSE}(m|\mathbf{X}) = \sigma^2 k_m + \boldsymbol{\beta}' \mathbf{X}' (\mathbf{I} - \mathbf{P}_m) \mathbf{X} \boldsymbol{\beta}$$

Previous Slide:

$$\mathbb{E} \left[\hat{\boldsymbol{\beta}}' \mathbf{X}' (\mathbf{I} - \mathbf{P}_m) \mathbf{X} \hat{\boldsymbol{\beta}} | \mathbf{X} \right] = \boldsymbol{\beta}' \mathbf{X}' (\mathbf{I} - \mathbf{P}_m) \mathbf{X} \boldsymbol{\beta} + \sigma^2 (K - k_m)$$

End Result:

$$\begin{aligned} \text{MC}(m) &= \hat{\sigma}^2 k_m + \left[\hat{\boldsymbol{\beta}}' \mathbf{X}' (\mathbf{I} - \mathbf{P}_m) \mathbf{X} \hat{\boldsymbol{\beta}} - \hat{\sigma}^2 (K - k_m) \right] \\ &= \hat{\boldsymbol{\beta}}' \mathbf{X}' (\mathbf{I} - \mathbf{P}_m) \mathbf{X} \hat{\boldsymbol{\beta}} + \hat{\sigma}^2 (2k_m - K) \end{aligned}$$

is an unbiased estimator of MSE, with $\hat{\sigma}^2 = \mathbf{y}'(\mathbf{I} - \mathbf{P})\mathbf{y}/(T - K)$

Why is this different from the textbook formula?

Just algebra, but tedious. . .

$$\begin{aligned}\text{MC}(m) - 2\hat{\sigma}^2 k_m &= \hat{\beta}' X' (\mathbf{I} - P_M) X \hat{\beta} - K \hat{\sigma}^2 \\ &\vdots \\ &= \mathbf{y}' (\mathbf{I} - P_M) \mathbf{y} - T \hat{\sigma}^2 \\ &= \text{RSS}(m) - T \hat{\sigma}^2\end{aligned}$$

Therefore:

$$\text{MC}(m) = \text{RSS}(m) + \hat{\sigma}^2(2k_m - T)$$

Divide Through by $\hat{\sigma}^2$:

$$C_p(m) = \frac{\text{RSS}(m)}{\hat{\sigma}^2} + 2k_m - T$$

Tells us how to adjust RSS for number of regressors. . .