

Problem Set 3: Instrumental Variables and Regression Discontinuity

The empirical portion of this problem set is based on the paper: *Does Hazardous Waste Matter? Evidence from the Housing Market and the Superfund Program* (Greenstone and Gallagher 2008). A copy of the paper can be found at: <http://econ-www.mit.edu/faculty/mgreenst/papers> (although it shouldn't be necessary to read the paper to complete this problem set).

The goal of the paper is to test the Market Willingness to Pay (WTP) for hazardous waste site cleanup using housing prices. Specifically, the paper is interested in observing how housing prices respond to changes in local environmental quality (and the associated health risks). The analysis uses a hedonic property value model which assumes that a single housing price can be thought of as the sum of prices for all of the housing and neighborhood characteristics. That is, holding all housing and neighborhood characteristics constant, if one were to add a 2-car garage onto a house, then the market price of the house will increase by an amount equal to how much the marginal consumer values the added garage. In the case of an environmental “bad”, such as living in close proximity to a hazardous waste site, one would expect that the market price of nearby housing would increase if the hazardous waste site were cleaned up (all else equal). This problem set will give you a chance to test this hypothesis.

You will use 4 different data files in your analysis. Three of the data files (allsites.dta, allcovariates.dta, and sitecovariates.dta) will be used in part (1)

of this question for background analysis. The 4th file (2miledata.dta) will be used for most of the empirical analysis. The variables in the files should be clear from either their names or their labels.

The unit of observation in all data files is a US Census Tract (roughly 4,000 people and 1,000 housing units). There are roughly 65,000 US Census Tracts. Those census tracts with missing property value housing data were dropped. All of the census tract housing data are from the 1970-2000 Decennial Censuses. We are most interested in the change in housing values between 1980 and 2000. To simplify matters for the purposes of this problem set we only include 1980 housing characteristics and property values from 1980 and 2000. The paper compares the evolution of housing prices between census tracts where hazardous waste sites were and were not cleaned up. The paper also looks at distances around the hazardous waste site (e.g. 1-4 miles) and uses the average housing values in concentric circles (of 1-4 miles) as the dependent variable. In this paper most of the analysis will focus on a data file using the “2 mile” sample.

The variation in environmental quality comes from US EPA’s Superfund Program. The goal of the Superfund program is to cleanup the country’s worst hazardous waste sites. There is a process for identifying the worst sites which includes a site assessment and 2 levels of site inspection (where soil and water samples are taken). If a site is among the most polluted or dangerous then scientists apply the Hazardous Ranking System (HRS) test on the site. Those sites that receive an HRS test are thought to be the worst

of the worst (less than 1% receive a test). The test is a way to get a composite score for the site. Those sites that pass a certain score threshold (28.5 out of 100) are placed on the “National Priorities List” (NPL). Once on the NPL the site is legally obligated to be cleaned up. We will abstract from hazardous waste site characteristics for the purpose of this problem set.

The important thing to note is that the HRS score provides a potential opportunity to apply a Regression Discontinuity research design. The Superfund program began in 1980. The first sites were tested using the HRS in 1982 and those sites that scored above 28.5 were the first sites listed on the NPL in 1983. One variable we focus on is whether a census tract contains a hazardous waste site listed on the NPL by year 2000. You can think of the list of NPL 2000 sites as representing some weighted combination of those sites that are slated for cleanup (where site cleanups are in different stages of completion including some that were not started as of 2000).

1. This question asks you to run OLS regressions that look at whether there is an association between 2000 housing values and whether a census tract contained a hazardous waste site that was placed on the NPL by 2000.
 - (a) Use the file `allsites.dta`. This file contains only own tract housing variables (i.e. no 2 mile averages). Use “robust” standard errors for all regressions. First regress 2000 housing prices on whether the census tract had an NPL site in 2000. Include 1980 housing values

as a control. Next add housing characteristics as controls. Run a third regression adding economic and demographic variables as controls. Finally run a 4th regression that also includes state fixed effects. Briefly interpret the regressions. Under what conditions will the coefficients on NPL 2000 status be unbiased?

- (b) Here we will compare covariates between potential treatment and comparison groups. First, use `allcovariates.dta` to compare covariates (i.e. those used in the above regressions) between census tracts with and without a hazardous waste site listed on the NPL by 2000. Next, use `sitecovariates.dta` to compare covariates between those census tracts with a hazardous waste site that had an HRS test in 1982. Specifically, compare those with sites that scored above 28.5 to those that scored below 28.5. Finally, compare those census tracts with sites between 16.5 and 28.5 to census tracts with sites between 28.5 and 40.5. What conclusions do you draw from these 3 comparisons?

2. This question examines the possibility of using a Regression Discontinuity research design. Note that the rest of the empirical question will use the file `2miledata.dta`. The housing variables in this file are 2 mile averages.

- (a) Consider the HRS score as the running variable for an RD research design. What assumptions are needed on the HRS score? How do

each of the following “facts” impact the appropriateness of these assumptions:

- i. The EPA assertion that “the 28.5 cutoff was selected because it produced a manageable number of sites.”
 - ii. None of the individuals involved in identifying the site, testing the level of pollution, or running the 1982 HRS test knew the cutoff threshold score.
 - iii. EPA documentation emphasizes that the HRS test is an imperfect scoring measure.
 - (b) Create a histogram of the distribution (i.e. density) of the 1982 HRS scores by dividing the HRS score into non-overlapping bins. Include a vertical line at 28.5. Next, run local linear regressions on either side of 28.5 using the midpoints of the bins as the data. What do you conclude?
3. This question examines the 1st stage equation of an RD design using the 1982 HRS score.
- (a) Use a 2SLS (IV) econometric setup that uses whether or not a census tract has a site scoring above/below 28.5 as the instrument. Write down the 1st stage equation. Run the 1st stage regression experimenting with the same set of covariates used in question (1). In addition, run a second specification in which you limit the sample to only those census tracts with sites between 16.5 and

40.5 and run the specification using all of the control variables (we will use this as the size of the bandwidth for the “regression discontinuity” regression). Interpret the results.

(b) Create a graph plotting the the 1982 HRS score against whether a site is listed on the NPL by year 2000 (NPL on the y -axis, HRS on the x -axis). Briefly explain and interpret this graph.

(c) Create a graph that plots the 1982 HRS score against 1980 property values (property values on the y -axis, HRS on the x -axis). What do you conclude from this graph?

4. Write down the 2nd stage equation (with housing values as the outcome) and the 2 standard assumptions for valid IV estimation. Run 2SLS to get the estimated coefficient on 2000 NPL status. Run the same two specifications as in the previous question. Briefly interpret the results.
5. Write a 1 paragraph conclusion summarizing your findings and interpreting the results. Be sure to comment on how the evidence from this problem set supports the primary research question.