Applied Econometrics with 

Chapter 1

Introduction

Introduction

An Introductory R Session

Demand for economics journals

Data set from Stock & Watson (2007), originally collected by T. Bergstrom, on subscriptions to 180 economics journals at US libraries, for the year 2000.

10 variables are provided including:

- `subs` – number of library subscriptions,
- `price` – library subscription price,
- `citations` – total number of citations,

and other information such as number of pages, founding year, characters per page, etc.

Of interest: relation between demand and price for economics journals. Price is measured as price per citation.

Demand for economics journals

Load data and obtain basic information:

```
R> library("AER")
R> data("Journals", package = "AER")
R> dim(Journals)
```

```
[1] 180  10
```

```
R> names(Journals)
```

```
 [1] "title"        "publisher"    "society"      "price"
 [5] "pages"        "charpp"       "citations"    "foundingyear"
 [9] "subs"         "field"
```

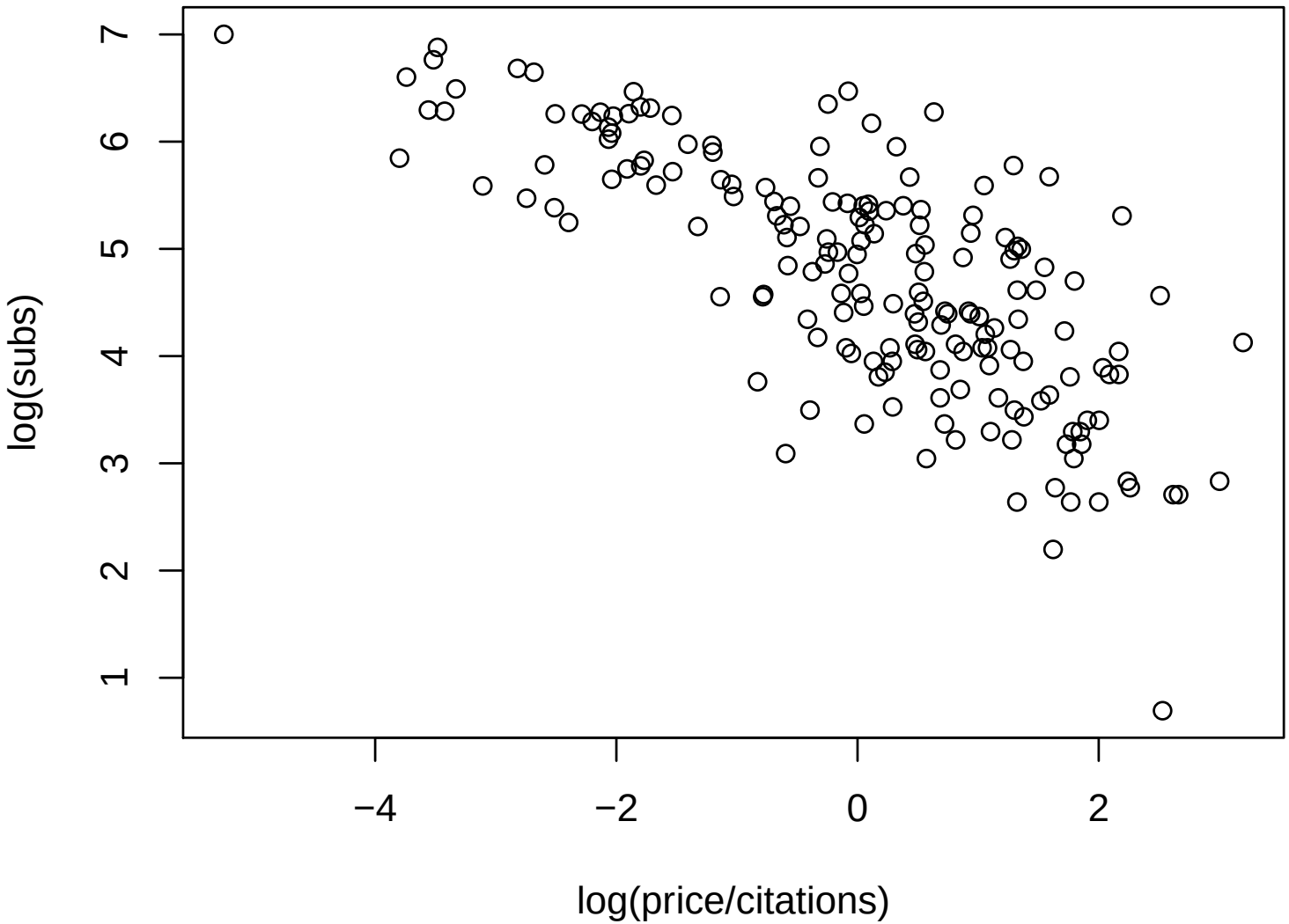
Plot variables of interest:

```
R> plot(log(subs) ~ log(price/citations), data = Journals)
```

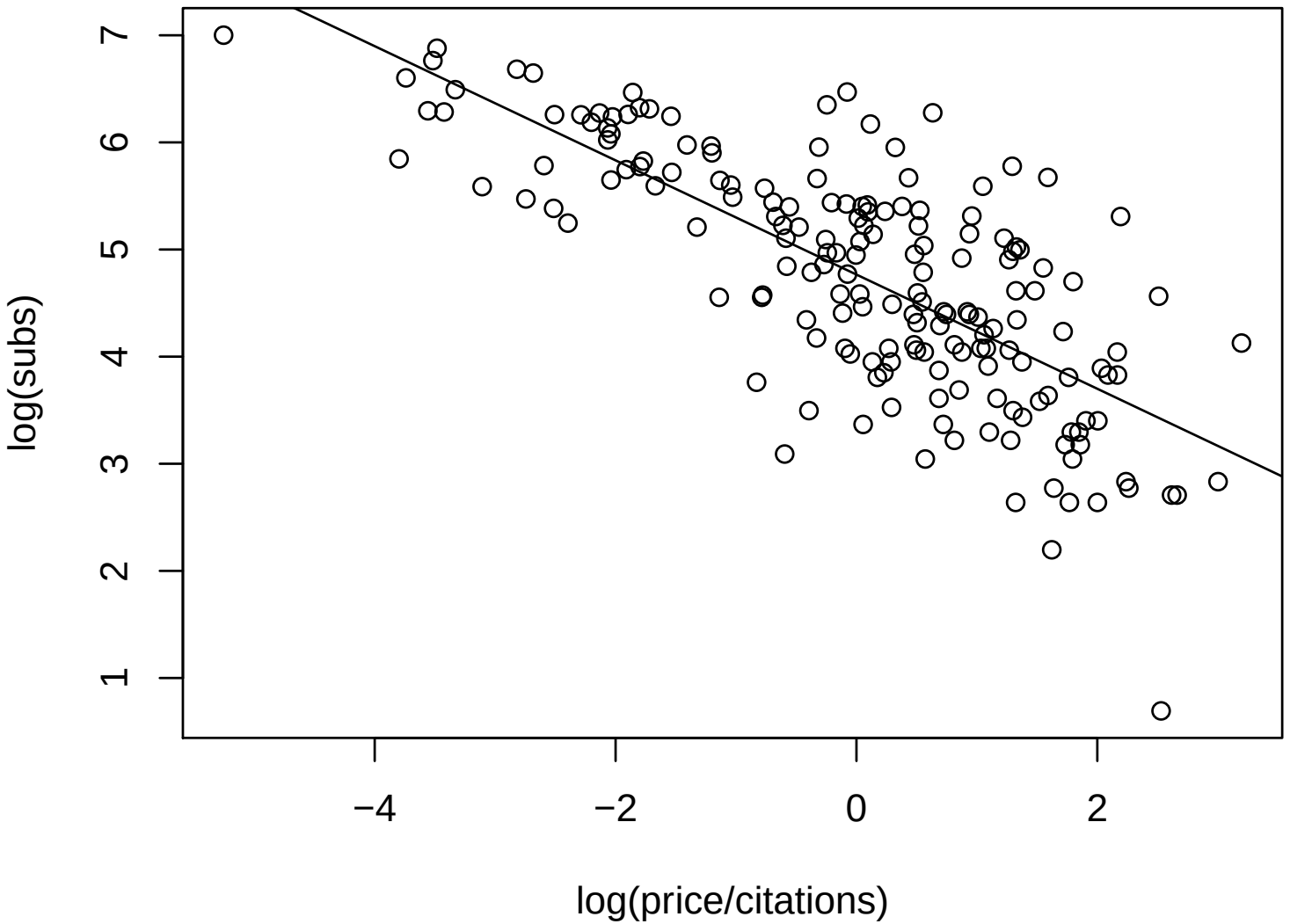
Fit linear regression model:

```
R> j_lm <- lm(log(subs) ~ log(price/citations), data = Journals)
R> abline(j_lm)
```

Demand for economics journals



Demand for economics journals



Demand for economics journals

```
R> summary(j_lm)

Call:
lm(formula = log(subs) ~ log(price/citations), data = Journals)

Residuals:
    Min      1Q  Median      3Q     Max
-2.7248 -0.5361  0.0372  0.4662  1.8481

Coefficients:
                     Estimate Std. Error t value Pr(>|t|)
(Intercept)            4.7662     0.0559    85.2   <2e-16
log(price/citations)  -0.5331     0.0356   -15.0   <2e-16

Residual standard error: 0.75 on 178 degrees of freedom
Multiple R-squared:  0.557, Adjusted R-squared:  0.555
F-statistic:  224 on 1 and 178 DF,  p-value: <2e-16
```

Determinants of wages

Data: random subsample of cross-section data from the May 1985 Current Population Survey.

Model: wage equation in semi-logarithmic form (with regressors education and quadratic polynomial in experience).

Comparison: OLS and LAD estimator (and further regression quantiles).

In R:

- use `lm()` again for more complex model,
- use `rq()` from **quantreg** for quantile regression (with the same type of interface),
- employ R's graphics capabilities for visualization and graphical comparison.

Determinants of wages

Load data:

```
R> data("CPS1985", package = "AER")
R> cps <- CPS1985
```

OLS regression:

```
R> cps_lm <- lm(log(wage) ~ experience + I(experience^2) +
+    education, data = cps)
```

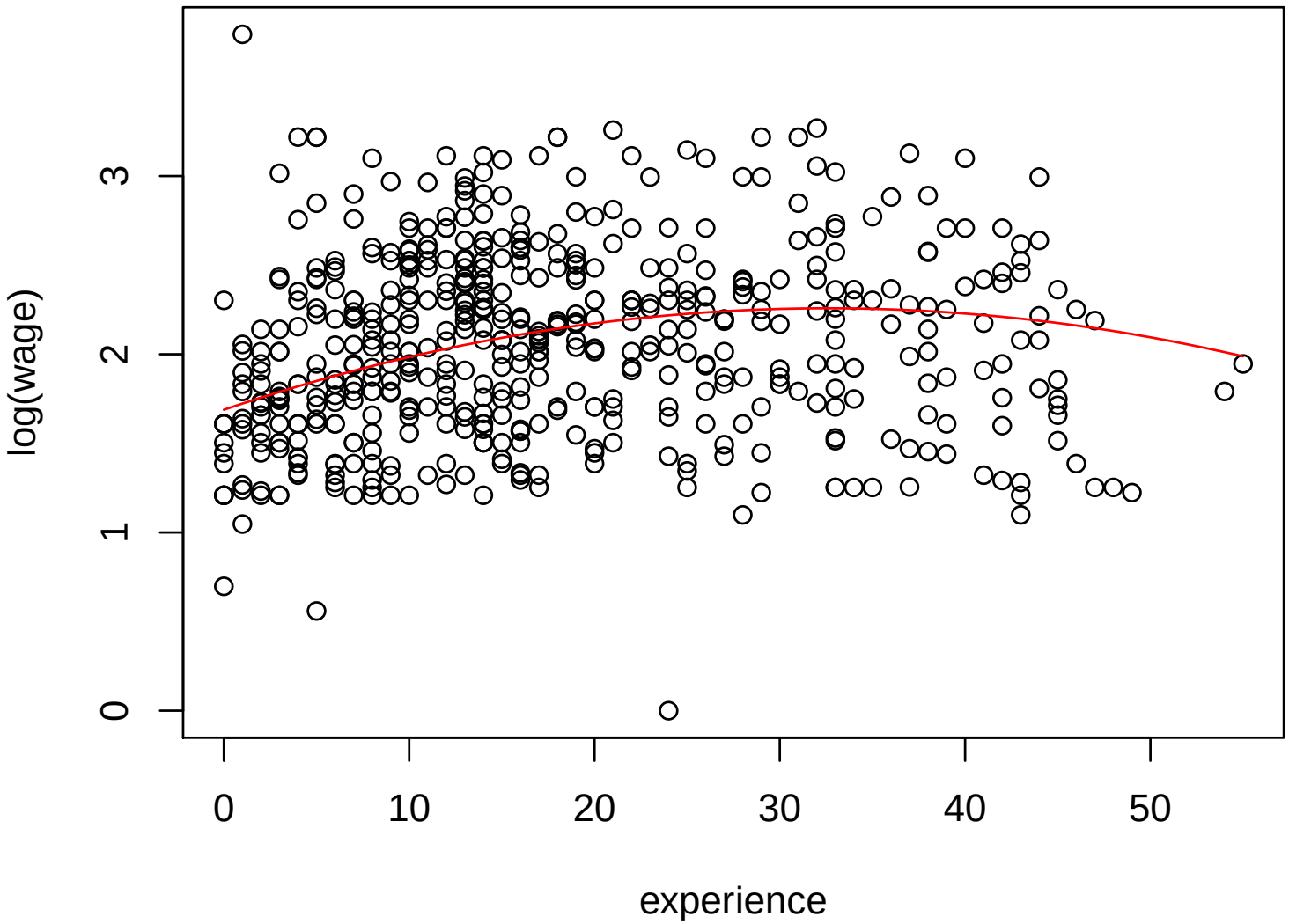
Fitted mean function:

```
R> cps2 <- data.frame(education = mean(cps$education),
+    experience = min(cps$experience):max(cps$experience))
R> cps2 <- cbind(cps2, predict(cps_lm, newdata = cps2,
+    interval = "prediction"))
```

Visualization:

```
R> plot(log(wage) ~ experience, data = cps)
R> lines(fit ~ experience, data = cps2, col = 2)
```

Determinants of wages



Determinants of wages

Quantile regression for $\tau = 0.2, 0.35, 0.5, 0.65, 0.8$:

```
R> library("quantreg")
R> cps_rq <- rq(log(wage) ~ experience + I(experience^2) +
+    education, data = cps, tau = seq(0.2, 0.8, by = 0.15))
```

Fitted quantile regressions:

```
R> cps2 <- cbind(cps2,
+    predict(cps_rq, newdata = cps2))
```

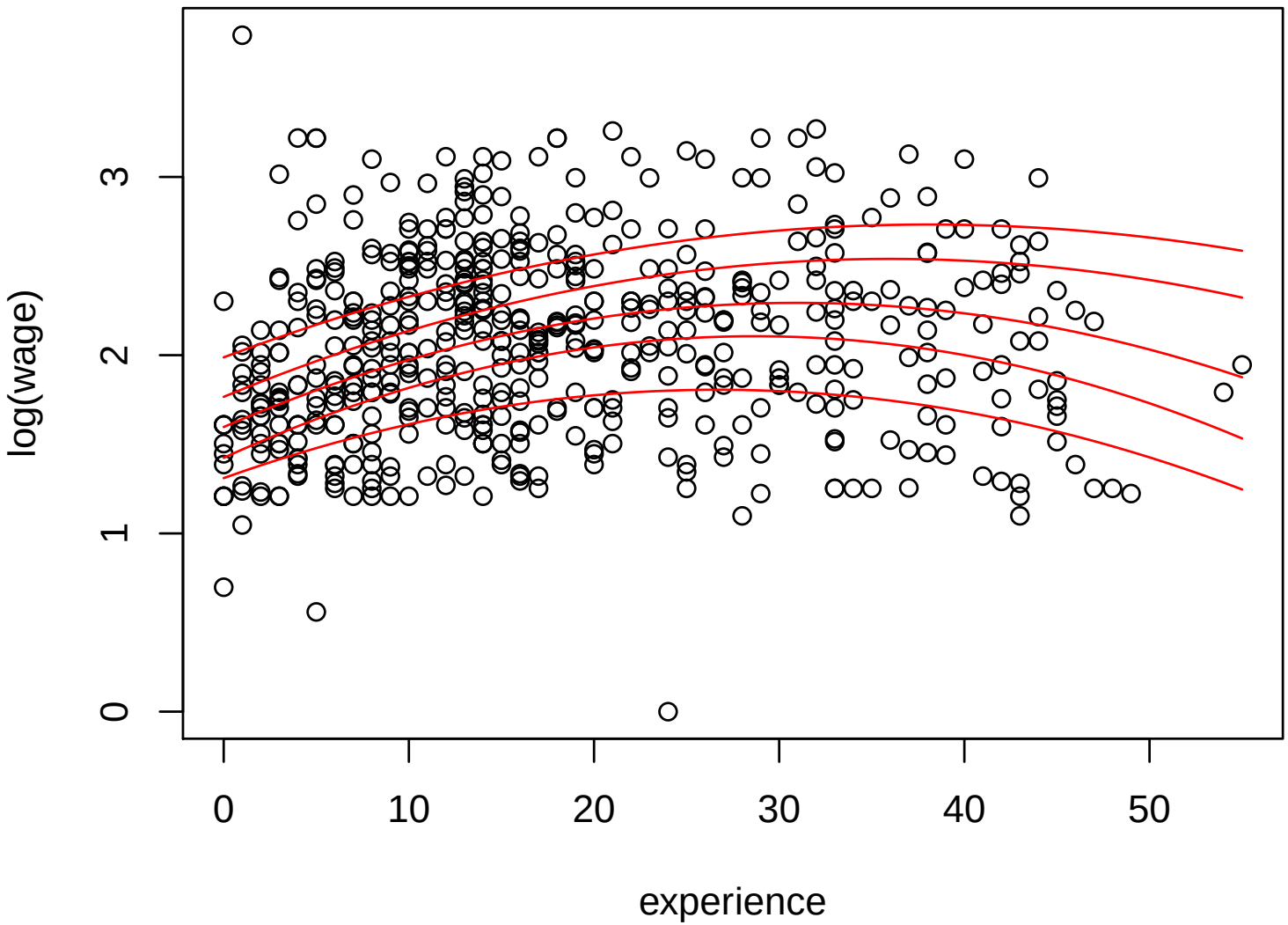
Visualization:

```
R> plot(log(wage) ~ experience, data = cps)
R> for(i in 6:10) lines(cps2[,i] ~ experience,
+    data = cps2, col = 2)
```

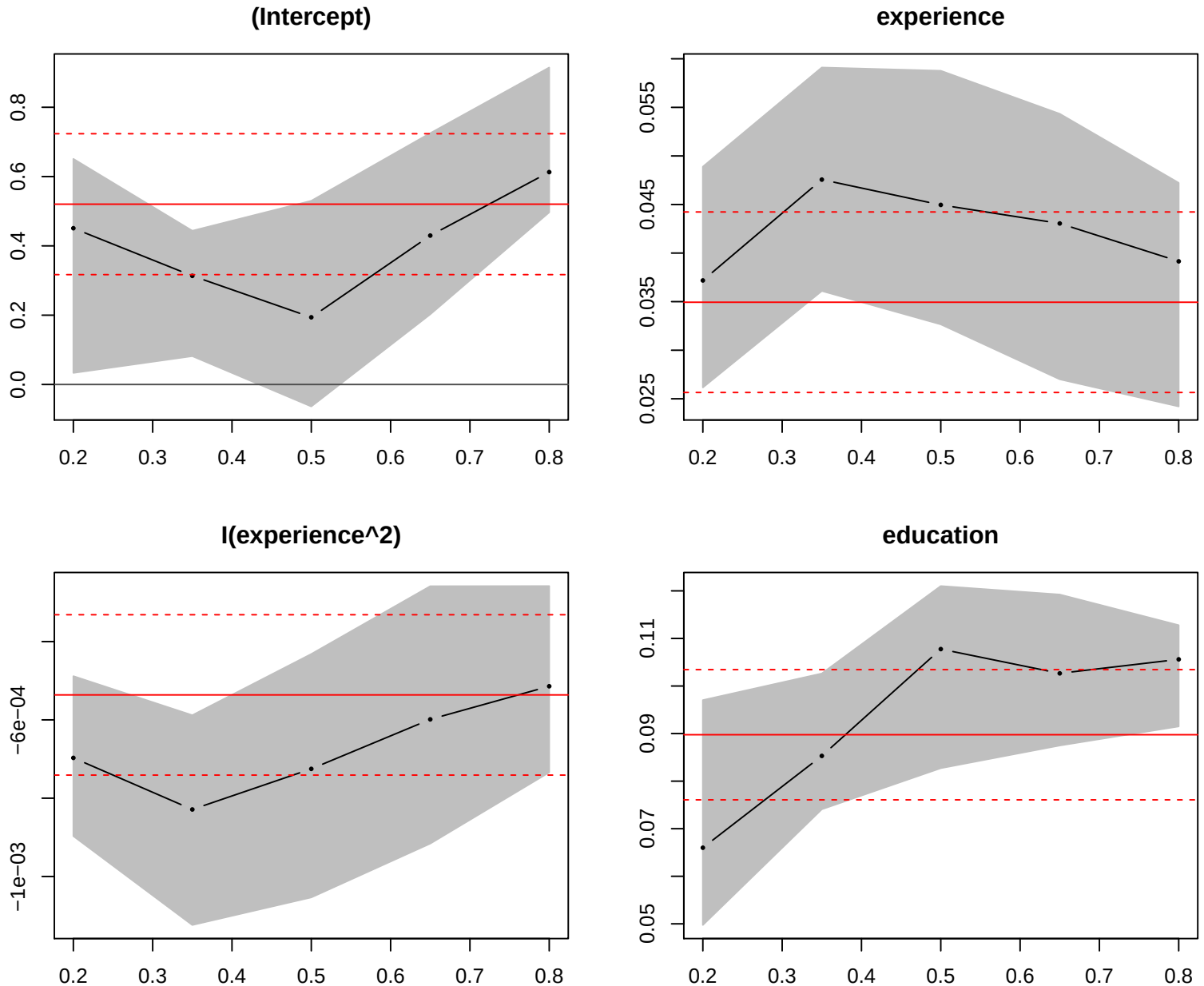
Graphical comparison of OLS and regression quantiles:

```
R> plot(summary(cps_rq))
```

Determinants of wages



Determinants of wages



Determinants of wages

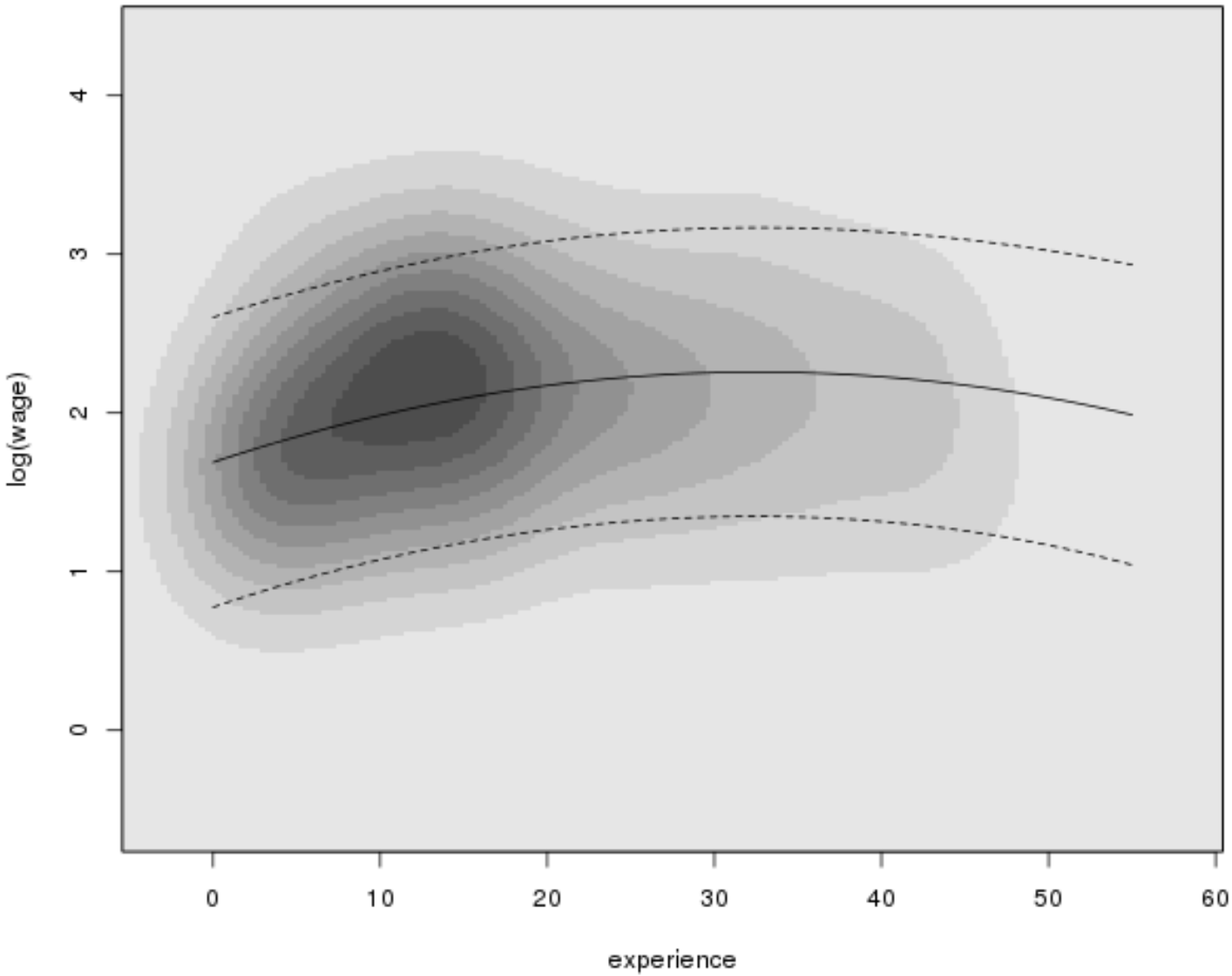
Bivariate kernel density estimate of `experience` and `log(wage)`:

```
R> library("KernSmooth")
R> cps_bkde <- bkde2D(cbind(cps$experience, log(cps$wage)),
+    bandwidth = c(3.5, 0.5), gridsize = c(200, 200))
```

Visualize with fitted OLS regression and confidence bounds:

```
R> image(cps_bkde$x1, cps_bkde$x2, cps_bkde$fhat,
+    col = rev(gray.colors(10, gamma = 1)),
+    xlab = "experience", ylab = "log(wage)")
R> box()
R> lines(fit ~ experience, data = cps2)
R> lines(lwr ~ experience, data = cps2, lty = 2)
R> lines(upr ~ experience, data = cps2, lty = 2)
```

Determinants of wages



Introduction

Getting Started

R system for statistical computing and graphics

- R project homepage: `http://www.R-project.org/`,
- open-source software project,
- released under the GNU General Public License (GPL), Version 2,
- full sources available online from Comprehensive R Archive Network (CRAN),
- binary versions for Microsoft Windows, various flavours of Linux (including Debian, Red Hat, SUSE, and Ubuntu), and for MacOS X,
- CRAN has a world-wide network of mirrors, see: `http://CRAN.R-project.org/mirrors.html`.

Installation

Installation of binary versions is straightforward:

- go to CRAN, pick up the version for your operating system, follow instructions in readme file,
- Microsoft Windows: download and run setup `.exe` file,
- Mac OS X: Installer package `.pkg` for base system and platform-specific GUI, along with additional programming tools (as disk image `.dmg` files),
- Linux: pre-packaged binaries for various flavors (`.deb` or `.rpm` files), also interfaced in various update managers (**apt**, **yum**, etc.).

Installation

Installation from source:

- possible on numerous (and also exotic) platforms,
- easy when compilers ship with the operating system (e.g., Unix/Linux) in the usual configure/make/install steps,
- compilers are also available for Windows but require some more installation/configuration.

Manual: *R Installation and Administration*.

Packages

R is highly extensible by means of *packages*:

- packages can contain R code, source code (e.g., C, Fortran), data, manual pages, further documentation, examples, demos, ...
- package can *depend* on other packages (that need to be available for using the package),
- "base" packages: contained in the R sources,
- "recommended" packages: included in every binary distribution,
- "contributed" packages: available from the CRAN servers (currently about 5,000) at `http://CRAN.R-project.org/web/packages/`.

Packages

Installing and loading packages:

- if connected to the internet, simply type `install.packages("AER")` for installing package **AER**,
- additionally on Windows and Mac: GUI installer menus,
- packages are installed in *libraries* (= collections of packages),
- library paths can be specified (see `?library`),
- packages are loaded by the command `library()`, e.g., `library("AER")`,
- `library()` lists all currently installed packages.

CRAN task views: provide overview of packages for certain tasks (e.g., econometrics, finance, social sciences, Bayesian statistics, ...).
`http://CRAN.R-project.org/web/views/`

User interfaces and development environments

Base R: Command line interface (CLI), possibly enhanced by some limited graphical user interface (GUI) capabilities on Windows and Mac.

Additionally:

- Various integrated development environments (IDEs).
- Various GUIs interfacing certain statistical functionality.
- See `http://www.R-project.org/GUI/` for an overview.

Popular choices:

- IDE: RStudio is freely available, open source, and relatively easy to use. See `http://www.RStudio.com/ide/`.
- Basic-statistics GUI: R Commander is an R package providing an extensible GUI intended primarily for introductory statistics. See `http://CRAN.R-project.org/package=Rcmdr`.

Working with R

Philosophy

In most other econometrics packages: an analysis leads to a large amount of output containing information on estimation, model diagnostics, specification tests etc.

In R:

- analysis is broken down into a series of steps,
- intermediate results are stored in *objects*,
- minimal output at each step (often none),
- objects can be manipulated and interrogated to obtain the information required (e.g., `print()`, `summary()`, `plot()`).

Fundamental design principle: "Everything is an object."

Examples: vectors and matrices are objects, but also functions and even function calls $\Rightarrow$ facilitates programming tasks.

Handling objects

List all objects in the global environment (i.e., the user's workspace):

```
R> objects()
```

```
[1] "CPS1985"  "Journals" "cps"      "cps2"     "cps_bkde"
[6] "cps_lm"   "cps_rq"   "i"        "j_lm"
```

More objects are available in the attached packages.

```
R> search()
```

```
 [1] ".GlobalEnv"         "package:KernSmooth"
 [3] "package:quantreg"   "package:SparseM"
 [5] "package:AER"        "package:survival"
 [7] "package:splines"    "package:strucchange"
 [9] "package:sandwich"   "package:lmtest"
[11] "package:zoo"        "package:Formula"
[13] "package:car"        "package:stats"
[15] "package:graphics"   "package:grDevices"
[17] "package:utils"      "package:datasets"
[19] "package:methods"    "Autoloads"
[21] "package:base"
```

Handling objects

The global environment `".GlobalEnv"` is always at the first position.

Several attached packages including the **base** package at its end.

```
R> objects("package:base")
```

shows the names of more than thousand objects defined in **base** (including the function `objects()`).

Objects can easily be created by assigning a value to a name, using the assignment operator `<-`.

Handling objects

Creating objects:

```
R> x <- 2
R> x
```

```
[1] 2
```

```
R> objects()
```

```
 [1] "CPS1985"  "Journals" "cps"      "cps2"     "cps_bkde"
 [6] "cps_lm"   "cps_rq"   "i"        "j_lm"     "x"
```

Removing objects with `remove()` or `rm()`:

```
R> remove(x)
R> objects()
```

```
[1] "CPS1985"  "Journals" "cps"      "cps2"     "cps_bkde"
[6] "cps_lm"   "cps_rq"   "i"        "j_lm"
```

Calling functions

For a function, `foo()` say:

- Typing an objects name at the prompt, `foo`, prints the object.
- For a function this prints the source code.
- If it is called with parentheses, `foo()`, it is a function call.
- If there are no arguments or all have defaults, `foo()` is a valid function call.
- A function call may use the arguments in any order, provided the name of the argument is given.
- If names of arguments are not given, R assumes they appear in the order of the function definition.
- If an argument has a default, it may be left out in a function call.

Calling functions

Example: The function `log()` has two arguments, `x` (a numeric scalar or vector), `base` (the base with respect to which logarithms are computed).

```
R> log(x = 16, base = 2)
```

```
[1] 4
```

The following calls all yield equivalent output:

```
R> log(16, 2)
R> log(x = 16, 2)
R> log(16, base = 2)
R> log(base = 2, x = 16)
```

Classes and generic functions

Every object has a *class* that can be queried using `class()`.

For each class, certain methods to *generic* functions can be available, e.g., `summary()` and `plot()`.

Examples:

- "`data.frame`": a list with a certain structure (preferred format for holding data),
- "`lm`": linear-model objects (returned by `lm()`).

Classes and generic functions

`summary()` for

- "`data.frame`": numeric summary (e.g., mean, quantiles, or frequency table) for each variable,
- "`lm`": standard regression output (coefficients, standard errors, Wald tests, etc.).

`plot()` for

- "`data.frame`": pairs of scatterplots,
- "`lm`": basic diagnostic plots.

Quitting R

One exits R by using the `q()` function:

```
R> q()
```

R asks whether to save the workspace:

- `n` (no): exit R without saving anything,
- `y` (yes): save all currently defined objects in `.RData` and the command history in `.Rhistory`, both in the working directory.

File management

Working directory:

- query with `getwd()`,
- change with `setwd()`,
- if available, `.RData` and/or `.Rhistory` are loaded upon startup,
- `dir()` lists available files.

More generally:

- directories can be listed with `dir()`,
- saved workspaces can be loaded using `load()`,
- R objects can be saved (in binary format) by `save()`.

Getting Help

Help pages

Documentation: The help page for any function or data set can be accessed using either `?` or `help()`:

```
R> ?options
R> help("options")
```

Examples: At the bottom of a help page, there are typically practical examples of how to use that function. These can easily be executed:

```
R> example("options")
R> example("lm")
```

Searching for help

If the exact name of a command is not known, the functions to use are `help.search()` and `apropos()`.

`help.search()` returns help files with aliases or concepts or titles matching a "pattern" using fuzzy matching. For example, searching for the pattern "option" will yield a (long) list of help pages, including the function `options()` used above.

```
R> help.search("option")
```

```
options(base)       Options Settings
```

`apropos()` lists all functions whose names include the pattern entered. As an illustration,

```
R> apropos("help")
```

```
[1] "help"          "help.request" "help.search"  "help.start"
```

Vignettes

More advanced: Vignettes are PDF files generated from integrated files containing both R code and documentation in LaTeX format $\Rightarrow$ all commands can be extracted and executed, reproducing the analysis.

Typically less technical information and written more in the style of tutorials.

For an example, see

```
R> vignette("strucchange-intro", package = "strucchange")
```

These slides and accompanying R scripts are actually written using the same tools.

Demos

A demo is an interface to run some demonstration R scripts. Type

```
R> demo()
```

for a list of available topics.

Examples: `"graphics"`, `"lm.glm"`.

For beginners, running

```
R> demo("graphics")
```

is recommended.

Manuals

R also comes with a number of manuals:

- An Introduction to R
- R Data Import/Export
- R Language Definition
- Writing R Extensions
- R Installation and Administration
- R Internals

FAQs

CRAN hosts several collections of frequently asked questions (FAQs).
`http://CRAN.R-project.org/faqs.html`

R FAQ: useful information for all platforms (Linux, Mac, Unix, Windows).
`http://CRAN.R-project.org/doc/FAQ/R-FAQ.html`

R Mac OS X FAQ: additional Mac-specific information.
`http://CRAN.R-project.org/bin/macosx/RMacOSX-FAQ.html`

R Windows FAQ: additional Windows-specific information.
`http://CRAN.R-project.org/bin/windows/base/rw-FAQ.html`

Publications

The R Journal: online journal launched in 2009, following up on the *R News* newsletter launched in 2001, published about two times per year. Features include recent developments in R, a "programmer's niche", and examples analyzing data with R.
`http://journal.R-project.org/`

Journal of Statistical Software: open-access journal that publishes articles and code snippets (as well as book and software reviews) on the subject of statistical software and algorithms. It has a growing number of publications on R packages, a special volume on *Econometrics in R* was published in Volume 27 (2008).
`http://www.jstatsoft.org/`

Publications

Books: rapidly growing list of books on R or on statistics using R. Prominent examples include

- Venables and Ripley (2002). *Modern Applied Statistics with S*, 4th ed., Springer-Verlag.
- Fox and Weisberg (2011). *An R Companion to Applied Regression*, 2nd ed., Sage Publications.
- Dalgaard (2008). *Introductory Statistics with R*, 2nd ed., Springer-Verlag.
- Faraway (2005). *Linear Models with R*, Chapman & Hall/CRC.
- Murrell (2011). *R Graphics*, 2nd ed., Chapman & Hall/CRC.
- Sarkar (2008). ***lattice**: Multivariate Data Visualization with R*, Springer-Verlag.
- Wickham (2010). ***ggplot2**: An Implementation of the Grammar of Graphics*, Springer-Verlag.

The Development Model

Development model

As R is an open-source project, its development model is quite different from many other econometrics software packages.

Extensibility: a key feature in R's success is the extensibility through packages. These can contain everything that the base system contains:

- R code (obviously),
- code in compiled languages (such as C, C++, or Fortran),
- data sets, demo files, test suites, vignettes, or further documentation.

Every R user can easily become an R developer by submitting his or her packages to CRAN.

Development model

Base system: Unlike the CRAN packages, base R is maintained by the R core team:

- major releases (i.e., versions x.y.0) annually,
- free read access to the development version in the SVN repository.

Version control: SVN stands for Subversion, see
`http://subversion.apache.org/`

Mailing lists

For communication between R users and developers, two means are particularly useful: CRAN packages (see above) and various mailing lists.

R-help: asking for help on using R.

R-devel: discussing issues related to the development of R.

Furthermore, bugs can be reported and feature requests made. The posting guide discusses some good strategies for doing this effectively.
`http://www.R-project.org/posting-guide.html`

Special interest groups: SIGs are mailing lists for special topics, including a list devoted to finance and (financial) econometrics: R-SIG-Finance.

A Brief History of R

History of S

1976 John Chambers and co-workers at Bell Labs begin work on a project that will become S (S1).

1981 Licenses for a new portable Unix version of S outside Bell Labs (S2, brown and blue book).

1988 Statistical software package S-PLUS based on S.

1992 Object orientation and statistical modeling toolbox included (S3, white book).

1993 Exclusively licensed to MathSoft (now Insightful).

1998 New object orientation model introduced (S4, green book).

1999 ACM Software System Award 1998 for John Chambers.

2004 S implementation sold to Insightful.

History of R

1991 Ross Ihaka and Robert Gentleman begin work on a project that will ultimately become R.

1993 First binary copies of R on Statlib.

1995 R release of sources under the GPL.

1997 R development core team is formed.

1998 Comprehensive R Archive Network (CRAN).

1999 First DSC meeting in Vienna, first R core meeting.

2000 R 1.0.0 is released.

2001 R News launched.

2002 R Foundation established.

2004 First useR! conference in Vienna.

2004 R 2.0.0 is released.

2007 R-Forge server launched.

2013 R 3.0.0 is released.

R in econometrics

- Cribari-Neto and Zarkos (1999), "R: Yet Another Econometric Programming Environment", *Journal of Applied Econometrics*, **14**, 319–329. (Review of R version 0.63.1.)
- Racine and Hyndman (2002), "Using R to Teach Econometrics", *Journal of Applied Econometrics*, **17**, 175–189. (Uses R 1.3.1.)
- Kleiber and Zeileis (2008), *Applied Econometrics with R*, Springer-Verlag, New York. (Uses R 2.7.0.)