# Assignment - 2: BUAN 6312 Harikrishna Dev HXD220000

## Answers

1. Use the data in APPLE to answer this question.

- Define a binary variable as ecobuy = 1 if ecolbs > 0 and ecobuy = 0 if ecolbs = 0. In other words, ecobuy indicates whether, at the prices given, a family would buy any ecologically friendly apples. What fraction of families claim they would buy ecolabeled apples?

The fraction of fammilies claim they would buy ecolabeled apples are 62.42%

```
. gen ecobuy = 0

. replace ecobuy = 1 if ecolbs > 0
(412 real changes made)

. tabulate ecobuy

     ecobuy |      Freq.     Percent        Cum.
------------+-----------------------------------
          0 |        248       37.58       37.58
          1 |        412       62.42      100.00
------------+-----------------------------------
      Total |        660      100.00
```

- Estimate the linear probability model below and and report the results in the usual form. Carefully interpret the coefficients on the price variables (***ecoprc*** and ***regprc*** ).

$$ecobuy = \beta_0 + \beta_1 ecoprc + \beta_2 regprc + \beta_3 faminc + \beta_4 hhsize + \beta_5 educ + \beta_6 age + u$$

We get the LRM equation as follows:

$$ecobuy = 0.4236865 + -0.8026219 \times ecoprc + 0.7192675 \times regprc + 0.0005518 \times faminc + 0.0238227 \times hhsize + 0.02$$

From the following equation, we can see that

```
. reg ecobuy ecoprc regprc faminc hhsize educ age

      Source |       SS           df       MS      Number of obs   =       660
-------------+----------------------------------   F(6, 653)       =     13.43
       Model |  17.0019785         6  2.83366308   Prob > F        =    0.0000
    Residual |  137.810143       653  .211041566   R-squared       =    0.1098
-------------+----------------------------------   Adj R-squared   =    0.1016
       Total |  154.812121       659  .234919759   Root MSE        =    .45939

------------------------------------------------------------------------------
      ecobuy | Coefficient  Std. err.      t    P>|t|     [95% conf. interval]
-------------+----------------------------------------------------------------
      ecoprc |  -.8026219   .1094037    -7.34   0.000    -1.017447   -.5877963
      regprc |   .7192675    .131639     5.46   0.000     .4607808    .9777543
      faminc |   .0005518   .0005295     1.04   0.298     -.000488    .0015916
      hhsize |   .0238227   .0125262     1.90   0.058    -.0007739    .0484193
        educ |   .0247849   .0083743     2.96   0.003      .008341    .0412287
         age |  -.0005008   .0012499    -0.40   0.689    -.0029551    .0019536
       _cons |   .4236865   .1649674     2.57   0.010      .099756     .747617
------------------------------------------------------------------------------
```

- Are the nonprice variables jointly significant in the LPM? (Use the usual F statistic, even though it is not valid when there is heteroskedasticity.) Which explanatory variable other than the price variables seems to have the most significant effect on the decision to buy ecolabeled apples? Does this make sense to you?

Answer here

- In the model from part (ii), replace $faminc$ with $log(faminc)$. Given the $R^2$, which model fits the data better? How many estimated probabilities are negative? How many are bigger than one? Should you be concerned? [Hint: Use command predict y to generate fitted values.]

Answer here

2. Use the data in EZANDERS for this exercise. The data are on monthly unemployment claims in Anderson Township in Indiana, from January 1980 through November 1988. In 1984, an enterprise zone (EZ) was located in Anderson (as well as other cities in Indiana).

- Regress log(uclms) on a monthly linear time trend and 11 monthly dummy variables. [Hint: Use jan as the base month for the monthly dummy variables.]What was the overall trend in unemployment claims over this period? (Interpret the coefficient on the time trend.) Is there evidence of seasonality in unemployment claims?

Answer here

- Add ez, a dummy variable equal to one in the months Anderson had an EZ, to the regression in part (i). Does having the enterprise zone seem to decrease unemployment claims? By how much?

Answer here

- Now use Δlog(invpc_t) as the dependent variable. Re-run the equation and report the results in standard form. How do your results of the coefficient β^_1 change from part (ii)? Is the time trend still significant? Why or why not?

Answer here

4. Recall that in the example of testing Efficient Markets Hypothesis, it may be that the expected value of the return at time t, given past returns, is a quadratic function of $return_{t-1}$.

- To check this possibility, use the data in NYSE to estimate

$$return_t = \beta_0 + \beta_1 return_{t-1} + \beta_2 return_{t-1}^2 + u_t$$

report the results in standard form.

Answer here

- State and test the null hypothesis that E(return_t |return_(t-1)) does not depend on returnt-1. [Hint: There are two restrictions to test here.] What do you conclude?

Answer here

- Drop $return_{t-1}^2$ from the model, but add the interaction term $return_{t-1} \times return_{t-2}$. Now test the efficient markets hypothesis. [Hint: stata can create lag (or lead) variables using subscripts conveniently. For example, you can use the command gen return_2 = return[_n-2] to create $return_{t-2}$ fast.]

Answer here

- What do you conclude about predicting weekly stock returns based on past stock returns?

Answer here

5. Use the data in KIELMC for this exercise.

- The variable dist is the distance from each home to the incinerator site, in feet. Consider the model

$$log(price) = \beta_0 + \delta_0 y_8 1 + \beta_1 log(dist) + \delta_1 y_8 1 \cdot log(dist) + u.$$

If building the incinerator reduces the value of homes closer to the site, what is the sign of δ1? What does it mean if β1 > 0?

Answer here

- Estimate the model from part (i) and report the results in the usual form. Interpret the coefficient on $y_8 1 \cdot log(dist)$. What do you conclude?

Answer here

- What do you conclude about predicting weekly stock returns based on past stock returns?

Answer here

- Add $age, age^2, rooms, baths, log(intst), log(land), andlog(area)$ to the equation. Now, what do you conclude about the effect of the incinerator on housing values?

Answer here

- Why is the coefficient on $log(dist)$ positive and statistically significant in part (ii) but not in part (iii)? What does this say about the controls used in part (iii)?

Answer here

6. Use the data in PHILLIPS for this exercise. As we mentioned in Lecture 7, instead of the static Phillips curve model, we can estimate an expectations-augmented Phillips curve of the form

$$\Delta inf_t = \beta_0 + \beta_1 unem_t + e_t$$

where $\Delta inf_t = inf_t - inf_{t-1}$

- Estimate this equation by OLS and report the results in the usual form. In estimating this equation by OLS, we assumed that the supply shock, et, was uncorrelated with unemt. If this is false, what can be said about the OLS estimator of β1?

Answer here

- Suppose that et is unpredictable given all past information: $E(e_t \mid inf_(t-1), unem_(t-1), \ldots) = 0$. Explain why this makes $unem_t - 1$ a good IV candidate for $unem_t$.

Answer here

- Does $unem_t - 1$ satisfy the instrument relevance assumption? [Hint: You need to run a regression to answer this question.]

Answer here

- Estimate the expectations augmented Phillips curve by 2SLS using $unem_t - 1$ as an IV for $unem_t$. Report the results in the usual form and compare them with the OLS estimates from (i).