

W271-2 – Spring 2016 – HW 2

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Data

In the United States, a 401K is a type of retirement savings plan that is tied to a worker's place of employment. Employees that put money into a 401K enjoy certain tax benefits. Moreover, many employers have a policy of promoting 401K use, by matching some percentage of an employee's contributions. If an employer matches at, say, 50%, for every dollar that an employee puts into a 401K, the employer will put in another 50 cents.

The file `401k_w271.RData` contains data on 401k contributions that were filed with the IRS on form 5500. It was collected by Professor L. E. Papke and may have been further modified by the instructors to test your proficiency.

Exercises

Complete the following exercises, following the best practices outlined in class. Place your answers in a written report (pdf, word, or jupyter notebook format) along with relevant R statements and output.

Load the `401k_w271.RData` dataset and look at the value of the function `desc()` to see what variables are included.

```
load("401k_w271.Rdata")
```

Question 1

Your dependent variable will be `prate`, representing the fraction of a company's employees participating in its 401k plan. Because this variable is bounded between 0 and 1, a linear model without any transformations may not be the most ideal way to analyze the data, but we can still learn a lot from it. Examine the `prate` variable and comment on the shape of its distribution.

```
# Descriptive statistics of the whole dataset
desc
```

```
##   variable                                label
## 1   prate      participation rate, percent
## 2   mrate      401k plan match rate
## 3   totpart     total 401k participants
## 4   totelg     total eligible for 401k plan
## 5   age        age of 401k plan
## 6   totemp     total number of firm employees
## 7   sole = 1 if 401k is firm's sole plan
## 8   ltotemp     log of totemp
```

```
str(data)
```

```
## 'data.frame':   1534 obs. of  8 variables:
## $ prate : num  26.1 100 97.6 100 82.5 ...
## $ mrate : num  0.21 1.42 0.91 0.42 0.53 ...
## $ totpart: num  1653 262 166 257 591 ...
## $ totelg : num  6322 262 170 257 716 ...
## $ age : int  8 6 10 7 28 7 31 13 21 10 ...
## $ totemp : num  8709 315 275 500 933 ...
## $ sole : int  0 1 1 0 1 1 1 0 1 1 ...
## $ ltotemp: num  9.07 5.75 5.62 6.21 6.84 ...
## - attr(*, "datalabel")= chr ""
## - attr(*, "time.stamp")= chr "25 Jun 2011 23:03"
## - attr(*, "formats")= chr  "%7.0g" "%7.0g" "%7.0g" "%7.0g" ...
## - attr(*, "types")= int  254 254 254 254 251 254 251 254
## - attr(*, "val.labels")= chr  "" "" "" "" ...
## - attr(*, "var.labels")= chr  "participation rate, percent" "401k plan match rate" "total 401k part.
## - attr(*, "version")= int  10
```

```
summary(data)
```

```
##      prate      mrate      totpart      totelg
## Min.   : 3.00   Min.   :0.0100   Min.   : 50.0   Min.   : 51.0
## 1st Qu.: 78.10   1st Qu.:0.3000   1st Qu.: 156.2   1st Qu.: 176.0
## Median : 95.70   Median :0.4600   Median : 276.0   Median : 330.0
## Mean   : 87.56   Mean   :0.7315   Mean   : 1354.2   Mean   : 1628.5
## 3rd Qu.:100.00   3rd Qu.:0.8300   3rd Qu.: 749.5   3rd Qu.: 890.5
## Max.   :200.00   Max.   :4.9100   Max.   :58811.0   Max.   :70429.0
##      age      totemp      sole      ltotemp
## Min.   : 4.00   Min.   : 58   Min.   :0.0000   Min.   : 4.060
## 1st Qu.: 7.00   1st Qu.: 261   1st Qu.:0.0000   1st Qu.: 5.565
## Median : 9.00   Median : 588   Median :0.0000   Median : 6.377
## Mean   :13.18   Mean   : 3568   Mean   :0.4876   Mean   : 6.686
## 3rd Qu.:18.00   3rd Qu.: 1804   3rd Qu.:1.0000   3rd Qu.: 7.498
## Max.   :51.00   Max.   :144387   Max.   :1.0000   Max.   :11.880
```

```
# Descriptive statistics of prate
summary(data$prate)
```

```
##      Min. 1st Qu.  Median    Mean 3rd Qu.    Max.
##      3.00  78.10   95.70   87.56 100.00   200.00
```

```
round(stat.desc(data$prate, desc = TRUE, basic = TRUE, norm = TRUE), 2)
```

```
##      nbr.val  nbr.null  nbr.na      min      max
##      1534.00      0.00      0.00      3.00     200.00
##      range      sum      median      mean  SE.mean
##      197.00 134314.70      95.70      87.56      0.44
## CI.mean.0.95      var      std.dev      coef.var      skewness
##      0.87      300.95      17.35      0.20      -0.95
##      skew.2SE      kurtosis      kurt.2SE      normtest.W      normtest.p
##      -7.56      4.36      17.44      0.78      0.00
```

```
round(quantile(data$prate, probs = c(1, 5, 10, 25, 50, 75, 90, 95, 99,
                                     100)/100), 1)
```

```
##      1%      5%      10%      25%      50%      75%      90%      95%      99%      100%
##      31.8      54.0      62.8      78.1      95.7      100.0      100.0      100.0      100.0      200.0
```

```
data$prate[data$prate > 100]
```

```
## [1] 200.0 177.2 200.0
```

Based on the R output above, **prate** is one of the 8 variables contained in the dataset. There are **1534** observations of **prate**, and 0 of them correspond to NA values.

Its minimum and **maximum** values are 3.0 and **200.0**, respectively: the latter must correspond to an error, since a rate cannot be greater than 100%. A further analysis reveals that there are **3 observations** in which **prate** exceeds 100, so we should and shall **discard** them from our analysis.

Its **mean** and **median** values are 87.6 and 95.7, respectively.

The **excess kurtosis** (the kurtosis minus 3) is positive (4.36), which indicates that the distribution of the sample is **leptokurtic** (a more acute peak around the mean and fatter tails than the normal distribution). Its skewness is negative (-0.95), which indicates that the distribution of the sample is **left-skewed** (it has a long left tail). The following Figures confirm both aspects.

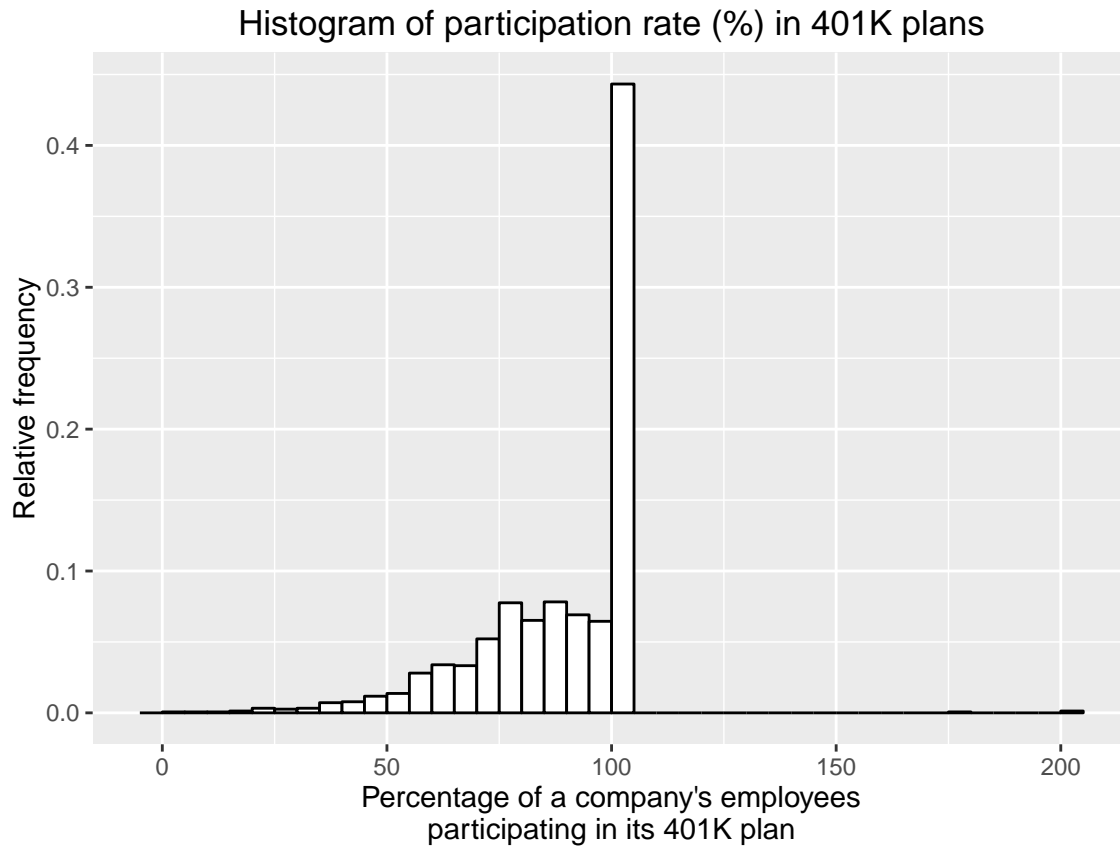


Figure 1: Histogram of participation rate (%) in 401K plans of a company's employees (bin width = 5)

Though hard to see (roughly 44.3% of the observations correspond to the exact value of 100%), the histogram above reveals the one observation with a value of 177.2 and the two observations with a value of 200.0.

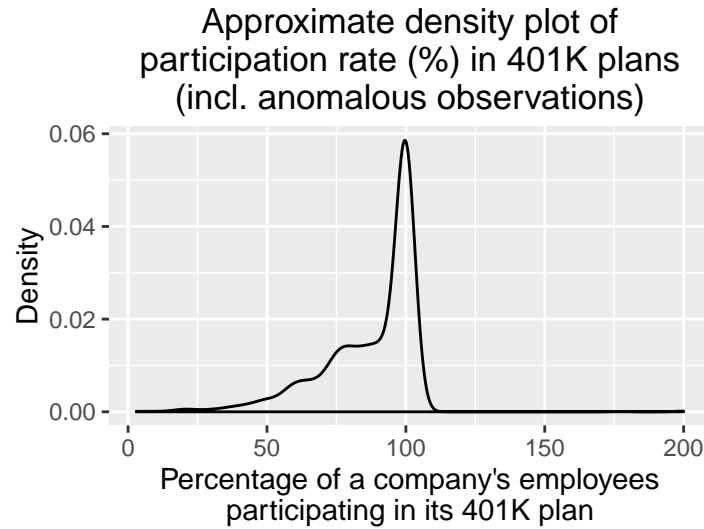


Figure 2: Approximate density plot of participation rate (%) in 401K plans of a company's employees

If we omit the 3 anomalous observations (which we'll do from now on), the (approximate) density plot looks like this (not normal at all):

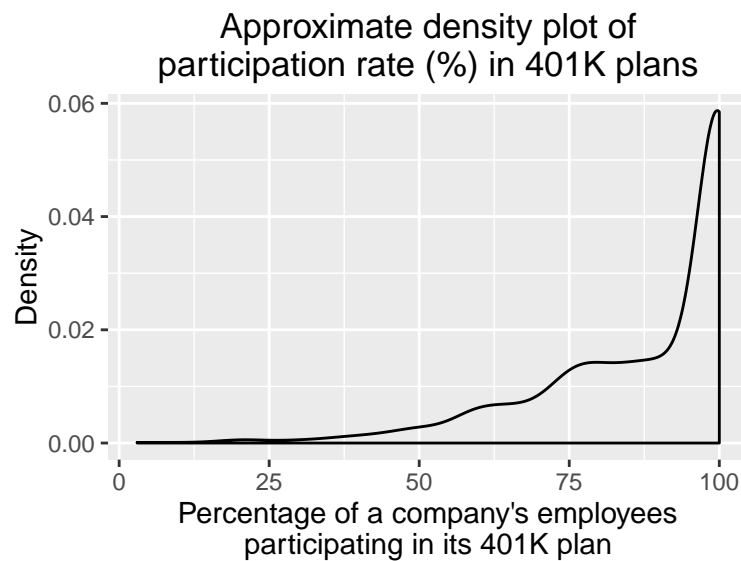


Figure 3: Approximate density plot of participation rate (%) in 401K plans of a company's employees (excluding wrong values, higher than 100%)

Question 2

Your independent variable will be `mrate`, the rate at which a company matches employee 401K contributions. Examine this variable and comment on the shape of its distribution.

```
# First, discard anomalous observations of prate
data2 <- data[data$prate <= 100, ]
# Descriptive statistics of prate
summary(data2$mrate)
```

```
##      Min. 1st Qu.  Median    Mean 3rd Qu.    Max.
##    0.010  0.300   0.460   0.732  0.830   4.910
```

```
round(stat.desc(data2$mrate, desc = TRUE, basic = TRUE, norm = TRUE), 2)
```

```
##      nbr.val    nbr.null    nbr.na      min      max
##    1531.00      0.00      0.00     0.01     4.91
##      range      sum    median     mean  SE.mean
##      4.90    1120.71     0.46     0.73     0.02
## CI.mean.0.95      var    std.dev   coef.var  skewness
##      0.04      0.61     0.78     1.07     2.59
##      skew.2SE    kurtosis    kurt.2SE  normtest.W  normtest.p
##      20.71      7.59      30.35     0.70     0.00
```

```
round(quantile(data2$mrate, probs = c(1, 5, 10, 25, 50, 75, 90, 95, 99,
100)/100), 1)
```

```
##      1%      5%     10%    25%    50%    75%    90%    95%    99%   100%
##    0.0    0.1    0.2    0.3    0.5    0.8    1.7    2.4    4.1    4.9
```

As with `prate`, there are no NA values of `mrate`.

Its minimum and maximum values are 0.0 and 4.9 (these values, as those of `prate`, correspond to percentages).

Its **mean** and **median** values are 0.732 and 0.460, respectively.

The **excess kurtosis** (the kurtosis minus 3) is positive (7.59), which indicates that the distribution of the sample is **leptokurtic** (a more acute peak around the mean and fatter tails than the normal distribution). Its skewness is positive (2.59), which indicates that the distribution of the sample is **right-skewed** (it has a long right tail). The following Figures confirm both aspects.

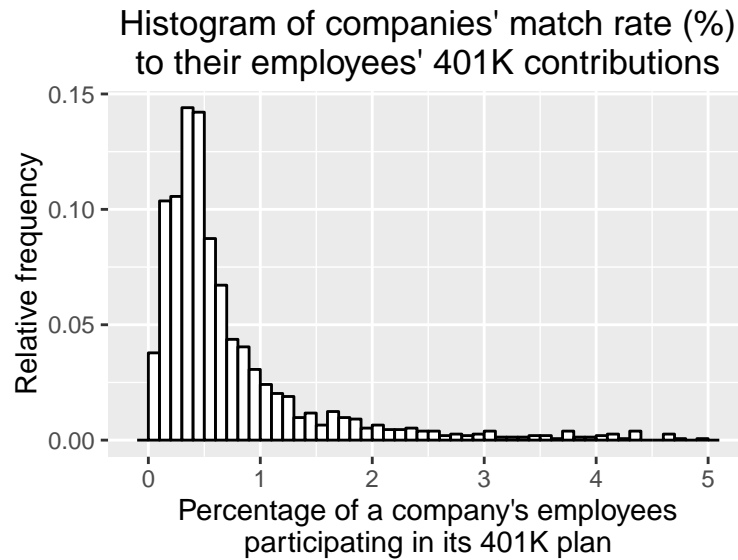


Figure 4: Histogram of companies' match rate (%) to their employees' 401K contributions (bin width = 0.1)

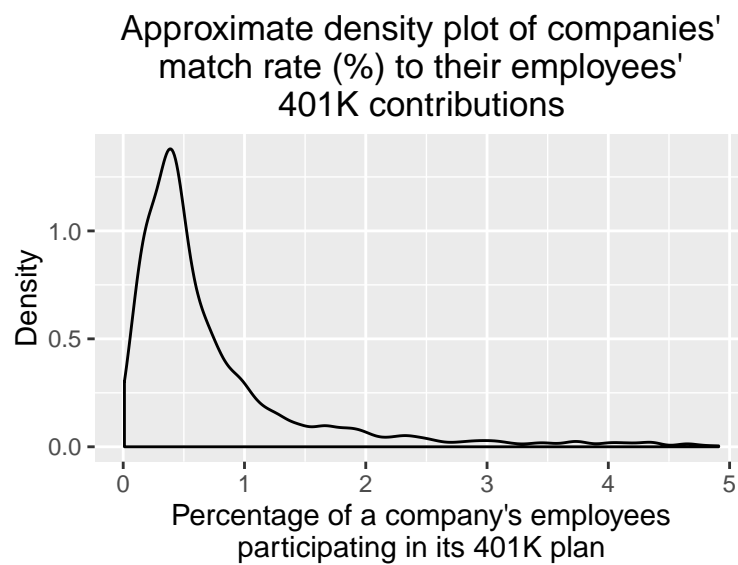


Figure 5: Approximate density plot of companies' match rate (%) to their employees' 401K contributions

Question 3

Generate a scatterplot of `prate` against `mrate`. Then estimate the linear regression of `prate` on `mrate`. What slope coefficient did you get?

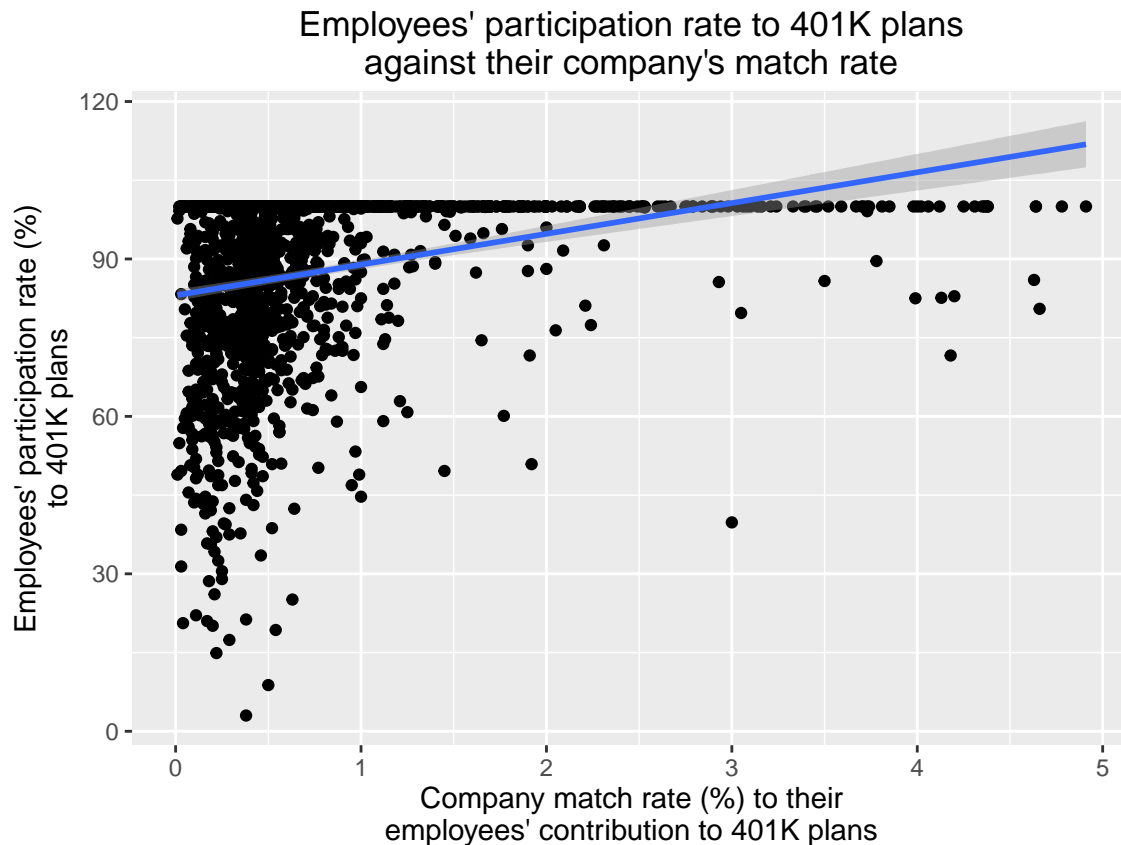


Figure 6: Scatterplot of the participation rate (%) to 401K plans of a company's employees against the match rate (%) of that company to their employees' contributions

While a low match rate of a company may correspond to almost the whole range of employees' participation rates, higher match rates correspond to high participation rates, which seems to indicate the positive relationship between both variables.

```
params <- "mrate" # regressor()
# Excluding bught == 0 (possible missing observations)
model <- lm(as.formula(paste("prate", paste(params, sep = "",
                                         collapse = " + ")), sep = " ~ ")),
            data = data2)
summary(model)
```

```
##
## Call:
## lm(formula = as.formula(paste("prate", paste(params, sep = "",
##      collapse = " + ")), sep = " ~ ")), data = data2)
##
## Residuals:
```



```
##      Min      1Q  Median      3Q      Max
## -82.289 -8.200   5.186  12.723  16.821
##
## Coefficients:
##              Estimate Std. Error t value Pr(>|t|)
## (Intercept)  83.0618     0.5641  147.24  <2e-16 ***
## mrate        5.8623     0.5275   11.11  <2e-16 ***
## ---
## Signif. codes:  0 '***' 0.001 '**' 0.01 '*' 0.05 '.' 0.1 ' ' 1
##
## Residual standard error: 16.09 on 1529 degrees of freedom
## Multiple R-squared:  0.07475,    Adjusted R-squared:  0.07414
## F-statistic: 123.5 on 1 and 1529 DF,  p-value: < 2.2e-16
```

Table 1: Effect of a company match rate to 401K plans on its employees' contribution

Employees' participation rate (%) to 401K plans	
Company match rate (%)	5.862*** (0.527)
Baseline (Intercept)	83.062*** (0.564)
R^2	0.075
F	123.525
p	0.000
N	1531

As shown in [Table 1](#) above, **the slope coefficient is 5.862 (0.527)**: a 1 percentage point increase in the match rate would correspond to an increase of almost 6 percentage points in the participation rate to 401K plans of the employees, which could indicate that more employees are willing to make this kind of investment when their companies promote 401K plans by matching a higher percentage of their own contributions.

Question 4

Is the assumption of zero-conditional mean realistic? Explain your evidence. What are the implications for your OLS coefficients?

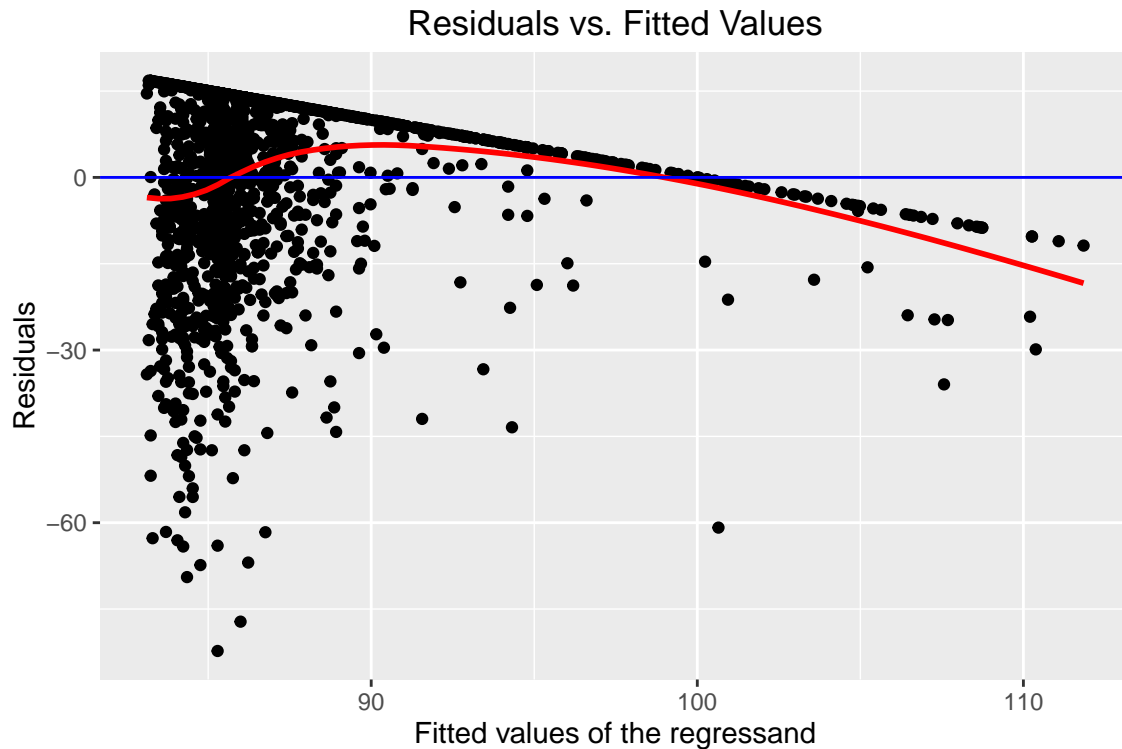
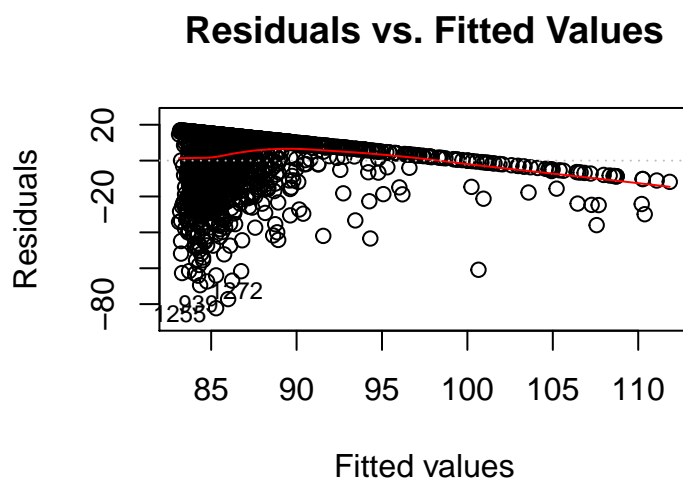


Figure 7: Scatterplot of fitted values of the regressand against the residuals



One of the ways to check this assumption is by plotting the residuals (\hat{u}) against the fitted values (\hat{y}), or even against the regressor when only one is used. This plot shows that the residuals change with the fitted

values, which suggests that the assumption may **not** be **realistic** (as well as a possible non-linear relationship between `mrate` and `prate`).

Question 5

Is the assumption of homoskedasticity realistic? Provide at least two pieces of evidence to support your conclusion. What are the implications for your OLS analysis?

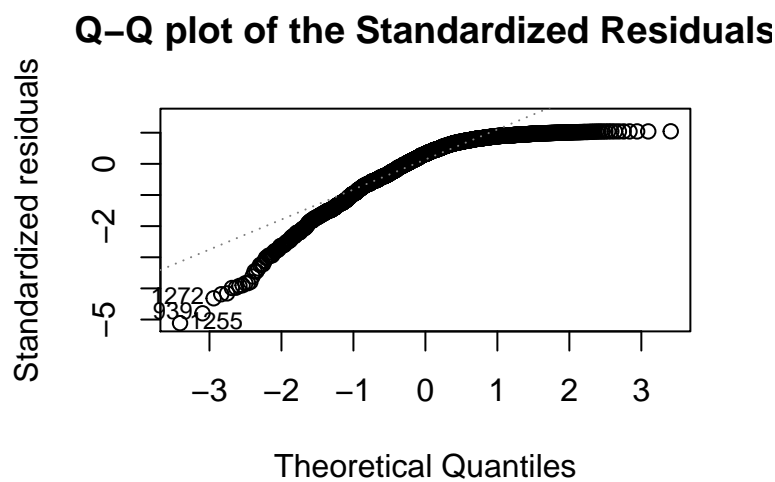
The funnel shape of [Figure 7](#) also suggests that the assumption of homoskedasticity is **not realistic**. based on the shape of the scatterplot: the variance of the residuals is much greater for lower values of \hat{y} than it is for greater values.

Question 6

Is the assumption of normal errors realistic? Provide at least two pieces of evidence to support your conclusion. What are the implications for your OLS analysis?



Figure 8: Q-Q plot of the residuals of the regression



The left tail of the Q-Q plot twists counterclockwise, while the right tail twists clockwise, which indicates that the distribution is left-skewed (and not normal).

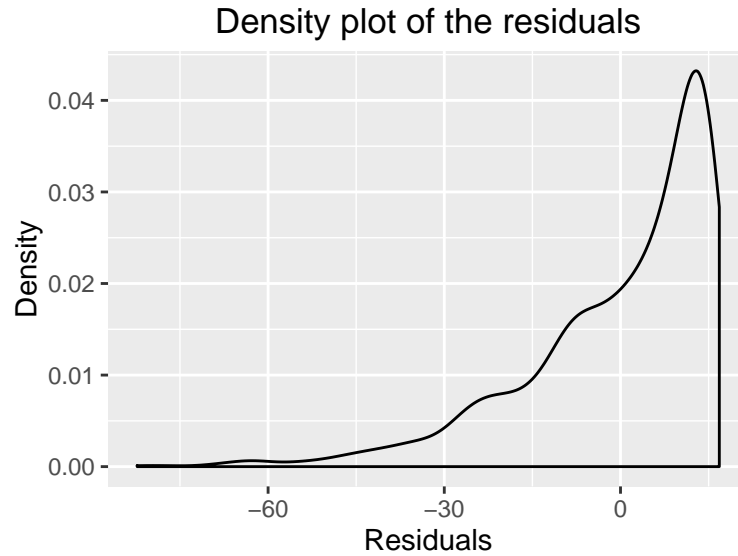


Figure 9: Density plot of the residuals of the regression

Question 7

Based on the above considerations, what is the standard error of your slope coefficient?

Question 8

Is the effect you find statistically significant, and is it practically significant?