Incidental Parameters Problem: The Case of Gompertz Model

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Authors’ contributions

This work was carried out in collaboration between both authors. Author IAB designed the study and wrote the computer program for simulation and the first draft of the manuscript. Author BTB compiled the results, managed the literature searches and wrote the conclusion. Both authors read and approved the final manuscript.

Article Information

DOI: 10.9734/AJPAS/2021/v15i13034

Editor(s):
(1) Dr. Manuel Alberto M. Ferreira, Lisbon University, Portugal.

Reviewers:
(1) Obite, Chukwudi Paul, Federal University of Technology, Nigeria.
(2) Zhichun Yang, Chongqing Normal University, China.

Complete Peer review History: https://www.sdiarticle4.com/review-history/71476

Received 10 July 2021
Accepted 11 September 2021
Published 02 October 2021

Abstract

The order of bias of the fixed effects gompertz model is studied, using Monte Carlo approach. Performance criteria are bias and root mean squared errors. For fixed N, bias is found to decrease steadily between T=5 and T=20 but exhibits a mixture of increase and decline afterwards. At each value of T involved, bias steadily decreases with increased value of N. Bias is found to be at most 123%, due to the combination of minimum of each of N and T involved. Decrease in order of bias is found to be more definite with increased N at fixed T than with increased T at fixed N.

Keywords: Bias; binary; fixed effects; inconsistency; maximum likelihood.

1 Introduction

In fixed effects panel data binary choice modeling, the individual specific effects, $\mu_i$ are assumed to be fixed and are to be estimated along with parameter vector, $\beta$. The obvious implication of such is that as the number of individuals involved in the study, N grows, the number of parameters to be estimated equally grows, with
attendant loss of degrees of freedom. The fact that, maximum likelihood estimators of such binary choice models are consistent only when the number of time points, T involved in the study and not N, tends to infinity, is well documented in the literature [1-3].

Unfortunately, most times, data are available for small T and large N, since it is much easier to increase the number of individuals in a study than to increase the number of time points. The inconsistency that characterizes the estimators as N grows for a fixed T is what is described in the literature as the *incidental parameters problem* [4,5]. Unlike in the linear models, where the individual specific effects can be eliminated by some form of transformation, the situation is not the same with binary choice models, which are mostly non-linear.

Within the parametric framework, a notable contribution, in form of panacea to the incidental parameters problem, based on some form of conditioning, for the logit model was made by Chamberlain [6]. This conditioning has not yielded useful results for most models. Heckman [7,8] studied order of bias for the binary probit model in static and dynamic models respectively. The order of bias for the static case is at most 10%. Results in the dynamic case indicate significant bias, which increases with the variance of the individual specific effects.

Greene [9] studied order of bias in logit and probit models and finds that at N=1000 and T=2, bias is 100%, thereby corroborating results obtained by Hsiao [2] for the logit. A few of several other works in both static and dynamic panel data models include Greene [10]; Moreira [11]; Hahn and Kuersteiner [12] and Moon, Perron and Philips [13]. More recent works include Femendez-Val and Weidner [14]; Moon and Wedner [15]; Boneva and Linton [16] and Juodis [17]. This article studies the order of bias of fixed effects gompertz model.

The remaining part of the article is organized as follows: Section 2 presents the Theoretical Framework; Section 3, presents the Methods; Section 4 presents the Results and Discussion while the last section concludes the article.

### 2 Theoretical Framework

The basic building block for the binary choice model of interest is the model

\[
y_{it}^* = \beta x_{it} + \mu_i + v_{it} \quad i=1, \ldots, N; \ t=1,\ldots, T
\]  

(2.1a)

The observability criterion is

\[
y_{it} = 1(y_{it}^* > 0)
\]  

(2.1b)

\(\mu_i\) is the unobserved individual specific heterogeneity;

\(v_{it}\) is the usual stochastic error term in regression;

\(\beta\) is a constant;

\(y_{it}^*\) is a latent variable observed through \(y_{it}\).

In binary choice modeling, the primary interest is the probability that the event occurs, given the vector of regressors, \(X\). This probability, within the context of fixed effects modeling is

\[
P[y_{it} = 1 | x_{it}, \mu_i] = F(\beta' x_{it} + \mu_i)
\]  

(2.2)
The probability distribution that describes \( V_a \) in (2.1a) is the tolerance, and it determines the form of binary choice model. For the binary choice model of interest, \( V_a \) is standard type I extreme value (maximum). The resulting binary choice model is gompertz, defined

\[
P[y_{it} = 1/ x_{it} , \mu_t] = \exp[-\exp(- (\beta^t x_{it} + \mu_t))]
\]  

(2.3)

Designating \( P[y_{it} = 1/ x_{it} , \mu_t] \) by \( p \), it follows from (2.3) that

\[
- \log(- \log p) = \beta^t x + \mu_i
\]  

(2.4)

\(- \log(- \log p)\) is the so called link function. Hence, the gompertz model is linear in the negative of log of the negative of the log of \( p \).

3 Methodology

This section presents the model, data generating procedure, parameter estimation and performance criteria.

3.1 The model

The model under consideration is one described by combination of (2.1a) and (2.1b). It is a balanced 1-way fixed effects error components model with a single regressor. This model is suitable for modeling binary panel data, when the omitted individual specific heterogeneity is taken into account and inference drawn is to apply only to units involved in the study.

3.2 Data generating procedure

The latent and observed response variables are generated according to (2.1a) and (2.1b) and the exogenous variable, \( x_{it} \), generated as obtainable in Nerlove [18]:

\[
x_{it} = 0.1t + 0.5x_{it-1} + \epsilon_{it}
\]  

(3.1)

where \( \epsilon_{it} \) is uniformly distributed on the interval (-.5, .5). \( x_{i0} \) is chosen as \( 5 + 10\epsilon_{i0} \). \( V_{it} \) is generated as standard extreme value (maximum) in harmony with the tolerance requirement for gompertz model. \( \sigma_{\mu}^2 \) and \( \beta \) are each set at 1. \( N \) is set at 25, 50, 100, 150, and 200 while \( T \) is set at 5, 10, 15, 20, 25, 30, and 40. 5000 replications are performed.

3.3 Estimation of parameters

Estimation of parameters is carried out through maximum likelihood method. Under the fixed effects framework, the likelihood function for NT observations is

\[
L = \prod_{i=1}^{N} \prod_{t=1}^{T} F(\beta^t x_{it} + \mu_t)^{y_{it}} (1 - F(\beta^t x_{it} + \mu_t))^{1-y_{it}}
\]  

(3.2)

So that
\[ \log L = \sum_{i=1}^{N} \sum_{t=1}^{T} \left( y_{it} \log F(\beta'_{i} x_{it} + \mu_i) + (1 - y_{it}) \log(1 - F(\beta'_{i} x_{it} + \mu_i)) \right) \]  

(3.3)

And

\[ \frac{\partial \log L}{\partial \beta} = \sum_{i=1}^{N} \sum_{t=1}^{T} \left[ \frac{(y_{it} - F(\beta'_{i} x_{it} + \mu_i))}{F(\beta'_{i} x_{it} + \mu_i)(1 - F(\beta'_{i} x_{it} + \mu_i))} \right] F'(\beta'_{i} x_{it} + \mu_i)x_{it} = 0 \]  

(3.4)

\[ \frac{\partial \log L_i}{\partial \mu_i} \] can be derived by noting that \( L_i \) is the likelihood for \( T \) time points for the \( i \)th individual.

Hence, \( L_i \) is

\[ L_i = \prod_{t=1}^{T} F(\beta'_{i} x_{it} + \mu_i)^{y_{it}}(1 - F(\beta'_{i} x_{it} + \mu_i))^{1 - y_{it}} \]  

(3.5)

\[ \log L_i = \sum_{t=1}^{T} \left[ y_{it} \log F(\beta'_{i} x_{it} + \mu_i) + (1 - y_{it}) \log(1 - F(\beta'_{i} x_{it} + \mu_i)) \right] \]  

(3.6)

\[ \frac{\partial \log L_i}{\partial \mu_i} = \sum_{t=1}^{T} \left[ \frac{y_{it}}{F(\beta'_{i} x_{it} + \mu_i)} \cdot \frac{\partial F(\beta'_{i} x_{it} + \mu_i)}{\partial \mu_i} + \frac{(1 - y_{it})}{1 - F(\beta'_{i} x_{it} + \mu_i)} \cdot \frac{\partial F(\beta'_{i} x_{it} + \mu_i)}{\partial \mu_i} \right] \]  

(3.7)

where

\[ F(\beta'_{i} x + \mu_i) = \exp(-\exp(-\beta'_{i} x + \mu_i)) \]  

(3.8a)

\[ F'(\beta'_{i} x_{it} + \mu_i) = \exp(-\exp(-\beta'_{i} x_{it} + \mu_i)) \exp(-\beta'_{i} x_{it} + \mu_i) \]  

(3.8b)

Numerical solution (using Newton-Raphson method) to (3.4) provides the parameter estimates.

3.4 Criteria for performance evaluation

The performance criteria are the bias (BIAS) and the root mean square error (RMSE), defined below:

For the experiment that is replicated \( r \) times, let us define by \( \hat{\beta}_j \), the \( j \)th estimate of the true parameter value, \( \beta \). Then,
\[
\text{BIAS}(\hat{\beta}) = \frac{1}{r} \sum_{j=1}^{r} (\hat{\beta}_j - \beta)
\]  
(3.8a)

\[
\text{RMSE}(\hat{\beta}) = \left( \frac{1}{r} \sum_{j=1}^{r} (\hat{\beta}_j - \beta)^2 \right)^{\frac{1}{2}}
\]  
(3.8b)

4 Results and Discussion

Results are presented in Tables 1 to 4, attached as Appendix. For fixed N, bias decreases steadily between T=5 and T=20 but exhibits a mixture of increase and decline afterwards. This pattern is typical for all values of N. Bias is at most 123% for T=5; 39% for T=10; 31% for T=15 and 20; 34% for T=25; 32% for T=30 and 34% for T=40. Maximum bias for each T occurs at N=25 (See Table 1).

For fixed T, the situation is different as it is devoid of mixture of increase and decline; rather, a definite pattern is exhibited. At each value of T involved, bias steadily decreases with increased value of N; lower biases are associated with higher N values. For instance, at T=5, bias crashes from 123% for N=25 to 68% for N=200. This is also typical for other values of T. Bias is at most 123% for N=25; 88% for N=50; 75% for N=100; 70% for N=150 and 68% for N=200.

Median bias also decreases with decreased N at fixed T and decreased T at fixed N (See Tables 2 and 3). Median biases for various N values range between 23 and 31% while median biases for various T range between 26 and 75%. The root mean squared errors decrease at each fixed T for increasing N, same does not however, hold for fixed N and increasing T as the behaviour mimics that of biases. The mean squared errors reduce consistently between T=5 and T=15 with increasing N, this is true for each N. The reverse is the cases of T values that greater than 25 as the values increase consistently (See Table 4).

5 Conclusion

This paper investigates the order of bias of the gompertz fixed effects model. The bias is found to be at most 123% and decreases with increased N. Decrease in order of bias is found to be more definite with increased N at fixed T than with increased T at fixed N. The need to extend study to other discrete choice models is recommended.

Competing Interests

Authors have declared that no competing interests exist.

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Appendix

Table 1. Biases

| T  | N=25   | N=50   | N=100  | N=150  | N=200  |
|----|--------|--------|--------|--------|--------|
| 5  | 1.22516| .87946 | .74767 | .70167 | .67765 |
| 10 | .39366 | .34355 | .31535 | .30660 | .30416 |
| 15 | .31207 | .26001 | .24240 | .23752 | .23349 |
| 20 | .30662 | .25163 | .23352 | .22346 | .22216 |
| 25 | .34342 | .25999 | .23333 | .22584 | .22428 |
| 30 | .32485 | .26208 | .24119 | .23329 | .23009 |
| 40 | .33602 | .29161 | .26339 | .25213 | .25206 |

Table 2. Median biases at N

| N  | 25   | 50   | 100  | 150  | 200  |
|----|------|------|------|------|------|
| Median | .30662 | .26208 | .2424 | .23752 | .23349 |

Table 3. Median biases at T

| T  | 5     | 10    | 15    | 20    | 25    | 30    | 40    |
|----|-------|-------|-------|-------|-------|-------|-------|
| Median | .74767 | .31535 | .24240 | .23352 | .23333 | .24119 | .26339 |

Table 4. Mean square errors

| T  | N=25   | N=50   | N=100  | N=150  | N=200  |
|----|--------|--------|--------|--------|--------|
| 5  | 2.962347| 1.650796| 1.354399| 1.271303| 1.226676|
| 10 | 1.026266| .905075 | .849644 | .832922 | .824934 |
| 15 | .902789 | .806723 | .774339 | .763100 | .757051 |
| 20 | .902962 | .795932 | .763799 | .750072 | .745967 |
| 25 | .908387 | .804628 | .763198 | .752396 | .748342 |
| 30 | .920917 | .804743 | .771570 | .758691 | .753082 |
| 40 | .922127 | .835150 | .789945 | .775680 | .772603 |

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Peer-review history:
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