



**AgEcon** SEARCH  
RESEARCH IN AGRICULTURAL & APPLIED ECONOMICS

*The World's Largest Open Access Agricultural & Applied Economics Digital Library*

**This document is discoverable and free to researchers across the globe due to the work of AgEcon Search.**

**Help ensure our sustainability.**

Give to AgEcon Search

AgEcon Search

<http://ageconsearch.umn.edu>

[aesearch@umn.edu](mailto:aesearch@umn.edu)

*Papers downloaded from **AgEcon Search** may be used for non-commercial purposes and personal study only. No other use, including posting to another Internet site, is permitted without permission from the copyright owner (not AgEcon Search), or as allowed under the provisions of Fair Use, U.S. Copyright Act, Title 17 U.S.C.*

# THE STATA JOURNAL

## Editor

H. Joseph Newton  
Department of Statistics  
Texas A & M University  
College Station, Texas 77843  
979-845-8817; FAX 979-845-6077  
jnewton@stata-journal.com

## Editor

Nicholas J. Cox  
Department of Geography  
Durham University  
South Road  
Durham City DH1 3LE UK  
n.j.cox@stata-journal.com

## Associate Editors

Christopher F. Baum  
Boston College

Rino Bellocco  
Karolinska Institutet, Sweden and  
Univ. degli Studi di Milano-Bicocca, Italy

A. Colin Cameron  
University of California–Davis

David Clayton  
Cambridge Inst. for Medical Research

Mario A. Cleves  
Univ. of Arkansas for Medical Sciences

William D. Dupont  
Vanderbilt University

Charles Franklin  
University of Wisconsin–Madison

Allan Gregory  
Queen’s University

James Hardin  
University of South Carolina

Ben Jann  
ETH Zürich, Switzerland

Stephen Jenkins  
University of Essex

Ulrich Kohler  
WZB, Berlin

Jens Lauritsen  
Odense University Hospital

Stanley Lemeshow  
Ohio State University

J. Scott Long  
Indiana University

Thomas Lumley  
University of Washington–Seattle

Roger Newson  
Imperial College, London

Marcello Pagano  
Harvard School of Public Health

Sophia Rabe-Hesketh  
University of California–Berkeley

J. Patrick Royston  
MRC Clinical Trials Unit, London

Philip Ryan  
University of Adelaide

Mark E. Schaffer  
Heriot-Watt University, Edinburgh

Jeroen Weesie  
Utrecht University

Nicholas J. G. Winter  
University of Virginia

Jeffrey Wooldridge  
Michigan State University

## Stata Press Production Manager

## Stata Press Copy Editor

Lisa Gilmore  
Deirdre Patterson

**Copyright Statement:** The Stata Journal and the contents of the supporting files (programs, datasets, and help files) are copyright © by StataCorp LP. The contents of the supporting files (programs, datasets, and help files) may be copied or reproduced by any means whatsoever, in whole or in part, as long as any copy or reproduction includes attribution to both (1) the author and (2) the Stata Journal.

The articles appearing in the Stata Journal may be copied or reproduced as printed copies, in whole or in part, as long as any copy or reproduction includes attribution to both (1) the author and (2) the Stata Journal.

Written permission must be obtained from StataCorp if you wish to make electronic copies of the insertions. This precludes placing electronic copies of the Stata Journal, in whole or in part, on publicly accessible web sites, fileservers, or other locations where the copy may be accessed by anyone other than the subscriber.

Users of any of the software, ideas, data, or other materials published in the Stata Journal or the supporting files understand that such use is made without warranty of any kind, by either the Stata Journal, the author, or StataCorp. In particular, there is no warranty of fitness of purpose or merchantability, nor for special, incidental, or consequential damages such as loss of profits. The purpose of the Stata Journal is to promote free communication among Stata users.

The *Stata Journal*, electronic version (ISSN 1536-8734) is a publication of Stata Press. Stata and Mata are registered trademarks of StataCorp LP.

# Causal inference with observational data

Austin Nichols  
Urban Institute  
Washington, DC  
austinnichols@gmail.com

**Abstract.** Problems with inferring causal relationships from nonexperimental data are briefly reviewed, and four broad classes of methods designed to allow estimation of and inference about causal parameters are described: panel regression, matching or reweighting, instrumental variables, and regression discontinuity. Practical examples are offered, and discussion focuses on checking required assumptions to the extent possible.

**Keywords:** st0136, xtreg, psmatch2, nnmatch, ivreg, ivreg2, ivregress, rd, lpoly, xtoverid, ranktest, causal inference, match, matching, reweighting, propensity score, panel, instrumental variables, excluded instrument, weak identification, regression, discontinuity, local polynomial

## 1 Introduction

Identifying the causal impact of some variables,  $X^T$ , on  $y$  is difficult in the best of circumstances, but faces seemingly insurmountable problems in observational data, where  $X^T$  is not manipulable by the researcher and cannot be randomly assigned. Nevertheless, estimating such an impact or “treatment effect” is the goal of much research, even much research that carefully states all findings in terms of associations rather than causal effects. I will call the variables  $X^T$  the “treatment” or treatment variables, and the term simply denotes variables of interest—they need not be binary (0/1) nor have any medical or agricultural application.

Experimental research designs offer the most plausibly unbiased estimates, but experiments are frequently infeasible due to cost or moral objections—no one proposes to randomly assign smoking to individuals to assess health risks or to randomly assign marital status to parents so as to measure the impacts on their children. Four types of quasiexperimental research designs offering approaches to causal inference using observational data are discussed below in rough order of increasing internal validity (Shadish, Cook, and Campbell 2002):

- Ordinary regression and panel methods
- Matching and reweighting estimators
- Instrumental variables (IV) and related methods
- Regression discontinuity (RD) designs

Each has strengths and weaknesses discussed below. In practice, the data often dictate the method, but it is incumbent upon the researcher to discuss and check (insofar as possible) the assumptions that allow causal inference with these models, and to qualify conclusions appropriately. Checking those assumptions is the focus of this paper.

A short summary of these methods and their properties is in order before we proceed. To eliminate bias, the regression and panel methods typically require confounding variables either to be measured directly or to be invariant along at least one dimension in the data, e.g., invariant over time. The matching and reweighting estimators require that selection of treatment  $X^T$  depend only on observable variables, both a stronger and weaker condition. IV methods require extra variables that affect  $X^T$  but not outcomes directly and throw away some information in  $X^T$  to get less efficient and biased estimates that are, however, consistent (i.e., approximately unbiased in sufficiently large samples). RD methods require that treatment  $X^T$  exhibit a discontinuous jump at a particular value (the “cutoff”) of an observed assignment variable and provide estimates of the effect of  $X^T$  for individuals with exactly that value of the assignment variable. To get plausibly unbiased estimates, one must either give up some efficiency or generalizability (or both, especially for IV and RD) or make strong assumptions about the process determining  $X^T$ .

## 1.1 Identifying a causal effect

Consider an example to fix ideas. Suppose that for people suffering from depression, the impact of mental health treatment on work is positive. However, those who seek mental health treatment (or seek more of it) are less likely to work, even conditional on all other observable characteristics, because their depression is more severe (in ways not measured by any data we can see). As a result, we estimate the impact of treatment on work, incorrectly, as being negative.

A classic example of an identification problem is the effect of college on earnings (Card 1999, 2001). College is surely nonrandomly assigned, and there are various important unobserved factors, including the alternatives available to individuals, their time preferences, the prices and quality of college options, academic achievement (often “ability” in economics parlance), and access to credit. Suppose that college graduates earn 60 and others earn 40 on average. One simple (implausible but instructive) story might be that college has no real effect on productivity or earnings, but those who pass a test  $S$  that grants entry to college have productivity of 60 on average and go to college. Even in the absence of college, they would earn 60 if they could signal (see Spence 1973) productivity to employers by another means (e.g., by merely reporting the result of test  $S$ ). Here extending college to a few people who failed test  $S$  would not improve their productivity at all and might not affect their earnings (if employers observed the result of test  $S$ ).

If we could see the outcome for each case when treated and not treated (assuming a single binary treatment  $X^T$ ) or an outcome  $y$  for each possible level of  $X^T$ , we could calculate the treatment effect for each individual  $i$  and compute an average. Of course,

this is not possible as each gets some level of  $X^T$  or some history of  $X^T$  in a panel setting. Thus we must compare individuals  $i$  and  $j$  with different  $X^T$  to estimate an average treatment effect (ATE). When  $X^T$  is nonrandomly assigned, we have no guarantee that individuals  $i$  and  $j$  are comparable in their response to treatment or what their outcome would have been given another  $X^T$ , even on average. The notion of “potential outcomes” (Rubin 1974) is known as the *Rubin causal model*. Holland (1986) provided the classic exposition of this now dominant theoretical framework for causal inference, and Rubin (1990) clarified the debt that the Rubin causal model owes to Neyman (1923) and Fisher (1918, 1925).

In all the models discussed in this paper, we assume that the effect of treatment is on individual observations and does not spill over onto other units. This is called the stable-unit-treatment-value assumption by Rubin (1986). Often, this may be only approximately true, e.g., the effect of a college education is not only on the earnings of the recipient, since each worker participates in a labor market with other graduates and nongraduates.

What is the most common concern about observational data? If  $X^T$  is correlated with some other variable  $X^U$  that also has a causal impact on  $y$ , but we do not measure  $X^U$ , we might assess the impact of  $X^T$  as negative even though its true impact is positive. Sign reversal is an extreme case, sometimes called *Simpson’s paradox*, though it is not a paradox and Simpson (1951) pointed out the possibility long after Yule (1903). More generally, the estimate of the impact of  $X^T$  may be biased and inconsistent when  $X^T$  is nonrandomly assigned. That is, even if the sign of the estimated impact is not the opposite of the true impact, our estimate need not be near the true causal impact on average, nor approach it asymptotically. This central problem is usually called *omitted-variable bias* or *selection bias* (here selection refers to the nonrandom selection of  $X^T$ , not selection on the dependent variable as in *heckman* and related models).

## 1.2 Sources of bias and inconsistency

The selection bias (or omitted-variable bias) in an ordinary regression arises from endogeneity (a regressor is said to be endogenous if it is correlated with the error), a condition that also occurs if the explanatory variable is measured with error or in a system of “simultaneous equations” (e.g., suppose that work also has a causal impact on mental health or higher earnings cause increases in education; in this case, it is not clear what impact, if any, our single-equation regressions identify).

Often a suspected type of endogeneity can be reformulated as a case of omitted variables, perhaps with an unobservable (as opposed to merely unobserved) omitted variable, about which we can nonetheless make some predictions from theory to sign the likely bias.

The formula for omitted-variable bias in linear regression is instructive. With a true model

$$y = \beta_0 + X^T \beta_T + X^U \beta_U + \varepsilon$$

where we regress  $y$  on  $X^T$  but leave out  $X^U$  (for example, because we cannot observe it), the estimate of  $\beta_T$  has bias

$$E(\hat{\beta}_T) - \beta_T = \delta\beta_U$$

where  $\delta$  is the coefficient of an auxiliary regression of  $X^U$  on  $X^T$  (or the matrix of coefficients of stacked regressions when  $X^U$  is a matrix containing multiple variables) so the bias is proportional to the correlation of  $X^U$  and  $X^T$  and to the effect of  $X^U$  (the omitted variables) on  $y$ .

In nonlinear models, such as a **probit** or **logit** regression, the estimate will be biased and inconsistent even when  $X^T$  and  $X^U$  are uncorrelated, though Wooldridge (2002, 471) demonstrates that some quantities of interest may still be identified under additional assumptions.

### 1.3 Sensitivity testing

Manski (1995) demonstrates how a causal effect can be bounded under very unrestrictive assumptions and then how the bounds can be narrowed under more restrictive parametric assumptions. Given how sensitive the quasiexperimental methods are to assumptions (selection on observables, exclusion restrictions, exchangeability, etc.), some kind of sensitivity testing is in order no matter what method is used. Rosenbaum (2002) provides a comprehensive treatment of formal sensitivity testing under various parametric assumptions.

Lee (2005) advocates another useful method of bounding treatment effects, which was used in Leibbrandt, Levinsohn, and McCrary (2005).

### 1.4 Systems of equations

Some of the techniques discussed here to address selection bias are also used in the simultaneous-equations setting. The literature on structural equations models is extensive, and a system of equations may encode a complicated conceptual causal model, with many “causal arrows” drawn to and from many variables. The present exercise of identifying the causal impact of some limited set of variables  $X^T$  on a single outcome  $y$  can be seen as restricting our attention in such a complicated system to just one equation, and identifying just some subset of causal effects.

For example, in a simplified supply-and-demand system:

$$\ln Q_{\text{supply}} = e_s \ln P + a \text{TransportCost} + \varepsilon_s$$

$$\ln Q_{\text{demand}} = e_d \ln P + b \text{Income} + \varepsilon_d$$

where price ( $\ln P$ ) is endogenously determined by a market-clearing condition  $\ln Q_{\text{supply}} = \ln Q_{\text{demand}}$ , our present enterprise limits us to identifying only the demand elasticity  $e_d$  using factors that shift supply to identify exogenous shifts in price faced by consumers

(exogenous relative to the second equation's error  $\varepsilon_d$ ), or identifying only the supply elasticity  $e_s$  using factors that shift demand to identify exogenous shifts in price faced by firms (exogenous relative to the first equation's error  $\varepsilon_s$ ).

See [R] **reg3** for alternative approaches that can simultaneously identify parameters in multiple equations, and Heckman and Vytlacil (2004) and Goldberger and Duncan (1973) for more detail.

## 1.5 ATE

In an experimental setting, typically the only two quantities to be estimated are the sample ATE or the population ATE—both estimated with a difference in averages across treatment groups (equal in expectation to the mean of individual treatment effects over the full sample). In a quasiexperimental setting, several other ATEs are commonly estimated: the ATE on the treated, the ATE on the untreated or control group, and a variety of local ATEs (LATE)—local to some range of values or some subpopulation. One can imagine constructing at least  $2^N$  different ATE estimates in a sample of  $N$  observations, restricting attention to two possible weights for each observation. Allowing a variety of weights and specifications leads to infinitely many LATE estimators, not all of which would be sensible.

For many decision problems, a highly relevant effect estimate is the marginal treatment effect (MTE), either the ATE for the marginal treated case—the expected treatment effect for the case that would get treatment with a small expansion of the availability of treatment—or the average effect of a small increase in a continuous treatment variable. Measures of comparable MTEs for several options can be used to decide where a marginal dollar (or metaphorical marginal dollar, including any opportunity costs and currency translations) should be spent. In other words, with finite resources, we care more about budget-neutral improvements in effectiveness than the effect of a unit increase in treatment, so we can choose among treatment options with equal cost. Quasiexperimental methods, especially IV and RD, often estimate such MTEs directly.

If the effect of a treatment  $X^T$  varies across individuals (i.e., it is not the case that  $\beta_i = \beta$  for all  $i$ ), the ATE for different subpopulations will differ. We should expect different consistent estimators to converge to different quantities. This problem is larger than the selection-bias issue. Even in the absence of endogenous selection of  $X^T$  (but possibly with some correlation between  $X_i^T$  and  $\beta_i$ , itself now properly regarded as a random variable) in a linear model, ordinary least squares (OLS) will not, in general, be consistent for the average over all  $i$  of individual effects  $\beta_i$ . Only with strong distributional assumptions can we proceed; e.g., if we assume  $\beta_i$  is normally distributed then the ATE may be consistently estimated by `xtmixed` or `xtrc`, or if we assume  $X^T$  is normally distributed then the ATE may be consistently estimated by OLS.

## 2 Regression and panel methods

If an omitted variable can be measured or proxied by another variable, an ordinary regression may yield an unbiased estimate. The most efficient estimates (ignoring issues around weights or nonindependent errors) are produced by OLS when it is unbiased. The measurement error entailed in a proxy for an unobservable, however, could actually exacerbate bias, rather than reduce it. One is usually concerned that cases with differing  $X^T$  may also differ in other ways, even conditional on all other observables  $X^C$  (“control” variables). Nonetheless, a sequence of ordinary regressions that add or drop variables can be instructive as to the nature of various forms of omitted-variable bias in the available data.

A complete discussion of panel methods would not fit in any one book, much less this article. However, the idea can be illuminated with one short example using linear regression.

Suppose that our theory dictates a model is of the form

$$y = \beta_0 + X^T \beta_T + X^U \beta_U + \varepsilon$$

where we do not observe  $X^U$ . The omitted variables  $X^U$  vary only across groups, where group membership is indexed by  $i$ , so a representative observation can be written as

$$y_{it} = \beta_0 + X_{it}^T \beta_T + u_i + \varepsilon_{it}$$

where  $u_i = X_i^U \beta_U$ . Then we can eliminate the bias arising from omission of  $X^U$  by differencing

$$y_{it} - y_{is} = (X_{it}^T - X_{is}^T) \beta_T + (\varepsilon_{it} - \varepsilon_{is})$$

using various definitions of  $s$ .

The idea of using panel methods to identify a causal impact is to use an individual panel  $i$  as its own control group, by including information from multiple points in time. The second dimension of the data indexed by  $t$  need not be time, but it is a convenient viewpoint.

A fixed-effects (FE) model such as `xtreg`, `fe` effectively subtracts the within- $i$  mean values of each variable, so, for example,  $\bar{X}_i^T = 1/N_i \sum_{s=1}^{N_i} X_{is}^T$ , and the model

$$y_{it} - \bar{y}_i = (X_{it}^T - \bar{X}_i^T) \beta_T + (\varepsilon_{it} - \bar{\varepsilon}_i)$$

can be estimated with OLS. This is also called the “within estimator” and is equivalent to a regression that includes an indicator variable for each panel  $i$ , allowing for a different intercept term for each panel.

An alternative to the FE model is to use the first difference (FD), i.e.,  $s = (t - 1)$  or

$$y_{it} - y_{i(t-1)} = (X_{it}^T - X_{i(t-1)}^T) \beta_T + (\varepsilon_{it} - \varepsilon_{i(t-1)})$$

which is `regress d.y d.x in tsset data` or `xtivreg2 y x, fd` (Schaffer and Stillman 2007), which offers more standard error (SE) corrections beyond `cluster()` and `robust`.

A third option is to use the long difference (LD), keeping only two observations per group. For a balanced panel, if  $t = b$  is the last observation and  $t = a$  is the first, the model is

$$y_{ib} - y_{ia} = (X_{ib}^T - X_{ia}^T)\beta_T + (\varepsilon_{ib} - \varepsilon_{ia})$$

producing only one observation per group (the difference of the first and last observations).

Figure 1 shows the interpretation of these three types of estimates by showing one panel's contribution to the estimated effect of an indicator variable that equals one for all  $t > 3$  ( $t$  in  $0, \dots, 10$ ) and equals zero elsewhere—e.g., a policy that comes into effect at some point in time (at  $t = 4$  in the example). The FE estimate compares the mean outcomes before and after, the FD estimate compares the outcome just prior to and just after the change in policy, and the LD estimate compares outcomes well before and well after the change in policy.

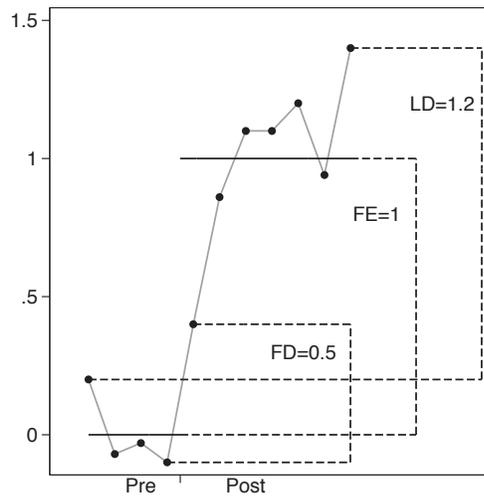


Figure 1: One panel's contributions to FE/FD/LD estimates

Clearly, one must impose some assumptions on the speed with which  $X^T$  affects  $y$  or have some evidence as to the right time frame for estimation. This type of choice comes up frequently when stock prices are supposed to have adjusted to some news, especially given the frequency of data available; economists believe the new information is capitalized in prices, but not instantaneously. Taking a difference in stock prices between 3 p.m. and 3:01 p.m. is inappropriate but taking a difference over a year is clearly inappropriate as well, because new information arrives continuously.

In panel models, one must usually think carefully about within-panel trends and the frequency of measurement. (We cannot usually obtain consistent estimates of within-panel trends for the same reason that we cannot usually obtain consistent estimates of

FE: the number of parameters increases linearly in the number of panels,  $N$ .) Baum (2006) discussed some filtering techniques to get different frequency “signals” from noisy data. A simple method used in Baker, Benjamin, and Stanger (1999) is often attractive, because it offers an easy way to decompose any variable  $X_t$  into two orthogonal components: a high-frequency component  $(X_t - X_{t-1})/2$  and a low-frequency component  $(X_t + X_{t-1})/2$  that together sum to  $X_t$ .

A simple example of all three (FE, FD, and LD) is

```
webuse grunfeld
xtreg inv ks, fe vce(cluster company)
regress d.inv d.ks, vce(cluster company)
summarize time, meanonly
generate t=time if time==r(min) | time==r(max)
tsset company t
regress d.inv d.ks, vce(cluster company)
```

Clearly, different assumptions about the error process apply in each case, in addition to assumptions about the speed with which  $X^T$  affects  $y$ . The FD and LD models require an ordered  $t$  index (such as time). The `vce(cluster clustvar)` option used above should be considered nearly *de rigueur* in panel models to allow for errors that may be correlated within group and not identically distributed across groups. The performance of the cluster-robust estimator is good with 50 or more clusters, or fewer if the clusters are large and balanced (Nichols and Schaffer 2007). For LD, the `vce(cluster clustvar)` option is equivalent to the `vce(robust)` option, because each group is represented by one observation.

Having eliminated bias due to unobservable heterogeneity across  $i$  units, it is often tempting to difference or demean again. It is common to include indicator variables for  $t$  in FE models, for example,

```
webuse grunfeld
quietly tabulate year, generate(d)
xtreg inv ks d*, fe vce(cluster company)
```

The above commands create a two-way FE model. If individuals,  $i$ , are observed in different settings,  $j$ —for example, students who attend various schools or workers who reside in various locales over time—we can also include indicator variables for  $j$  in an FE model. Thus we can consider various  $n$ -way FE models, though models with large numbers of dimensions for FE may rapidly become unstable or computationally challenging to fit.

The LD, FD, and FE estimators use none of the cross-sectional differences across groups (individuals),  $i$ , which can lead to lower efficiency (relative to an estimator that exploits cross-sectional variation). They also drop any variables that do not vary over  $t$  within  $i$ , so the coefficients on some variables of interest may not be estimated with these methods.

The random-effects estimator (RE) available with `xtreg` exploits cross-sectional variation and reports coefficients on variables that do not vary over  $t$  within  $i$ , but it requires strong assumptions about error terms that are often violated in practice. Particularly,

for RE to be unbiased in situations where FE is unbiased, we must assume that  $u_i$  is uncorrelated with  $X_{it}^T$  (which contradicts our starting point above, where we worried about a  $X^U$  correlated with  $X^T$ ). There is no direct test of this assumption about an unobservable disturbance term, but `hausman` and `xtoverid` (Schaffer and Stillman 2006) offer a test that the coefficients estimated in both the RE and FE models are the same, e.g.,

```
ssc install xtoverid
webuse grunfeld
egen ik=max(ks*(year==1935)), by(company)
xtreg inv ks ik, re vce(cluster company)
xtoverid
```

where a rejection casts doubt on whether RE is unbiased when FE is biased.

Other xt commands, such as `xtmixed` (see [XT] `xtmixed`) and `xthtaylor` (see [XT] `xthtaylor`), offer a variety of other panel methods that generally make further assumptions about the distribution of disturbances and sources of endogeneity. Typically, there is a tradeoff between improved efficiency bought by making assumptions about the data-generating process versus robustness to various violations of assumptions. See also Griliches and Hausman (1986) for more considerations related to all the above panel methods. Rothstein (2007) offers a useful applied examination of identifying assumptions in FE models and correlated RE models.

Generally, panel methods eliminate the bias because of some unobserved factors and not others. Considering the FE, FD, and LD models, it is often hard to believe that all the selection on unobservables is because of time-invariant factors. Other panel models often require unpalatable distributional assumptions.

### 3 Matching estimators

For one discrete set of treatments,  $X^T$ , we want to compare means or proportions much as we would in an experimental setting. We may be able to include indicators and interactions for factors (in  $X^C$ ) that affect selection into the treatment group (say, defined by  $X^T = 1$ ), to estimate the impact of treatment within groups of identical  $X^C$  using a fully saturated regression. There are also matching estimators (Cochran and Rubin 1973; Stuart and Rubin 2007) that compare observations with  $X^C$  by pairing observations that are close by some metric (see also Imai and van Dyk 2004). A set of alternative approaches involve reweighting so the joint or marginal distributions of  $X^C$  are identical for different groups.

Matching or reweighting approaches can give consistent estimates of a huge variety of ATEs, but only under the assumptions that the selection process depends on observables and that the model used to match or reweight is a good one. Often we push the problems associated with observational data from estimating the effect of  $X^T$  on  $y$  down onto estimating the effect of  $X^C$  on  $X^T$ . For this reason, estimates based on reweighting or matching are unlikely to convince someone unconvinced by OLS results. Selection on observables is not the type of selection most critics have in mind.

### 3.1 Nearest-neighbor matching

Nearest-neighbor matching pairs observations in the treatment and control groups and computes the difference in outcome  $y$  for each pair and then the mean difference across pairs. The Stata command `nnmatch` was described by Abadie et al. (2004). Imbens (2004) covered details of nearest-neighbor matching methods. The downside to nearest-neighbor matching is that it can be computationally intensive, and bootstrapped SEs are infeasible owing to the discontinuous nature of matching (Abadie and Imbens 2006).

### 3.2 Propensity-score matching

Propensity-score matching essentially estimates each individual's propensity to receive a binary treatment (with a `probit` or `logit`) as a function of observables and matches individuals with similar propensities. As Rosenbaum and Rubin (1983) showed, if the propensity was known for each case, it would incorporate all the information about selection, and propensity-score matching could achieve optimal efficiency and consistency. In practice, the propensity must be estimated and selection is not only on observables, so the estimator will be both biased and inefficient.

Morgan and Harding (2006) provide an excellent overview of practical and theoretical issues in matching and comparisons of nearest-neighbor matching and propensity-score matching. Their expositions of different types of propensity-score matching and simulations showing when it performs badly are particularly helpful. Stuart and Rubin (2007) offer a more formal but equally helpful discussion of best practices in matching.

Typically, one treatment case is matched to several control cases, but one-to-one matching is also common and may be preferred (Glazerman, Levy, and Myers 2003). One Stata command `psmatch2` (Leuven and Sianesi 2003) is available from the Statistical Software Components (SSC) archive (`ssc describe psmatch2`) and has a useful help file. There is another useful Stata command `pscore` (Becker and Ichino 2002; `findit pscore` in Stata). `psmatch2` will perform one-to-one (nearest neighbor or within caliper, with or without replacement),  $k$ -nearest neighbors, radius, kernel, local linear regression, and Mahalanobis matching.

Propensity-score methods typically assume a common support; i.e., the range of propensities to be treated is the same for treated and control cases, even if the density functions have different shapes. In practice, it is rare that the ranges of estimated propensity scores are the same for both the treatment and control groups, but they do nearly always overlap. Generalizations about treatment effects should probably be limited to the smallest connected area of common support.

Often a density estimate below some threshold greater than zero defines the end of common support; see Heckman, Ichimura, and Todd (1997) for more discussion. This is because the common support is the range where both densities are nonzero, but the estimated propensity scores take on a finite number of values. Thus the empirical densities will be zero almost everywhere. Generally, we need to use a kernel density estimator like `kdensity` to obtain smooth estimated densities of the propensity score

for both treatment and control groups, but then areas of zero density will have positive density estimates. Thus some small value  $f_0$  is redefined to be effectively zero, and the smallest connected range of estimated propensity scores  $\hat{\lambda}$  with  $\hat{f}(\hat{\lambda}) \geq f_0$  for both treatment and control groups is used in the analysis, and observations outside this range are discarded.

Regardless of whether the estimation or extrapolation of estimates is limited to a range of propensities or ranges of  $X^C$  variables, the analyst should present evidence on how the treatment and control groups differ and on which subpopulation is being studied. The standard graph here is an overlay of kernel density estimates of propensity scores for treatment and control groups. This is easy to create in Stata with `twoway kdensity`.

### 3.3 Sensitivity testing

Matching estimators have perhaps the most detailed literature on formal sensitivity testing. Rosenbaum (2002) bounds on treatment effects may be constructed by using `psmatch2` and `rbounds`, a user-written command by DiPrete and Gangl (2004), who compare Rosenbaum bounds in a matching model with IV estimates. `sensatt` by Nannicini (2006) and `mhbounds` by Becker and Caliendo (2007) are also Stata programs for sensitivity testing in matching models.

### 3.4 Reweighting

The propensity score can also be used to reweight treatment and control groups so the distribution of  $X^C$  looks the same in both groups. The basic idea is to use a `probit` or `logit` regression of treatment on  $X^C$  to estimate the conditional probability  $\hat{\lambda}$  of being in the treatment group and to use the odds  $\hat{\lambda}/(1 - \hat{\lambda})$  as a weight. This is like inverting the test of randomization used in experimental designs to make the group status look as if it were randomly assigned.

As Morgan and Harding (2006) point out, all the matching estimators can also be thought of various reweighting schemes whereby treatment and control observations are reweighted to allow causal inference on the difference in means. A treatment case  $i$  matched to  $k$  cases in an interval, or  $k$ -nearest neighbors, contributes  $y_i - k^{-1} \sum_1^k y_j$  to the estimate of a treatment effect. One could easily rewrite the estimate of a treatment effect as a weighted-mean difference.

The reweighting approach leads to a whole class of weighted least-squares estimators and is connected to techniques described by DiNardo, Fortin, and Lemieux (1996), Autor, Katz, and Kerney (2005), Leibbrandt, Levinsohn, and McCrary (2005), and Machado and Mata (2005). These techniques are related to various decomposition techniques in Blinder (1973), Oaxaca (1973), Yun (2004, 2005a,b), Gomulka and Stern (1990), and Juhn, Murphy, and Pierce (1991, 1993). DiNardo (2002) usefully outlines some connections between propensity-score methods and the decomposition techniques.

The `df1` (Azevedo 2005), `oaxaca` (Jann 2005b), and `jmpierce` (Jann 2005a) commands available from the SSC archive are useful for the latter. The decomposition techniques seek to attribute observed differences in an outcome  $y$  both to differences in  $X^C$  variables and differences in the associations between  $X^C$  variables and  $y$ . They are most useful for comparing two distributions where the binary variable defining the group to which an observation belongs is properly considered exogenous, e.g., sex or calendar year. See also Rubin (1986).

The reweighting approach is particularly useful in combining matching-type estimators with other methods, e.g., FE regression. After constructing weights  $w = \hat{\lambda}/(1 - \hat{\lambda})$  (or the product of weights  $w = w_0\hat{\lambda}/(1 - \hat{\lambda})$ , where  $w_0$  is an existing weight on the data used in the construction of  $\hat{\lambda}$ ) that equalize the distributions of  $X^C$ , other commands can be run on the reweighted data, e.g., `areg` for a FE estimator.

### 3.5 Examples

Imagine the outcome is wage and the treatment variable is union membership. One can reweight union members to have distributions of education, age, race/ethnicity, and other job and demographic characteristics equivalent to nonunion workers (or a subset of nonunion workers). One could compare otherwise identical persons within occupation and industry cells by using a regression approach or `nnmatch` with exact matching on some characteristics. An example comparing several regressions with propensity-score matching is

```
ssc install psmatch2
webuse nlswork
xi i.race i.ind i.occ
local x "union coll age ten not_s c_city south nev_m _I*"
regress ln_w union
regress ln_w `x'
generate u=uniform()
sort u
psmatch2 `x', out(ln_w) ate
tway kdensity _ps if _tr || kdensity _ps if !_tr
generate w=_ps/(1-_ps)
regress ln_w `x' [pw=w] if _ps<.3
regress ln_w `x' [pw=w]
```

The estimated union wage premium is about 13% in a regression but about 15% in the matching estimate of the average benefit to union workers (the ATE on the treated) and about 10% on average for everyone (the ATE). The reweighted regressions give different estimates: for the more than 70% of individuals who are unlikely to be unionized (propensity under 30%), the wage premium is about 9%, and for the full sample, it is about 18%.

Arguably none of these estimates of wage premiums correspond to a readily specified thought experiment, such as “what is the estimated effect on wages of being in a union for a randomly chosen individual?” (the ATE) or “what is the estimated effect on wages of being in a union for an individual just on the margin of being in a union or not?” (the

LATE). DiNardo and Lee (2002) offer a much more convincing set of causal estimates of the LATE by using an RD design (see below).

We could also have estimated the wage premium of a college education by switching `coll` and `union` in the above syntax (to find a wage premium of 25% in a regression or 27% using `psmatch2`). We could use data from Card (1995a,b) on education and wages to find a college wage premium of 29% using a regression or 30% using `psmatch2`.

```
use http://fmwww.bc.edu/ec-p/data/wooldridge/card
generate byte coll=educ>15
local x "coll age exper* smsa* south mar black reg662-reg669"
regress lw `x'
psmatch2 `x', out(lw) ate
```

We return to this example in the next section.

## 4 Instrumental variables

An alternative to panel methods and matching estimators is to find another set of variables  $Z$  correlated with  $X^T$  but not correlated with the error term, e.g.,  $e$  in

$$y = X^T \beta_T + X^C \beta_C + e$$

so  $Z$  must satisfy  $E(Z'e) = 0$  and  $E(Z'X^T) \neq 0$ . The variables  $Z$  are called *excluded instruments*, and a class of IV methods can then be used to consistently estimate an impact of  $X^T$  on  $y$ .

Various interpretations of the IV estimate have been advanced, typically as the LATE (Angrist, Imbens, and Rubin 1996), meaning the effect of  $X^T$  on  $y$  for those who are induced by their level of  $Z$  to have higher  $X^T$ . For the college-graduate example, this might be the average gain  $E_i\{y_i(t) - y_i(0)\}$  over all those  $i$  in the treatment group with  $Z = 1$  (where  $Z$  might be “lived close to a college” or “received a Pell grant”), arising from an increase from  $X^T = 0$  to  $X^T = t$  in treatment, i.e., the wage premium due to college averaged over those who were induced to go to college by  $Z$ .

The IV estimators are generally only as good as the excluded instruments used, so naturally criticisms of the predictors in a standard regression model become criticisms of the excluded instruments in an IV model.

Also, the IV estimators are biased, but consistent, and are much less efficient than OLS. Thus failure to reject the null should not be taken as acceptance of the alternative. That is, one should never compare the IV estimate with only a zero effect; other plausible values should be compared as well, including the OLS estimate. Some other common pitfalls discussed below include improper exclusion restrictions (addressed with overidentification tests) and weak identification (addressed with diagnostics and robust inference).

Since IV estimators are biased in finite samples, they are justified only for large samples. Nelson and Startz (1990) showed how strange the finite sample behavior of an

IV estimator can be. Bound, Jaeger, and Baker (1995) showed that even large samples of millions of observations are insufficient for asymptotic justifications to apply in the presence of weak instruments (see also Stock and Yogo 2005).

## 4.1 Key assumptions

Because IV can lead one astray if any of the assumptions is violated, anyone using an IV estimator should conduct and report tests of the following:

- instrument validity (overidentification or `overid` tests)
- endogeneity
- identification
- presence of weak instruments
- misspecification of functional form (e.g., RESET)

Further discussion and suggestions on what to do when a test is failed appear in the relevant sections below.

## 4.2 Forms of IV

The standard IV estimator in a model

$$y = X^T \beta_T + X^C \beta_C + e$$

where we have  $Z$  satisfying  $E(Z'e) = 0$  and  $E(Z'X^T) \neq 0$  is

$$\hat{\beta}^{\text{IV}} = \begin{pmatrix} \hat{\beta}_T^{\text{IV}} \\ \hat{\beta}_C^{\text{IV}} \end{pmatrix} = (X'P_Z X)^{-1} X'P_Z y$$

(ignoring weights), where  $X = (X^T X^C)$  and  $P_Z$  is the projection matrix  $Z_a(Z_a'Z_a)^{-1}Z_a'$  with  $Z_a = (ZX^C)$ . We use the component of  $X^T$  along  $Z$ , which is exogenous, as the only source of variation in  $X^T$  that we use to estimate the effect on  $y$ .

These estimates are easily obtained in Stata 6–9 with the syntax `ivreg y xc* (xt* = z*)`, where `xc*` are all exogenous “included instruments”  $X^C$  and `xt*` are endogenous variables  $X^T$ . In Stata 10, the syntax is `ivregress 2sls y xc* (xt* = z*)`. For Stata 9 and later, the `ivreg2` command (Baum, Schaffer, and Stillman 2007) would be typed as

```
ssc install ivreg2
ivreg2 y xc* (xt* = z*)
```

Example data for using these commands can be easily generated, e.g.,

```
use http://fmwww.bc.edu/ec-p/data/wooldridge/card, clear
rename lw y
rename nearc4 z
rename educ xt
rename exper xc
```

The standard IV estimator is equivalent to two forms of two-stage estimators. The first, which gave rise to the moniker *two-stage least squares* (2SLS), has you regress  $X^T$  on  $X^C$  and  $Z$ , predict  $\hat{X}_T$ , and then regress  $y$  on  $\hat{X}_T$  and  $X^C$ . The coefficient on  $\hat{X}_T$  is  $\hat{\beta}_T^{IV}$ , so

```
foreach xt of varlist xt* {
    regress `xt' xc* z*
    predict `xt'_hat
}
regress y xt*_hat xc*
```

will give the same estimates as the above IV commands. However, the reported SEs will be wrong as Stata will use  $\hat{X}_T$  rather than  $X^T$  to compute them. Even though IV is not implemented in these two stages, the conceptual model of these first-stage and second-stage regressions is pervasive, and the properties of said first-stage regressions are central to the section on identification and weak instruments below.

The second two-stage estimator that generates identical estimates is a *control-function approach*. Regress each variable in  $X^T$  on the other variables in  $X^T$ ,  $X^C$ , and  $Z$  to predict the errors  $\hat{v}_T = X^T - \hat{X}_T$  and then regress  $y$  on  $X^T$ ,  $\hat{v}_T$ , and  $X^C$ . You will find that the coefficient on  $X^T$  is  $\hat{\beta}_T^{IV}$ , and tests of significance on each  $\hat{v}_T$  are tests of endogeneity of each  $X^T$ . Thus

```
capture drop *_hat
unab xt: xt*
foreach v of loc xt {
    local otht: list xt-v
    regress `v' xc* z* `otht'
    predict v_`xt', resid
}
regress y xt* xc* v_*
```

will give the IV estimates, though again the standard errors will be wrong. However, the tests of endogeneity (given by the reported  $p$ -values on variables  $v_*$  above) will be correct. A similar approach works for nonlinear models such as `probit` or `poisson` (`help ivprobit` and `findit ivpois` for relevant commands). The tests of endogeneity in nonlinear models given by the control-function approach are also robust (see, for example, Wooldridge 2002, 474 or 665).

The third two-stage version of the IV strategy, which applies for one endogenous variable and one excluded instrument, is sometimes called the *Wald estimator*. First, regress  $X^T$  on  $X^C$  and  $Z$  (let  $\hat{\pi}$  be the estimated coefficient on  $Z$ ) and then regress  $y$  on  $Z$  and  $X^C$  (let  $\hat{\gamma}$  be the estimated coefficient on  $Z$ ). The ratio of coefficients on  $Z$  ( $\hat{\gamma}/\hat{\pi}$ ) is  $\hat{\beta}_{IV}$ , so

```

regress xt z xc*
local p=_b[z]
regress y z xc*
local g=_b[z]
display `g'/'`p'

```

will give the same estimate as the IV command `ivreg2 y xc* (xt=z)`. The regression of  $y$  on  $Z$  and  $X^C$  is sometimes called the *reduced-form regression*. This name is often applied to other regressions, so I will avoid using the term.

The generalized method of moments, limited-information maximum likelihood, and continuously updated estimation and generalized method of moments forms of IV are discussed at length in Baum, Schaffer, and Stillman (2007). Various implementations are available with the `ivregress` and `ivreg2` commands. Some forms of IV may be expressed as  $k$ -class estimation, available from `ivreg2`, and there are many other forms of IV models, including official Stata commands, such as `ivprobit`, `treatreg`, and `ivtobit`, and user-written additions, such as `qvf` (Hardin, Schmiediche, and Carroll 2003), `jive` (Poi 2006), and `ivpois` (on SSC).

### 4.3 Finding excluded instruments

The hard part of IV is finding a suitable  $Z$  matrix. The excluded instruments in  $Z$  have to be strongly correlated with the endogenous  $X^T$  and uncorrelated with the unobservable error  $e$ . However, the problem we want to solve is that the endogenous  $X^T$  is correlated with the unobservable error  $e$ . A good story is the crucial element in any plausible IV specification. We must believe that  $Z$  is strongly correlated with the endogenous  $X^T$  but has no direct impact on  $y$  (is uncorrelated with the unobservable error  $e$ ), because the assumptions are not directly testable. However, the tests discussed in the following sections can help support a convincing story and should be reported anyways.

Generally, specification search in the first-stage regressions of  $X^T$  on some  $Z$  does not bias estimates or inference nor does using generated regressors. However, it is easy to produce counterexamples to this general rule. For example, taking  $Z = X^T + \nu$ , where  $\nu$  is a small random error, will produce strong identification diagnostics—and might pass overidentification tests described in the next section—but will not improve estimates (and could lead to substantially less accurate inference).

If some  $Z$  are weak instruments, then regressing  $X^T$  on  $Z$  to get  $\hat{X}_T$  and using  $\hat{X}_T$  as the excluded instruments in an IV regression of  $y$  on  $X^T$  and  $X^C$  will likewise produce strong identification diagnostics but will not improve estimates or inference. Hall, Rudebusch, and Wilcox (1996) reported that choosing instruments based on measures of the strength of identification could actually increase bias and size distortions.

### 4.4 Exclusion restrictions in IV

The exclusion restrictions  $E(Z'e) = 0$  cannot be directly tested, but if there are more excluded instruments than endogenous regressors, an overidentification (overid) test

is feasible and the result should be reported. If there are exactly as many excluded instruments as endogenous regressors, the equation is *exactly identified*, and no overid test is feasible.

However, if  $Z$  is truly exogenous, it is likely also true that  $E(W'e) = 0$ , where  $W$  contains  $Z$ , squares, and cross products of  $Z$ . Thus there is always a feasible overid test by using an augmented set of excluded instruments, though  $E(W'e) = 0$  is a stronger condition than  $E(Z'e) = 0$ . For example, if you have two good excluded instruments, you might multiply them together and square each to produce five excluded instruments. Testing the three extra overid restrictions is like Ramsey's regression specification-error (RESET) test of excluded instruments. Interactions of  $Z$  and  $X^C$  may also be good candidates for excluded instruments. For reasons discussed below, adding excluded instruments haphazardly is a bad idea, and with many weak instruments, limited-information maximum likelihood or continuously updated estimation is preferred to standard IV/2SLS.

Baum, Schaffer, and Stillman (2007) discuss the implementation of overid tests in `ivreg2` (see also `overid` from Baum et al. 2006). Passing the overid test (i.e., failing to reject the null of zero correlation) is neither necessary nor sufficient for instrument validity,  $E(Z'e) = 0$ , but rejecting the null in an overid test should lead you to reconsider your IV strategy and perhaps to look for different excluded instruments.

## 4.5 Tests of endogeneity

Even if we have an excluded instrument that satisfies  $E(Z'e) = 0$ , there is no guarantee that  $E(X^T'\varepsilon) \neq 0$  as we have been assuming. If  $E(X^T'\varepsilon) = 0$ , we prefer ordinary regression to IV. Thus we should test the null that  $E(X^T'\varepsilon) = 0$  (a test of endogeneity), though this test requires instrument validity,  $E(Z'e) = 0$ , so it should follow any feasible overid tests.

Baum, Schaffer, and Stillman (2007) describe several methods to test the endogeneity of a variable in  $X^T$ , including the `endog()` option of `ivreg2` and the standalone `ivendog` command (both available from SSC archive, with excellent help files). Section 4.2 also shows how the control function form of IV can be used to test endogeneity of a variable in  $X^T$ .

## 4.6 Identification and weak instruments

This is the second of the two crucial assumptions and presents problems of various sizes in almost all IV specifications. The extent to which  $E(Z'X^T) \neq 0$  determines the strength of identification. Baum, Schaffer, and Stillman (2007) describe tests of identification, which amount to tests of the rank of  $E(Z'X^T)$ . These rank tests address the concern that a number of excluded instruments may generate exogenous variation in one endogenous variable and be uncorrelated with another endogenous variable, so the equation is not identified even though it satisfies the order condition (the number of excluded instruments is at least as great as the number of endogenous variables).

For example, if we have two endogenous variables  $X_1$  and  $X_2$  and three excluded instruments, all three excluded instruments may be correlated with  $X_1$  and not with  $X_2$ . The identification tests look at the least partial correlation, or the minimum eigenvalue of the Cragg–Donald statistic (?), for example, and measures of whether at least one endogenous variable has no correlation with the excluded instruments.

Even if we reject the null of underidentification and conclude  $E(Z'X^T) \neq 0$ , we can still face a “weak-instruments” problem if some elements of  $E(Z'X^T)$  are close to zero.

Even if we have an excluded instrument that satisfies  $E(Z'e) = 0$ , there is no guarantee that  $E(Z'X^T) \neq 0$ . The IV estimate is always biased but is less biased than OLS to the extent that identification is strong. In the limit of weak instruments, there would be no improvement over OLS for bias and the bias would be 100% of OLS. In the other limit, the bias would be 0% of the OLS bias (though this would require that the correlation between  $X^T$  and  $Z$  be perfect, which is impossible since  $X^T$  is endogenous and  $Z$  is exogenous). In applications, you would like to know where you are on that spectrum, even if only approximately.

There is also a distortion in the size of hypothesis tests. If you believe that you are incorrectly rejecting a null hypothesis about 5% of the time (i.e., you have chosen a size  $\alpha = 0.05$ ), you may actually face a size of 10% or 20% or more.

Stock and Yogo (2005) reported rule-of-thumb critical values to measure the extent of both of these problems. Their table 1 shows the value of a statistic measuring the predictive power of the excluded instruments that will imply a limit of the bias to some percentage of OLS. For two endogenous variables and three excluded instruments ( $n = 2$ ,  $K_2 = 5$ ), the minimum value to limit the bias to 20% of OLS is 5.91. `ivreg2` reports these values as *Stock–Yogo weak ID test critical values*: one set for various percentages of “maximal IV relative bias” (largest bias relative to OLS) and one set for “maximal IV size” (the largest size of a nominal 5% test).

The key point is that all IV and IV-type specifications can suffer from bias and size distortions, not to mention inefficiency and sometimes failures of exclusion restrictions. The Stock and Yogo (2005) approach measures how strong identification is in your sample, and `ranktest` (Kleibergen and Schaffer 2007) offers a similar statistic for cases where errors are not assumed to be independently and identically distributed. Neither provides solutions in the event that weak instruments appear to be a problem. A further limitation is that these identification statistics only apply to the linear case, not the nonlinear analogs, including those estimated with generalized linear models. In practice, researchers should report the identification statistics for the closest linear analog; i.e., run `ivreg2` and report the output alongside the output from `ivprobit`, `ivpois`, etc.

If you suspect weak instruments may be producing large bias or size distortions, you have several options. You can find better excluded instruments, possibly by transforming your existing instruments. You can use limited-information maximum likelihood or continuously updated estimation, which are more robust to many weak instruments than standard IV. Perhaps best of all, you can conduct inference that is robust to

weak instruments: with one endogenous variable, use `condivreg` (Mikusheva and Poi 2006), or with more than one, use tests described by Anderson and Rubin (1949) and Baum, Schaffer, and Stillman (2007, sec. 7.4 and 8).

#### 4.7 Functional form tests in IV

As Baum, Schaffer, and Stillman (2007, sec. 9) and Wooldridge (2002, 125) discuss, the RESET test regressing residuals on predicted  $y$  and powers thereof is properly a test of a linearity assumption or a test of functional-form restrictions. `ivreset` performs the IV version of the test in Stata. A more informative specification check is the graphical version of RESET: predict  $\hat{X}_T$  after the first-stage regressions, compute forecasts  $\hat{y} = X^T \hat{\beta}_T^{IV} + X^C \hat{\beta}_C$  and  $\hat{y}_f = \hat{X}_T \hat{\beta}_T^{IV} + X^C \hat{\beta}_C$ , and graph a scatterplot of the residuals  $\hat{\varepsilon} = y - \hat{y}$  against  $\hat{y}_f$ . Any unmodeled nonlinearities may be apparent as a pattern in the scatterplot.

#### 4.8 Standard errors in IV

The largest issue in IV estimation is often that the variance of the estimator is much larger than ordinary regression. Just as with ordinary regression, the SEs are asymptotically valid for inference under the restrictive assumptions that the disturbances are independently and identically distributed. Getting SEs robust to various violations of these assumptions is easily accomplished by using the `ivreg2` command (Baum, Schaffer, and Stillman 2007). Many other commands fitting IV models offer no equivalent robust SE estimates, but it may be possible to assess the size and direction of SE corrections by using the nearest linear analog in the spirit of using estimated design effects in the survey regression context.

#### 4.9 Inference in IV

Assuming that we have computed consistent SEs and the best IV estimate we can by using a good set of  $Z$  and  $X^C$  variables, there remains the question of how we interpret the estimates and tests. Typically, IV identifies a particular LATE, namely the effect of an increase in  $X^T$  due to an increase in  $Z$ . If  $X^T$  were college and  $Z$  were an exogenous source of financial aid, then the IV estimate of the effect of  $X^T$  on wages would be the college wage premium for those who were induced to attend college by being eligible for the marginally more generous aid package.

Angrist and Krueger (1991) estimated the effect of education on earnings by using compulsory schooling laws as a justification for using quarter of birth dummies as instruments. Even if the critiques of Bound, Jaeger, and Baker (1995) did not apply, the identified effect would be for an increase in education due to being forced to remain in school a few months more. That is, the measured wage effect of another year of education is roughly for the eleventh grade and only for those who would have dropped out if not for compulsory schooling laws.

Sometimes a LATE of this form is exactly the estimate desired. If, however, we cannot reject that the IV estimate differs from the OLS estimate or the IV confidence region includes the OLS confidence region, we may not have improved estimates but merely produced noisier ones. Only where the IV estimate differs can we hope to ascertain the nature of selection bias.

## 4.10 Examples

We can use the data from Card (1995a,b) to estimate the impact of education on wages, where nearness to a college is used as a source of exogenous variation in educational attainment:

```
use http://fmwww.bc.edu/ec-p/data/wooldridge/card
local x "exper* smsa* south mar black reg662-reg669"
regress lw educ `x'
ivreg2 lw `x' (educ=nearc2 nearc4), first endog(educ)
ivreg2 lw `x' (educ=nearc2 nearc4), gmm
ivreg2 lw `x' (educ=nearc2 nearc4), liml
```

The return to another year of education is found to be about 7% by using ordinary regression or 16% or 17% by using IV methods. The Sargan statistic fails to reject that excluded instruments are valid, the test of endogeneity is marginally significant (giving different results at the 95% and 90% levels), and the Anderson–Rubin and Stock–Wright tests of identification strongly reject that the model is underidentified.

The test for weak instruments is the  $F$  test on the excluded instruments in the first-stage regression, which at 7.49 with a  $p$ -value of 0.0006 seems to indicate that the excluded instruments influence educational attainment, but the size of Wald tests on `educ`, which we specify as 5%, might be roughly 25%. To construct an Anderson–Rubin confidence interval, we can type

```
generate y=.
foreach beta in .069 .0695 .07 .36 .365 .37 {
    quietly replace y=lw-`beta'*educ
    quietly regress y `x' nearc2 nearc4
    display as res "Test of beta=" `beta'
    test nearc2 nearc4
}
```

This gives a confidence interval of (.07, .37); see Nichols (2006, 18) and Baum, Schaffer, and Stillman (2007, 30). Thus the IV confidence region includes the OLS estimate and nearly includes the OLS confidence interval, so the evidence on selection bias is weak. Still, if we accept the exclusion restrictions as valid, the evidence does not support a story where omitting ability (causing both increased wages and increased education) leads to positive bias. If anything, the bias seems likely to be negative, perhaps due to unobserved heterogeneity in discount rates or credit market failures. In the latter case, the omitted factor may be a social or economic disadvantage observable by lenders.

A similar set of conclusions apply if we model the education response as a binary treatment, `college`:

```

generate byte coll=educ>15
regress lw coll `x'
treatreg lw `x', treat(coll=nearc2 nearc4)
ivreg2 lw `x' (coll=nearc2 nearc4), first endog(coll)
ivreg2 lw `x' (coll=nearc2 nearc4), gmm
ivreg2 lw `x' (coll=nearc2 nearc4), liml

```

These regressions also indicate that the OLS estimate may be biased downward, but the OLS confidence interval is contained in the `treatreg` and IV confidence intervals. Thus we cannot conclude much with confidence.

## 5 RD designs

The idea of the RD design is to exploit an observable discontinuity in the level of treatment related to an assignment variable  $Z$ , so the level of treatment  $X^T$  jumps discontinuously at some value of  $Z$ , called the cutoff. Let  $Z_0$  denote the cutoff. In the neighborhood of  $Z_0$ , under some often plausible assumptions, a discontinuous jump in the outcome  $y$  can be attributed to the change in the level of treatment. Near  $Z_0$ , the level of treatment can be treated as if it is randomly assigned. For this reason, the RD design is generally regarded as having the greatest internal validity of the quasiexperimental estimators.

Examples include share of votes received in a U.S. Congressional election by the Democratic candidate as  $Z$ , which induces a clear discontinuity in  $X^T$ , the probability of a Democrat occupying office the following term, and  $X^T$  may affect various outcomes  $y$ , if Democratic and Republican candidates actually differ in close races (Lee 2001). DiNardo and Lee (2002) use the share of votes received for a union as  $Z$ , and unions may affect the survival of a firm (but do not seem to). They point out that the union wage premium,  $y$ , can be consistently estimated only if survival is not affected (no differential attrition around  $Z_0$ ), and they find negligibly small effects of unions on wages.

The standard treatment of RD is Hahn, Todd, and van der Klaauw (2001), who clarify the link to IV methods. Recent working papers by Imbens and Lemieux (2007) and McCrary (2007) focus on some important practical issues related to RD designs.

Many authors stress a distinction between “sharp” and “fuzzy” RD. In sharp RD designs, the level of treatment rises from zero to one at  $Z_0$ , as in the case where treatment is having a Democratic representative in the U.S. Congress or establishing a union, and a winning vote share defines  $Z_0$ . In fuzzy RD designs, the level of treatment increases discontinuously, or the probability of treatment increases discontinuously, but not from zero to one. Thus we may want to deflate by the increase in  $X^T$  at  $Z_0$  in constructing our estimate of the causal impact of a one-unit change in  $X^T$ .

In sharp RD designs, the jump in  $y$  at  $Z_0$  is the estimate of the causal impact of  $X^T$ . In a fuzzy RD design, the jump in  $y$  divided by the jump in  $X^T$  at  $Z_0$  is the local Wald estimate (equivalent to a local IV estimate) of the causal impact. The local Wald estimate reduces to the jump in  $y$  at  $Z_0$  in a sharp RD design as the jump in  $X^T$  is one,

so the distinction between fuzzy and sharp RD is not that sharp. Some authors, e.g., Shadish, Cook, and Campbell (2002, 229), seem to characterize as fuzzy RD a wider class of problems, where the cutoff itself may not be sharply defined. However, without a true discontinuity, there can be no RD. The fuzziness in fuzzy RD arises only from probabilistic assignment of  $X^T$  in the neighborhood of  $Z_0$ .

## 5.1 Key assumptions and tests

The assumptions that allow us to infer a causal effect on  $y$  because of an abrupt change in  $X^T$  at  $Z_0$  are the change in  $X^T$  at  $Z_0$  is truly discontinuous,  $Z$  is observed without error (Lee and Card 2006),  $y$  is a continuous function of  $Z$  at  $Z_0$  in the absence of treatment (for individuals), and that individuals are not sorted across  $Z_0$  in their responsiveness to treatment. None of these assumptions can be directly tested, but there are diagnostic tests that should always be used.

The first is to test the null that no discontinuity in treatment occurs at  $Z_0$ , since without identifying a jump in  $X^T$  we will be unable to identify the causal impact of said jump. The second is to test that there are no other extraneous discontinuities in  $X^T$  or  $y$  away from  $Z_0$ , as this would call into question whether the functions would be smooth through  $Z_0$  in the absence of treatment. The third and fourth test that predetermined characteristics and the density of  $Z$  exhibit no jump at  $Z_0$ , since these call into question the exchangeability of observations on either side of  $Z_0$ . Then the estimate itself usually supplies a test that the treatment effect is nonzero ( $y$  jumps at  $Z_0$  because  $X^T$  jumps at  $Z_0$ ).

Abusing notation somewhat so that  $\Delta$  is an estimate of the discontinuous jump in a variable, we can enumerate these tests as

- (T1)  $\Delta X^T(Z_0) \neq 0$
- (T2)  $\Delta X^T(Z \neq Z_0) = 0$  and  $\Delta y(Z \neq Z_0) = 0$
- (T3)  $\Delta X^C(Z_0) = 0$
- (T4)  $\Delta f(Z_0) = 0$
- (T5)  $\Delta y(Z_0) \neq 0$  or  $\left(\frac{\Delta y(Z_0)}{\Delta X^T(Z_0)}\right) \neq 0$

## 5.2 Methodological choices

Estimating the size of a discontinuous jump can be accomplished by comparing means in small bins of  $Z$  to the left and right of  $Z_0$  or with a regression of various powers of  $Z$ , an indicator  $D$  for  $Z > Z_0$ , and interactions of all  $Z$  terms with  $D$  (estimating a polynomial in  $Z$  on both sides of  $Z_0$ , and comparing the intercepts at  $Z_0$ ). However, since the goal is to compute an effect at precisely one point ( $Z_0$ ) using only the closest observations, the standard approach is to use local linear regression, which minimizes

bias (Fan and Gibels 1996). In Stata 10, this is done with the `lpoly` command; users of previous Stata versions can use `locpoly` (Gutierrez, Linhart, and Pitblado 2003).

Having chosen to use local linear regression, other key issues are the choice of bandwidth and kernel. Various techniques are available for choosing bandwidths (see e.g., Fan and Gibels 1996, Stone 1974, 1977), and the triangle kernel has good properties in the RD context, due to being boundary optimal (Cheng, Jianqing, and Marron 1997).

There are several rule-of-thumb bandwidth choosers and cross-validation techniques for automating bandwidth choice, but none is foolproof. McCrary (2007) contains a useful discussion of bandwidth choice and claims that there is no substitute for visual inspection comparing the local polynomial smooth with the pattern in a scatterplot. Because different bandwidth choices can produce different estimates, the researcher should report at least three estimates as an informal sensitivity test: one using the preferred bandwidth, one using twice the preferred bandwidth, and another using half the preferred bandwidth.

### 5.3 (T1) $X^T$ jumps at $Z_0$

The identifying assumption is that  $X^T$  jumps at  $Z_0$  because of some known legal or program-design rules, but we can test that assumption easily enough. The standard approach to computing SEs is to `bootstrap` the local linear regression, which requires wrapping the estimation in a program, for example,

```

program discontinuity, rclass
    version 10
    syntax [varlist(min=2 max=2)] [, *]
    tokenize `varlist'
    tempvar z f0 f1
    quietly generate `z'=0 in 1
    local opt "at(`z') nogr k(tri) deg(1) `options'"
    lpoly `1' `2' if `2'<0, gen(`f0') `opt'
    lpoly `1' `2' if `2'>=0, gen(`f1') `opt'
    return scalar d=`f1'[1]-`f0'[1]'
    display as txt "Estimate: " as res `f1'[1]-`f0'[1]
    ereturn clear
end

```

In the program, the assignment variable  $Z$  is assumed to be defined so that the cutoff  $Z_0 = 0$  (easily done with one `replace` or `generate` command subtracting  $Z_0$  from  $Z$ ). The triangle kernel is used and the default bandwidth is chosen by `lpoly`, which is probably suboptimal for this application. The local linear regressions are computed twice: once using observations on one side of the cutoff for  $Z < 0$  and once for  $Z \geq 0$ . The estimate of a jump uses only the predictions at the cutoff  $Z_0 = 0$ , so these are the only values computed by `lpoly`.

We can easily generate data to use this example program:

```
ssc install rd, replace
net get rd
use vortex if i==1
rename lne y
rename win xt
rename d z
foreach v of varlist pop-vet {
    rename `v' xc_`v'
}
bs: discount y z
```

In a more elaborate version of this program called `rd` (which also supports earlier versions of Stata), available by typing `ssc inst rd` in Stata, the default bandwidth is selected to include at least 30 observations in estimates at both sides of the boundary. Other options are also available. Try `findit bandwidth` to find more sophisticated bandwidth choosers for Stata. The key point is to use the `at()` option of `lpoly` so that the difference in local regression predictions can be computed at  $Z_0$ .

A slightly more elaborate version of this program would save local linear regression estimates at a number of points and offer a graph to assess fit:

```
program discount2, rclass
    version 10
    syntax [varlist(min=2 max=2)] [, s(str) Graph *]
    tokenize `varlist'
    tempvar z f0 f1 se0 ub0 ub1 lb0 lb1
    summarize `2', meanonly
    local N=round(100*(r(max)-r(min)))
    cap set obs `N'
    quietly generate `z'=(`n-1)/100 in 1/50
    quietly replace `z'=-(`n-50)/100 in 51/`N'
    local opt "at(`z') nogr k(tri) deg(1) `options'"
    lpoly `1' `2' if `2'<0, gen(`f0') se(`se0') `opt'
    quietly replace `f0'=. if `z'>0
    quietly generate `ub0'=`f0'+1.96*`se0'
    quietly generate `lb0'=`f0'-1.96*`se0'
    lpoly `1' `2' if `2'>=0, gen(`f1') se(`se1') `opt'
    quietly replace `f1'=. if `z'<0
    quietly generate `ub1'=`f1'+1.96*`se1'
    quietly generate `lb1'=`f1'-1.96*`se1'
    return scalar d=`f1'[1]-`f0'[1]'
    return scalar f1=`f1'[1]'
    return scalar f0=`f0'[1]'
    forvalues i=1/50 {
        return scalar p`i'=`f1'[`i]'
    }
    forvalues i=51/`N' {
        return scalar n`i'=`f0'[`i]'
    }
    display as txt "Estimate: " as res `f1'[1]-`f0'[1]
    if "`graph'"!="" {
        label var `z' "Assignment Variable"
        local lines "|| line `f0' `f1' `z'"
        local a "tw rarea `lb0' `ub0' `z' || rarea `lb1' `ub1' `z'"
        `a' || sc `1' `2', mc(gs14) leg(off) sort `lines'
    }
}
```

```

    if "`s'"!="" {
        rename `z' `s'`2'
        rename `f0' `s'`1'0
        rename `lb0' `s'`1'lb0
        rename `ub0' `s'`1'ub0
        rename `f1' `s'`1'1
        rename `lb1' `s'`1'lb1
        rename `ub1' `s'`1'ub1
    }
    ereturn clear
end

```

In this version, the local linear regressions are computed at a number of points on either side of the cutoff  $Z_0$  (in the example, the maximum of  $Z$  is assumed to be 0.5, so the program uses hundredths as a convenient unit for  $Z$ ), but the estimate of a jump still uses only the two estimates at  $Z_0$ . The `s()` option in the above program saves the local linear regression predictions (and `lpoly` confidence intervals) to new variables that can then be graphed. Graphs of all output are advisable to assess the quality of the fit for each of several bandwidths. This program may also be bootstrapped, although recovering the standard errors around each point estimate from `bootstrap` for graphing the fit is much more work than using the output of `lpoly` as above.

#### 5.4 (T2) $y$ and $X^C$ continuous away from $Z_0$

Although we need only assume continuity at  $Z_0$  and need no assumption that the outcome and treatment variables are continuous at values of  $Z$  away from the cutoff  $Z_0$  (i.e.,  $\Delta X^T(Z \neq Z_0) = 0$  and  $\Delta y(Z \neq Z_0) = 0$ ), it is reassuring if we fail to reject the null of a zero jump at various values of  $Z$  away from the cutoff  $Z_0$  (or reject the null only in 5% of cases or so). Having defined a program `discont`, we can easily randomly choose 100 placebo cutoff points  $Z_p \neq Z_0$ , without replacement in the example below, and test the continuity of  $X^T$  and  $y$  at each.

```

by z, sort: generate f=_n>1 if z!=0
generate u=uniform()
sort f u
replace u=( _n<=100)
levelsof z if u, loc(p)
foreach val of local p {
    capture drop newz
    generate newz=z-`val'
    bootstrap r(d), reps(100): discont y znew
    bootstrap r(d), reps(100): discont xt znew
}

```

#### 5.5 (T3) $X^C$ continuous around $Z_0$

If we can regard an increase in treatment  $X^T$  as randomly assigned in the neighborhood of the cutoff  $Z_0$ , then predetermined characteristics  $X^C$  such as race or sex of treated individuals should not exhibit a discontinuity at the cutoff  $Z_0$ . This is equivalent to the standard test of randomization in an experimental design, using a test of the equality

of the mean of every variable in  $X^C$  across treatment and control groups (see `help hotelling` in Stata), or the logically equivalent test that all the coefficients on  $X^C$  in a regression of  $X^T$  on  $X^C$  are zero. As in the experimental setting, in practice the tests are usually done one at a time with no adjustment for multiple hypothesis testing (see `help _mtest` in Stata).

In the RD setting, this is simply a test that the measured jump in each predetermined  $X^C$  is zero at the cutoff  $Z_0$  or  $\Delta X^C(Z_0) = 0$  for all  $X^C$ . If we fail to reject that the measured jump in  $X^C$  is zero, for all  $X^C$ , we have more evidence that observations on both sides of the cutoff are exchangeable, at least in some neighborhood of the cutoff, and we can treat them as if they were randomly assigned treatment in that neighborhood.

Having defined the programs `discont` and `discont2`, we can simply type

```
foreach v of varlist xc* {
    bootstrap r(d), reps(100): discont `v' z
    discont2 `v' z, s(h)
    scatter `v' z, mc(gs14) sort || line h`v'0 h`v'1 hz, name(`v')
    drop hz
}
```

## 5.6 (T4) Density of Z continuous at cutoff

McCrary (2007) gives an excellent account of a violation of exchangeability of observations around the cutoff. If individuals have preferences over treatment and can manipulate assignment, for instance by altering their  $Z$  or misreporting it, then individuals close to  $Z_0$  may shift across the boundary. For example, some nonrandomly selected subpopulation of those who are nearly eligible for food stamps may misreport income, whereas those who are eligible do not. This creates a discontinuity in the density of  $Z$  at  $Z_0$ . McCrary (2007) points out that the absence of a discontinuity in the density of  $Z$  at  $Z_0$  is neither necessary nor sufficient for exchangeability. However, a failure to reject the null hypothesis, which indicates the jump in the density of  $Z$  at  $Z_0$  is zero, is reassuring nonetheless.

McCrary (2007) discussed a test in detail and advocated a bandwidth chooser. We can also adapt our existing program to this purpose by using multiple `kdensity` commands to estimate the density to the left and right of  $Z_0$ :

```
kdensity z if z<0, gen(f0) at(z) tri nogr
count f0 if z>=0
replace f0=f0/r(N)*`=_N'/4
kdensity z if z>=0, gen(f1) at(z) tri nogr
count f1 if z<0
replace f1=f1/r(N)*`=_N'/4
generate f=cond(z>=0,f1,f0)
bootstrap r(d), reps(100): discont f z
discont2 f z, s(h) g
```

We could also wrap the `kdensity` estimation inside the program that estimates the jump, so that both are bootstrapped together; this approach is taken by the `rd` command available by typing `ssc inst rd`.

## 5.7 (T5) Treatment-effect estimator

Having defined the program `discont`, we can type

```
bootstrap r(d), reps(100): discont y z
```

to get an estimate of the treatment effect in a sharp RD setting, where  $X^T$  jumps from zero to one at  $Z_0$ . For a fuzzy RD design, we want to compute the jump in  $y$  scaled by the jump in  $X^T$  at  $Z_0$ , or the local Wald estimate, for which we need to modify our program to estimate both discontinuities. The program `rd` available by typing `ssc inst rd` does this, but the idea is illustrated in the program below by using the previously defined `discont` program twice.

```
program lwald, rclass
    version 10
    syntax varlist [, w(real .06) ]
    tokenize `varlist'
    display as txt "Numerator"
    discont `1' `3', bw(`w')
    local n=r(d)
    return scalar numerator=`n'
    display as txt "Denominator"
    discont `2' `3', s(`sd') bw(`w')
    local d=r(d)
    return scalar denominator=`d'
    return scalar lwald=`n'/'`d'
    display as txt "Local Wald Estimate:" as res `n'/'`d'
    ereturn clear
end
```

This program takes three arguments—the variables  $y$ ,  $X^T$ , and  $Z$ —assumes  $Z_0 = 0$ , and uses a hardwired default bandwidth of 0.06. The default bandwidth selected by `lpoly` is inappropriate for these models, because we do not use a Gaussian kernel and are interested in boundary estimates. The `rd` program from SSC archive is similar to the above; however, it offers more options—particularly with regard to bandwidth selection.

## 5.8 Examples

Voting examples abound. A novel estimate in Nichols and Rader (2007) measures the effect of electing as a Representative a Democratic incumbent versus a Republican incumbent on a district's receipt of federal grants:

```
ssc install rd
net get rd
use votex if i==1
rd lne d, gr
bs: rd lne d, x(pop-vet)
```

The above estimates that the marginally victorious Democratic incumbent brings 20% less to his home district than a marginally victorious Republican incumbent. However, we cannot reject the null of zero difference. This is true for a variety of bandwidth choices (figure 2 shows the small insignificant effect). The above is a sharp RD design,

but the Wald estimator can be used to estimate effect, because the jump in `win` at 50% of vote share is one and dividing by one has no impact on estimates.

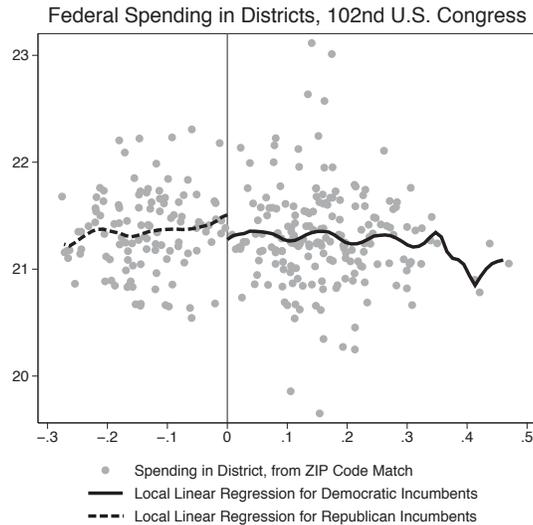


Figure 2: RD example

Many good examples of fuzzy RD designs concern educational policy or interventions (e.g., van der Klaauw 2002 or Ludwig and Miller 2005). Many educational grants are awarded by using deterministic functions of predetermined characteristics, lending themselves to evaluation using RD. For example, some U.S. Department of Education grants to states are awarded to districts with a poverty (or near-poverty) rate above a threshold, as determined by data from a prior Census, which satisfies all of the requirements for RD. The size of the discontinuity in funding may often be insufficient to identify an effect. Often a power analysis is warranted to determine the minimum detectable effect.

Returning to the Card (1995a,b) example of the effect of education on earnings, we can imagine exploiting a discontinuity in the availability of college to residents of certain U.S. states at the state boundary. College applicants who live 4.8 miles and 5 miles from a college may look similar in various observable characteristics, but if a state boundary separates them at 4.9 miles from the college, and the college is a state institution, they may face different probabilities of admission or tuition costs. The data in Card (1995a,b) do not support this strategy, of course, because we would need to know the exact locations of all individuals relative to state boundaries. However, it helps to clarify the assumptions that justify the IV approach. We need to assume that location relative to colleges is randomly sprinkled over potential applicants, which seems questionable (Black 1999), especially when one considers including parental education in the model.

## 6 Conclusions

Often exploring data using quasiexperimental methods is the only option for estimating a causal effect when experiments are infeasible, and may sometimes be preferred even when an experiment is feasible, particularly if a MTE is of interest. However, the methods can suffer several severe problems when assumptions are violated, even weakly. For this reason, the details of implementation are frequently crucial, and a kind of cookbook or checklist for verifying that essential assumptions are satisfied has been provided above for the interested researcher. As the topics discussed continue to be active research areas, this cookbook should be taken merely as a starting point for further explorations of the applied econometric literature on the relevant subjects.

## 7 References

- Abadie, A., D. Drukker, J. Leber Herr, and G. W. Imbens. 2004. Implementing matching estimators for average treatment effects in Stata. *Stata Journal* 4: 290–311.
- Abadie, A., and G. W. Imbens. 2006. On the failure of the bootstrap for matching estimators. NBER Technical Working Paper No. 325. <http://www.nber.org/papers/t0325/>.
- Anderson, T., and H. Rubin. 1949. Estimation of the parameters of a single equation in a complete system of stochastic equations. *Annals of Mathematical Statistics* 20: 46–63.
- Angrist, J. D., G. W. Imbens, and D. B. Rubin. 1996. Identification of causal effects using instrumental variables. *Journal of the American Statistical Association* 91: 444–472.
- Angrist, J. D., and A. B. Krueger. 1991. Does compulsory school attendance affect schooling and earnings? *Quarterly Journal of Economics* 106: 979–1014.
- Autor, D. H., L. F. Katz, and M. S. Kerney. 2005. Rising wage inequality: The role of composition and prices. NBER Technical Working Paper No. 11628. <http://www.nber.org/papers/w11628/>.
- Azevedo, J. P. 2005. dfl: Stata module to estimate DiNardo, Fortin, and Lemieux counterfactual kernel density. Statistical Software Components S449001, Boston College Department of Economics. Downloadable from <http://ideas.repec.org/c/boc/bocode/s449001.html>.
- Baker, M., D. Benjamin, and S. Stanger. 1999. The highs and lows of the minimum wage effect: A time-series cross-section study of the Canadian law. *Journal of Labor Economics* 17: 318–350.
- Baum, C. F. 2006. Time-series filtering techniques in Stata. Boston, MA: 5th North American Stata Users Group meetings. [http://www.stata.com/meeting/5nasug/TSTFiltering\\_beamer.pdf](http://www.stata.com/meeting/5nasug/TSTFiltering_beamer.pdf).

- Baum, C. F., M. Schaffer, and S. Stillman. 2007. Enhanced routines for IV/GMM estimation and testing. *Stata Journal* 7: 465–506.
- Baum, C. F., M. Schaffer, S. Stillman, and V. Wiggins. 2006. `overid`: Stata module to calculate tests of overidentifying restrictions after `ivreg`, `ivreg2`, `ivprobit`, `ivtobit`, and `reg3`. Statistical Software Components S396802, Boston College Department of Economics. Downloadable from <http://ideas.repec.org/c/boc/bocode/s396802.html>.
- Becker, S., and M. Caliendo. 2007. Sensitivity analysis for average treatment effects. *Stata Journal* 7: 71–83.
- Becker, S. O., and A. Ichino. 2002. Estimation of average treatment effects based on propensity scores. *Stata Journal* 2: 358–377.
- Black, S. 1999. Do better schools matter? Parental valuation of elementary education. *Quarterly Journal of Economics* 114: 577–599.
- Blinder, A. S. 1973. Wage discrimination: Reduced form and structural estimates. *Journal of Human Resources* 8: 436–455.
- Bound, J., D. Jaeger, and R. Baker. 1995. Problems with instrumental variable estimation when the correlation between the instruments and the endogenous explanatory variables is weak. *Journal of the American Statistical Association* 90: 443–450.
- Card, D. E. 1995a. Using geographic variation in college proximity to estimate the return to schooling. In *Aspects of Labour Economics: Essays in Honour of John Vanderkamp*, ed. L. Christofides, E. K. Grant, and R. Swindinsky. Toronto, Canada: University of Toronto Press.
- . 1995b. Earnings, schooling, and ability revisited. *Research in Labor Economics* 14: 23–48.
- . 1999. The causal effect of education on earnings. *Handbook of Labor Economics* 3: 1761–1800.
- . 2001. Estimating the return to schooling: Progress on some persistent econometric problems. *Econometrica* 69: 1127–1160.
- Cheng, M., F. Jianqing, and J. S. Marron. 1997. On automatic boundary corrections. *Annals of Statistics* 25: 1691–1708.
- Cochran, W., and D. B. Rubin. 1973. Controlling bias in observational studies. *Sankhyā* 35: 417–446.
- DiNardo, J. 2002. Propensity score reweighting and changes in wage distributions. Working Paper, University of Michigan. <http://www-personal.umich.edu/~jdinardo/bztalk5.pdf>.
- DiNardo, J., N. M. Fortin, and T. Lemieux. 1996. Labor market institutions and the distribution of wages, 1973–1992: A semiparametric approach. *Econometrica* 64: 1001–1044.

- DiNardo, J., and D. Lee. 2002. The impact of unionization on establishment closure: A regression discontinuity analysis of representation elections. NBER Technical Working Paper No. 8993. <http://www.nber.org/papers/w8993/>.
- DiPrete, T., and M. Gangl. 2004. Assessing bias in the estimation of causal effects: Rosenbaum bounds on matching estimators and instrumental variables estimation with imperfect instruments. *Sociological Methodology* 34: 271–310.
- Fan, J., and I. Gibels. 1996. *Local Polynomial Modelling and Its Applications*. New York: Chapman & Hall.
- Fisher, R. A. 1918. The causes of human variability. *Eugenics Review* 10: 213–220.
- . 1925. *Statistical Methods for Research Workers*. Edinburgh: Oliver & Boyd.
- Glazerman, S., D. M. Levy, and D. Myers. 2003. Nonexperimental versus experimental estimates of earnings impacts. *Annals of the American Academy of Political and Social Science* 589: 63–93.
- Goldberger, A. S., and O. D. Duncan. 1973. *Structural Equation Models in the Social Sciences*. New York: Seminar Press.
- Gomulka, J., and N. Stern. 1990. The employment of married women in the United Kingdom, 1970–1983. *Econometrica* 57: 171–199.
- Griliches, Z., and J. A. Hausman. 1986. Errors in variables in panel data. *Journal of Econometrics* 31: 93–118.
- Gutierrez, R. G., J. M. Linhart, and J. S. Pitblado. 2003. From the help desk: Local polynomial regression and Stata plugins. *Stata Journal* 3: 412–419.
- Hahn, J., P. Todd, and W. van der Klaauw. 2001. Identification and estimation of treatment effects with a regression-discontinuity design. *Econometrica* 69: 201–209.
- Hall, A. R., G. D. Rudebusch, and D. W. Wilcox. 1996. Judging instrument relevance in instrumental variables estimation. *International Economic Review* 37: 283–298.
- Hardin, J. W., H. Schmiediche, and R. J. Carroll. 2003. Instrumental variables, bootstrapping, and generalized linear models. *Stata Journal* 3: 351–360.
- Heckman, J., H. Ichimura, and P. Todd. 1997. Matching as an econometric evaluation estimator: Evidence from evaluating a job training program. *Review of Economic Studies* 64: 605–654.
- Heckman, J. J., and E. Vytlacil. 2004. Structural equations, treatment effects, and econometric policy evaluation. *Econometrica* 73: 669–738.
- Holland, P. W. 1986. Statistics and causal inference. *Journal of the American Statistical Association* 8: 945–960.

- Imai, K., and D. A. van Dyk. 2004. Causal inference with general treatment regimes: Generalizing the propensity score. *Journal of the American Statistical Association* 99: 854–866.
- Imbens, G. 2004. Nonparametric estimation of average treatment effects under exogeneity: A review. *Review of Economics and Statistics* 86: 4–29.
- Imbens, G. W., and T. Lemieux. 2007. Regression discontinuity designs: A guide to Practice. NBER Technical Working Paper No. 13039. <http://www.nber.org/papers/w13039/>.
- Jann, B. 2005a. jmpierce: Stata module to perform Juhn–Murphy–Pierce decomposition. Statistical Software Components S448803, Boston College Department of Economics. Downloadable from <http://ideas.repec.org/c/boc/bocode/s448803.html>.
- . 2005b. oaxaca: Stata module to compute decompositions of outcome differentials. Statistical Software Components S450604, Boston College Department of Economics. Downloadable from <http://ideas.repec.org/c/boc/bocode/s450604.html>.
- Juhn, C., K. M. Murphy, and B. Pierce. 1991. Accounting for the slowdown in black–white wage convergence. In *Workers and Their Wages: Changing Patterns in the United States*, ed. M. Kosters, 107–143. Washington, DC: American Enterprise Institute.
- . 1993. Wage inequality and the rise in returns to skill. *Journal of Political Economy* 101: 410–442.
- Kleibergen, F., and M. Schaffer. 2007. ranktest: Stata module to test the rank of a matrix using the Kleibergen–Paap rk statistic. Boston College Department of Economics, Statistical Software Components S456865. Downloadable from <http://ideas.repec.org/c/boc/bocode/s456865.html>.
- Lee, D. S. 2001. The electoral advantage to incumbency and voters’ valuation of politicians’ experience: A regression discontinuity analysis of elections to the U.S. House. NBER Technical Working Paper No. 8441. <http://www.nber.org/papers/w8441/>.
- . 2005. Training, wages, and sample selection: Estimating sharp bounds on treatment effects. NBER Technical Working Paper No. 11721. <http://www.nber.org/papers/w11721/>.
- Lee, D. S., and D. Card. 2006. Regression discontinuity inference with specification error. NBER Technical Working Paper No. 322. <http://www.nber.org/papers/t0322/>.
- Leibbrandt, M., J. Levinsohn, and J. McCrary. 2005. Incomes in South Africa since the fall of apartheid. NBER Technical Working Paper No. 11384. <http://www.nber.org/papers/w11384/>.

- Leuven, E., and B. Sianesi. 2003. psmatch2: Stata module to perform full Mahalanobis and propensity score matching, common support graphing, and covariate imbalance testing. Boston College Department of Economics, Statistical Software Components. Downloadable from <http://ideas.repec.org/c/boc/bocode/s432001.html>.
- Ludwig, J., and D. L. Miller. 2005. Does head start improve children's life chances? Evidence from a regression discontinuity design. NBER Technical Working Paper No. 11702. <http://www.nber.org/papers/w11702/>.
- Machado, J., and J. Mata. 2005. Counterfactual decompositions of changes in wage distributions using quantile regression. *Journal of Applied Econometrics* 20: 445–465.
- Manski, C. 1995. *Identification Problems in the Social Sciences*. Cambridge, MA: Harvard University Press.
- McCrary, J. 2007. Manipulation of the running variable in the regression discontinuity design: A density test. NBER Technical Working Paper No. 334. <http://www.nber.org/papers/t0334/>.
- Mikusheva, A., and B. P. Poi. 2006. Tests and confidence sets with correct size when instruments are potentially weak. *Stata Journal* 6: 335–347.
- Morgan, S. L., and D. J. Harding. 2006. Matching estimators of causal effects: Prospects and pitfalls in theory and practice. *Sociological Methods and Research* 35: 3–60.
- Nannicini, T. 2006. sensatt: A simulation-based sensitivity analysis for matching estimators. Boston College Department of Economics, Statistical Software Components. Downloadable from <http://ideas.repec.org/c/boc/bocode/s456747.html>.
- Nelson, C., and R. Startz. 1990. Some further results on the exact small sample properties of the instrumental variable estimator. *Econometrica* 58: 967–976.
- Neyman, J. 1923. *Roczniki Nauk Rolniczych* (Annals of Agricultural Sciences) Tom X: 1–51 [In Polish]. Translated as “On the application of probability theory to agricultural experiments. Essay on principles. Section 9,” by D. M. Dabrowska and T. P. Speed (Statistical Science 5: 465–472, 1990).
- Nichols, A. 2006. Weak instruments: An overview and new techniques. Boston, MA: 5th North American Stata Users Group meetings. <http://www.stata.com/meeting/5nasug/wiv.pdf>.
- Nichols, A., and K. Rader. 2007. Spending in the districts of marginal incumbent victors in the House of Representatives. Unpublished working paper.
- Nichols, A., and M. E. Schaffer. 2007. Cluster-robust and GLS corrections. Unpublished working paper.
- Oaxaca, R. 1973. Male–female wage differentials in urban labor markets. *International Economic Review* 14: 693–709.

- Poi, B. P. 2006. Jackknife instrumental variables estimation in Stata. *Stata Journal* 6: 364–376.
- Rosenbaum, P. R. 2002. *Observational Studies*. 2nd ed. New York: Springer.
- Rosenbaum, P. R., and D. B. Rubin. 1983. The central role of the propensity score in observational studies for causal effects. *Biometrika* 70: 41–55.
- Rothstein, J. 2007. Do value-added models add value? Tracking fixed effects and causal inference. Unpublished working paper.
- Rubin, D. B. 1974. Estimating causal effects of treatments in randomised and non-randomised studies. *Journal of Educational Psychology* 66: 688–701.
- . 1986. Statistics and causal inference: Comment: Which ifs have causal answers. *Journal of the American Statistical Association* 81: 961–962.
- . 1990. Comment: Neyman (1923) and causal inference in experiments and observational studies. *Statistical Science* 5: 472–480.
- Schaffer, M., and S. Stillman. 2006. xtoverid: Stata module to calculate tests of overidentifying restrictions after xtreg, xtivreg, xtivreg2, and xthtaylor. Statistical Software Components S456779, Boston College Department of Economics. Downloadable from <http://ideas.repec.org/c/boc/bocode/s456779.html>.
- . 2007. xtivreg2: Stata module to perform extended IV/2SLS, GMM and AC/HAC, LIML, and  $k$ -class regression for panel-data models. Statistical Software Components S456501, Boston College Department of Economics. Downloadable from <http://ideas.repec.org/c/boc/bocode/s456501.html>.
- Shadish, W. R., T. D. Cook, and D. T. Campbell. 2002. *Experimental and Quasi-Experimental Designs for Generalized Causal Inference*. Boston: Houghton Mifflin.
- Simpson, E. H. 1951. The interpretation of interaction in contingency tables. *Journal of the Royal Statistical Society, Series B* 13: 238–241.
- Spence, M. 1973. Job market signaling. *Quarterly Journal of Economics* 87: 355–374.
- Stock, J. H., and M. Yogo. 2005. Testing for weak instruments in linear IV regression. In *Identification and Inference for Econometric Models: Essays in Honor of Thomas Rothenberg*, ed. D. W. K. Andrews and J. H. Stock, 80–108. Cambridge: Cambridge University Press.
- Stone, M. 1974. Cross-validation and multinomial prediction. *Biometrika* 61: 509–515.
- . 1977. Asymptotics for and against cross-validation. *Biometrika* 64: 29–35.
- Stuart, E. A., and D. B. Rubin. 2007. Best practices in quasiexperimental designs: Matching methods for causal inference. In *Best Practices in Quantitative Social Science*, ed. J. Osborne. Thousand Oaks, CA: Sage.

- van der Klaauw, W. 2002. Estimating the effect of financial aid offers on college enrollment: A regression discontinuity approach. *International Economic Review* 43: 1249–1287.
- Wooldridge, J. M. 2002. *Econometric Analysis of Cross Section and Panel Data*. Cambridge, MA: MIT Press.
- Yule, G. U. 1903. Notes on the theory of association of attributes in statistics. *Biometrika* 2: 275–280.
- Yun, M.-S. 2004. Decomposing differences in the first moment. *Economics Letters* 82: 275–280.
- . 2005a. Normalized equation and decomposition analysis: Computation and inference. IZA Discussion Paper No. 1822. <ftp://ftp.iza.org/dps/dp1822.pdf>.
- . 2005b. A simple solution to the identification problem in detailed wage decompositions. *Economic Inquiry* 43: 766–772.

**About the author**

Austin Nichols is an economist at the Urban Institute, a nonprofit, nonpartisan think tank. He occasionally teaches statistics and econometrics, and he has used Stata almost daily since 1995. His research interests include poverty, social insurance, tax policy, and demographic outcomes such as fertility, marital status, health, and education.