Evaluating Program Impact using Panel or Longitudinal Data Models

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I. The basic setup

Our basic empirical model:

\[ Y_{ij} = X_{ij}\beta + W_j\delta + \alpha Prog_{ij} + (\mu_{ij} + \mu_j + \theta_{ij}) \]  

(1)

Where,

\( Y_{ij} \) = Outcome of interest (Use of FP)

\( X_{ij} \) = Individual-level observed characteristics (age, education, SES, gender)

\( W_j \) = Community-level observed characteristics (rural)

\( Prog_{ij} \) = Program variable, at individual level

\( \mu_{ij} \) = Unobserved individual-level characteristics (preferences, risk aversion, genetic background)

\( \mu_j \) = Unobserved community-level characteristics (sanitation, schools)

\( \theta_{ij} \) = Unobserved random shocks to \( Y \), at the individual level

\( i= 1, 2, \ldots, N_j \) individuals in community \( j \)

\( j= 1, 2, \ldots, J \) communities

**Estimation procedure:**

It depends on the assumptions about the unobservables \( \mu_{ij} \) and \( \mu_j \).

1) If the explanatory variables \( X_{ij} \), \( W_j \) and \( Prog_{ij} \) are not correlated with \( \mu_{ij} \) and \( \mu_j \), OLS will provide an unbiased and consistent estimator. You will need to correct the standard errors because the error terms will be correlated (use option `vce(cluster clustvar)` in Stata.)

2) If you suspect any of the explanatory variables \( X_{ij} \), \( W_j \) or \( Prog_{ij} \) are correlated with either \( \mu_{ij} \) or \( \mu_j \), you should not use OLS, because it will generate biased and inconsistent estimates. This is the case of endogeneous \( Prog_{ij} \).

*: Notice that \( \theta_{ij} \) represents random shocks specific to individual \( i \) which influence the outcome of interest. So, they are assumed uncorrelated with the explanatory variables (\( X_{ij} \), \( W_j \) and \( Prog_{ij} \))

**What can we do?**

Remember that the source of endogeneity are unobserved factors (either \( \mu_{ij} \) or \( \mu_j \)) that influence both Prog (or any other explanatory variable) and \( Y \) (the outcome).

**Question:** What if we could observe the same individual at two points in time, say, two years apart, at time 0 and time 1?
First, rewrite model (1) to allow for variables that change over time and for variables that remain fixed between time 0 and time 1.

Then,

\[ Y_{ijt} = X_{ijt} \beta_1 + X^F_{ijt} \beta_2 + W_{jt} \delta_1 + W^F_{jt} \delta_2 + \alpha \text{Prog}_{ijt} + (\mu_{ij} + \mu_j + \theta_{ijt}) \quad (2) \]

Where,

- \( Y_{ijt} \) = Outcome of interest, time-varying (Use of FP)
- \( X_{ijt} \) = Individual-level observed characteristics, time-varying (age, education, SES)
- \( X^F_{ijt} \) = Individual-level observed characteristics, time-invariant or fixed (sex)
- \( W_{jt} \) = Community-level observed characteristics, time-varying
- \( W^F_{jt} \) = Community-level observed characteristics, time-invariant or fixed (rural)
- \( \text{Prog}_{ijt} \) = Program variable, at individual level, time-varying
- \( \mu_{ij} \) = Unobserved individual-level fixed characteristics (preferences, risk aversion, genetic background)
- \( \mu_j \) = Unobserved community-level fixed characteristics (sanitation, schools)
- \( \theta_{ijt} \) = Unobserved random shocks to \( Y \), at the individual level, time-varying.

**Key assumption:** Unobserved factors \( \mu_{ij} \) and \( \mu_j \) do not change between time 0 and time 1. They remain “fixed” in the observation time interval. All time-varying unobservables are summarized by \( \theta_{ijt} \) which is uncorrelated with the observed explanatory variables.

Second, let’s write the model for each point in time:

At t=0, \( Y_{ij0} = X_{ij0} \beta_1 + X^F_{ij0} \beta_2 + W_{j0} \delta_1 + W^F_{j0} \delta_2 + \alpha \text{Prog}_{ij0} + (\mu_{ij} + \mu_j + \theta_{ij0}) \)

At t=1, \( Y_{ij1} = X_{ij1} \beta_1 + X^F_{ij1} \beta_2 + W_{j1} \delta_1 + W^F_{j1} \delta_2 + \alpha \text{Prog}_{ij1} + (\mu_{ij} + \mu_j + \theta_{ij1}) \)

Then, take the difference between time 0 and time 1:

\[ Y_{ij1} - Y_{ij0} = (X_{ij1} - X_{ij0}) \beta_1 + (W_{j1} - W_{j0}) \delta_1 + \alpha (\text{Prog}_{ij1} - \text{Prog}_{ij0}) + (\theta_{ij1} - \theta_{ij0}) \]

All “fixed” or time-invariant variables, including \( \mu_{ij} \) and \( \mu_j \), difference out. The sources of the endogeneity in model (1) have been eliminated in the new specification! You can apply OLS to new model. It will generate unbiased and consistent estimates of \( \alpha \), the program impact.

That is the **First-Differences Model.**
Advantages:
1. Easy to implement.
2. It provides unbiased and consistent estimates of $\alpha$ even if $X_{ij}$, $W_j$ or Prog$_{ij}$ are correlated with either $\mu_{ij}$ or $\mu_j$ in model (1). Individuals act as their own controls.

Disadvantages:
1. It does not generate estimates for fixed variables (education, sex, rural or even the program variable if it is time invariant.)
2. Large reduction in effective sample size makes it more difficult to obtain significant results when they really exist.
3. The new variables expressed in differences, 
   $\{ (X_{ij1} - X_{ij0})$, $(W_{j1} - W_{j0})$, $(Prog_{ij1} - Prog_{ij0}) \}$, have less variability than the original variables. Standard errors will be larger and confidence intervals wider. It will be harder to find significant program effects if they exist. So, the model is not efficient.
4. It does not control well for the “time” trend.

Important: We solved the problem of endogeneity without having to find IV variables.

You will need to control for clustering of error terms to obtain correct standard errors (option `vce(cluster clustvar) in Stata).

Extension for multiple time observations $T > 2$:

Suppose you have $T$ observations for each individual in the sample.

Take the average of all time observations for each individual and define the "between-quation":

$$\bar{Y}_{ij} = \bar{X}_{ij} \beta_1 + \bar{X}_{ij}^F \beta_2 + \bar{W}_j \delta_1 + \bar{W}_j^F \delta_2 + \alpha \bar{P}rog_{ij} + (\mu_{ij} + \mu_j + \bar{\theta}_{ij}) \quad (3)$$

Where,

- $\bar{Y}_{ij}$: Average of all time observations of time-varying individual-level outcome, for each individual
- $\bar{X}_{ij}$: Average of all time observations of time-varying individual-level characteristics, for each individual
- $\bar{X}_{ij}^F$: Individual-level observed characteristics, time invariant or Fixed
- $\bar{W}_j$: Average of all time observations of time-varying community-level characteristics, for each community
- $\bar{W}_j^F$: Community-level observed characteristics, time invariant or Fixed

We still assume that $\mu_{ij}$ and $\mu_j$ do not change over time.

Then, substract this equation from equation (2) for each time you observe:
\[ Y_{ijt} - \bar{Y}_{ij} = (X_{ijt} - \bar{X}_{ij})\beta_1 + (W_{jt} - \bar{W}_j)\delta_1 + \alpha(Prog_{ijt} - \bar{Prog}_{ij}) + (\theta_{ijt} - \bar{\theta}_{ij}) \]

All “Fixed” variables, including \( \mu_{ij} \) and \( \mu_j \), were differenced out. OLS will generate unbiased and consistent estimates of \( \alpha \), the program impact.

Same advantages and disadvantages as in \( T=2 \) case. You need a “large” \( T \).

**Dummy variables model**

Model:

\[ Y_{ijt} = X_{ijt}\beta + W_{jt}\delta + \alpha Prog_{ijt} + (\mu_{ij} + \theta_{ijt}) \] \hspace{1cm} (4)

\( \mu_{ij} \) represents omitted individual-level unobserved characteristics. These are fixed over time.

You have several time observations for each individual.

**Estimation**
- Create a dummy variable for each individual
- Add all dummies minus one to the model
- Run the model with standard methods

**Advantages**
- Easy to estimate (if number of time observations is large)
- Provides control for bias due to omitted variables.

**Disadvantage**
- Loss of “degrees of freedom”.
- Inefficient because you have to estimate a large number of parameters.
**Difference-in-Differences Model**

**Basic setup:**
- Two areas: Program area and Non-program area
- Two surveys: Baseline and Follow-up

Let’s define:

\[ P_{ij} = \begin{cases} 1, & \text{individual } i \text{ is in Program Area} \\ 0, & \text{individual } i \text{ is in Non-program Area} \end{cases} \]

\[ T_{ijt} = \begin{cases} 1, & \text{if observation at Follow-up (} t=1 \text{)} \\ 0, & \text{if observation at Baseline (} t=0 \text{)} \end{cases} \]

The model:

\[ Y_{ijt} = \beta_0 + \beta_1 P_{ij} + \beta_2 T_{ijt} + \beta_3 P_{ij} T_{ijt} + \mu_i + \mu_j + \theta_{ijt} \quad (5) \]

Let’s examine different cases:

**I. In Program Areas (P_{ij}=1)**
- At Baseline (T_{ij0}=0): \[ Y_{ij0} = \beta_0 + \beta_1 + 0 + 0 + \mu_i + \mu_j + \theta_{ij0} \] (A)
- At Follow-up (T_{ij1}=1): \[ Y_{ij1} = \beta_0 + \beta_1 + \beta_2 + \beta_3 + \mu_i + \mu_j + \theta_{ij1} \] (B)

Taking the difference: \[ (Y_{ij1} - Y_{ij0}) = \beta_2 + \beta_3 + (\theta_{ij1} - \theta_{ij0}) \] (B-A)

Expected value: \[ E(Y_{ij1} - Y_{ij0} | P_{ij}=1) = \beta_2 + \beta_3 \]

assuming that \[ E(\theta_{ij1} - \theta_{ij0} | P_{ij}=1) = 0 \]

**II. In Non-Program Areas (P_{ij}=0)**
- At Baseline (T_{ij0}=0): \[ Y_{ij0} = \beta_0 + 0 + 0 + 0 + \mu_i + \mu_j + \theta_{ij0} \] (C)
- At Follow-up (T_{ij1}=1): \[ Y_{ij1} = \beta_0 + 0 + \beta_2 + 0 + \mu_i + \mu_j + \theta_{ij1} \] (D)

Taking the difference: \[ (Y_{ij1} - Y_{ij0}) = \beta_2 + (\theta_{ij1} - \theta_{ij0}) \] (D-C)

Expected value: \[ E(Y_{ij1} - Y_{ij0} | P_{ij}=0) = \beta_2 \]

assuming that \[ E(\theta_{ij1} - \theta_{ij0} | P_{ij}=0) = 0 \]

Now, the difference of the differences:

\[ E(Y_{ij1} - Y_{ij0} | P_{ij}=1) - E(Y_{ij1} - Y_{ij0} | P_{ij}=0) = (\beta_2 + \beta_3) - \beta_2 = \beta_3 \]

Notice that \( \mu_{ij} \) and \( \mu_j \) were differenced out.

**Key Question: Is \( \beta_3 \) our program impact?**

**Answer:** Yes, if the “Parallel assumption” holds.
- The “Parallel assumption” holds if the time-varying unobservables do not vary over time with program status.

That is, \( E(\theta_{ij1} - \theta_{ij0}|P_{ij}=1) = 0 \) and \( E(\theta_{ij1} - \theta_{ij0}|P_{ij}=0) = 0 \)

Which means that assignment of the program does not influence the change in unobservables that vary over time.
In other words, time-varying unobservables are not a potential source of endogeneity.

Also, the Program Area would have had the same change as the Non-program Area in the absence of the program. The time trend, \( \beta_2 \), is the same for both groups.

Under the “Parallel Assumption”, \( \beta_3 \) is an estimate of Program Impact.

In some cases this could be a strong assumption. The time-varying unobservables could change depending on treatment status. The “time trend” could be different for unobserved reasons related to the program.

Graphically (see ppt file material)

*** When is the Parallel Assumption valid?

- If the Non-program areas (comparison group) were selected to be “as similar as” possible as the Program Areas.
  
  Best case: Program was randomly assigned to the areas (experimental evaluation design).
  
  If you cannot implement an experiment, it is recommended to select Non-program areas by some matching procedure, using community-level aggregates collected before the baseline.
  
  You will have to define the extent of the “pool of areas” from which to obtain the matched Non-program areas to include in the baseline.

- There is a “relatively short” time interval between baseline and follow-up. But, the program might need more time to have an impact.

- Fixed factors \( \mu_{ij} \) and \( \mu_j \) are the only, or the main, source of potential endogeneity of the program variable. Even if there is correlation between time-varying unobservables and program, its effect is small.

Notice that you can easily add covariates (\( X_{ijt} \)) to the model to control for observed differences between the program and non-program areas. It is recommended that the covariates are measured at baseline. You need to make sure the covariates are not endogeneous.
Testing the Parallel Assumption

You need pre-baseline survey data.

Setup:
- Two areas: Program area and Non-program area
- Two surveys: Pre-baseline and Baseline

Define:
P_{ij} = 1, individual i in Program Area
       0, individual i in Non-program Area

T_{ijt} = 1, if observation at Baseline (t=0)
       0, if observation at Pre-Baseline (t=-1)

The basic model:
\[ Y_{ijt} = \beta_0 + \beta_1 P_{ij} + \beta_2 T_{ijt} + \beta_3 P_{ij} T_{ijt} + \mu_{ij} + \mu_j + \theta_{ijt} \] (6)

Let’s examine the different cases:

I. In Program Areas (P_{ij} = 1)
- At Pre-baseline (T_{ij-1}=0): Y_{ij-1} = \beta_0 + \beta_1 + 0 + 0 + \mu_{ij} + \mu_j + \theta_{ij-1} \quad (E)
- At Baseline (T_{ij0}=1): Y_{ij0} = \beta_0 + \beta_1 + \beta_2 + \beta_3 + \mu_{ij} + \mu_j + \theta_{ij0} \quad (A)

Taking the difference: \( (Y_{ij0} - Y_{ij-1}) = \beta_2 + \beta_3 + (\theta_{ij0} - \theta_{ij-1}) \) \quad (A-E)

Expected value: \[ E(Y_{ij0} - Y_{ij-1} | P_{ij}=1) = \beta_2 + \beta_3 \]
assuming: \[ E(\theta_{ij0} - \theta_{ij-1} | P_{ij}=1) = 0 \]

II. In Non-Program Areas (P_{ij} = 0)
- At Pre-baseline (T_{ij-1}=0): Y_{ij-1} = \beta_0 + 0 + 0 + 0 + \mu_{ij} + \mu_j + \theta_{ij-1} \quad (F)
- At Baseline (T_{ij0}=1): Y_{ij0} = \beta_0 + 0 + \beta_2 + 0 + \mu_{ij} + \mu_j + \theta_{ij0} \quad (C)

Taking the difference: \( (Y_{ij0} - Y_{ij-1}) = \beta_2 + (\theta_{ij0} - \theta_{ij-1}) \) \quad (C-F)

Expected value: \[ E(Y_{ij0} - Y_{ij-1} | P_{ij} = 0) = \beta_2 \]
assuming: \[ E(\theta_{ij0} - \theta_{ij-1} | P_{ij} = 0) = 0 \]
Then, the difference of the differences is:

\[ E(Y_{ij0} - Y_{ij-1}|P_{ij}=1) - E(Y_{ij0} - Y_{ij-1}|P_{ij}=0) = \]
\[ (\beta_2 + \beta_3) - \beta_2 = \beta_3 \]

The test for the Parallel Assumption is: \( Ho: \beta_3 = 0. \)

Graphically (see ppt material)

If \( \beta_3 \neq 0, \) there is no evidence that the parallel assumption should hold in the following time period (baseline to follow-up).

Other ways to examine the Parallel Assumption

Duflo, E. (2002) “Empirical methods” proposes two other ways:

+ Use other control groups
+ Use a different outcome \( Y \) which is not supposed to be affected by the program.

**Dif-in-Dif with three observations**

Let’s define:

\( P_{ij} = \)

1, individual \( i \) in Program Area

0, individual \( i \) in Non-program Area

\( T_{1ijt} = \)

1, if observation at Follow-up 1 (\( t=1 \))

0, if observation at other time (baseline or follow-up 2)

\( T_{2ijt} = \)

1, if observation at Follow-up 2 (\( t=2 \))

0, if observation at other time (baseline or follow-up 1)

The basic model:

\[ Y_{ijt} = \beta_0 + \beta_1 P_{ij} + \beta_2 T_{1ijt} + \beta_3 T_{2ijt} + \beta_4 P_{ij} T_{1ijt} + \beta_5 P_{ij} T_{2ijt} + \mu_{ij} + \mu_j + \theta_{ijt} \]

I. **In Program Areas (\( P_{ij}=1 \))**

- At baseline (\( T1=0 \) and \( T2=0 \)): \( Y_{ij0} = \beta_0 + \beta_1 + 0 + 0 + 0 + 0 + \mu_{ij} + \mu_j + \theta_{ij0} \) (A)
- At follow-up 1 (\( T1=1 \) and \( T2=0 \)): \( Y_{ij1} = \beta_0 + \beta_1 + \beta_2 + 0 + 0 + \mu_{ij} + \mu_j + \theta_{ij1} \) (B)
- At follow-up 2 (\( T1=0 \) and \( T2=1 \)): \( Y_{ij2} = \beta_0 + \beta_1 + 0 + \beta_3 + 0 + \beta_5 + \mu_{ij} + \mu_j + \theta_{ij2} \) (G)

Taking the difference:

\( Fu1-Base: \) \( E(Y_{ij1} - Y_{ij0} | P_{ij}=1) = \beta_2 + \beta_4 \) (B-A)

\( Fu2-Base: \) \( E(Y_{ij2} - Y_{ij0} | P_{ij}=1) = \beta_3 + \beta_5 \) (G-A)

\( Fu2-Fu1: \) \( E(Y_{ij2} - Y_{ij1} | P_{ij}=1) = (\beta_3 + \beta_5) - (\beta_2 + \beta_4) \) (G-B)
assuming:
\[ E(\theta_{ij1} - \theta_{ij0} \mid P_{ij}=1) = 0 \]
\[ E(\theta_{ij2} - \theta_{ij0} \mid P_{ij}=1) = 0 \]
\[ E(\theta_{ij2} - \theta_{ij1} \mid P_{ij}=1) = 0 \]

II. In Non-Program Areas (P_{ij}=0)

- At baseline (T1=0 and T2=0): \( Y_{ij0} = \beta_0 + 0 + 0 + 0 +0 + \mu_{ij} + \mu_j + \theta_{ij0} \) (C)
- At follow-up 1 (T1=1 and T2=0): \( Y_{ij1} = \beta_0 + 0 + \beta_2 + 0 + 0 + 0 + \mu_{ij} + \mu_j + \theta_{ij1} \) (D)
- At follow-up 2 (T1=0 and T2=1): \( Y_{ij2} = \beta_0 + 0 + \beta_3 + 0 + 0 + \mu_{ij} + \mu_j + \theta_{ij2} \) (H)

Taking the difference:
- \( \text{Fu1-Base: } E(Y_{ij1} - Y_{ij0} \mid P_{ij}=0) = \beta_2 \) (D-C)
- \( \text{Fu2-Base: } E(Y_{ij2} - Y_{ij0} \mid P_{ij}=0) = \beta_3 \) (H-C)
- \( \text{Fu2-Fu1: } E(Y_{ij2} - Y_{ij1} \mid P_{ij}=0) = \beta_3 - \beta_2 \) (H-D)

assuming:
\[ E(\theta_{ij1} - \theta_{ij0} \mid P_{ij}=0) = 0 \]
\[ E(\theta_{ij2} - \theta_{ij0} \mid P_{ij}=0) = 0 \]
\[ E(\theta_{ij2} - \theta_{ij1} \mid P_{ij}=0) = 0 \]

Then, the estimated program impacts are:

Impact 1 (Base to Fu1) = \( (\beta_2 + \beta_4) - \beta_2 = \beta_4 \)
Impact 2 (Base to Fu2) = \( (\beta_3 + \beta_5) - \beta_3 = \beta_5 \)
Impact 3 (Fu1 to Fu2) = \( (\beta_3 + \beta_5) - (\beta_2 + \beta_4) - (\beta_3 - \beta_2) = (\beta_5 - \beta_4) \)

Notice that \( \mu_{ij} \) and \( \mu_j \) were differenced out, again.

The validity of this model rests in the assumption that time-varying unobservables do not vary over time in a systematic way related to program status. That is, time-varying unobservables are not a source of endogeneity of the program variable.

Graphically (see ppt material).

**What if you only have a panel of communities, not individuals?**
You can only control for community-level fixed unobservables. You cannot control for individual-level unobservables. You will have to assess whether that is enough to control for the potential sources of endogeneity in your model.
Random Effects Model (RE)

Model: \( Y_{ti} = X_{ti}\beta + \alpha P_{ti} + Z_{ti}\delta + \mu_i + \varepsilon_i \)

Error terms assumptions:
1. \( \varepsilon_i \) and \( \mu_i \) are random variables normally distributed with zero means and variances \( \sigma^2_{\varepsilon} \) and \( \sigma^2_{\mu} \) respectively. They are not correlated with each other.
2. The error terms are not correlated with explanatory variables.

Note: FE assumes \( \mu_i \) are fixed coefficients that affect intercept
RE assumes \( \mu_i \) are random and not correlated with regressors

- RE resolves potential serial correlation and heteroscedasticity problems
- RE does not solve endogeneity problem

Given the assumptions, an additional parameter of interest:

\[
\rho = \frac{\sigma^2_{\mu}}{\sigma^2_{\mu} + \sigma^2_{\varepsilon}}
\]

It is a measure of the degree of correlation across time.
- If \( \rho = 0 \), all observations are independent (\( \sigma_{\mu} = 0 \))
- If \( \rho = 1 \), means perfect correlation for time observations so there are only N observations.

Important: Similar to the "design effect" of multiple stage survey sample selection

Given the assumptions the Generalized Least Squares (GLS) can be used to obtain optimal estimates (STATA \texttt{xtreg }).
However, OLS with corrected standard errors is an option if one is not interested in obtaining an estimate of $\rho$ (STATA).

**Choosing between FE and RE**

1. If there is no endogeneity, the estimated parameters obtained with FE should be identical to those obtained with RE. But, the RE model has the advantage of being more efficient;

2. If there is endogeneity, then the estimated parameters obtained with FE should be different to those obtained with RE, and FE is preferred as it generates unbiased and consistent estimates.

**Haussman test:**

It is based on the difference between $\hat{\beta}_{FE}$ and $\hat{\beta}_{RE}$

- If $\hat{\beta}_{FE} = \hat{\beta}_{RE}$, there is no endogeneity, use RE

- If $\hat{\beta}_{FE} \neq \hat{\beta}_{RE}$, there is endogeneity, use FE