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# A NOTE ON ESTIMATING PROPORTIONS BY LINEAR REGRESSIONS

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## A NOTE ON ESTIMATING PROPORTIONS BY LINEAR REGRESSION

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The estimation of the parameters of a linear regression model in which the dependent variable is a fraction or proportion frequently occurs in statistical analyses. This proportion reflects some specific activity such as the proportion of income spent on some good and is related to a number of exogenous characteristics. The estimation of a proportion relationship is not always performed in isolation. The relationship of the exogenous variables to the remainder of the population, or complementary proportions, is usually of equal interest.

An example of such an analysis has been performed by McCall<sup>1</sup> in studying the movements of people into and/or out of various income classes over time. In one part of his study McCall calculates a first order Markov transition matrix of peoples' movements into, out of, or remaining in income classes. Each cell contains a transition probability reflecting the propensity of individuals to move out of a given income class or remain in it. The changes in the transition probabilities for each cell are then related to changes in GNP for the period

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<sup>&</sup>lt;sup>1</sup>John J. McCall, <u>Earnings Mobility and Economic Growth</u>, R-526-0EO, The RAND Corporation, October 1970.

from 1958 to 1966. In each matrix the probabilities sum to one and each cell will undoubtedly be affected differently by changes in GNP.

In McCall's and ysis and in many analyses, the probabilities or proportions across all cells sum to one in the raw data. For prediction purposes it is desirable that the estimated proportions always sum to one as well. In this note we show that the estimated proportions sum to one and no constraint is needed on the proportions if the parameter estimates are BLUE. If the parameters are not, then a constraint can be constructed using Zellner's<sup>2</sup> technique of Seemingly Unrelated Least Squares (SULS) to ensure that the estimated proportions sum to one. It is further noted that the results can be generalized to any system of equations containing the same exogenous variables in each equation and specifying an exact linear constraint on the dependent yariables for all observations in the raw data.

## UNCONSTRAINED LEAST SQUARES

Assume that there are z proportions  $p_i$  and n observations on each  $p_i$  such that  $\sum_{j=1}^{z} p_{j} = 1$ , for every j = 1, ..., n. Each regression equation can then be written

(1)  $p_i = X\beta_i + \varepsilon_i \quad i = 1, ..., z$ 

where each  $p'_i$  is a 1 x n vector of observations  $(p_{i1}, \ldots, p_{in})$ , X =  $(1, X_1, \ldots, X_s)$  where each  $X_k$  is an n x 1 vector of observations,  $\beta_i$  is an (s+1) x 1 vector of regression coefficients,  $\epsilon_i \sim N(0, \sigma^2)$ ,

<sup>2</sup>Arnold Zellner, "An Efficient Method of Estimating Seemingly Unrelated Regressions and Teets for Aggregation Bias," <u>Journal of the</u> <u>American Statistical Association</u>, Vol. 57, June 1962, pp. 348-368.

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$$\begin{split} & \mathsf{E}(\varepsilon_{\mathbf{i}} \mathbf{X}_{\mathbf{k}}) = 0 \text{ for all } \mathbf{i} \text{ and } \mathbf{k}, \ \mathsf{E}(\varepsilon_{\mathbf{i}\mathbf{j}} \varepsilon_{\mathbf{i}\mathbf{j}},) = 0, \ \sum_{i=1}^{2} \mathbf{p}_{i\mathbf{j}} = 1 \text{ for all } \mathbf{j}, \\ & \text{and } 0 \leq \mathbf{p}_{i\mathbf{j}} \leq 1, \text{ all } \mathbf{i}, \mathbf{j}. \end{split}$$

The equations in (1) represent actually z-1 independent equations z-1and  $\sum p_i = 1-p_z$ . Thus  $p_z$  can be easily calculated, but the separate i=1 i = 1-p\_z. Thus  $p_z$  can be easily calculated, but the separate effects of the exogenous variables on  $p_z$  are omitted. To ensure that  $\sum_{i=1}^{z} p_i = 1$  and to obtain the separate coefficients  $\hat{\beta}_{ik}$  for all i and k, i=1 is not necessary to use a Lagrangean constraint. Estimation of (1) by Ordinary Least Squares (OLS) yields the unbiased estimate

(2) 
$$\hat{\beta}_{i} = (X'X)^{-1}X'p_{i}$$
,  $i = 1, ..., z$ 

and

(3) 
$$\hat{p}_i = X\hat{\beta}_i$$
,  $i = 1, ..., z$ .

By summing the estimated proportions over all i, we obtain

(4) 
$$\sum_{i=1}^{z} \hat{p}_{i} = \sum_{i=1}^{z} x \hat{\beta}_{i} = \sum_{i=1}^{z} x (x'x)^{-1} x' p_{i}$$
$$= \sum_{i=1}^{z} p_{i} = 1 .$$

Therefore OLS ensures that the  $\hat{p}_i$  sum to one regardless of variances of each estimate as long as the  $\hat{\beta}_i$  are unbiased. Similarly the variance of the sum of the estimated proportions is zero using the above result:

(5) 
$$\operatorname{Var}\left(\sum_{i=1}^{z} \hat{p}_{i}\right) = E\left(\sum_{i=1}^{z} \hat{p}_{i} - \sum_{i=1}^{z} p_{i}\right)^{2}$$
$$= E\left[\left(\sum_{i=1}^{z} \hat{p}_{i}\right)^{2} + \left(\sum_{i=1}^{z} p_{i}\right)^{2} - 2\left(\sum_{i=1}^{z} \hat{p}_{i}\right)\left(\sum_{i=1}^{z} p_{i}\right)\right]$$
$$= 0.$$

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#### IMPLICIT CONSTRAINTS ON THE REGRESSION COEFFICIENTS

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The fact that the proportions sum to one implies a constraint on  $\beta_{ik}$  across all i equations. If the  $\beta_i$  are BLUE (and the  $X_k$  are fixed or independently distributed), then  $\sum_{i=1}^{z} p_i = 1$  implies  $\sum_{i=1}^{z} \hat{\beta}_{ij} = 0$  for all j. Consider

(6) 
$$d\left(\sum_{i=1}^{z} \widetilde{p}_{i}\right) = \sum_{i=1}^{z} d\widetilde{p}_{i} = \sum_{i=1}^{z} \sum_{j=1}^{s} \frac{\partial \widetilde{p}_{i}}{\partial X_{j}} dX_{j}$$
$$= \sum_{i=1}^{z} \sum_{j=1}^{s} \widetilde{\beta}_{ij} dX_{j}$$
$$= \sum_{j=1}^{s} \left(\sum_{i=1}^{z} \widetilde{\beta}_{ij}\right) dX_{j}$$
$$= (\widetilde{\beta}_{11} + \dots + \widetilde{\beta}_{z1}) dX_{1} + \dots + (\widetilde{\beta}_{1s} + \dots + \widetilde{\beta}_{zs}) dX_{s}$$
$$= 0$$

Considering a total change in the summation of the  $\hat{p}_i$  due to a total change in any exogenous variable, say  $X_i$ , yields

(7) 
$$0 = (\beta_{11} + \dots + \beta_{z1}) \frac{dX_1}{dX_j} + \dots + (\beta_{1j} + \dots + \beta_{zj}) + \dots + (\beta_{1s} + \dots + \beta_{zs}) \frac{dX_s}{dX_j}.$$

But  $dX_i/dX_j = 0$  for i = 1, ..., s;  $i \neq j$ . By considering total changes in  $\sum_{i=1}^{Z} \hat{p}_i$  due to  $dX_j$ , j = 1, ..., s, we obtain the result that  $\sum_{i=1}^{Z} \hat{\beta}_{ij} = 0$ for every j. The summation of intercept terms, however, does not equal zero:

(8) 
$$\hat{\beta}_{i0} = \vec{p}_i - \sum_{j=1}^{N} \hat{\beta}_{ij} \vec{X}_j$$

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and

(9) 
$$\sum_{i=1}^{z} \hat{\beta}_{i0} = \sum_{i=1}^{z} \bar{p}_{i} - \sum_{i=1}^{z} \sum_{j=1}^{s} \hat{\beta}_{ij} \bar{x}_{j}$$
$$= 1 - \sum_{j=1}^{s} \left( \sum_{i=1}^{z} \hat{\beta}_{ij} \right) \bar{x}_{j} .$$

Based on the above result of  $\sum_{i=1}^{2} \hat{\beta}_{ij} = 0$  for every j, <sup>3</sup>

(10) 
$$\sum_{i=1}^{2} \hat{\beta}_{i0} = 1$$
.

It is immediate from (4) that an exact linear constraint on the dependent variables in the raw data implies the same exact linear constraint for the estimated dependent variables across the z equations. Further, the results of Eqs. (6) to (10) imply that the  $\hat{\beta}_{ij}$  sum to zero across i and the  $\hat{\beta}_{i0}$  sum to the value of the constraint if an exact linear constraint exists on the dependent variables. Moreover, as will be seen below, the parameters may be constrained to ensure the exact linear constraint on the dependent variables if the parameters are not unbiased.

#### ESTIMATION WITH THE COEFFICIENT CONSTRAINT

If the parameters are not BLUE, the  $\hat{p}_i$  and  $\hat{\beta}_{i0}$  may not sum to one, nor may the  $\begin{bmatrix} z \\ \hat{c} \\ i \end{bmatrix}$  sum to zero for every j. These conditions can be

<sup>3</sup>Anotner p:oof of these results was pointed out to me by b. fron. Let  $e_1$  represent the (j×1) vector of ones. Write all z equations  $\hat{p}_1 = x\hat{\beta}_1$  side by side to obtain  $\hat{p} = X\hat{p}$  where  $\hat{p}$  is n x z. X is n x (s+1), and  $\hat{\beta}$  is (s+1) x z. It is then  $pe_2 = X\hat{b}e_2$ . But  $\hat{p}e_2 = e_n$  by equation (4) and X  $\cdot$  (1,0,...,0)' =  $e_n$  by definition. This implies that  $\varepsilon e_2 = (1,0,...,0)$  which contains the above results.

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forced on the system however by treating the z equations as a system of seeming unrelated regressions as developed by Zellner. Rewritz (1) as

(11) 
$$\begin{bmatrix} P_1 \\ \vdots \\ \vdots \\ P_z \end{bmatrix} = \begin{bmatrix} X_1 & 0 & \dots & 0 \\ 0 & X_2 & \vdots \\ \vdots \\ \vdots \\ 0 & \dots & \vdots \\ 0 & \dots & \vdots \\ x_z \end{bmatrix} \begin{bmatrix} \beta_1 \\ \vdots \\ \beta_z \end{bmatrix} + \begin{bmatrix} \varepsilon_1 \\ \vdots \\ \vdots \\ \beta_z \end{bmatrix}$$

where each  $X_i$  is a vector of independent variables (1,  $X_{i1}$ , ...,  $X_{is}$ ) and each  $\beta_i$  a vector ( $\beta_{i0}$ ,  $\beta_{i1}$ ,  $\beta_{i2}$ , ...,  $\beta_{is}$ ); Eq. (10) can be simplified as

(12) 
$$p = XB + u$$
.

Application of least squares yields the BLU estimator,

(13) 
$$\beta^* = (X' \Sigma^{-1} X) X' \Sigma^{-1} p$$

where  $\Sigma$  is estimated by the disturbance variance-covariance matrix.<sup>4</sup> By further constraining the  $\beta_{ij}$  to sum to zero across all i equations for every j and the  $\beta_{i0}$  to sum to one, we obtain simultaneous constraint estimates<sup>5</sup>

(14) 
$$\tilde{\beta} = \beta^* + (\tilde{x}^* \tilde{z}^{-1} \tilde{x})^{-1} Q' [Q(\tilde{x}^* \tilde{z}^{-1} \tilde{x})^{-1} Q']^{-1} (W-OB^*)$$

<sup>&</sup>lt;sup>4</sup>See A. Zellner, "An Efficient Method of Estimating Seemingly Unrelated Regressions and Tests for Aggregation Bias," <u>Journal of the</u> <u>American Statistical Association</u>, June 1962.

<sup>&</sup>lt;sup>5</sup>See H. Theil, <u>Economic Forecasts and Policy</u> (2nd ed.), North-Holland Publishing Co., Amsterdam, 1961.

The estimate  $\tilde{\beta}$  satisfies the constraint  $Q\tilde{\beta} = W$ , where Q is a matrix specifying the combination of the  $\tilde{\beta}_{ij}$  and W is a vector describing the constraint. For the constraints above the intercepts sum to one and the slope coefficients across each  $X_j$  sum to zero, therefore W = (1, 0, ..., 0), a 1 X (s+1) vector. Thus all constraints may be forced in the event that unconstrained OLS is not consistent with the implied constraints on the  $\beta_{i,i}$ .

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