NOTES AND PROBLEMS

Starting with the present volume 21, the editorial changes announced in *ET* 20(4), pp. 643–644, to *Econometric Theory* Problems and Solutions take effect. This section is now called Notes and Problems (NP) and will include both a problem and its solution published together. To complete the former Problems and Solutions series, in the present volume 21, *ET* publishes in a separate section the Solutions to the Problems proposed in volume 20.

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AN ALTERNATIVE TO MAXIMUM LIKELIHOOD BASED ON SPACINGS

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In the statistics literature, asymptotic properties of the Maximum Product of Spacings estimator are derived from first principles. We propose an alternative derivation based on the comparison between its objective function and that of the Maximum Likelihood estimator.

1. MOTIVATION

Consider a scalar continuously distributed random variable x with probability density function (p.d.f.) $f(x) \equiv f(x, \theta)$ and corresponding cumulative distribution function (c.d.f.) $F(x) \equiv F(x, \theta)$ known up to a possibly multidimensional parameter $\theta \in \Theta$. Denote the true value of the parameter by θ_0. Suppose that a random sample $x_1, \ldots, x_n$ is available. To estimate θ_0, one usually uses the maximum likelihood (ML) estimator

$$\hat{\theta}_{ML} = \arg\max_{\theta \in \Theta} Q_{ML}(\theta),$$

where

$$Q_{ML}(\theta) \equiv \frac{1}{n} \sum_{i=1}^{n} \log f(x_{(i)}, \theta)$$

and $x_{(i)}$ is ith order statistic. The ML procedure adjusts the shape of the density by tuning the parameter θ so that the product of density values at the sample observations is maximized. Suppose that the regularity conditions for consistency and asymptotic normality of the ML estimator hold; in particular, assume that the support of x does not depend on θ and θ_0 is a well-separated point of maximum of $E[\log f(x, \theta)]$ (see, e.g., van der Vaart, 2000, Ch. 5).

The following maximum product of spacings (MPS) estimator has been encountered in the statistics literature but is not widespread among econometricians:

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$$\hat{\theta}_{MPS} = \arg\max_{\theta\in\Theta} Q_{MPS}(\theta),$$

where

$$Q_{MPS}(\theta) \equiv \frac{1}{n}\sum_{i=1}^{n+1} \log[F(x_{(i)}) - F(x_{(i-1)})]$$

and $F(x_{(0)}) \equiv 0$, $F(x_{(n+1)}) \equiv 1$. The MPS criterion amounts to tuning the parameter θ so that the product of probabilities of a new observation falling between each two neighboring sample points in the set of order statistics is maximized (a similar interpretation was given by Titterington, 1985). Given that the sum of those probabilities equals one, at the optimum they are as close to each other as possible.

The MPS estimation was introduced independently by Cheng and Amin (1983) and Ranneby (1984). The advantages of MPS over ML were demonstrated when the boundedness of the objective function by construction leads to the consistency of MPS estimates when ML estimates may not exist or may not be unique, and in numerous examples when the density is positive only to the right of a shifted origin, it being one of unknown parameters (Cheng and Amin, 1983). In regular cases MPS estimates are consistent, asymptotically normal, and efficient, which was derived in subsequent papers from first principles (e.g., Shao and Hahn, 1999; Ghosh and Jammalamadaka, 2001).

However, in regular cases when both the ML and MPS estimators are well defined, one can derive the asymptotic properties of the MPS by contrasting the two estimators to the first order as $n \to \infty$.

2. RESULTS AND DISCUSSION

We require that $f(x,\theta)$ be twice continuously differentiable in θ and continuous in x for all $\theta \in \Theta$. We will denote by x_L and x_U the minimal and maximal points of the support of x (either or both may be infinite). The support is supposed to be independent of the parameter θ and be connected, so that $f(x) > 0$ for any $x \in (x_L, x_U)$. Denote the true p.d.f. by $f_0(x) \equiv f(x,\theta_0)$ and the true c.d.f. by $F_0(x) \equiv F(x,\theta_0)$. We assume that $F(x,\theta)$ and $f(x,\theta)$ satisfy the following additional conditions.

Additional Assumption.

(i) $\lim_{x\to x_L} F_0(x)\log^2 F(x) = \lim_{x\to x_L} F_0(x)\log^2 f(x) = 0$,
$\lim_{x\to x_U}(1 - F_0(x))\log^2(1 - F(x)) = \lim_{x\to x_U}(1 - F_0(x))\log^2 f(x) = 0$.
(ii) For any $\theta \in \Theta$, the number of local optima of $f(x)$ is finite.

Part (i) imposes a sort of continuity on the tails as the parameter varies. Part (ii) is not necessary, but it facilitates the proof. It is straightforward to

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verify that the Additional Assumption is satisfied for frequently used distributions. Our main result follows a helpful lemma.

LEMMA 1. *If for some* $g(x)$ *we have* $\lim_{x\to x_L} F_0(x)g(x) = 0$, *then* $g(x_{(1)}) = o_p(n)$. *Similarly, if for some* $g(x)$ *we have* $\lim_{x\to x_U}(1 - F_0(x))g(x) = 0$, *then* $g(x_{(n)}) = o_p(n)$.

Proof. The distribution of $F_0(x)$ is uniform on $[0,1]$, and hence (e.g., Feller, 1971)

$$\Pr\{nF_0(x_{(1)}) > t\} = \left(1 - \frac{t}{n}\right)^n \xrightarrow[n\to\infty]{} e^{-t}, \qquad t \geq 0,$$

so that $nF_0(x_{(1)}) = O_p(1)$, but not $o_p(1)$, as $n \to \infty$. Observe that, as $\operatorname{plim}_{n\to\infty} x_{(1)} = x_L$,

$$o_p(1) = F_0(x_{(1)})g(x_{(1)}) = nF_0(x_{(1)})\cdot n^{-1}g(x_{(1)}) = O_p(1)\cdot n^{-1}g(x_{(1)}).$$

It follows that $g(x_{(1)}) = o_p(n)$. One handles the second implication in a similar manner. ■

THEOREM 2. *Let the regularity conditions for consistency and asymptotic normality of the ML estimator* $\hat\theta_{ML}$ *hold. Let the Additional Assumption also hold. Then* $\sqrt{n}(\hat\theta_{ML} - \hat\theta_{MPS}) = o_p(1)$.

Proof. Denote $\Delta x_{(i)} \equiv x_{(i)} - x_{(i-1)}$. By the mean value theorem, for $i = 2,\dots,n$,

$$F(x_{(i)}) - F(x_{(i-1)}) = \Delta x_{(i)} f(x^*_{(i)}),$$

where $x^*_{(i)} \in (x_{(i-1)}, x_{(i)})$. Then

$$\prod_{i=2}^n [F(x_{(i)}) - F(x_{(i-1)})] = \prod_{i=2}^n \Delta x_{(i)} \prod_{i=2}^n f(x^*_{(i)}) = \prod_{i=2}^n \Delta x_{(i)}\cdot\exp(\Lambda)\cdot\prod_{i=1}^n f(x_{(i)}),$$

where

$$\Lambda = \sum_{i=2}^n \log f(x^*_{(i)}) - \sum_{i=1}^n \log f(x_{(i)}).$$

Hence

$$Q_{MPS}(\theta) - Q_{ML}(\theta) = \frac{1}{n}\sum_{i=2}^n \log \Delta x_{(i)} + \frac{1}{n}\log F(x_{(1)}) + \frac{1}{n}\log(1 - F(x_{(n)})) + \frac{1}{n}\Lambda.$$

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The first term is independent of θ and thus does not affect the optimizer. By Additional Assumption(i) and Lemma 1 appropriately applied with $g(x) = \log^2 F(x)$ and $g(x) = \log^2(1 - F(x))$, the second and third terms are $o_p(n^{-1/2})$.

Let us denote the K local optima of $f(x, \theta)$ by $\hat{x}_k$, $k = 1, \ldots, K$, and define in addition $\hat{x}_0 = x_L$ and $\hat{x}_{K+1} = x_U$. For every interval between adjacent points $\hat{x}_{k-1}$ and $\hat{x}_k$, $k = 1, \ldots, K+1$, denote by $x_{(i_k^l)}$ and $x_{(i_k^r)}$ the leftmost and rightmost order statistics that belong to the interval, and by $x^*_{(i_k)} \in (x_{(i_k^r)}, x_{(i_{k+1}^l)})$, $k = 1, \ldots, K$, those $x^*_{(i)}$-points that do not belong to $\bigcup_{k=1}^{K+1} (x_{(i_k^l)}, x_{(i_k^r)})$. Then

$$\Lambda = \sum_{k=1}^{K} \log f(x^*_{(i_k)}) + \sum_{k=1}^{K+1} \Lambda_k, \qquad \Lambda_k = \sum_{i=i_k^l+1}^{i_k^r} \log f(x^*_{(i)}) - \sum_{i=i_k^l}^{i_k^r} \log f(x_{(i)}).$$

The density $f(x, \theta)$ is monotone on any interval $[x_{(i_k^l)}, x_{(i_k^r)}]$. Suppose it is monotonically increasing. Then the greatest possible value taken by any $f(x^*_{(i)})$, $i_k^l + 1 \le i \le i_k^l$, is $f(x_{(i)})$. Thus Λ_k is bounded from above by $-\log f(x_{(i_k^l)})$. Analogously, Λ_k is bounded from below by $-\log f(x_{(i_k^r)})$. Therefore, $|\Lambda_k| \le |\log f(x_{(i_k^l)})| + |\log f(x_{(i_k^r)})|$. Similarly, the same inequality holds if $f(x, \theta)$ is monotonically decreasing on the interval considered. Summing over the intervals and rearranging we obtain

$$|\Lambda| \le |\log f(x_{(1)})| + |\log f(x_{(n)})| + \sum_{k=1}^{K} [|\log f(x^*_{(i_k)})| + |\log f(x_{(i_k^r)})| + |\log f(x_{(i_{k+1}^l)})|].$$

By Lemma 1 applied to $g(x) = \log^2 f(x)$, we have $|\log f(x_{(1)})| = o_p(n^{1/2})$ and $|\log f(x_{(n)})| = o_p(n^{1/2})$. The term with the summation is $O_p(1)$ because, for all $k = 1, \ldots, K$,

$$\operatorname*{plim}_{n\to\infty} |\log f(x^*_{(i_k)})| = \operatorname*{plim}_{n\to\infty} |\log f(x_{(i_k^r)})| = \operatorname*{plim}_{n\to\infty} |\log f(x_{(i_{k+1}^l)})| = |\log f(\hat{x}_k)|$$

and K is finite.

To summarize, $Q_{MPS}(\theta) = Q_{ML}(\theta) + A + o_p(n^{-1/2})$, where A does not depend on θ. Therefore, $\hat{\theta}_{MPS} = \hat{\theta}_{ML} + o_p(n^{-1/2})$. ■

The asymptotic equivalence of the two estimators implies that the asymptotic or bootstrap inference about θ_0 on the basis of the MPS estimator may be carried out using the ML asymptotics. In small samples the unpleasant behavior of the ML estimator is well known. Using the alternative MPS criterion one may be able to improve the small sample performance of the ML estimator without changing the asymptotic distribution, as the following example attests.

Example

The MPS estimator can be expected to be more efficient than the ML estimator in small samples when the density is skewed and/or the tails are heavy. Con-

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sider the exponential distribution $f(x, \lambda) = \lambda e^{-\lambda x} \mathbb{I}[x \geq 0]$ and let the true value λ_0 be 1. The mean squared error of λ_{MPS} obtained from 10,000 simulations is 65.4%, 73.1%, and 85.2% that of λ_{ML} for sample sizes of 6, 10, and 20, respectively. Very similar comparisons emerge for the Pareto distribution $f(x) = \lambda x^{-(\lambda+1)} \mathbb{I}[x \geq 1]$ with the true value λ_0 being 1.

Of course, the efficiency property is not universal: the MPS and ML estimators are equally efficient when a mean of a normal distribution with known variance is estimated, whereas when a standard deviation of a centered normal distribution is estimated, the mean squared error of the MPS estimator exceeds that of the ML estimator by a factor that ranges from 2.7 to 1.4 as the sample size increases from 6 to 50.

As far as extensions of the MPS idea are concerned, Lind (1994) provides a rationale for the MPS in the information theory, Ekström (1997) suggests use of "high order" spacings, Ghosh and Jammalamadaka (2001) expand the class to contain estimators with objective functions based on various divergence criteria (interestingly, the MPS estimator is the only one asymptotically efficient in the extended class), and Ranneby, Jammalamadaka, and Teterukovskiy (2004) propose a generalization to multivariate situations.

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