

Frontier Topics in Empirical Economics: Week 9

Causal Inference with Panel Data II

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Staggered DID: Settings

- Up until now, we consider a plain vanilla DID setting
- Some policy is implemented at time t_0 in one set of units (treated group), but not the other set of units (untreated group)
- Let's go to more general case of TWFE $\Rightarrow$ Staggered DID
- Policy can be rolled out in different places at different time

Staggered DID: Settings

- Assume we have policy implemented at group g level, rolling out in different periods
- Let's run the same TWFE regression for individual i in group g at time t :

$$Y_{igt} = \gamma_g + \lambda_t + \delta D_{gt} + \epsilon_{igt} \quad (1)$$

- $D_{gt} = 1$ if group g is treated at time t
- In homogeneous treatment effect case: δ is TE
- In heterogeneous treatment effect case: δ is a weighted sum of ATE in each group and period
- But, is this in general a good estimator? NO!

De Chaisemartin and d'Haultfoeuille (2020) Two-Way Fixed Effects Estimators with Heterogeneous Treatment Effects

- Main issue of the TWFE **when treatment effect is heterogeneous**
- TWFE identifies a weighted average TE
- But **some of the weights can be negative**
- Thus, the weighted average may be negative even if signs of all cell TEs are positive
- Let's see why (Please read CD(2020), this is important!)

CD(2020): Settings

Setup in CD(2020)

- Three-level of data: individual i , group g , period t
- $N_{g,t}$ is the number of observations in cell (g, t) , N is the total number of samples
- Assume $D_{i,g,t}$ is a binary treatment, $Y_{i,g,t}(0)$ and $Y_{i,g,t}(1)$ are potential outcomes
- We have (g,t) cell-level average variables as:

$$D_{g,t} = \frac{1}{N_{g,t}} \sum_{i \in (g,t)} D_{i,g,t}, \quad Y_{g,t}(0) = \frac{1}{N_{g,t}} \sum_{i \in (g,t)} Y_{i,g,t}(0)$$
$$Y_{g,t}(1) = \frac{1}{N_{g,t}} \sum_{i \in (g,t)} Y_{i,g,t}(1), \quad Y_{g,t} = \frac{1}{N_{g,t}} \sum_{i \in (g,t)} Y_{i,g,t}$$

CD(2020): Settings

- Assumption 1: For all (g, t) , $N_{g,t} > 0$ (Full Support)
- Assumption 2: For all (g, t) , $D_{i,g,t} = D_{g,t}$ (Sharp Design)
Treatment is identical for everyone in the same group-time cell
- Assumption 3: Vectors $(Y_{g,t}(0), Y_{g,t}(1), D_{g,t})_{1 \leq t \leq T}$ are mutually independent
No correlation across groups (correlations within group across time is allowed)
Weaker version of iid

- Assumption 4:

For all (g, t) , $E(Y_{g,t}(0) - Y_{g,t-1}(0) | D_{g,1}, \dots, D_{g,T}) = E(Y_{g,t}(0) - Y_{g,t-1}(0))$

- This is called "Strong exogeneity".
- Treatment cannot be assigned to some group because they experienced a negative/positive shock
- No Ashenfelter dip
- Exogenous treatment group assignment and treatment timing

CD(2020): Settings

- In a more general case than staggered DID, exit is also allowed
- Some groups can cancel the policy after some periods, then we have $D_{g,t} = 1, D_{g,t+1} = 0$
- Let's run the TWFE regression:

$$Y_{igt} = \gamma_g + \lambda_t + \beta^{fe} D_{gt} + \epsilon_{igt}$$

- Assumption 5: For $t \geq 2$, $E(Y_{g,t}(0) - Y_{g,t-1}(0))$ does not vary across g
Common trends
- Potential outcomes without treatment evolve identically across groups.

CD(2020): ATT and TWFE Estimator

- ATT: $\delta^{TR} = E[Y_{i,g,t}(1) - Y_{i,g,t}(0) | D_{g,t} = 1]$
- Cell average TE: $\Delta_{g,t} = \frac{1}{N_{g,t}} \sum_{i \in (g,t)} [Y_{i,g,t}(1) - Y_{i,g,t}(0)]$
- Thus, we have ATT to be an expected weighted average of cell averages:

$$\delta^{TR} = E\left[\sum_{(g,t): D_{g,t}=1} \frac{N_{g,t}}{N_1} \Delta_{g,t}\right] \quad (2)$$

- Let $\hat{\beta}^{fe}$ be the TWFE estimator and $\beta^{fe} = E(\hat{\beta}^{fe})$

CD(2020): ATT and TWFE Estimator

- Let $\epsilon_{g,t}$ denote the residual of the regression of $D_{g,t}$ on group and period FE

$$D_{g,t} = \alpha + \gamma_g + \lambda_t + \epsilon_{g,t} \quad (3)$$

Theorem 1 in CD(2020)

If we have Assumption 1-5, then

$$\beta^{fe} = E\left[\sum_{(g,t):D_{g,t}=1} \frac{N_{g,t}}{N_1} w_{g,t} \Delta_{g,t}\right]$$
$$w_{g,t} = \frac{\epsilon_{g,t}}{\sum_{(g,t):D_{g,t}=1} \frac{N_{g,t}}{N_1} \epsilon_{g,t}}$$

The TWFE estimator is a weighted average of cell-level ATE, with $w_{g,t}$ as weights.

CD(2020): ATT and TWFE Estimator

- How to interpret this weight $w_{g,t}$?
- You assign more weights to cells (g, t) deviating from the average treatment level
 - of all cells in group g
 - of all cells at time t
- If everyone in this group, or every one in this year is not treated, but you are treated, then you will be assigned a large weight
- Seems OK to you? A big issue is negative weight

CD(2020): An Example

- Assume that $N_{g,t}/N_{g,t-1}$ does not vary across g (balanced panel)
- Consider a simple case with 2 groups and 3 periods with equal group size
- Group 1 gets treated at periods 3; group 2 gets treated at periods 2 and 3

	t=1	t=2	t=3
G1	×	×	✓
G2	×	✓	✓

CD(2020): An Example

- Group 1 gets treated at periods 3; group 2 gets treated at periods 2 and 3
- Let $D_{g,.} = \sum_t \frac{N_{g,t}}{N_g} D_{g,t}$, $D_{.,t} = \sum_g \frac{N_{g,t}}{N_t} D_{g,t}$, $D_{.,.} = \sum_{(g,t)} \frac{N_{g,t}}{N} D_{g,t}$:

$$\epsilon_{g,t} = D_{g,t} - D_{g,.} - D_{.,t} + D_{.,.} \quad (4)$$

- Thus, we have:

$$\epsilon_{1,3} = 1 - \frac{1}{3} - 1 + \frac{1}{2} = \frac{1}{6}$$

$$\epsilon_{2,2} = 1 - \frac{2}{3} - \frac{1}{2} + \frac{1}{2} = \frac{1}{3}$$

$$\epsilon_{2,3} = 1 - \frac{2}{3} - 1 + \frac{1}{2} = -\frac{1}{6}$$

- $\epsilon_{2,3} < 0!!!$

CD(2020): An Example

- In this special case, we have:

$$\beta^{fe} = \frac{1}{2}E[\Delta_{1,3}] + E[\Delta_{2,2}] - \frac{1}{2}E[\Delta_{2,3}]$$

- We assign negative weight to $\Delta_{2,3}$
- Negative weight can make results weird
- If $E[\Delta_{1,3}] = E[\Delta_{2,2}] = 1$, $E[\Delta_{2,3}] = 4$, we have:

$$\beta^{fe} = \frac{1}{2} \times 1 + 1 - \frac{1}{2} \times 4 = -\frac{1}{2}$$

- We have a negative TWFE estimation, when all treatment effects are positive

CD(2020): Negative Weights

- Let's see in more details why there is negative weight
- In this case, we have two switches: Group 1 at period 3, and group 2 at period 2
- Thus, we have two DID comparisons
- It can be proved that β^{fe} is the average of these two:

$$DID_1 = E(Y_{2,2}) - E(Y_{2,1}) - [E(Y_{1,2}) - E(Y_{1,1})]$$

$$DID_2 = E(Y_{1,3}) - E(Y_{1,2}) - [E(Y_{2,3}) - E(Y_{2,2})]$$

$$\beta^{fe} = \frac{1}{2}(DID_1 + DID_2)$$

CD(2020): Negative Weights

- We can show that $DID_2 = E[\Delta_{1,3}] - (E[\Delta_{2,3}] - E[\Delta_{2,2}])$, NOT $DID_2 = E[\Delta_{1,3}]$

Proof:

$$\begin{aligned} DID_2 &= E(Y_{1,3}) - E(Y_{1,2}) - [E(Y_{2,3}) - E(Y_{2,2})] \\ &= E(Y_{1,3}(1)) - E(Y_{1,2}(0)) - [E(Y_{2,3}(1)) - E(Y_{2,2}(1)))] \\ &= \color{red}{E(Y_{1,3}(1)) - E(Y_{1,3}(0))} + \underbrace{E(Y_{1,3}(0)) - E(Y_{1,2}(0)) - [E(Y_{2,3}(1)) - E(Y_{2,2}(1))]}_{\text{You cannot cancel this in a forbidden comparison!}} \\ &= \color{red}{E[\Delta_{1,3}]} + E(Y_{1,3}(0)) - E(Y_{1,2}(0)) \\ &\quad - [\color{green}{E(Y_{2,3}(1)) - E(Y_{2,3}(0))} + E(Y_{2,3}(0)) - E(Y_{2,2}(1)))] \\ &= \color{red}{E[\Delta_{1,3}]} - \color{green}{E[\Delta_{2,3}]} \\ &\quad + [\color{blue}{E(Y_{2,2}(1)) - E(Y_{2,2}(0))} + \underbrace{E(Y_{2,2}(0)) - E(Y_{2,3}(0)) - [E(Y_{1,2}(0)) - E(Y_{1,3}(0))]}_{=0}] \\ &= \color{red}{E[\Delta_{1,3}]} - (\color{green}{E[\Delta_{2,3}]} - \color{blue}{E[\Delta_{2,2}]}) \end{aligned}$$

CD(2020): Negative Weights

$$DID_2 = E[\Delta_{1,3}] - \underbrace{(E[\Delta_{2,3}] - E[\Delta_{2,2}])}_{\text{bias term}}$$

- Then, $E[\Delta_{2,3}]$ enters into β^{fe} with a negative weight
- What does this equation mean?
- It means that this DID comparison, is ATE in group 1 period 3, minus a bias term
- Bias term: changes in group 2's ATE between period 2 and 3
- You are using treated cells as the "control" group!! $\Leftarrow [E(Y_{2,3}) - E(Y_{2,2})]$
- For this already treated group, although there is no treatment status change from period 2 to 3, the outcome change of $Y(1)$ is not comparable to that of $Y(0)$!
- Changes in $Y(1)$ additionally contains changes in TE across time

CD(2020): Negative Weights

- That's why you may assign negative weights to some cell ATEs
- Do not use "continuously treated groups" as "control groups"
- This is called **forbidden comparison**

CD(2020): Negative Weights

- Homework : Show what is DID_1 , express it in terms of $E[\Delta_{g,t}]$, tell me what is the difference between the derivation of DID_1 and DID_2 . Why some terms can be canceled out in the derivation of DID_1 , but not DID_2
- This homework can make you have a deeper understanding of why using treated cells as "controls" can be dangerous!

CD(2020): Negative Weights

- In general, which kind of cells are more likely to have negative weights?
- Let's go back to the function of weight

$$D_{g,t} = \alpha + \gamma_g + \lambda_t + \epsilon_{g,t} \quad (5)$$

- When will $\epsilon_{g,t}$ become negative?
- A cell is more likely to have negative weight if
 - (1) At a period when many groups are treated;
 - (2) In a group where it is treated for many periods;

CD(2020): Negative Weights

- This is the opposite of who are assigned larger weight
- If everyone in this group, or every one in this year are treated, then you are assigned negative weight
- Just like group 2 in period 3 in this example

CD(2020): Negative Weights

- The intuition is that they are more likely to take treated cells as "control"
- Many chances for you to do forbidden comparisons in these cells
- Specifically, in staggered adoption case, these are very dangerous
 - Groups adopting treatment/policy earlier
 - Periods that are very late

CD(2020): Sensitivity Check

So, what should we do?

- Step 1: Check how sensitive your result is to treatment effect heterogeneity
 - (1) Compute the weights, see whether some of them are negative
 - (2) Dividing $|\hat{\beta}^{fe}|$ by std dev of the weights, you can derive the minimal value of the std dev of ATE across (g, t) cells under which ATT may have the opposite sign
- If there are many negative weights, or $\frac{|\hat{\beta}_{fe}|}{sd(w)}$ is small, do not use TWFE
- Since TWFE estimator is vulnerable to treatment effect heterogeneity in this case
- In practice, you can use *twowayfeweights* Stata package

CD(2020): New Estimator

- Step 2: If you have many negative weights, or the threshold value of the flipped sign is small, using a **new estimator**
- CD(2020) constructs a new estimator for TWFE regression, called DID_M
- We define a new average treatment effect:

$$\delta^s = E\left[\frac{1}{N_s} \sum_{(i,g,t): t \geq 2, D_{g,t} \neq D_{g,t-1}} [Y_{i,g,t}(1) - Y_{i,g,t}(0)]\right]$$

- $N_s = \sum_{(g,t): t \geq 2, D_{g,t} \neq D_{g,t-1}} N_{g,t}$, number of obs changing their treatment status from $t-1$ to t
- δ^s is the ATE of all switching cells
- Switching cells include joiners and leavers

CD(2020): New Estimator

Additional assumptions

- Assumption 9: Strong Exogeneity for $Y(1)$ (corresponding to A4)
For all (g, t) , $E(Y_{g,t}(1) - Y_{g,t-1}(1) | D_{g,1}, \dots, D_{g,T}) = E(Y_{g,t}(1) - Y_{g,t-1}(1))$
- Assumption 10: Common Trends for $Y(1)$ (corresponding to A5)
For $t \geq 2$, $E(Y_{g,t}(1) - Y_{g,t-1}(1))$ does not vary across g
- A10 sets some homogeneity for the treatment effect
- These two assumptions ensure one to reconstruct the potential outcomes of leavers
- They are needed only when you have exits
- They are not necessary if we have a staggered adoption (no leavers)

CD(2020): New Estimator

Additional assumptions

- Assumption 11: Existence of "Stable" Groups (existence of control groups)

- (i) If there is g such that $D_{g,t-1} = 0, D_{g,t} = 1$, there exists g' such that $D_{g',t-1} = D_{g',t} = 0$.
- (ii) If there is g such that $D_{g,t-1} = 1, D_{g,t} = 0$, there exists g' such that $D_{g',t-1} = D_{g',t} = 1$

- Assumption 12: Mean Independence between a group's outcome and other groups' treatment (No spillover)

For all g, t , $E(Y_{g,t}(0)|D) = E(Y_{g,t}(0)|D_g), E(Y_{g,t}(1)|D) = E(Y_{g,t}(1)|D_g)$

CD(2020): New Estimator

- Let's define the DID_M estimator
- Let $N_{d,d',t} = \sum_{g:D_{g,t}=d,D_{g,t-1}=d'} N_{g,t}$, that is, number of obs with treatment d at t and d' at $t-1$
- Let's define two parts of DID comparisons:

$$DID_{+,t} = \sum_{g:D_{g,t}=1,D_{g,t-1}=0} \frac{N_{g,t}}{N_{1,0,t}} (Y_{g,t} - Y_{g,t-1}) - \sum_{g:D_{g,t}=D_{g,t-1}=0} \frac{N_{g,t}}{N_{0,0,t}} (Y_{g,t} - Y_{g,t-1})$$
$$DID_{-,t} = \sum_{g:D_{g,t}=D_{g,t-1}=1} \frac{N_{g,t}}{N_{1,1,t}} (Y_{g,t} - Y_{g,t-1}) - \sum_{g:D_{g,t}=0,D_{g,t-1}=1} \frac{N_{g,t}}{N_{0,1,t}} (Y_{g,t} - Y_{g,t-1})$$

- DID_+ is DID for joiners vs untreated, DID_- is DID for leavers vs treated

CD(2020): New Estimator

- DID_M estimator is defined as

$$DID_M = \sum_{t=2}^T \left(\frac{N_{1,0,t}}{N_s} DID_{+,t} + \frac{N_{0,1,t}}{N_s} DID_{-,t} \right) \quad (6)$$

Theorem 3 in CD(2020)

If we have Assumptions 1,2,4,5, and 9-12 then

$$E[DID_M] = \delta^s$$

The DID_M estimator is a weighted average of joiners' and leavers' treatment effect. It is an unbiased estimator of δ^s , that is, the ATE of all switching cells.

CD(2020): New Estimator

- DID_M is also consistent and asymptotically normal
- DID_M is nonparametric, thus, less efficient than TWFE (bias-variance tradeoff)
- A placebo test can be constructed, to check the parallel trend assumption
- Basic idea: Compare outcome's evolution from $t - 2$ to $t - 1$ between groups which change and don't change their treatments from $t - 1$ to t (pre-trend test)
- Calculate $DID_{+,t}$ and $DID_{-,t}$ by changing $Y_{g,t}$ to be $Y_{g,t-1}$ and $Y_{g,t-1}$ to be $Y_{g,t-2}$
- You should expect zeros for $DID_{+,t}$ and $DID_{-,t}$ in this placebo
- You can use Stata packages *fuzzydid* or *did_multiplegt*

CD(2020): Conclusion

Main takeaways of De Chaisemartin and d'Haultfoeuille (2020)

- In general, TWFE is not a good estimator in settings with heterogeneous treatment effect
- It may assign negative weights to some group-period ATEs
- If you have periods when many groups are treated, or groups treated for many periods, be careful!
- In practice, here are the things you can do
 - Calculate weights and the threshold value of flipping the sign
 - If there are negative weights, or the threshold is small, use DID_M rather than TWFE
 - If use DID_M , implement placebo test to validate the parallel trend assumption
- In general, the argument can be applied to any ordered treatment D

CD(2020): Conclusion

- Homework 2: Will plain vanilla DID (like Card and Krueger (1994)) suffer from the same issue when we use TWFE estimator? Explain your answer in words. (Do not use math)

Continuous DID

- We only considered discrete treatment variables in previous lectures
- What about continuous cases? They are also very common
- For example, the effect of US-China trade war tariff on China's employment

Continuous DID

- In general, we will see that TWFE with continuous treatment is much more complicated
- We need additional assumptions to identify some meaningful causal effects
- It also suffers from forbidden comparison issue in staggered DID case
- More generally, we will see how to interpret continuous treatment in the potential outcome framework (usually complicated)

Callaway et al(2021): Introduction

Callaway, Goodman-Bacon, and Sant'Anna (2021) Difference-in-Differences with a Continuous Treatment

- Define two types of causal effects: level effect (d vs 0) and slope effect (d vs d')
- Consider a simple two-period DID case
 - Discuss assumptions that are needed for the identification of these causal effects (non-parametrically)
 - Analyze TWFE estimator: relation to causal effects
- Extend results to more than two periods and staggered DID

Callaway et al(2021): Settings

Two-period, one-time policy treatment

- We have two periods, t and $t - 1$
- Units receive a treatment dose D_i in t , not $t - 1$ ($D_{it-1} = 0$)
- Potential outcome of individual i at time s receiving d is $Y_{is}(d)$
- Assumption 1: We have i.i.d. samples.
- Assumption 2: Full support of D ,
 $D = \{0\} \cup D_+$. $P(D = 0) > 0$, $dF_D(d) > 0$, $\forall d \in D_+$. No units are treated in $t - 1$.
- Assumption 3: No anticipation effect. $Y_{it-1} = Y_{it-1}(0)$, $Y_{it} = Y_{it}(D_i)$
- Assumption 4: Continuous treatment.
 $D_+ = [d_L, d_U]$, $0 < d_L < d_U < \infty$, $P(D = 0) > 0$, $f_D(d) > 0 \forall d \in D_+$

Callaway et al(2021): Settings

- The definition of causal effect can be much more complicated in continuous treatment case
- Since you are not only comparing d and 0 , but also d and d'
- 1. Level effect: $Y_t(d) - Y_t(0)$
Difference between effect of some dose level d and no treatment
- 2. Slope effect: $Y_t'(d)$
The derivative of the potential outcome function. The marginal increase in the effect when dose is increased.

Callaway et al(2021): Settings

- We define average **level effects** as:

$$ATT(a|b) = E[Y_t(a) - Y_t(0)|D = b], \quad ATE(d) = E[Y_t(d) - Y_t(0)]$$

- $ATT(a|b)$: Average effect of dose a on units that who actually experience dose b
- a is potential treatment, b is real treatment
- $ATE(d)$: Average effect of dose d on all units

Callaway et al(2021): Settings

- We define average **slope effects** as:

$$ACRT(d|d) = \frac{\partial E[Y_t(l)|D = d]}{\partial l} \Big|_{l=d}, \quad ACR(d) = \frac{\partial E[Y_t(d)]}{\partial d}$$

- We call them Average Causal Response Function
- $ACRT(d|d)$: Average causal response of a small change in dose d , for the group of units who actually experience dose d (similar to ATT)
- What is the impact for people who get dose d to get a little bit more dose
- $ACR(d)$: Average causal response of a small change in dose d for everyone (similar to ATE)

Callaway et al(2021): Non-parametric Identification

- Assumption 4: Parallel Trends.

$$\forall d, E[Y_t(0) - Y_{t-1}(0)|D = d] = E[Y_t(0) - Y_{t-1}(0)|D = 0]$$

- It says that the path of untreated potential outcomes would have been the same for untreated group and treated group with any dose level

Theorem 1 in Callaway et al(2021)

Under Assumptions 1 to 4, $ATT(d|d)$ is identified for all $d \in D$:

$$ATT(d|d) = E[\Delta Y_t|D = d] - E[\Delta Y_t|D = 0]$$

where $\Delta Y_t = Y_t - Y_{t-1}$

- We can non-parametrically identify ATT (level effect) under parallel trend assumption in a DID fashion.

Callaway et al(2021): Non-parametric Identification

Proposition 3 (a) in Callaway et al(2021)

Under Assumptions 1 to 4, generally, $ACRT(d|d)$ is NOT identified:

$$\frac{\partial E[\Delta Y_t | D = d]}{\partial d} = ACRT(d|d) + \underbrace{\frac{\partial ATT(d|l)}{\partial l} \Big|_{l=d}}_{\text{Selection bias}}$$

- Under traditional parallel trend assumption, local comparisons of paths of outcomes mix $ACRT(d|d)$ and a selection bias term
- The bias is the marginal change in ATT of group $D = l$ if they get dose d
- **ACRT CANNOT be identified with traditional parallel trend assumption in a DID fashion! Why?**

Callaway et al(2021): Non-parametric Identification

- For $ACRT(d|d)$, you consider a marginal increase from d to l
- You are comparing d and l , but not d and 0 !
- We assume parallel trends only for group $D = d$ and group $D = l$ if they are not treated ($Y_t(0) - Y_{t-1}(0)|D$)
- But not parallel trends for group $D = d$ and group $D = l$ if they are treated at level d ($Y_t(d) - Y_{t-1}(0)|D$)
- Parallel trends only for untreated potential outcome ($d = 0$), not any dose level ($d = d, l$)
- You need some exogeneity/homogeneity about the dose assignment

Callaway et al(2021): Non-parametric Identification

- Let's write the selection bias in the form of local difference

$$\begin{aligned}\frac{\partial ATT(d|I)}{\partial I} \Big|_{I=d} &= E[\Delta Y_t(d)|D = d'] - E[\Delta Y_t(d)|D = d] \\ &= E[Y_t(d) - Y_{t-1}(0)|D = d'] - E[Y_t(d) - Y_{t-1}(0)|D = d]\end{aligned}$$

- When subtracting observed average outcome of $D = d$ from $D = d'$
- We have both causal effect for group $D = d$ and differences in effects for group $D = d$ and $D = d'$
- Need more assumption to identify meaningful causal response

Callaway et al(2021): Non-parametric Identification

- Assumption 5: Strong Parallel Trends.

$$\forall d, E[Y_t(d) - Y_{t-1}(0)] = E[Y_t(d) - Y_{t-1}(0) | D = d]$$

- It says that for all doses, the average change in outcomes over time across all units if they had been assigned dose d , is the same as those actually experienced dose d .
- It imposes some homogeneity on treatment effect
- Not as strong as saying "parallel trend for group $D = d$ and any other group $D = d'$ if they are assigned dose d' "
- Instead, we assume "parallel trend for group $D = d$ and average of all other group $D = d'$ if they are assigned dose d' "

Callaway et al(2021): Non-parametric Identification

- We can non-parametrically identify ACR under **strong parallel trend** assumption, in a DID fashion.

Proposition 3 (b) in Callaway et al(2021)

Under Assumptions 1 to 3 and 5, $ACR(d)$ is identified:

$$\frac{\partial E[\Delta Y_t | D = d]}{\partial d} = ACR(d)$$

Callaway et al(2021): Causal Effect and TWFE Estimator

- Now we consider the causal interpretation of the traditional TWFE Estimator

Theorem 3 (a) in Callaway et al(2021)

Under Assumptions 1 to 4,

$$\beta^{twfe} = \int_{d_L}^{d_U} w_1(l) \left[ACRT(l|l) + \left. \frac{\partial ATT(l|h)}{\partial h} \right|_{h=l} \right] dl + w_0 \frac{ATT(d_L|d_L)}{d_L}$$

$$\text{where, (i) } w_1(l) \geq 0, w_0 > 0, \text{ (ii) } \int_{d_L}^{d_U} w_1(l) dl + w_0 = 1$$

- The first term is the average causal effect (for the treated) of running from d_L to d_U
- The third term is the causal effect of having the lowest dose (d_L vs 0)
- The second term is the selection bias (without Assumption 5)

Callaway et al(2021): Causal Effect and TWFE Estimator

Theorem 3 (b) in Callaway et al(2021)

Under Assumptions 1 to 5,

$$\beta^{twfe} = \int_{d_L}^{d_U} w_1(I)[ACR(I)]dI + w_0 \frac{ATE(d_L)}{d_L}$$

- Under strong parallel trend assumption, we eliminate the selection bias

Callaway et al(2021): Causal Effect and TWFE Estimator

- What if we extend it to multiple periods and staggered DID?
- Under strong parallel trend assumption, β^{twfe} is composed of four comparisons
 - (i) paths of outcomes for units treated at the same time but with different doses;
 - (ii) paths of outcomes in early-treated relative to later-treated groups in periods before later is treated;
 - (iii) paths of outcomes between later-treated and already treated groups in post-treatment period of the later-treated group;
 - (iv) paths of outcomes between early-treated and later-treated groups in their common post treatment periods relative to their common pre periods.
- First two are fine. (iii) and (iv) are forbidden comparison!
- The control group is not $Y_t(0) - Y_{t-1}(0)$
- Same issue as in CD(2020)

Callaway et al(2021): Conclusion

- In general, it is hard to identify meaningful causal effects using DID fashion in continuous treatment case
- Causal level effects on the treated are non-parametrically identified under common parallel trend assumption
- But causal slope effects are non-parametrically identified (in a DID fashion) only under strong parallel trend assumption, which is not testable by pre-trend
- You need not only random assignment of treatment, but also random assignment of dose amount

Callaway et al(2021): Conclusion

- In a simple two period case, TWFE estimator delivers a weighted average of causal responses only under strong parallel trend assumption
- In a staggered DID case, TWFE estimator suffers from negative weight and forbidden comparison issue even under strong parallel trend assumption

Callaway et al(2021): Conclusion

Bad News! What should we do?

- Using non-parametric method to estimate the effect (Callaway, Goodman-Bacon, and Sant'Anna (2021) does not give the Stata Package)
- Using structural method or theoretical models to help you to interpret your results
- Be careful about the strong parallel trend assumption you have to impose

Final Conclusion

- Linear regression is, after all, a parametric method, which imposes strong functional form assumptions
- It is a simple and elegant statistical tool
- But when things become more and more complicated (heterogeneous, dynamic, continuous...), regression may not be capable to capture many data patterns and give weird results
- Fundamental solution 1: Non-parametric tools which gives you enough flexibility to capture complicated patterns
- Fundamental solution 2: Structural model which helps you to regulate and rationalize the data with economic theories

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