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**Size Corrected Power for  
Bootstrap Tests**

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# SIZE CORRECTED POWER FOR BOOTSTRAP TESTS

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## Abstract

This note provides an alternative perspective for size-corrected power for a test. The advantage of this approach is that it allows the calculation of size-corrected power for bootstrap tests.

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# 1 Introduction

This note is motivated by the following two observations:

a) When a researcher has several testing procedures available for a given problem, a common practice is to choose the one with the highest empirical power. However, this usage is difficult because the empirical rejection probabilities (RP's) of the tests under the null hypothesis are different to the nominal level and among themselves. Hence, a widely employed practice in Econometrics is to report what is called size-corrected power, that is computing the empirical power with simulated critical values. See, for instance, Stock (1994), Hong and White (1995) or Dufour and Kiviet (1998).

b) Recently, there has been a big increase in the use of bootstrap tests in Econometrics. These tests employ simulated critical values (of the bootstrap estimate of the true distribution) instead of asymptotic critical values. See, for instance, Hall and Horowitz (1996), Hansen (1996) or Andrews (1997).

Given that the bootstrap test already computes simulated critical values, it does not appear to be obvious how to perform size corrected power for bootstrap tests. In the next Section we describe size corrected power for a typical asymptotic test and reinterpret it in an alternative form. In Section 3 we show how the alternative way can be applied to bootstrap tests. A word about notation. For any cumulative distribution function  $F$  and any  $\alpha \in (0, 1)$ ,  $F^{-1}(\alpha)$  denotes the  $\alpha$ -th quantile of  $F$ .

## 2 Size corrected power for an asymptotic test

Let  $\alpha$  denote the nominal level (typically,  $\alpha = 0.95$ ) at which the one-sided test is carried out. Let  $T_n$  be the relevant test statistic calculated with a sample of size  $n$ , and denote by  $F_{T_n}$  and  $F_{T_1}$  the exact and asymptotic distribution functions of the statistic  $T_n$  under the null hypothesis, respectively. The standard asymptotic test consists in comparing the test statistic  $T_n$  against the appropriate asymptotic critical value, that is,

$$\text{reject the null hypothesis if } T_n > F_{T_1}^{-1}(\alpha) = q_1; \quad (1)$$

Since  $F_{T_n} \neq F_{T_1}$  the RP of the test (1) is not exactly  $\alpha$  under the null hypothesis but  $\alpha^*$  where  $\alpha^* = F_{T_n}(F_{T_1}^{-1}(\alpha))$ , (see Figure 1). Since  $F_{T_n}$  is unknown, in Monte Carlo experiments it has often been used the test

$$\text{reject the null hypothesis if } T_n > F_{T_n}^{-1}(\alpha) = q_2; \quad (2)$$

Figure 1:

where  $\hat{F}_{T_n}$  is a Monte Carlo estimate of  $F_{T_n}$ : Since  $\hat{F}_{T_n}$  can be made as accurate as necessary, in Figure 1 we have plotted  $F_{T_n}$  and  $\hat{F}_{T_n}$  identical. In fact, the same practice has been followed for all figures in this note. The power of the test (2) is called size corrected power. Notice that since  $F_{T_n}^{i,1}$  and  $\hat{F}_{T_n}^{i,1}$  are case dependent, in practice the test (2) cannot be computed.

An alternative way of looking at size corrected power is the following. Let  $\alpha^2 = F_{T_1}(\hat{F}_{T_n}^{i,1}(\alpha))$ : In Figure 1 notice that  $F_{T_1}^{i,1}(\alpha^2) = F_{T_n}^{i,1}(\alpha) = q_2$ ; therefore the test (2) is equivalent to

reject the null hypothesis if  $T_n > F_{T_1}^{i,1}(\alpha^2) = q_2$ :

### 3 Size corrected power for a bootstrap test

Recently, bootstrap tests have been employed extensively in Econometrics. A bootstrap test is based on the construction of a bootstrap test statistic,  $T_n^*$ : This statistic is constructed by applying the same procedure to an artificial sample obtained by drawing observations from the original sample with replacement. In addition, the role played in the asymptotic test by  $F_{T_1}$  is now assumed by  $F_{T_n^*}$ . Hence, an ideal bootstrap test would be the following:

reject the null hypothesis if  $T_n > F_{T_n^*}^{i,1}(\alpha)$ ;

where  $F_{T_n^*}$  denotes the exact distribution of the bootstrap test statistic  $T_n^*$ . However, frequently  $F_{T_n^*}$  is difficult to obtain and is estimated by Monte Carlo simulations. Denote this estimate by  $\hat{F}_{T_n^*}$ : Hence, the typical bootstrap test is the following:

$$\text{reject the null hypothesis if } T_n > \hat{F}_{T_n^*}^{-1}(\alpha) \quad (3)$$

Here again we have the problem that  $\hat{F}_{T_n^*}$  is not exactly the same as  $F_{T_n^*}$ , so the RP of the test (3) is not exactly  $1 - \alpha$  but  $1 - \alpha^b$ . How can the researcher perform size corrected power in this framework? As we have seen in the previous section, the idea is to continue using the  $\hat{F}_{T_n^*}$  distribution but with the critical value that corresponds to the desired level. For this purpose define (see Figure 2)

$$\alpha^c = F_{T_n^*}^{-1}(F_{T_n^*}^{-1}(\alpha)):$$

The test would be

$$\text{reject the null hypothesis if } T_n > \hat{F}_{T_n^*}^{-1}(\alpha^c) \quad (4)$$

However, since  $\alpha^c$  is unknown, the test (4) can not be carried out. The solution is to estimate  $\alpha^c$  by

$$\hat{\alpha}^c = \hat{F}_{T_n^*}(\hat{F}_{T_n^*}^{-1}(\alpha)) \quad (5)$$

Hence, the size corrected power bootstrap test is

$$\text{reject the null hypothesis if } T_n > \hat{F}_{T_n^*}^{-1}(\hat{\alpha}^c):$$

Therefore, the practical procedure for performing size-corrected power for a bootstrap test consists in the following steps:

- 1) Calculate  $\hat{\alpha}^c$  using (5).
- 2) Generate a different data set and calculate  $T_n$ . Then, generate  $B$  bootstrap estimators of  $T_n$ . Call them  $t_{nb}^* : b = 1; \dots; B$ : Let  $T_{n(d)}^*$  be the  $d$ -th order statistic of the sample  $t_{nb}^* : b = 1; \dots; B$ .

Then, reject the null if

$$T_n > T_{n(d)}^*(\hat{\alpha}^c)$$

- 3) Repeat step 2  $R$  times where  $R$  is the number of replications chosen by the researcher in the Monte Carlo study.

- 4) Finally, the size corrected power of the bootstrap test is

$$\frac{\#(T_n > T_{n(d)}^*(\hat{\alpha}^c))}{R}:$$

Remark. Note that in the case of the classical size corrected power, the critical value is fixed but in the bootstrap context it changes from one sample to another in a Monte Carlo experiment, keeping fixed the value  $\hat{\alpha}^c$ .

Figure 2:

## 4 Size-corrected testing

The exposition so far is related to carrying out a finite sample comparison among several tests. However, it is also of interest to perform size-corrected tests in applications. We propose to do that by iterating the bootstrap as we explain next.

Notice that in practice, the data generating process is not available and so,  $\mathfrak{D}^c$  in (5) can not be computed since  $\mathfrak{P}_{T_n}$  is, in general, case dependent. In this situation we suggest to approximate  $\mathfrak{D}^c$  by using the iterated bootstrap. Let  $T_n^{**}$  be the bootstrap statistic applied to a resample drawn with replacement from a previous bootstrap sample of the original data set. The idea is to estimate  $\mathfrak{D}^c$  by

$$\mathfrak{D}^{c**} = \mathfrak{P}_{T_n^{**}}(\mathfrak{P}_{T_n}^{i-1}(\mathfrak{D}^c));$$

where  $\mathfrak{P}_{T_n^{**}}$  denotes a Monte Carlo estimate of the exact distribution of the iterated bootstrap statistic  $T_n^{**}$ , see Figure 3.

Hence, in practice a size-corrected test would be

$$\text{reject the null hypothesis if } T_n > \mathfrak{P}_{T_n}^{i-1}(\mathfrak{D}^{c**}); \quad (6)$$

Notice that size distortion is a finite sample problem. The rationale behind (6) is that the iterated bootstrap converges faster than the one-step bootstrap for asymptotically pivotal statistics, and hence, some improvement in finite sample behavior can be expected. Also,

Figure 3:

note that here we are employing size-correction as the analogous of bias-correction in the bootstrap literature (see Hall (1992)).

Finally, the discussion in this note refers to one-sided test that is the most common situation found in practice. The analysis for two-sided tests is completely analogous.

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