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Multiplicative Measurement Error and the Simulation Extrapolation Method

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January 16, 2008

Abstract

Whereas the literature on additive measurement error has known a considerable treatment, less work has been done for multiplicative noise. In this paper we concentrate on multiplicative measurement error in the covariates, which contrary to additive error not only modifies proportionally the original value, but also conserves the structural zeros.

This paper compares three variants to specify the multiplicative measurement error model in the simulation step of the Simulation-Extrapolation (SIMEX) method originally proposed by Cook and Stefanski (1994): i) as an additive one without using a logarithmic transformation, ii) as the well-known logarithmic transformation of the multiplicative error model, and iii) as an approach using the multiplicative measurement error model as such. The aim of the paper is to analyze how well these three approaches reduce the bias caused by the multiplicative measurement error. We apply three variants to the case of data masking by multiplicative measurement error, in order to obtain parameter estimates of the true data generating process. We produce Monte Carlo evidence on how the reduction of data quality can be minimized.

JEL classification: C13, C21

Keywords: Errors-in-variables in nonlinear models, disclosure limitation methods, multiplicative error

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1 Introduction

The growing demand of firm-level data from the empirical research side creates a tradeoff for the data collecting institutions between providing a maximum amount of information to the scientific users, and guarantying confidentiality and privacy to the firms. To protect the identity of firms, statistical offices apply different disclosure limitation techniques, where the most popular one consists in the addition of independent noise to the covariates. This leads to the well-known error-in-variables problem, where the effects of additive measurement error on the properties of linear estimators are well understood (see e.g. Fuller (1987)). The monograph of Carroll, Ruppert, and Stefanski (1995) surveys various approaches to errors-in-variables for nonlinear models. Nevertheless, even if this anonymization method can easily be implemented, it does not minimize the probability of re-identifying a single observation. Additive measurement error indeed only slightly modified the original value, especially when the original value is high.

This paper is concerned with multiplicative measurement error, which contrary to additive measurement error not only modifies proportionally the original value, so that a single observation is better protected against disclosure, but also conserves the structural zeros contained in the dataset.

Whereas the literature on additive measurement error has known a considerable treatment, less work has been done for multiplicative noise. Hwang (1986) derives a consistent estimator for the slope parameter in a linear regression model in the presence of multiplicative measurement error in the regressors. This model is extended by Lin (1989) to include also multiplicative error in the dependent variable. Schafer (1990) analyzes a quasi-likelihood approach when no distributional assumptions are made about the true and the mismeasured variables. Lyles and Kupper (1997) compare three methods of adjusting for multiplicative measurement error to obtain consistent estimators of the true parameters: a simple ordinary least squares correction, a regression of the dependent variable on the covariates and on the conditional expectation of true variable given the mismeasured one, and a quasi-likelihood approach. Iturria, Carroll, and Firth (1999) derive a consistent moment estimator for a polynomial regression model in the presence of multiplicative measurement error.
Cook and Stefanski (1994) introduce the Simulation Extrapolation method (SIMEX),
which is well suited to estimate and reduce the bias due to additive measurement
error. In this paper, we compare three variants to specify the multiplicative measure-
ment error model in the simulation step of the SIMEX method, and analyze their
effects on the estimates. First, we consider the approach of Ronning et al. (2005) and
Rosemann (2006), who interpret the multiplicative error model as an additive one.
Then we consider the most popular method to deal with multiplicative measurement
error, which applies a logarithmic transformation to the multiplicative measurement
error model in order to get an additive one (Carroll, Ruppert, and Stefanski (1995)).
And finally, we consider the approach of Nolte (2007) who extends the SIMEX ap-
proach to the multiplicative noise case, without using a logarithmic transformation.

The outline of the paper is as follows. Section 2 gives a short review of the original
SIMEX method. Section 3 presents all three ways to specify the multiplicative
measurement error in the simulation step of the SIMEX method. Using Monte Carlo
design for data which are masked by multiplicative measurement error, we analyse
in Section 4 the small sample properties of the three proposed variants of the SIMEX
procedure applied to a binary choice example. Finally, Section 5 summarizes the
main results and addresses further research questions.
2 Additive Measurement Error: SIMEX Approach

In this section, we briefly sketch the idea of the SIMEX approach developed by Cook and Stefanski (1994), which was suggested in order to estimate and reduce the bias due to additive measurement error. In the simulation step additional measurement error is added to the mismeasured variable, so that the statistician can infer in which way the estimation bias is affected by the increase of variance of the measurement error. In the extrapolation step, the estimated parameters are modelled as a function of the magnitude of the variance of the measurement error and extrapolated to the case of no measurement error.

Without loss of generality, let us consider the simple case, where rather than observing an explanatory variable $X_i$, we observe a masked explanatory variable $X_i^m$ defined as:

$$X_i^m = X_i + u_i, \quad i = 1, \ldots, N,$$

(2.1)

where $u_i$ is an independent normally distributed random variable with $E[u_i | X_i] = 0$ and $V[u_i | X_i] = \sigma_u^2$, that is added to the original variable in order to mask it.

In the simulation step, $B$ new covariates $X_{i,b}^m(\lambda_t)$ are generated by the rule:

$$X_{i,b}^m(\lambda_t) = X_i^m + \sqrt{\lambda_t} u_{i,b}, \quad b = 1, \ldots, B, \quad t = 0, \ldots, T, \quad i = 1, \ldots, N,$$

(2.2)

where $\lambda_0 < \lambda_1 < \lambda_2 < \ldots < \lambda_T$ are given parameters controlling for the variance of the measurement error, and $\{u_{i,b}\}_{b=1}^B$ are iid computer simulated normal random numbers with mean zero and variance $\sigma_u^2$.\footnote{The value $\lambda_T = 2$ is recommended by Carroll, Ruppert, and Stefanski (1995)}

An average estimate $\hat{\beta}(\lambda_t) = \frac{1}{B} \sum_{b=1}^B \hat{\beta}_b(\lambda_t)$ is finally computed, where $\hat{\beta}_b(\lambda_t)$ denotes the naive parameters estimates obtained by regression of $Y$ on $\{X_{i,b}^m(\lambda_t)\}$ for each $\lambda_t$, and for $b = 1, \ldots, B$.

In the extrapolation step each component $\hat{\beta}(\lambda_t)$ is modelled as a function of $\lambda_t$ for $\lambda_t \geq 0$. The SIMEX estimator is defined as the extrapolation of $\hat{\beta}(\lambda_t)$ to $\hat{\beta}(\lambda_t = -1)$,\footnote{Note that the variance of the explanatory variable $X_{i,b}^m(\lambda_t)$ increases with the control parameter $\lambda_t$, and is given by

$$V[X_{i,b}^m(\lambda_t)] = \sigma_x^2 + (1 + \lambda_t)\sigma_u^2,$$

(2.3)

where $\sigma_x^2$ is the variance of $X$.}
which represents the bias free estimate of $\beta$, since at that point the variance of the mismeasured variable is equal to the variance of the original one. Cook and Stefanski (1994) suggest to use a linear, quadratic or a nonlinear extrapolation function. All of them will be used and specified later in the paper (See Section 4).

To estimate the variance of the SIMEX estimator, one can either use the delta method (Carroll, Kuechenhoff, Lombard, and Stefanski (1996)), the jackknife (Stefanski and Cook (1995)) or the bootstrap. Carroll, Kuechenhoff, Lombard, and Stefanski (1996) derive the asymptotic distribution of the SIMEX estimator for parametric models.

**Note:** Here we see that the SIMEX algorithm does not depend on the functional form of the model, so that this method is well suited for linear regression models as well as for nonlinear regression models.

### 3 Multiplicative Measurement Error

In this section we focus on the multiplicative error. We first define the general structure of a multiplicative measurement error model, and then present the three specifications used in this paper.

#### 3.1 General Model

Without loss of generality, let us consider the following multiplicative measurement error model:

$$X_i^{m} = X_i \cdot w_i,$$

(3.1)

where $w_i$ is an independent random variable with $E[w_i|X_i] = 1$ and $V[w_i|X_i] = \sigma^2_\omega$, that is multiplied with the original variable. We suppose that $E[w_i|X_i] = 1$, because in the context of disclosure limitation techniques it is noticeable that the mean of the masked data is equal to the mean of the original one.

\footnote{Usually the latter is preferred.}

4
3.2 SIMEX Approach in the Multiplicative Case

In the previous section we have described the SIMEX approach for the additive measurement error model. This method can also be extended to the multiplicative case. In the following we present three approaches to handle the simulation extrapolation method in the case of multiplicative measurement error.

3.2.1 Interpretation of the Multiplicative Measurement Error Model as an Additive One (Variant 1)

Originally the SIMEX method was designed for the case of additive measurement errors. Therefore, it seems illuminating to write the multiplicative measurement errors as an additive one (Ronning et al. (2005), Rosemann (2006)). This might be important particularly if real data are used since the structure of the measurement error usually is unknown.

We can write for the variable $X^m$ measured with multiplicative error:

$$X^m_i = X_i \cdot w_i = X_i + u_i. \quad (3.2)$$

Thus, for the additive measurement error holds:

$$u_i = X_i \cdot w_i - X_i = X_i(w_i - 1), \quad i = 1, \ldots, N, \quad (3.3)$$

whereas the expectation of $u_i$ is given by

$$E[u_i] = E[X_i(w_i - 1)] = E[X_i]E[w_i - 1] = 0 \quad (3.4)$$

In (3.4) we exploited the fact that the measurement error $w_i$ is independent of $X$.

The variance of $u_i$ is

$$V[u_i] = V[X_i(w_i - 1)]$$
$$= E[(X_i(w_i - 1))(X_i(w_i - 1))]$$
$$= E[X_i^2 w_i^2 - 2w_i X_i^2 + X_i^2]$$
$$= (\sigma_x^2 + \mu_x^2) (\sigma_w^2 + 1) - (\sigma_x^2 + \mu_x^2)$$
$$= (\sigma_x^2 + \mu_x^2) \sigma_w^2, \quad (3.5)$$
where $\mu_x$ denotes the mean of $X$ and $\sigma^2_x$ denotes the variance of $X$.

In this approach only the variance of the measurement error $u_i$ differs from the additive case and one can use the SIMEX method for additive measurement error presented in Section 2, whereas the variance of the explanatory variable $X_{i,b}^{m}(\lambda_t)$ is now given by

$$V \left[ X_{i,b}^{m}(\lambda_t) \right] = \sigma^2_x + (1 + \lambda_t) \left( \sigma^2_x + \mu_x^2 \right) \sigma^2_w. \quad (3.6)$$

### 3.2.2 Logarithmic Transformation of the Multiplicative Measurement Error Model (Variant 2)

The easiest way to deal with multiplicative measurement error is to transform the measurement error model into an additive one, through a logarithmic transformation, as pointed out by Hwang (1986). Here we follow the suggestion of Carroll, Ruppert, and Stefanski (1995) and perform the simulation step of the SIMEX procedure on the logarithms of the masked covariates

$$X_{i,b}^{m}(\lambda_t) = \exp \{ \log(X_i^m) + \sqrt{\lambda_t} \log(w_{i,b}) \}, \quad b = 1, \ldots B, \ t = 0, \ldots T, \ i = 1, \ldots N. \quad (3.7)$$

The rest of the procedure remains unchanged.

The disadvantage of this approach lies in the fact that it can not be used with negative values of the covariates, since we are taking the logarithm of them. In the next section, we will propose a development of this approach, which did not lead to any restrictions concerning the range of variable values.

### 3.2.3 Multiplicative SIMEX Approach (Variant 3)

Finally we consider the multiplicative SIMEX estimator proposed by Nolte (2007). In the simulation step, the mismeasured variable is multiplied by an additional measurement error, such that $B$ new covariates $X_{i,b}^{m}(\lambda_t)$ are generated by the rule

$$X_{i,b}^{m}(\lambda_t) = X_i^m \cdot w_{i,b}^{\lambda_t}, \quad b = 1, \ldots B, \ t = 0, \ldots T, \ i = 1, \ldots N, \quad (3.8)$$
where \(0 = \lambda_0 < \lambda_1 < \lambda_2 < \ldots < \lambda_T\), are positive parameters controlling for the variance of the measurement error, and \(\{w_{i,b}\}_{b=1}^B\) are independent and identically distributed computer simulated log-normally distributed random numbers with mean one and variance \(\sigma^2_w\).\(^4\) The vector of average estimates is computed in the same way as in the additive case. The extrapolation step is finally equivalent to the extrapolation step of the original SIMEX approach described in Section 2.

For positive values of the mismeasured variable \(X_i^m\) this approach is identical to the approach proposed in Subsection 3.2.2 so that we expect that the results will be the same.

Note: In the additive or multiplicative measurement error case, the data collecting institutions only have to provide the variance-covariance matrix \(\sigma^2_u\) or \(\sigma^2_w\) to the data users, which is sufficient to get a consistent estimate of the parameters of interest. It is important to mention, that this additional information does not increase the probability of re-identifying a single observation.

4 Monte Carlo Simulations

4.1 Simulation Design

In this section we investigate the small sample properties of the three proposed variants of the SIMEX procedure, when multiplicative measurement error occurs in the covariates in a binary choice model. Without loss of generality, let us focus on the following binary probit model with one regressor, which has been perturbed by multiplicative noise

\[
Y_i = \mathbb{I}[\alpha + \beta X_i + \varepsilon_i \geq 0], \quad (4.1)
\]

\[
X_i^m = X_i \cdot w_i, \quad i = 1, \ldots, N, \quad (4.2)
\]

\(^4\)Note that for each \(\lambda_t\) the simulation step creates \(B\) additional datasets (replication samples) with the same dependent variable \(Y_i\) and the explanatory variable \(X_{i,b}^m(\lambda_t)\) with variance equal to

\[
V[X_{i,b}^m(\lambda_t)] = \mathbb{E}\left[\left(u_{i,b}^{\lambda_t+1}\right)^2\right] \mathbb{E}[X_i^2] - \mathbb{E}\left[u_{i,b}^{\lambda_t+1}\right]^2 \mathbb{E}[X_i]^2. \quad (3.9)
\]

See Nolte (2007) for a detailed derivation.
where $\varepsilon_i$ follows a standard normal distribution. We determine that the true value of $\alpha$ and $\beta$ are -2.5 and 0.6 respectively. In order to be able to compare all three variants, the support of the independent variable needs to be positive. That is why we use $X_i \sim \text{Log-N}(4.35, 1.75^2)$. The multiplicative error $w_i$ follows a log-normal distribution with mean 1 and variance $\sigma_w^2 = \{0.01^2, \ldots, 0.2^2\}$. The choice of the log-normal distribution is due to the fact that the data collecting institutions want to preserve the same sign for the original variable as for the anonymized one. This avoids erroneous values of some observations, for example that the number of employees becomes negative after the anonymization procedure.

The extrapolation function fits the regression $\hat{\theta}(\lambda) = f(\lambda, \gamma)$, in which $\hat{\theta}(\lambda)$ is point estimate from the naive Maximum-Likelihood estimation of the probit model. The extrapolation function builds up the relationship between $\hat{\theta}(\lambda)$ and the parameter controlling for the variance of the measurement error, $\lambda$. In modelling the SIMEX correction we follow Cook and Stefanski (1994) who suggest three different specifications of the extrapolation function.

1. Linear extrapolation function:

$$\hat{\theta}(\lambda) = \gamma_1 + \gamma_2 \lambda$$  \hspace{1cm} (4.3)

2. Quadratic extrapolation function:

$$\hat{\theta}(\lambda) = \gamma_1 + \gamma_2 \lambda + \gamma_3 \lambda^2$$  \hspace{1cm} (4.4)

3. Nonlinear extrapolation function:

$$\hat{\theta}(\lambda) = \gamma_1 + \frac{\gamma_2}{\gamma_3 + \lambda}$$  \hspace{1cm} (4.5)

The number of observations is 1,000. In our simulation experiments we use 500 Monte Carlo replications for each variant and each extrapolation function. In the SIMEX correction one hundred replications are used for each $\lambda$. $\lambda$-values for the variants 1 and 2 are $\lambda \in \{0, 0.5, 1.0, 1.5, 2.0\}$, and we take the root of $\lambda$ for the third variant to be able to compare those results with the other ones.

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5The examples of different extrapolations functions in a simple linear model are schematically described in Ronning et al. (2005), pp.241-243.
4.2 Results

Let us first consider the results of the naive probit estimation (Table 1). The standard errors of the multiplicative noise are given in the first column. In addition to the average estimator and the standard deviation we display also the average bias and root mean squared error (RMSE). The higher the value of the standard error of the multiplicative measurement error, the greater the bias of the naive estimates becomes, as expected. The RMSE rises strongly with the perturbation degree.

The simulation results of the SIMEX estimation are given in Tables 2, 3 and 4. We see that in all experiments, the SIMEX procedure is able to reduce the bias due to the presence of multiplicative measurement error. Figure 1 shows the RMSE of the point estimate $\beta$ depending on the standard error of the multiplicative noise $\sigma_w^2$. Compared with the results of the naive estimation, the RMSE obtained with the SIMEX estimation procedure is considerably reduced regardless which extrapolation function or which variant was used.

In the following we analyze only the results of the SIMEX estimation. Comparing the results in Figure 1 and Tables 2, 3 and 4, we can detect only slight differences between three variants. However, the choice of a certain extrapolation function has a strong impact on the results.

Now, let us consider which extrapolation function yields the best results. With small errors ($\sigma_w = 0.02$), there are no significant differences. The quadratic extrapolation function is superior to the other functions. Before $\sigma_w$ reaches 0.12 (at this point the measurement error is already fairly high), the corrected estimators are very close to the true value. The linear function is second best. It delivers good correction results if the error is middling ($\sigma_w$ about 0.06). The nonlinear function fares worst. However, when the error is very large ($\sigma_w = 0.2$) the nonlinear function comes closer to the linear one.

Thus, the quality of the estimation depends on the choice of the extrapolation function. In addition to that, the margin of error also plays a role. With minimal noise ($\sigma_w = 0.02$) the differences between the variants and extrapolation functions are also

---

6The development for $\alpha$ is similar and therefore not reported here.

7However, the nonlinear extrapolation function in variants 2 and 3 has an outlier at the point $\sigma_w^2 = 0.04$ which is probably caused by numerical problems.
minimal (except for an outlier in variants 2 and 3 with the nonlinear extrapolation function). If we increase the range to middling ($\sigma_w = 0.06$), only quadratic and linear extrapolation functions work well. If the multiplicative noise is high ($\sigma_w = 0.08$ and larger) only the variants with quadratic extrapolation result in better estimates.
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<td>avg. bias</td>
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Figure 1: RMSE of Probit Estimation ($\beta$)

- **Variant 1:** interpretation of multiplicative noise as an additive one
  - naive estimation
  - linear extrapolation
  - quadratic extrapolation
  - nonlinear extrapolation

- **Variant 2:** logarithmic transformation of multiplicative noise
  - naive estimation
  - linear extrapolation
  - quadratic extrapolation
  - nonlinear extrapolation

- **Variant 3:** an approach using multiplicative noise as such
<table>
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5 Conclusion

In this paper we compare three variants to specify the multiplicative measurement error model in the simulation step of the SIMEX method. The choice of the SIMEX approach allows us to consider linear or nonlinear regression models with multiplicative measurement error, because this approach does not depend on the functional form of the model. The only restriction we have in our approach is that the variance of the multiplicative measurement error has to be known. The Monte Carlo experiments show that all three variants work equally well and that the quality of the estimation depends only on the choice of the extrapolation function as well as on the margin of the measurement error. In the light of our Monte Carlo results, we see also that it is always better to use several extrapolation functions and not to restrict oneself to a specific one from the beginning on, as for example the quadratic one which is principally used in applied works, since each of them seems to perform better for a certain values of the variance of the measurement error.

Since our approach is purely descriptive and leaves a lot of questions open a final conclusion concerning the relative ability of the different variants to estimate the parameters of the true data generating process, if multiplicative measurement error occurs, is somewhat premature. More Monte Carlo evidence on various nonlinear and linear regression models is needed. First, in this paper we considered the case of positive noise. From a methodic point of view it might be of interest to analyze how the variants 1 and 3 perform in the the case of uniformly or normally distributed measurement error which adopts also negative values. Second, other specifications of the extrapolation function (for instance, an exponential one) might be used in order to mimic better the relationship between the naive estimates and the control parameter for the variance of the measurement error. Finally, in order to take the outliers or in other words the extreme values of the covariates generated during the simulation step of the algorithm better into account, it will be useful to consider the median of the estimates instead of their mean; this is in progress.
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