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## **Estimation and Inference in Parametric Stochastic Frontier Models: A SAS/IML Procedure for a Bootstrap Method**

by Sylvie Tchumtchoua

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University of Connecticut  
Department of Agricultural and Resource Economics

Estimation and Inference in Parametric Stochastic Frontier Models: A SAS/IML  
Procedure for a Bootstrap Method

Sylvie Tchumtchoua  
University of Connecticut Storrs

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**Abstract**

Parametric Stochastic Frontier Models are widely used in productivity analysis and are commonly estimated using FRONTIER, STATA or LIMDEP packages, which only provide point estimates for firm-specific technical efficiency. Confidence intervals for technical efficiencies with superior coverage properties than those offered by the Horrace and Schmidt (1996) method may be computed using the Bootstrap method introduced by Simar and Wilson (2005). To facilitate these calculations, we propose a SAS/IML procedure, which computes these confidence intervals for stochastic frontier models with or without inefficiency effects. We apply the program to estimating supermarket-specific technical efficiency in the U.S. Results indicates that the program works very well and produce narrower confidence intervals than those obtain using Horrace and Schmidt (1996) method.

## 1. Introduction

The parametric stochastic frontier model (PSFM) was introduced independently by Aigner et al. (1977) and Meeusen and van den Broeck (1977) and has been extensively used in productivity analysis (see Kumbhakar and Lovell, 2000 and references therein). In this model the output of a production unit is specified in terms of a response function and a composed error  $v-u$ , where  $v$  is a symmetric noise, and  $u$  is a nonnegative term representing technical inefficiency. In applications, researchers are mainly interested in point estimates and confidence intervals for the marginal effects and firm-specific technical efficiency.

PSFM are commonly estimated by maximum likelihood method using either the routine Frontier in LIMDEP or STATA, two general-purpose econometric packages, or FRONTIER, a noncommercial special-purpose program (Sena, 1999; Herrero and Pascoe, 2002). All of these packages have strengths and weaknesses. First, they provide both point estimates and confidence intervals for the model quantities of interest, but only point estimates of firm-specific and mean level technical efficiency. Second, although FRONTIER has more analytical capabilities compared to LIMDEP, it is less user-friendly. Third, none of the package allows the user to compute additional quantities within the program and thus cannot be used in studies where the model likelihood function has to be maximized repeatedly. In her review of FRONTIER and LIMDEP packages, Sena (1999) concludes that the ideal software would be one that combines their strengths.

In this paper, we propose a program that addresses some of the shortcomings of STATA, LIMDEP and FRONTIER with respect to estimation and inference of stochastic

frontier models. Our program computes confidence intervals for firm-specific technical efficiency using a bootstrap method introduced by Simar and Wilson (2005), which make inference about technical efficiency based on their sampling distribution. Previously Horrace and Schmidt (1996) proposed an approach for inference about efficiency in PSFM based on the percentiles of the estimated distribution of the one-sided error term, conditional on the composite error, which is not the sampling distribution of the inefficiency estimator.

The program is written using matrix language SAS/IML with the optimization subroutine NLPQN. The program follows the step-by-step computational processes for estimating PSFM by maximum likelihood, thus is more pedagogically useful, whereas FRONTIER and the routine frontier in LIMDEP and STATA are in black boxes. In addition, the program can be extended to various specifications of frontier models, or simplified to a model without inefficiency effects.

We apply the program to the estimation of technical efficiencies in the U.S. supermarket industry using a cross-section of 772 supermarkets in 2004.

The rest of the paper is organized as follows. Section 2 presents the model and derives the likelihood function. Simar and Wilson (2005) bootstrap method is discussed in section 3 and its SAS/IML implementation in section 4. Section 5 discusses some extensions of the program. Application to U.S. supermarket industry follows in section 6 and section 7 concludes.

## 2. Model and likelihood function

We present the Battese and Coelli (1995) model which is the basic stochastic production frontier model of Aigner et al. (1977) with technical inefficiency effects. The model for cross-sectional data is given by

$$y_i = X_i\beta + v_i - u_i, \quad i=1, \dots, N, \quad (1)$$

where  $y_i$  represents the logarithm of output for firm  $i$ ;  $X_i$  is a  $1 \times k$  vector of logarithm of inputs of firm  $i$ , including a column of ones. This specification corresponds to the Codd-Douglas production function. Other formulations such as Translog production function are used in applications.

$\beta$  is a  $k \times 1$  vector representing marginal effects.

The  $v_i$ 's are random noise and are independently and identically distributed as  $N(0, \sigma_v^2)$  and are independent from the  $u_i$ 's. The  $u_i$  represent inefficiency and are assumed independently distributed as a truncated (above zero) normal distribution with mean  $Z_i\delta$  and variance  $\sigma_u^2$ , where  $Z_i$  is a  $(1 \times m)$  vector of firm-specific variables and  $\delta$  a  $m \times 1$  vector of unknown coefficients of the firm-specific inefficiency variables.

Under the above assumptions and following Battese and Coelli (1995), the density function of the composed error  $e_i = v_i - u$  is given by

$$f(e_i) = \left[ (\sigma_u^2 + \sigma_v^2)^{1/2} \Phi\left(\frac{Z_i\delta}{\sigma_u}\right) \right]^{-1} \phi\left(\frac{e_i + Z_i\delta}{(\sigma_u^2 + \sigma_v^2)^{1/2}}\right) \Phi\left(\frac{\mu^*}{\sigma^*}\right) \quad (2)$$

where  $\sigma^* = \frac{\sigma_u \sigma_v}{(\sigma_u^2 + \sigma_v^2)^{1/2}}$ , and  $\mu^* = \frac{\sigma_v^2 Z_i\delta - \sigma_u^2 e_i}{\sigma_u^2 + \sigma_v^2}$ .

The model log likelihood on the basis of  $N$  observations is then given by

$$L(\beta, \delta, \sigma_u^2, \sigma_v^2; y) = \sum_{i=1}^N \ln(f(e_i))$$

$$= -\frac{N}{2} (\ln 2\pi + \ln(\sigma_u^2 + \sigma_v^2)) - \frac{1}{2} \sum_{i=1}^N (y_i - X_i\beta + Z_i\delta)^2 / (\sigma_u^2 + \sigma_v^2) - \sum_{i=1}^N \left( \ln \Phi\left(\frac{Z_i\delta}{\sigma_u}\right) - \ln \Phi\left(\frac{\mu_i^*}{\sigma^*}\right) \right)$$

Using the re-parameterization involving the parameters  $\sigma^2 = \sigma_v^2 + \sigma_u^2$  and  $\gamma = \sigma_u^2 / \sigma^2$ , the log likelihood function is expressed as

$$L(\beta, \delta, \sigma^2, \gamma; y) = -\frac{N}{2} (\ln 2\pi + \ln \sigma^2) - \frac{1}{2} \sum_{i=1}^N (y_i - X_i\beta + Z_i\delta)^2 / \sigma^2 - \sum_{i=1}^N \left( \ln \Phi\left(\frac{Z_i\delta}{(\gamma\sigma^2)^{1/2}}\right) - \ln \Phi\left(\frac{(1-\gamma)Z_i\delta - \gamma(y_i - X_i\beta)}{(\gamma(1-\gamma)\sigma^2)^{1/2}}\right) \right) \quad (3)$$

Firm level technical efficiency is given by

$$\tau_i = \tau_i(\beta, \delta, \sigma^2, \gamma | X_i, Z_i, y_i) = E[e^{-u_i} | \varepsilon_i] = \frac{\Phi\left[\frac{\mu_i}{\sigma^*} - \sigma^*\right]}{\Phi\left[\frac{\mu_i}{\sigma^*}\right]} \exp\left[-\mu_i + \frac{1}{2}\sigma^{*2}\right] \quad (4)$$

where  $\mu_i = (1-\gamma)Z_i\delta - \gamma\varepsilon_i$ ,  $\sigma^{*2} = \gamma(1-\gamma)\sigma^2$ ,  $\sigma^2 = \sigma_u^2 + \sigma_v^2$ ,  $\gamma = \frac{\sigma_u^2}{\sigma^2}$ , and  $\Phi$  is the cumulative density function of the standard normal distribution.

Using the data  $\{(X_i, Z_i, y_i)\}_{i=1}^N$ , the log likelihood in (3) must be maximized to obtain estimates of the parameters  $\beta$ ,  $\delta$ ,  $\sigma^2$ ,  $\gamma$  which are then plug in (4) to get point estimates of firm-specific technical efficiency  $\{\tau_i\}_{i=1}^N$ . This is done automatically in STATA and LIMDEP by using the routine frontier, or in FRONTIER by typing instructions interactively on the screen or using an instruction file.

Horrace and Schmidt (1996) proposed an after-estimation formula for confidence intervals of firm-specific technical efficiency. They compute a  $(1-\alpha)100\%$  confidence interval for  $\tau_i = E[e^{-u_i} | \varepsilon_i]$  as

$$\left( \exp(-\mu_i - z_{L_i}\sigma_i^*), \exp(-\mu_i - z_{U_i}\sigma_i^*) \right)$$

where  $z_{Li} = \Phi^{-1}\{1 - (\alpha/2)\Phi(\mu_i / \sigma_i^*)\}$  and  $z_{Ui} = \Phi^{-1}\{1 - (1 - \alpha/2)\Phi(\mu_i / \sigma_i^*)\}$ .  $\alpha$  is the nominal size.

However, the above interval considers the parameters of the model to be known and therefore do not reflect uncertainty about these parameters. As Wilson and Simar (2005) pointed out, it is based on the percentile of the distribution of  $e^{-u_i} | \varepsilon_i$ , instead of the sampling distribution of  $\hat{\tau}_i$ .

### 3. Wilson and Simar bootstrap method

Wilson and Simar (2005) introduced a parametric bootstrap method which we modify to incorporate the efficiency model; in their model the one sided error has a half normal distribution whereas in our model we have a truncated normal distribution with mean expressed as a function of firm-specific inefficiency variables. The method computes confidence intervals for firm-specific technical efficiency using its sampling distribution.

It consists of the following steps:

(i) Using the data  $D_n = \{(X_i, Z_i, y_i)\}_{i=1}^N$ , maximize the log-likelihood in (3) to obtain the parameters  $\hat{\beta}$ ,  $\hat{\delta}$ ,  $\hat{\sigma}^2$ ,  $\hat{\gamma}$ ; recover  $\hat{\sigma}_u^2$  and  $\hat{\sigma}_v^2$  from  $\hat{\sigma}^2$  and  $\hat{\gamma}$ .

(ii) For  $i=1, \dots, N$ , draw  $v_i^* \sim N(0, \hat{\sigma}_v^2)$  and  $u_i^* \sim N^+(Z_i \hat{\delta}, \hat{\sigma}_u^2)$ , and compute  $y_i^* = X_i \hat{\beta} + v_i^* - u_i^*$ .

(iii) Using the pseudo-data  $D_n^* = \{(X_i, Z_i, y_i^*)\}_{i=1}^n$ , maximize (3) and obtain bootstrap estimates  $\hat{\beta}^*$ ,  $\hat{\delta}^*$ ,  $\hat{\sigma}^{*2}$ ,  $\hat{\gamma}^*$ , then compute  $\hat{\tau}_i^* = \tau(\hat{\beta}^*, \hat{\delta}^*, \hat{\sigma}^{*2}, \hat{\gamma}^* | X_i, Z_i, y_i)$ ,  $i=1, \dots, N$ .

(iv) Repeat (2) – (3) B times to obtain the bootstrap estimates

$$B = \{(\hat{\beta}_b^*, \hat{\delta}_b^*, \hat{\sigma}_b^{*2}, \hat{\gamma}_b^*, (\{\hat{\tau}_i^*\}_{i=1}^N)_b)\}_{b=1}^B.$$

The bootstrap estimates are then used to compute the mean and percentiles of the model parameters  $\beta$ ,  $\delta$ ,  $\sigma^2$ , and  $\gamma$ , and each firm's technical efficiency scores. The percentiles can be used to compute  $\alpha \times 100\%$  confidence intervals as  $\left( \hat{\theta}^{(\frac{\alpha}{2})}, \hat{\theta}^{(1-\frac{\alpha}{2})} \right)$  where  $\hat{\theta}^{(\alpha)}$  denotes the  $\alpha \times 100$ -percentile of  $\{\hat{\theta}_b^*\}_{b=1}^B$ ,  $\hat{\theta}_b^* \in \{\hat{\beta}_b^*, \hat{\delta}_b^*, \hat{\sigma}_b^{*2}, \hat{\gamma}_b^*, \hat{\tau}_{i_b}^*\}$ ,  $\alpha$  being the nominal size. Note that standard software packages FRONTIER, LIMDEP and STATA do not provide confidence interval for technical efficiency scores and rely on asymptotic normality for inference about the parameter  $\beta$  and  $\delta$ .

#### 4. SAS/IML implementation of Wilson and Simar bootstrap method

The program listings in the appendix demonstrate the step-by-step computational process for estimation of parametric stochastic frontier models based on the method of Wilson and Simar. This method requires repeated maximization of the log-likelihood function (3). Each maximization can only be done using nonlinear optimization methods.

SAS/IML provides all the pieces necessary to carry out the complete method. It is a high-level matrix language for programming purposes that includes a set of build-in nonlinear optimization subroutines for estimation of constrained and unconstrained parameters through iterative process (SAS Institute, 2000). The SAS/IML program is very flexible, thus giving the user control over all aspects of the maximum likelihood, and the possibility to compute any quantity of interest.

The program consists of two macros: *Maximize* and *bootstrap*. We describe each macro in turn.



#### 4.1. Macro for maximizing the loglikelihood

Macro *Maximize* maximizes the log likelihood (3). We select the NLPQN subroutine that uses the quasi-Newton optimization method as nonlinear optimization routine. The arguments for the NLPQN are: the objective function module, the gradient module, the starting values, the parameter constraints, the termination criteria, and the update method. We discuss each of the argument in turn.

The objective function module “LL” specifies the function to be maximized (the log likelihood function given by (3)). Its argument is *theta*, the column vector of the parameters underlying the log likelihood function. Other quantities needed to evaluate LL (the observed data) are passed to LL via the *global* function.

The module “GRAD” specifies the gradient function to compute the first-order derivatives. The arguments and the quantities needed to evaluate the module are the same as in LL. The first-order derivatives are given below:

$$\frac{\partial L}{\partial \beta} = \sum_{i=1}^N \left( \frac{y_i - X_i \beta + Z_i \delta}{\sigma^2} + \frac{\phi \left( \frac{(1-\gamma)Z_i \delta - \gamma(y_i - X_i \beta)}{(\gamma(1-\gamma)\sigma^2)^{1/2}} \right)}{\Phi \left( \frac{(1-\gamma)Z_i \delta - \gamma(y_i - X_i \beta)}{(\gamma(1-\gamma)\sigma^2)^{1/2}} \right)} \frac{\gamma}{(\gamma(1-\gamma)\sigma^2)^{1/2}} \right) X_i'$$

$$\frac{\partial L}{\partial \delta} = - \sum_{i=1}^N \left( \frac{y_i - X_i \beta + Z_i \delta}{\sigma^2} + \frac{\phi \left( \frac{Z_i \delta}{(\gamma\sigma^2)^{1/2}} \right)}{\Phi \left( \frac{Z_i \delta}{(\gamma\sigma^2)^{1/2}} \right)} \frac{1}{(\gamma\sigma^2)^{1/2}} - \frac{\phi \left( \frac{(1-\gamma)Z_i \delta - \gamma(y_i - X_i \beta)}{(\gamma(1-\gamma)\sigma^2)^{1/2}} \right)}{\Phi \left( \frac{(1-\gamma)Z_i \delta - \gamma(y_i - X_i \beta)}{(\gamma(1-\gamma)\sigma^2)^{1/2}} \right)} \frac{1-\gamma}{(\gamma(1-\gamma)\sigma^2)^{1/2}} \right) Z_i'$$

$$\frac{\partial L}{\partial \sigma^2} = -\frac{1}{2\sigma^2} \left\{ N - \sum_{i=1}^N \left( \frac{(y_i - X_i\beta + Z_i\delta)^2}{\sigma^2} + \frac{\phi\left(\frac{Z_i\delta}{(\gamma\sigma^2)^{1/2}}\right)}{\Phi\left(\frac{Z_i\delta}{(\gamma\sigma^2)^{1/2}}\right)} \frac{Z_i\delta}{(\gamma\sigma^2)^{1/2}} - \frac{\phi\left(\frac{(1-\gamma)Z_i\delta - \gamma(y_i - X_i\beta)}{(\gamma(1-\gamma)\sigma^2)^{1/2}}\right)}{\Phi\left(\frac{(1-\gamma)Z_i\delta - \gamma(y_i - X_i\beta)}{(\gamma(1-\gamma)\sigma^2)^{1/2}}\right)} \frac{(1-\gamma)Z_i\delta - \gamma(y_i - X_i\beta)}{(\gamma(1-\gamma)\sigma^2)^{1/2}} \right) \right\}$$

$$\frac{\partial L}{\partial \gamma} = \sum \left\{ \frac{\phi\left(\frac{Z_i\delta}{(\gamma\sigma^2)^{1/2}}\right)}{\Phi\left(\frac{Z_i\delta}{(\gamma\sigma^2)^{1/2}}\right)} \frac{Z_i\delta}{2\gamma(\gamma\sigma^2)^{1/2}} - \frac{\phi\left(\frac{(1-\gamma)Z_i\delta - \gamma(y_i - X_i\beta)}{(\gamma(1-\gamma)\sigma^2)^{1/2}}\right)}{\Phi\left(\frac{(1-\gamma)Z_i\delta - \gamma(y_i - X_i\beta)}{(\gamma(1-\gamma)\sigma^2)^{1/2}}\right)} \left[ \frac{y_i - X_i\beta + Z_i\delta}{(\gamma(1-\gamma)\sigma^2)^{1/2}} + \frac{(1-2\gamma)[(1-\gamma)Z_i\delta - \gamma(y_i - X_i\beta)]}{2\gamma(1-\gamma)(\gamma(1-\gamma)\sigma^2)^{1/2}} \right] \right\}$$

The gradient module is not required in the NLPQN subroutine and when it is not specified, the NLPQN subroutine uses numerical approximations of the gradient vector by the finite difference method. But, it usually requires more calls to the function module for the iterative process to converge. It is better to use these analytic derivatives if they are available instead of relying on finite difference approximations.

We define the starting values of the iteration process as in Coelli (1994). The OLS estimates are obtained and a grid search procedure is used to obtain a starting value for  $\gamma$ .

The parameter constraints are specified in the input argument *con*, which is a  $2 \times (k + m + 2)$  matrix (the model has  $k$  parameters in  $\beta$ ,  $m$  in  $\delta$ , and two additional parameters  $\sigma^2$  and  $\gamma$ ). The first row and second row define the lower and upper bounds respectively. Except for  $\gamma$  and  $\sigma^2$  all the other elements of the matrix are specified as missing values.  $\gamma$  and  $\sigma^2$  are constrained with a lower bound of  $1 \times 10^{-8}$  to prevent their becoming zero or negative. The upper bound of  $\gamma$  is 1.

The input argument *ter* specifies a vector of bounds corresponding to a set of termination criteria that are tested in each iteration and determine when the optimization process stops. Stopping criterion selected is  $\max(\text{gradient}) < 1e-5$ . The first three components of *ter* vector are set to missing values to allow use of the default values.

Following Coelli (1994), we specify the original Davidon, Fletcher, and Powell (DFP) (option [4] =4) as update method for the inverse Hessian matrix. The DFP method performs a line search in each iteration on the search direction with quadratic interpolation and cubic extrapolation.

A call of the NLPQN subroutine returns two results. The first one is a number  $rc$ , which, when positive, indicates that the iteration process has terminated successfully with one of the specified criteria, and when negative indicates unsuccessful termination. The second result is a vector  $xr$  of length equal to the length of the starting values matrix, which contains the optimal values when  $rc > 0$ . These optimal values are then used to compute firm-specific technical efficiency scores using (4), to draw values for  $v_i^*$ ,  $u_i^*$ , to compute pseudo dependent variable  $y_i^*$ , for  $i=1, \dots, N$  as described in step (ii) in the method, and to form the pseudo data  $D_n^* = \{(X_i, Z_i, y_i^*)\}_{i=1}^n$ .

#### **4.2. The macro for estimation of confidence intervals**

Macro bootstrap estimates the confidence intervals of marginal effects and firm-specific technical efficiency by bootstrapping. It follows the four steps of Wilson and Simar algorithm outlined above. First it uses the original data to maximize the log-likelihood function and obtain initial parameters estimates. Second, these initial parameter estimates are used to draw the error terms (noise and inefficiency term) and compute the pseudo-data. Third, the pseudo-data are used to maximize the log-likelihood function using macro *Maximize* and obtain Bootstrap estimates. Fourth, steps 1-3 are repeated B times, where B is the number of Bootstrap replications.

Input for this macro consists of the SAS dataset put in the format described below, the number of production inputs, the number of inefficiency variables, and the number of bootstrap replications. The macro returns

Testing for the presence of technical inefficiencies in the data using likelihood-ratio test is straightforward using the program. Following Battese and Coelli (1995), the null hypothesis is  $H_0 : \gamma = \delta_1 = \dots = \delta_m = 0$ . The likelihood ratio test statistic is calculated as

$$LR = -2\{\log \text{likelihood}(H_0) - \log \text{likelihood}(H_1)\}$$

where  $\log \text{likelihood}(H_0)$  and  $\log \text{likelihood}(H_1)$  are the values of the log likelihood function under the null and the alternative hypothesis, respectively.

Under  $H_0$ , LR has an asymptotic distribution which is a mixture of chi-square distributions, namely  $\frac{1}{2}\chi_0^2 + \frac{1}{2}\chi_1^2$  (Coelli, 1995).

### How to use the SAS/IML procedure

The program listing is given in the appendix. It is very easy to use; all the user has to do is to put the data in the following format:

1	$y_1$	$x_{11} \dots x_{1k}$	$z_{11} \dots z_{1m}$
2	$y_2$	$x_{21} \dots x_{2k}$	$z_{21} \dots z_{2m}$
.	.	.	.
N	$y_N$	$x_{N1} \dots x_{Nk}$	$z_{N1} \dots z_{Nm}$

where the first column list the N firms, the second column represents firms' outputs, the next k columns represent the k inputs and the last m columns represents the m possible determinants of technical efficiency.

After importing the data as

```
proc import datafile="C:\data.xls"
```

```
out=data replace;
```

```
run;
```

the procedure is called using

```
%Bootstrap (dsn=data, K=k, M=m, B=b).
```

## 5. Extensions

The SAS/IML program presented in appendix can easily be extended in many ways. For panel data, all the user has to do is to specify the appropriate log likelihood function and derive the corresponding first-order derivatives. The specification of the composed errors can be extended to incorporate heteroscedasticity in both the symmetric component and the one-sided component as in Hadri et al. (2003). In the presence of heteroscedasticity, the variances of  $u_i$  and  $v_i$  are not constant across observations. Following Hadri (1999) and Hadri et al. (2003), heteroscedasticity can be incorporated multiplicatively by specifying the variances of the error components as  $\sigma_{ui} = \exp(V_i \rho)$ , and  $\sigma_{vi} = \exp(W_i \varphi)$ , where  $V_i$  and  $W_i$  are vectors of nonstochastic explanatory variables the researcher believes explain differences in variances across observations. In the presence of heteroscedasticity, the log likelihood function in (3) is still appropriate, except that the variances are replaced by their new expressions.

## 6. Application

We apply the program to the estimation of technical efficiency in U.S. supermarket industry. Data came from the Trade Dimension database at the Food Marketing Policy

Center at the University of Connecticut. It consists of 772 supermarkets (not including Wall-Mart) in the U.S. in 2004. Additional information on socio-demographic characteristics was obtained from the U.S. Census bureau web page. Output is measured by the average weekly dollar sales. We consider two inputs: labor measured by the number of full time and part time equivalent employees, and capital by the area of selling space. As possible determinants of technical efficiency, we use dummy variables of whether a store belongs to a chain, has a pharmacy department or sells liquor.

Using the SAS/IML program, we compute  $B=500$  bootstrap estimates of the model parameters and technical efficiencies. Running the 500 bootstrap replications took 22 minutes on a 2.40 GHz Pentium 4 processor. Table 1 displays the mean, standard deviation, 5% and 95% percentiles of the model parameters. We also display in table 2 estimates of means and standard deviations obtained using FRONTIER, STATA, and SAS/IML side by side. It appears that the two sets of estimates are approximately the same.

Figure 1 plots SAS/IML point estimates and 95% confidence intervals of the ranked values efficiency scores. It appears that technical efficiencies are estimated with moderate precision as indicated by the relatively narrow 95% confidence intervals.

Figure 2 plots confidence intervals for technical efficiency using Horrace and Schmidt (1996) method. Compared to the Bootstrap estimates, Horrace and Schmidt confidence intervals are wider. This may be due to the fact that they do not take into account uncertainty about the parameters of the model.

## **7. Conclusion**

In this paper we have proposed a SAS/IML program for estimation and inference in parametric stochastic frontier models. The program is useful to practitioners for many reasons. First, it computes point estimates and statistically sound confidence interval estimates for firm-specific technical efficiency whereas commonly available software packages do not have built in commands for obtaining confidence intervals for technical efficiency. Second, the program is pedagogically very useful as it demonstrates the step-by-step estimation process. Third, the program is very flexible and can be extended to various specifications of stochastic frontier model. Fourth, researchers may find the program useful in conducting Monte Carlo studies to investigate the properties of stochastic frontier methods that involve numerical optimization.

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## Appendix: SAS/IML codes

```

/*****
/*      SAS/IML Procedure for Bootstrap Computation of Confidence Intervals      */
/*      for Technical Efficiencies in Stochastic Frontier Models                */
/*****

/*****
/*      Macro MAXIMIZE(dsn=,K=, M=)                                           */
/*      Maximizes the log-likelihood;                                         */
/*      dsn: dataset                                                           */
/*      K: number inputs                                                       */
/*      M: number determinants of technical efficiency                         */
/*****

%macro Maximize(dsn=,K=,M=);
proc iml;
reset noname;
use &dsn var _all_;
read all var _num_ into Da;
id=Da[,1];
yy=Da[,2];
nob=nrow(yy);
xx = j(nob,1);
do i=1 to &K;
    xx = xx||Da[,i+2];
end;
zz = j(nob,1);
do i=1 to &M;
    zz = zz||Da[,i+&K+2];
end;

/*Module objective function*/

start LL(theta) global(xx, yy, zz);
pi = arcos(-1);
nb = ncol(xx);
xz = xx || zz;
nr = ncol(xz);
n1 = nr+1;
n2 = nr+2;
beta=theta[1:nb];delta=theta[(nb+1):nr];sigma=theta[n1];gama=theta[n2];
nob = nrow(yy);
sum = 0;
do i = 1 to nob;
d= (zz[i,]*delta)/sqrt(gama*sigma);
dstar = ((1-gama)*(zz[i,]*delta)-gama*(yy[i]- xx[i,]*beta))/sqrt(gama*(1-gama)*sigma);
pd = probnorm(d);
pdstar = probnorm(dstar);
if pd<=0 then pda=0.1e-8;
else pda=pd;
if pdstar<=0 then pdstara=0.1e-8;
else pdstara=pdstar;
sum = sum + log(pda)-log(pdstara);
end;
f = (nob/2)*(log(2*pi)+log(sigma))+ssq(yy - xx*beta + zz*delta)/(2*sigma) + sum ;
return(f);
finish LL;

/*Module gradient*/

start gradi(theta) global(xx, yy, zz);
k=ncol(theta);
g=j(1,k,0);
nb = ncol(xx);
nz=ncol(zz);
xz = xx || zz;
nr = ncol(xz);
beta=theta[1:nb];delta=theta[(nb+1):nr];sigma=theta[nr+1];gama=theta[nr+2];
nob = nrow(yy);pi = arcos(-1);
sumbeta = j(nb,1,0); sumdelta = j(nz,1,0); sumsigma = 0; sumgama = 0;

```

```

do i = 1 to nob;
es = (yy[i]- xx[i,]*beta + zz[i,]*delta)/sigma;
es2=(yy[i]- xx[i,]*beta + zz[i,]*delta)*(yy[i]- xx[i,]*beta + zz[i,]*delta)/sigma;
dstar = ((1-gama)*(zz[i,]*delta)-gama*(yy[i]-xx[i,]*beta))/sqrt(gama*(1-gama)*sigma);
cdfdstar = probnorm(dstar);
pdfdstar = (1/sqrt(2*pi))*exp(-dstar*dstar/2);
d = (zz[i,]*delta)/sqrt(gama*sigma);
cdfd = probnorm(d);
pdfd = (1/sqrt(2*pi))*exp(-d*d/2);

sigmastar=sqrt(gama*(1-gama)*sigma);
sumbeta = sumbeta+(es + (gama/sigmastar)*pdfdstar/cdfdstar)*xx[i,]`;
sumdelta = sumdelta-(es + (pdfd/cdfd)/sqrt(gama*sigma)-(pdfdstar/cdfdstar)*((1-
gama)/sigmastar))*zz[i,]`;
sumsigma = sumsigma -(1/(2*sigma))*(1-es2 -((pdfd/cdfd)*d - (pdfdstar/cdfdstar)*dstar));
sumgama = sumgama+(pdfd/cdfd)*d/(2*gama)-(pdfdstar/cdfdstar)*((yy[i]-
xx[i,]*beta+zz[i,]*delta)/sigmastar + (1-2*gama)*dstar/(2*gama*(1-gama)));
end;
g[1,1:nb]=--sumbeta`;
g[1,(nb+1):nr]=--sumdelta`;
g[1,nr+1]=--sumsigma;
g[1,nr+2]=--sumgama;
return(g);
finish gradi;

/*Grid search for starting values*/
* Ordinary least squares estimates;

nb = ncol(xx);
obl = inv(xx`*xx)*xx`*yy;
e = yy - xx*obl;
sigma2 = ssq(e)/(nob-nb);

*Grid search for gamma;
ob = j(1,nb+1,0);
ob[1:nb]=obl;
ob[nb+1]=sigma2;
pi = arcos(-1);
nob = nrow(yy);
xz = xx || zz;
nb = ncol(xx);
nr = ncol(xz);
n1 = nr + 1;
n2 = nr + 2;
theta0 = j(1,n2,0);
y = j(1,n2,0);
x = j(1,n2,0);
var=ob[nb+1]*(nob-nb)/nob;
b0 = ob[1];
do i=1 to nb;
y[i] = ob[i];
end;

do i= nb+1 to nr;
y[i]=0;
end;

fx = 1e+16;
gridno = 0.1;
y6b=gridno;
y6t=1.0-gridno;
do y6= y6b to y6t by gridno;
y[n2]=y6;
y[n1]= var/(1-2*y[n2]/pi);
c=(y[n2]*y[n1]*2/pi)**0.5;
y[1]=b0+c;
f = LL(y);
if f < fx then do;
fx=f;
do i=1 to n2;
x[i] = y[i];

```

```

        end;
    end;
end;
do i = 1 to n2;
theta0[i]=x[i];
end;

/*Options and parameters constraints*/
ter = j(1,13,.);
ter[1]=4000; ter[2]=4000; ter[3]=.; ter[6]=1e-5;ter[9]=0;
ter[4]=0; ter[5]=0; ter[7]=0; ter[8]=0;
ter[11]=1e-5; ter[12]=0; ter[13]=1e-5;
con=j(2,&K+&M+4,.);
con[1,&K+&M+3]=1e-18; con[2,&K+&M+4]=1;
option = {0 2 . 4};

call nlpqn(rc,xr,"LL",theta0,option,con)grd="gradi" tc=ter;

create opt from xr;
append from xr;
close opt;

if rc >0 then print '*The iterative process terminates successfully*';
else print '*Warning: unsuccessful termination*';
quit;
%mend;

/*****
/*      Macro BOOTSTRAP(dsn=,K=, M=, B=)                                     */
/*      Computes bootstap estimates                                         */
/*      dsn: dataset                                                         */
/*      K: number inputs                                                     */
/*      M: number determinants of technical efficiency                       */
/*      B: number bootstrap replications                                     */
*****/

%macro Bootstrap(dsn=,K=,M=,B=);

/*Use original data to maximize the log-likelihood and obtain initial parameter and
technical efficiencies estimates*/

%Maximize(dsn=&dsn,K=&K,M=&M);
proc iml;
use opt var _all_;
read all var _num_ into Pa;
beta=Pa[1:&K+1]; delta=Pa[&K+2:&K+&M+2];sigma2=Pa[&K+&M+3];gama=Pa[&K+&M+4];
sigmau=gama*sigma2;
sigmav=sigma2*(1-gama);
param=beta`||delta`||sigmau||sigmav||gama;
create paramet from param;
append from param;
close paramet;
create parameters from param;
append from param;
close parameters;

use &dsn var _all_;
read all var _num_ into Da;
id=Da[,1];
yy=Da[,2];
nob=nrow(yy);
xx = j(nob,1);
do i=1 to &K;
    xx = xx||Da[,i+2];
end;
zz = j(nob,1);
do i=1 to &M;
    zz = zz||Da[,i+&K+2];
end;

te = j(nob,1,0.);

```

```

do i = 1 to nob;
    zd=zz[i,]*delta;
    xb=xx[i,]*beta;
    us = (1-gama)*zd-gama*(yy[i]-xb);
    ss = (gama*(1-gama)*sigma2)**0.5;
    ds=us/ss;
    te[i] = exp(-us+0.5*ss**2)*probnorm(ds-ss)/probnorm(ds);
end;
tei=id||te;
create efficiency from tei;
append from tei;
close efficiency;
quit;

/*Repeatedly create pseudo-data and use them to maximize the log-likelihood*/

%do i=1 %to &B;
    proc iml;
        /*Create pseudo data*/
        use paramet var _all_;
        read all var _num_ into Par;
        beta=Par[1:&K+1];
        delta=Par[&K+2:&K+&M+2]; sigmau=Par[&K+&M+3]; sigmav=par[&K+&M+4];
        gama=par[&K+&M+5];
        use &dsn var _all_;
        read all var _num_ into Da;
        id=Da[,1];
        yy=Da[,2];
        nob=nrow(yy);
        xx = j(nob,1);
        do i=1 to &K;
            xx = xx||Da[,i+2];
        end;
        zz = j(nob,1);
        do i=1 to &M;
            zz = zz||Da[,i+&K+2];
        end;
        v=j(nob,1,0.);
        u=j(nob,1,0.);
        yys=j(nob,1,0.);
        do i =1 to nob;
            seed=-i;
            v[i]=(sqrt(sigmav))*rannor(seed);
            u[i]=zz[i,]*delta+(sqrt(sigmau))*rannor(seed);
            do while (u[i]<0);
                u[i]=zz[i,]*delta+(sqrt(sigmau))*rannor(seed);
            end;
            yys[i]=xx[i,]*beta+v[i]-u[i];
        end;
        pseudo=id||yys||xx[,2:&K+1]||zz[,2:&M+1];
        create pdata from pseudo;
        append from pseudo;
        close pdata;
        quit;

        /*Use pseudo-data to maximize the likelihood*/
        %Maximize(dsn=pdata,K=&K,M=&M);

        /*Save parameters Bootstrap estimates*/
        proc iml;
            use opt var _all_;
            read all var _num_ into Pab;
            beta=Pab[1:&K+1]; delta=Pab[(&K+2):&K+&M+2];
            gama=Pab[&K+&M+4];sigma2=Pab[&K+&M+3];
            sigmau=gama*sigma2;
            sigmav=sigma2*(1-gama);
            par=beta`||delta`||sigmau|| sigmav|| gama;
            edit parameters;
            append from par;
            run;

```

```

/*Compute and save technical efficiencies Bootstrap estimates*/
use &dsn var _all_;
read all var _num_ into Da;
id=Da[,1];
yy=Da[,2];
nob=nrow(yy);
xx = j(nob,1);
do i=1 to &K;
    xx = xx||Da[,i+2];
end;
zz = j(nob,1);
do i=1 to &M;
    zz = zz||Da[,i+&K+2];
end;
te = j(nob,1,0.);
do i = 1 to nob;
    zd=zz[i,]*delta;
    xb=xx[i,]*beta;
    us = (1-gama)*zd-gama*(yy[i]-xb);
    ss = (gama*(1-gama)*sigma2)**0.5;
    ds=us/ss;
    te[i] = exp(-us+0.5*ss**2)*probnorm(ds-ss)/probnorm(ds);
end;
ty = id||te;
edit efficiency;
append from ty;
close efficiency;
quit;
%end;

%mend;

```

## Computing SAS/IML point estimates, 2.5 percentiles and 97.5 percentiles of firm-specific technical efficiency

```

proc sort data=efficiency;
by Coll1;
run;
proc univariate data=efficiency noprint;
by coll1;
var col2;
output out=outind mean=M pctlpts=2.5 97.5 pctlpre=P;
run;

```

## Computing Horrace and Schmidt (1995) 2.5 percentiles and 97.5 percentiles of firm-specific technical efficiency

```

%Maximize(dsn=data3601,id=id,yy=yy,ones=ones,x1=x1,x2=x2,z1=z1,z2=z2,z3=z3);
proc iml;
use opt;
read all var{b0 b1 b2 d0 d1 d2 d3 sigma2 gama};
sigmau=gama*sigma2;
sigmav=sigma2*(1-gama);
use data3601;
read all var{id yy ones x1 x2 z1 z2 z3};
xx = ones || x1 || x2;
zz = ones || z1 || z2 || z3 || z4 || z5 || z6 || z7;
beta = b0||b1||b2;
delta= d0||d1||d2||d3;

```

```

nob = nrow(yy);
lb=j(nob,1,0.);
ub=j(nob,1,0.);
te = j(nob,1,0.);
do i = 1 to nob;
e= yy[i]- xx[i,]*beta`;
mu = (1-gama)*zz[i,]*delta`-gama*e;
ss = gama*(1-gama)*sigma2;
te[i] = exp(-mu+0.5*ss)*probnorm(mu/sqrt(ss)-sqrt(ss))/probnorm(mu/sqrt(ss));
lb[i]=exp(-mu-sqrt(ss)*probit(1-0.025*probnorm(mu/sqrt(ss))));
ub[i]=exp(-mu-sqrt(ss)*probit(1-0.975*probnorm(mu/sqrt(ss))));
end;
create heffic var {id te lb ub};
append;
close heffic;
quit;

```

**Table 1.** Parameter estimates from SAS/IML program

Variables	Coefficient	Mean	Std. deviation	2.5% percentile	97.5% percentile
Constant	$\beta_0$	7.494	0.331	6.831	8.123
Log Labor	$\beta_1$	0.307	0.020	0.349	0.476
Log Selling space	$\beta_2$	0.408	0.031	0.270	0.342
Constant	$\delta_0$	0.655	0.121	0.408	0.885
Chain	$\delta_1$	-0.786	0.477	-1.306	-0.483
Pharmacy	$\delta_3$	-0.446	0.197	-0.936	-0.183
Liquor	$\delta_4$	0.113	0.091	-0.055	0.297
	$\sigma_u^2$	0.095	0.030	0.047	0.161
	$\sigma_v^2$	0.069	0.011	0.046	0.089
	$\gamma$	0.568	0.101	0.364	0.731



**Table 2.** Parameter estimates from FRONTIER, STATA, and SAS/IML

Variables		FRONTIER/STATA		SAS/IML	
		Mean	Std. deviation	Mean	Std. deviation
Constant	$\beta_0$	7.524	0.338	7.494	0.331
Log Labor	$\beta_1$	0.305	0.022	0.307	0.020
Log Selling space	$\beta_2$	0.406	0.032	0.408	0.031
Constant	$\delta_0$	0.684	0.096	0.655	0.121
Chain	$\delta_1$	-0.729	0.150	-0.786	0.477
Pharmacy	$\delta_3$	-0.408	0.131	-0.446	0.197
Liquor	$\delta_4$	0.104	0.085	0.113	0.091
	$\sigma_u^2$	0.098	0.028	0.095	0.030
	$\sigma_v^2$	0.070	0.009	0.069	0.011
	$\gamma$	0.583	0.087	0.568	0.101

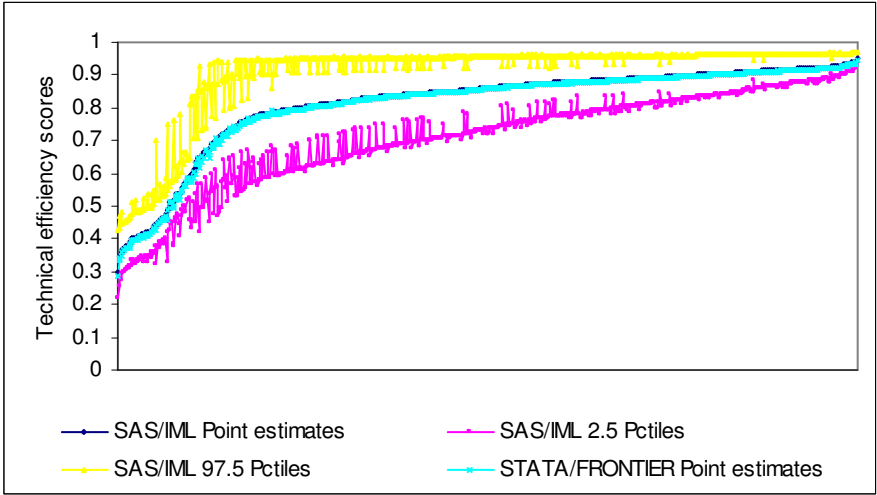


Figure 1. SAS/IML Technical efficiency scores

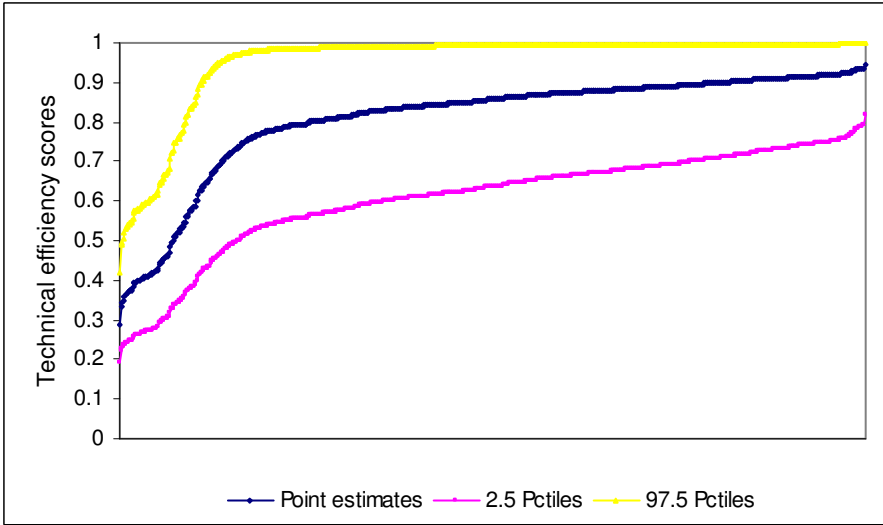


Figure 2. Technical efficiency scores using Horrace and Schmidt (1996) formulas

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1376 Storrs Road, Unit 4021  
University of Connecticut  
Storrs, CT 06269-4021

Tel: (860) 486-1927  
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