Various versatile variances: An object-oriented implementation of clustered covariances in R

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Various Versatile Variances: An Object-Oriented Implementation of Clustered Covariances in **R**

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Abstract

Clustered covariances or clustered standard errors are very widely used to account for correlated or clustered data, especially in economics, political sciences, or other social sciences. They are employed to adjust the inference following estimation of a standard least-squares regression or generalized linear model estimated by maximum likelihood. Although many publications just refer to "the" clustered standard errors, there is a surprisingly wide variety of clustered covariances, particularly due to different flavors of bias corrections. Furthermore, while the linear regression model is certainly the most important application case, the same strategies can be employed in more general models (e.g. for zero-inflated, censored, or limited responses).

In R, functions for covariances in clustered or panel models have been somewhat scattered or available only for certain modeling functions, notably the (generalized) linear regression model. In contrast, an object-oriented approach to "robust" covariance matrix estimation – applicable beyond `lm()` and `glm()` – is available in the **sandwich** package but has been limited to the case of cross-section or time series data. Now, this shortcoming has been corrected in **sandwich** (starting from version 2.4.0): Based on methods for two generic functions (`estfun()` and `bread()`), clustered and panel covariances are now provided in `vcovCL()`, `vcovPL()`, and `vcovPC()`. These are directly applicable to models from many packages, e.g., including **MASS**, **pscl**, **countreg**, **betareg**, among others. Some empirical illustrations are provided as well as an assessment of the methods' performance in a simulation study.

Keywords: clustered data, clustered covariance matrix estimators, object orientation, simulation, R.

1. Introduction

Observations with correlations between objects of the same group/cluster are often referred to as "cluster-correlated" observations. Each cluster comprises multiple objects that are correlated within, but not across, clusters, leading to a nested or hierarchical structure (Galbraith, Daniel, and Vissel 2010). Ignoring this dependency and pretending observations are independent not only across but also within the clusters, still leads to parameter estimates that are consistent (albeit not efficient) in many situations. However, the observations' information will typically be overestimated and hence lead to overstated precision of the parameter estimates and inflated type I errors in the corresponding tests (Moulton 1986, 1990). Therefore, clustered covariances are widely used to account for clustered correlations in the data.

Such clustering effects can emerge both in cross-section and in panel (or longitudinal) data.

Typical examples for clustered cross-section data include firms within the same industry or students within the same school or class. In panel data, a common source of clustering is that observations for the same individual at different time points are correlated while the individuals may be independent (Cameron and Miller 2015).

This paper contributes to the literature particularly in two respects: (1) Most importantly, we discuss a set of computational tools for the R system for statistical computing (R Core Team 2017), providing an object-oriented implementation of clustered covariances/standard errors in the R package **sandwich** (Zeileis 2004, 2006b). Using this infrastructure, sandwich covariances for cross-section or time series data have been available for models beyond `lm()` or `glm()`, e.g., for packages **MASS** (Venables and Ripley 2002), **pscl**/**countreg** (Zeileis, Kleiber, and Jackman 2008), **betareg** (Cribari-Neto and Zeileis 2010; Grün, Kosmidis, and Zeileis 2012), among many others. However, corresponding functions for clustered or panel data had not been available in **sandwich** but have been somewhat scattered or available only for certain modeling functions.

(2) Moreover, we perform a Monte Carlo simulation study for various response distributions with the aim to assess the performance of clustered standard errors beyond `lm()` and `glm()`. This also includes special cases for which such a finite-sample assessment has not yet been carried out in the literature (to the best of our knowledge).

The rest of this manuscript is structured as follows: Section 2 discusses the idea of clustered covariances and reviews existing R packages for sandwich as well as clustered covariances. Section 3 deals with the theory behind sandwich covariances, especially with respect to clustered covariances for cross-sectional and longitudinal data, clustered data, as well as panel data. Section 4 then takes a look behind the scenes of the new object-oriented R implementation for clustered covariances, Section 5 gives an empirical illustration based on data provided from Petersen (2009) and Aghion, Van Reenen, and Zingales (2013). The simulation setup and results are discussed in Section 6.

2. Overview

There is a range of popular strategies for dealing with clustered dependencies in regression models. In the statistics literature, random effects (especially random intercepts) are often introduced to capture unobserved cluster correlations (e.g., using the **lme4** package in R, Bates, Mächler, Bolker, and Walker 2015). Alternatively, generalized estimating equations (GEE) can account for such correlations by adjusting the model's scores in the estimation, also leading naturally to a clustered covariance (e.g., available in the **geepack** package for R, Halekoh, Højsgaard, and Yan 2005). Another approach, widely used in econometrics and the social sciences, is to assume that the model's score function was correctly specified but that only the remaining likelihood was potentially misspecified, e.g., due to a lack of independence as in the case of clustered correlations (see White 1994, for a classic textbook, and Freedman 2006, for a criticial review). This approach leaves the parameter estimator unchanged – then also known as quasi-maximum likelihood (QML) estimator or, in GEE jargon, as independence working model – but adjusts the covariance matrix by using a sandwich estimator, especially in Wald tests and corresponding confidence intervals.

Important special cases of this QML approach combined with sandwich covariances include: (1) independent but heteroscedastic observations necessitating heteroscedasticity-consistent

(HC) covariances (see e.g., Long and Ervin 2000), (2) autocorrelated time series of observations requiring heteroscedasticity- and autocorrelation-consistent (HAC) covariances (such as Newey and West 1987; Andrews 1991), (3) and clustered sandwich covariances for clustered or panel data (see e.g., Cameron and Miller 2015).

Various kinds of sandwich covariances have already been implemented in several R packages, with the linear regression case receiving most attention. But some packages also cover more general models.

2.1. R packages for sandwich covariances

The standard R package for sandwich covariance estimators is the **sandwich** package (Zeileis 2004, 2006b), which provides an object-oriented implementation for the building blocks of the sandwich that rely only on a small set of extractor functions (`estfun()` and `bread()`) for fitted model objects. The function `sandwich()` computes a plain sandwich estimate (Eicker 1963; Huber 1967; White 1980) from a fitted model object, defaulting to what is known as HC0 or HC1 in linear regresion models. `vcovHC()` is a wrapper to `sandwich()` combined with `meatHC()` and `bread()` to compute general HC covariances ranging from HC0 to HC5. `vcovHAC()`, based on `sandwich()` with `meatHAC()` and `bread()`, computes HAC covariance matrix estimates. Further convenience interfaces `kernHAC()` for Andrews' kernel HAC (Andrews 1991) and `NeweyWest()` for Newey-West-style HAC (Newey and West 1987, 1994) are available. However, in versions prior to 2.4.0 of **sandwich** no similarly object-oriented approach to clustered sandwich covariances was available.

Another R package that includes heteroscedasticity-consistent covariance estimators (HC0–HC4), for models produced by `lm()` only, is the **car** package (Fox and Weisberg 2011) in function `hccm()`. Like `vcovHC()` from **sandwich** this is limited to the cross-section case without clustering, though.

2.2. R packages for clustered covariances

The lack of support for clustered sandwich covariances in standard packages like **sandwich** or **car** has led to a number of different implementations scattered over various packages. Typically, these are tied to either objects from `lm()` or dedicated model objects fitting certain (generalized) linear models for clustered or panel data. The list of packages includes: **multiwayvcov** (Graham, Arai, and Hagströmer 2016), **plm** (Croissant and Millo 2008), **geepack** (Halekoh *et al.* 2005), **lfe** (Gaure 2016), **clubSandwich** (Pustejovsky 2016), and **clusterSEs** (Esarey 2017), among others.

In **multiwayvcov**, the implementation was object-oriented in many aspects building on **sandwich** infrastructure. However, certain details assumed `lm` or `glm`-like objects. In **plm** and **lfe** several types of sandwich covariances are available for the packages' `plm` (panel linear models) and `felm` (fixed-effect linear models), respectively. The **geepack** package can estimate independence working models for `glm`-type models, also supporting clustered covariances for the resulting `geeglm` objects. Finally, **clusterSEs** and **clubSandwich** focus on the case of ordinary or weighted least squares regression models.

In a nutshell, there is good coverage of clustered covariances for (generalized) linear regression objects albeit potentially necessitating reestimating a certain model using a different model-fitting function/packages. However, there was no object-oriented implementation for

clustered covariances in R, that enabled plugging in different model objects from in principle any class. Therefore, starting from the implementation in **multiwayvcov** a new and object-oriented implementation was established and integrated in **sandwich**, allowing application to more general models, including zero-inflated, censored, or limited responses.

3. Methods

To establish the theoretical background of sandwich covariances for clustered as well as panel data the notation of Zeileis (2006b) is adopted. Here, the conceptual building blocks from Zeileis (2006b) are briefly repeated and then carried further for clustered covariances.

3.1. Sandwich covariances

Let (y_i, x_i) for $i = 1, \ldots, n$ be data with some distribution controlled by a parameter vector θ with k dimensions. For a wide range of models the (quasi-)maximum likelihood estimator $\hat{\theta}$ is governed by a central limit theorem (White 1994) so that $\hat{\theta} \approx \mathcal{N}(\theta, n^{-1}S(\theta))$. Moreover, the covariance matrix is of sandwich type with a meat matrix $M(\theta)$ between two slices of bread $B(\theta)$:

$$
\begin{align}
S(\theta) &= B(\theta) \cdot M(\theta) \cdot B(\theta) \tag{1} \\
B(\theta) &= \left(\mathsf{E}[-\psi'(y, x, \theta)]\right)^{-1} \tag{2} \\
M(\theta) &= \mathsf{VAR}[\psi(y, x, \theta)]. \tag{3}
\end{align}
$$

An estimating function

$$
\psi(y, x, \theta) \quad = \quad \frac{\partial \Psi(y, x, \theta)}{\partial \theta} \tag{4}
$$

is defined as the derivative of an objective function $\Psi(y, x, \theta)$, typically the log-likelihood, with respect to the parameter vector θ. Thus, an empirical estimating (or score) function evaluates an estimating function at the observed data and the estimated parameters such that an $n \times k$ matrix is obtained (Zeileis 2006b):

$$
\begin{pmatrix} \psi(y_1, x_1, \hat{\theta}) \\ \vdots \\ \psi(y_n, x_n, \hat{\theta}) \end{pmatrix}. \tag{5}
$$

The estimate for $\hat{B}$ is based on second derivatives, i.e., the empirical version of the inverse Hessian

$$
\hat{B} \quad = \quad \left(\frac{1}{n}\sum_{i=1}^{n} -\psi'(y_i, x_i, \hat{\theta})\right)^{-1}, \tag{6}
$$

whereas $\hat{M}, \hat{M}_{\mathrm{HAC}}, \hat{M}_{\mathrm{HC}}$ compute outer product, HAC and HC estimators for the meat, re-

spectively,

$$\hat{M} \quad = \quad \frac{1}{n} \sum_{i=1}^{n} \psi(y_i, x_i, \hat{\theta}) \psi(y_i, x_i, \hat{\theta})^{\top} \tag{7}$$

$$\hat{M}_{\text{HAC}} \quad = \quad \frac{1}{n} \sum_{i,j=1}^{n} w_{|i-j|} \, \psi(y_i, x_i, \hat{\theta}) \psi(y_j, x_j, \hat{\theta})^{\top} \tag{8}$$

$$\hat{M}_{\text{HC}} \quad = \quad \frac{1}{n} X^{\top} \begin{pmatrix} \omega(r(y_1, x_1^{\top}\theta)) & \cdots & 0 \\ \vdots & \ddots & \vdots \\ 0 & \cdots & \omega(r(y_n, x_n^{\top}\theta)) \end{pmatrix} X. \tag{9}$$

The outer product estimator in Equation 7 corresponds to the basic sandwich estimator (Eicker 1963; Huber 1967; White 1980). $w_{|i-j|}$ in Equation 8 is a vector of weights (Zeileis 2004). In Equation 9, functions $\omega(\cdot)$ derive estimates of the variance of the empirical working residuals $r(y_1, x_1^{\top}\hat{\theta}), \ldots, r(y_n, x_n^{\top}\hat{\theta})$ and may also depend on hat values as well as degrees of freedom (Zeileis 2006b). The HC type of the model in Equation 9 has to be of a form that allows factorization of the scores

$$\psi(y_i, x_i, \hat{\theta}) = r(y_i, x_i^{\top}\hat{\theta}) \cdot x_i \tag{10}$$

into empirical working residuals times the regressor vector. This is, however, only possible in situations where the parameter of the response distribution depends on a single linear predictor (possibly through a link function).

The building blocks for the calculation of the sandwich are provided by the **sandwich** package, where the `sandwich()` function calculates an estimator of the sandwich $S(\theta)$ (see Equation 1) by multiplying estimators for the meat (from Equation 3) between two slices of bread (from Equation 2). A natural idea for an object-oriented implementation of these estimators is to provide common building blocks, namely a simple `bread()` extractor that computes $\hat{B}$ from Equation 6 and an `estfun()` extractor that returns the empirical estimating functions from Equation 5. On top of these extractors a number of meat estimators can be defined: `meat()` for $\hat{M}$ from Equation 7, `meatHAC()` for $\hat{M}_{\text{HAC}}$ from Equation 8, and `meatHC()` for $\hat{M}_{\text{HC}}$ from Equation 9, respectively. In addition to the `estfun()` method a `model.matrix()` method is needed in `meatHC()` for the decomposition of the scores into empirical working residuals and regressor matrix.

3.2. Clustered covariances

For clustered observations, similar ideas as above can be employed but the data has more structure that needs to be incorporated into the meat estimators. Specifically, for one-way clustering there is not simply an observation i from $1, \ldots, n$ observations but an observation (i, g) from $1, \ldots, n_g$ observations within cluster/group g (with $g = 1, \ldots, G$ and $n = n_1 + \cdots + n_G$). As only the G groups can be assumed to be independent while there might be correlation withing the cluster/group, the empirical estimation function is summed up within each group prior to computing meat estimators. Thus, the core idea of many clustered covariances is to replace Equation 5 with the following equation and then proceeding "as usual" in the

computation of meat estimators afterwards:

$$
\begin{pmatrix}
\psi(y_{11}, x_{11}, \hat{\theta}) + \cdots + \psi(y_{n_1 1}, x_{n_1 1}, \hat{\theta}) \\
\vdots \\
\psi(y_{1G}, x_{1G}, \hat{\theta}) + \cdots + \psi(y_{n_G G}, x_{n_G G}, \hat{\theta})
\end{pmatrix}. \tag{11}
$$

The basic meat estimator based on the outer product then becomes:

$$
\hat{M}_{\mathrm{CL}} \quad = \quad \frac{1}{n} \sum_{g=1}^{G} \sum_{i=1}^{n_g} \psi(y_{ig}, x_{ig}, \hat{\theta}) \psi(y_{ig}, x_{ig}, \hat{\theta})^{\top}. \tag{12}
$$

In the case where observation is its own cluster, the clustered $\hat{M}_{\mathrm{CL}}$ corresponds to the basic $\hat{M}$.

The new function `meatCL()` in the **sandwich** package implements this basic trick along with several types of bias correction and the possibility for multi-way instead of one-way clustering.

Types of bias correction

The clustered covariance estimator controls for both heteroscedasticity across as well as within clusters, but this comes at the cost that the number of clusters G must approach infinity, not just the number of observations n (Cameron, Gelbach, and Miller 2008; Cameron and Miller 2015). Although many publications just refer to "the" clustered standard errors, there is a surprisingly wide variation in clustered covariances, particularly due to different flavors of bias corrections. The bias correction factor can be split in two parts, a "cluster bias correction" and an "HC bias correction". The cluster bias correction captures the effect of having just a finite number of clusters G and it is defined as

$$
\frac{G}{G - 1}. \tag{13}
$$

The HC bias correction can be applied additionally similar to the corresponding cross-section data estimators. HC0 to HC3 bias corrections for cluster g are defined as

$$
\begin{aligned}
\mathrm{HC0}: \quad & 1 & \tag{14} \\
\mathrm{HC1}: \quad & \frac{n}{n - k} & \tag{15} \\
\mathrm{HC2}: \quad & (I_{n_g} - H_{gg})^{-0.5} & \tag{16} \\
\mathrm{HC3}: \quad & (I_{n_g} - H_{gg})^{-1}, & \tag{17}
\end{aligned}
$$

where n is the number of observations and k is the number of estimated parameters, I_{n_g} is an identity matrix of size n_g, H_{gg} is the block from the hat matrix H that pertains to cluster g. Thus, it is completely straightforward to add the factors for HC0 and HC1 to $\hat{M}_{\mathrm{CL}}$ (Equation 12). However, it is more demanding to apply the cluster generalizations of HC2 and HC3 (due to Kauermann and Carroll 2001; Bell and McCaffrey 2002) for which the correction factors from Equations 16 and 17 have to be applied to the (working) residuals prior to computing the clustered meat matrix. More precisely, the empirical working residuals $r(y_g, x_g^{\top} \hat{\theta})$ in group g are adjusted via

$$
\tilde{r}(y_g, x_g^{\top} \hat{\theta}) = (I_{n_g} - H_{gg})^{\alpha} \cdot r(y_g, x_g^{\top} \hat{\theta}) \tag{18}
$$

with $\alpha = -0.5$ for HC2 and $\alpha = -1$ for HC3, before obtaining the adjusted empirical estimating functions based on Equation 10 as

$$\tilde{\psi}(y_i, x_i, \hat{\theta}) = \tilde{r}(y_i, x_i^\top \hat{\theta}) \cdot x_i. \tag{19}$$

Then these adjusted estimating functions can be employed "as usual" to obtain the $\hat{M}_{\text{CL}}$.

Note that in terms of methods in R, it is not sufficient to have just `estfun()` and `model.matrix()` extractors but an extractor for (blocks of) the full hat matrix are required as well. Currently, no such extractor method is available in base R (as `hatvalues()` just extracts diag$H$) and hence HC2 and HC3 in `meatCL()` are just available for `lm` and `glm` objects.

Two-way and multi-way clustered covariances

Certainly, there can be more than one cluster dimension, as for example observations that are characterized by housholds within states or companies within industries. It can therefore sometimes be helpful that one-way clustered covariances can be extended to so-called multi-way clustering as shown by Miglioretti and Heagerty (2007), Thompson (2011) and Cameron, Gelbach, and Miller (2011).

Multi-way clustered covariances comprise clustering on $2^D - 1$ dimensional combinations. Clustering in two dimensions, for example in *id* and *time*, gives $D = 2$, such that the clustered covariance matrix is composed of $2^2 - 1 = 3$ one-way clustered covariance matrices that have to be added up or substracted off, respectively. For two-way clustered covariances with cluster dimensions *id* and *time*, the one-way clustered covariance matrices on *id* and on *time* are added up, and the two-way clustered covariance matrix with clusters formed by the intersection of *id* and *time* is substacted off

$$\hat{M}_{\text{CL}(id,time)} = \hat{M}_{\text{CL}(id)} + \hat{M}_{\text{CL}(time)} - \hat{M}_{\text{CL}(id \cap time)}. \tag{20}$$

The same idea is used for obtaining clustered covariances with more than two clustering dimensions: Meat parts with an odd number of cluster dimensions are added up, whereas those with an even number are substracted.

Petersen (2009), Thompson (2011) and Ma (2014) suggest to substract the standard sandwich estimator in case that the clusters formed by the intersection of *id* and *time* do only contain a single observation. As Ma (2014) argues, the standard sandwich estimator does not take into account any bias adjustment, such that the cluster bias correction $\frac{G}{G-1}$ is larger than one. Thus, covariances are underestimated if always the clustered covariance matrix with cluster bias correction $\frac{G}{G-1}$ is substracted as the last substracted matrix instead of standard sandwich covariances.

3.3. Clustered covariances for panel data

The information of panel data sets is often overstated, as cross-sectional as well as temporal dependencies may occur (Hoechle 2007). Cameron and Trivedi (2005, p. 702) noticed that "*NT* correlated observations have less information than *NT* independent observations". For panel data, the source of dependence in the data is crucial to find out what kind of covariance is optimal (Petersen 2009). In the following, panel Newey-West standard errors as well as Driscoll and Kraay standard errors are examined (see also Millo 2014, for a unifying view).

To reflect that the data are now panel data with time ordering within each cluster/group/id we change our notation to an index (i, t) for $i = 1, \ldots, n_t$ observations at time $t = 1, \ldots, T$ (with $n = n_1 + \cdots + n_T$). Note that compared to the notation from the clustered case above, the variable i now denotes the group/id (e.g., firm) which was previously denoted by g.

Panel Newey-West

Newey and West (1987) proposed a heteroscedasticity and autocorrelation consistent standard error estimator that is traditionally used for time-series data, but can be modified for use in panel data (see for example Petersen 2009). A panel Newey-West estimator can be obtained by setting the cross-sectional as well as the cross-serial correlation to zero (Millo 2014). The meat is composed of

$$\hat{M}_{\mathrm{PL}}^{NW} \quad = \quad \frac{1}{n} \sum_{i,j=1}^{n} w_{|i-j|} \, \psi(y_i, x_i, \hat{\theta}) \psi(y_j, x_j, \hat{\theta})^\top. \tag{21}$$

Newey and West (1987) employ a Bartlett kernel for obtaining the weights as $w_{|i-j|} = 1 - \frac{|i-j|}{L+1}$ at lag $\ell = |i-j|$ up to lag L. As Petersen (2009) noticed, the maximal lag length L in a panel data set is $n_t - 1$, i.e., the maximum number of *time* periods per *id* minus one.

Driscoll and Kraay

Driscoll and Kraay (1998) have adapted the Newey-West approach by using the aggregated estimating functions at each time point. This can be shown to be robust to spatial and temporal dependence of general form, but with the caveat that a long enough time dimension must be available.

Thus, the idea is again to replace Equation 5 by Equation 11 before computing $\hat{M}_{\mathrm{HAC}}$ from Equation 8. Note, however, that the aggregation is now done across cluster/id within each time period t. This yields a panel sandwich estimator where the meat is computed as

$$\hat{M}_{\mathrm{PL}} \quad = \quad \frac{1}{n} \sum_{t=1}^{T} \sum_{i,j=1}^{n_t} w_{|i-j|} \, \psi(y_{it}, x_{it}, \hat{\theta}) \psi(y_{jt}, x_{jt}, \hat{\theta})^\top, \tag{22}$$

The weights $w_{|i-j|}$ are usually again the Bartlett weights up to lag L. Note that for $L = 0$, $\hat{M}_{\mathrm{PL}}$ reduced to $\hat{M}_{\mathrm{CL}(time)}$, i.e., the one-way covariance clustered by time. Also, for the special case that there is just one observation at each time point t, this panel covariance by Driscoll and Kraay (1998) simply yields the panel Newey-West covariance.

The new function `meatPL()` in the **sandwich** package implements this approach analogously to `meatCL()`. For the computation of the weights w_ℓ the same function is employed that `meatHAC()` uses.

3.4. Panel-corrected standard errors

Beck and Katz (1995) proposed another form or panel-corrected covariances – typically referred to as panel-corrected standard errors (PCSE). They are intended for panel data (also called time-series-cross-section data in this literature) with moderate dimensions of time and cross-section (Millo 2014). They are robust against panel heteroscedasticity and contemporaneously correlation, with the crucial assumption that contemporaneous correlation accross

cluster follows a fixed pattern (Millo 2014; Johnson 2004). Autocorrelation within a cluster is assumed to be absent.

Hoechle (2007) argues that for the PCSE estimator the finite sample properties are rather poor if the cross-sectional dimension is large compared to the time dimension. This is in contrast to the panel covariance by Driscoll and Kraay (1998) which relies on large-t asymptotics and is robust to quite general forms of cross-sectional and temporal dependence and is consistent independently of the cross-sectional dimension.

To emphasize that now both cross section *and* and time ordering are considered, index (t, g) is employed for the observation from cluster/group $g = 1, \ldots, G$ at time $t = 1, \ldots, n_g$. In the balanced case (that we focus on below) $n_g = T$ for all groups g so that there are $n = G \cdot T$ observations overall.

The basic idea for PCSE is to employ the outer product of (working) residuals within each cluster g. Thus, the working residuals are split into vectors for each cluster g: $r(y_1, x_1^\top \hat{\theta}), \ldots,$ $r(y_G, x_G^\top \hat{\theta})$. For balanced data these can be arranged in a $T \times G$ matrix,

$$R = [r(y_1, x_1^\top \hat{\theta}) \quad r(y_2, x_2^\top \hat{\theta}) \quad \ldots \quad r(y_G, x_G^\top \hat{\theta})], \tag{23}$$

and the meat of the panel-corrected covariance matrix can be computed using the Kronecker product as

$$\hat{M}_{\mathrm{PC}} = \frac{1}{n} X^\top \left[\frac{(R^\top R)}{T} \otimes \boldsymbol{I}_T \right] X. \tag{24}$$

The details for the unbalanced case are omitted here for brevity but are discussed in detail in Bailey and Katz (2011).

The new function `meatPC()` in the **sandwich** package implements both the balanced and unbalanced case. As for `meatHC()` it is necessary to have a `model.matrix()` extractor in addition to the `estfun()` extractor for splitting up the empirical estimating functions into residuals and regressor matrix.

4. Software

As conveyed already in Section 3, the **sandwich** package has been extended along the same lines it was originally established in (Zeileis 2006b). The new clustered and panel covariances require a new `meat*()` function that ideally only extracts the `estfun()` from a fitted model object. For the full sandwich covariance an accompanying `vcov*()` function is provided that couples the `meat*()` with the `bread()` estimate extracted from the model object.

The new sandwich covariances `vcovCL()` for clustered data and `vcovPL()` for panel data, as well as `vcovPC()` for panel-corrected covariances all follow this structure and are introduced in more detail below.

Model classes which provide the necessary building blocks include `betareg`, `clm`, `coxph`, `crch`, `glm`, `hurdle`, `lm`, `mlm`, `mlogit`, `nls`, `polr`, `rlm`, `survreg`, or `zeroinfl` from packages **stats** (R Core Team 2017), **betareg** (Cribari-Neto and Zeileis 2010; Grün *et al.* 2012), **crch** (Messner, Mayr, and Zeileis 2016), **MASS** (Venables and Ripley 2002), **mlogit** (Croissant 2013), **ordinal** (Christensen 2015), and **survival** (Therneau 2017). For all of these an `estfun` method is available along with a `bread()` method (or the default method works). In case the models are based on a single linear predictor only, they also provide `model.matrix()` extractors so

that the factorization from Equation 10 into working residuals and regressor matrix can be easily computed.

4.1. Clustered covariances

One-, two-, and multi-way clustered covariances with HC0–HC3 bias correction are implemented in

```
vcovCL(x, cluster = NULL, type = NULL, sandwich = TRUE, fix = FALSE, ...)
```

for a fitted-model-object `x` with the underlying meat estimator in

```
meatCL(x, cluster = NULL, type = NULL, cadjust = TRUE, multi0 = FALSE, ...)
```

The essential idea is to aggregate the empirical estimating functions within each cluster and then compute a HC covariance analogous to `vcovHC()`.

The `cluster` argument allows to supply either one cluster vector or a list (or data frame) of several cluster variables. If no cluster variable is supplied, each observation is its own cluster per default. Thus, by default, the clustered covariance estimator collapses to the basic sandwich estimator.

The bias correction is composed of two parts that can be switched on and off separately: First, the cluster bias correction from Equation 13 is controlled by `cadjust`. Second, the HC bias correction from Equations 14–17 is specified via `type` with the default to use `"HC1"` for `lm` objects and `"HC0"` otherwise. Moreover, `type = "HC2"` and `"HC3"` are only available for `lm` and `glm` objects as they require computation of full blocks of the hat matrix (rather than just the diagonal elements as in `hatvalues()`). Hence, the hat matrices of (generalized) linear models are provided directly in `meatCL()` and are not object-oriented in the current implementation.

The `multi0` argument is relevant only for multi-way clustered covariances with more than one clustering dimension. It specifies whether to substract the basic cross-section HC0 covariance matrix as the last substracted matrix in Equation 20 instead of the covariance matrix formed by the intersection of groups (Petersen 2009; Thompson 2011; Ma 2014).

For consistency with Zeileis (2004), the `sandwich` argument specifies whether the full sandwich estimator is computed (default) or only the meat.

Finally, the `fix` argument specifies whether the covariance matrix should be fixed to be positive semi-definite in case it is not. This is achieved by converting any negative eigenvalues from the eigendecomposition to zero. Cameron *et al.* (2011) observe that this is most likely to be necessary in applications with fixed effects, especially when clustering is done over the same groups as the fixed effects.

4.2. Clustered covariances for panel data

For panel data,

```
vcovPL(x, cluster = NULL, order.by = NULL, kernel = "Bartlett",
  sandwich = TRUE, fix = FALSE, ...)
```

based on

```
meatPL(x, cluster = NULL, order.by = NULL, kernel = "Bartlett",
  lag = "NW1987", bw = NULL, adjust = TRUE, ...)
```

computes sandwich covariances for panel data, specificially including panel Newey and West (1987) and Driscoll and Kraay (1998). The essential idea is to aggregate the empirical estimating functions within each time period and then compute a HAC covariance analogous to `vcovHAC()`.

Again, `vcovPL()` returns the full sandwich if the argument `sandwich = TRUE`, and `fix = TRUE` forces a positive semi-definite result if necessary.

The `cluster` argument allows to specify a variable indicating the cluster/group/id variable while `order.by` specifies the time variable. If only one of the two variables is provided, then it is assumed that observations are ordered within the other variable. And if neither is provided, only one cluster is used for all observations resulting in the standard (Newey and West 1987) estimator. Finally, `cluster` can also be a list with both variables: the cluster/group/id and the time/ordering variable, respectively.

The weights in the panel sandwich covariance are set up by means of a `kernel` function along with a bandwidth `bw` or the corresponding `lag`. All kernels described in Andrews (1991) and implemented in `vcovHAC()` by Zeileis (2006a) are available, namely truncated, Bartlett, Parzen, Tukey-Hanning, and quadratic spectral. For the default case of the Bartlett kernel, the bandwidth `bw` corresponds to `lag + 1` and only one of the two arguments should be specified. The `lag` argument can either be an integer or one of three character specifications: `"max"`, `"NW1987"`, or `"NW1994"`). `"max"` (or equivalently, `"P2009"` for Petersen 2009) indicates the maximum lag length $T - 1$, i.e., the number of time periods minus one. `"NW1987"` corresponds to Newey and West (1987), who have shown that their estimator is consistent if the number of lags increases with time periods T, but with speed less than $T^{1/4}$ (see also Hoechle 2007). `"NW1994"` sets the lag length to floor$[4 \cdot (\frac{T}{100})^{2/9}]$ (Newey and West 1994).

The `adjust` argument allows to make a finite sample adjustment, which amounts to multiplication with $n/(n - k)$, where n is the number of observations, and k is the number of estimated parameters.

4.3. Panel-corrected covariance

Panel-corrected covariances and panel-corrected standard errors (PCSE) a la Beck and Katz (1995) are implemented in

```
vcovPC(x, cluster = NULL, order.by = NULL, pairwise = FALSE,
  sandwich = TRUE, fix = FALSE, ...)
```

based on

```
meatPC(x,  cluster = NULL, order.by = NULL, pairwise = FALSE,
  kronecker = FALSE, ...)
```

They are usually used for panel data or time-series-cross-section (TSCS) data with a large enough time dimension. The arguments `sandwich`, `fix`, `cluster`, and `order.by` have the same meaning as in `vcovCL()` and `vcovPL()`.

While estimation in balanced panels is straightforward, there are two alternatives to estimate the meat for unbalanced panels (Bailey and Katz 2011). For `pairwise = TRUE`, a pairwise balanced sample is employed, whereas for `pairwise = FALSE`, the largest balanced subset of the panel is used. For details, see Bailey and Katz (2011).

The argument `kronecker` relates to estimation of the meat and determines whether calculations are executed with the Kronecker product or elementwise. The former is typically computationally faster in moderately large data sets while the latter is less memory-intensive so that it can be applied to larger numbers of observations.

5. Illustrations

The main motivation for the new object-oriented implementation of clustered covariances in **sandwich** was the applicability to models beyond `lm()` or `glm()`. Specifically when working on Berger, Stocker, and Zeileis (2017) – an extended replication of Aghion *et al.* (2013) – clustered covariances for negative binomial hurdle models were needed to confirm reproducibility. After doing this "by hand" in Berger *et al.* (2017), we show in Section 5.1 how the same results can now conveniently obtained with the new general `vcovCL()` framework.

Furthermore, to show that the new **sandwich** package can also replicate the classic linear regression results that are currently scattered over various packages, the benchmark data from Petersen (2009) is considered in Section 5.2. This focuses on linear regression with model errors that are correlated within clusters. Section 5.2 replicates a variety of clustered covariances from the R packages **multiwayvcov**, **plm**, **geepack**, and **pcse**. More specifically, one- and two-way clustered standard errors from **multiwayvcov** are replicated with `vcovCL()`. Furthermore, one-way clustered standard errors from **plm** and **geepack** can also be obtained by `vcovCL()`. The Driscoll and Kraay standard errors from **plm**'s `vcovSCC()` can also be computed with the new `vcovPL()`. Finally, panel-corrected standard errors can be estimated by function `vcovPC()` from **pcse** and are benchmarked against the new `vcovPC()` from **sandwich**.

5.1. Aghion *et al.* (2013) and Berger *et al.* (2017)

Aghion *et al.* (2013) investigate the effect of institutional owners (these are, for example, pension funds, insurance companies, etc.) on innovation. The authors use firm-level panel data on innovation and institutional ownership from 1991 to 1999 over 803 firms, with the data clustered at company as well as industry level. To capture the differing value of patents, citation-weighted patent counts are used as a proxy for innovation, whereby the authors weight the patents by the number of future citations. This motivates the use of count data models.

Aghion *et al.* (2013) mostly employ Poisson and negative binomial models in a quasi-maximum likelihood approach and cluster standard errors by either companies or industries. Berger *et al.* (2017) argue that zero responses should be treated separately both for statistical and economic reasons, as there is a difference in determinants of "first innovation" and "continuing innovation". Therefore, they employ two-part hurdle models with a binary part that models the decision to innovate at all, and a count part that models ongoing innovation, respectively.

A basic negative binomial hurdle model is fitted with the `hurdle` function from the **pscl** package (Zeileis *et al.* 2008) using the Aghion *et al.* (2013) data provided in the **sandwich** package.

```
R> data("InstInnovation", package = "sandwich")
R> library("pscl")
R> h_innov <- hurdle(
+     cites ~ institutions + log(capital/employment) + log(sales),
+     data = InstInnovation, dist = "negbin")
```

The partial Wald tests for all coefficients based on clustered standard errors can be obtained by using `coeftest()` from **lmtest** (Zeileis and Hothorn 2002) and setting `vcov = vcovCL` and providing the company-level clustering (with a total of 803 clusters) via `cluster = InstInnovation$company`.

```
R> library("sandwich")
R> library("lmtest")
R> coeftest(h_innov, vcov = vcovCL, cluster = InstInnovation$company)

t test of coefficients:

                             Estimate Std. Error t value Pr(>|t|)
count_(Intercept)             0.49025    0.89445    0.55   0.5836
count_institutions            0.00397    0.00430    0.92   0.3567
count_log(capital/employment) 0.30431    0.15214    2.00   0.0455 *
count_log(sales)              0.38434    0.04999    7.69 1.7e-14 ***
zero_(Intercept)             -0.01007    0.26908   -0.04   0.9701
zero_institutions             0.00658    0.00209    3.15   0.0016 **
zero_log(capital/employment) -0.17431    0.06481   -2.69   0.0072 **
zero_log(sales)               0.17601    0.02776    6.34 2.5e-10 ***
---
Signif. codes:  0 '***' 0.001 '**' 0.01 '*' 0.05 '.' 0.1 ' ' 1
```

This shows that institutional owners are have a small but positive impact in both submodels but that only the coefficient in the zero hurdle is significant.

Below, the need for clustering is brought out through a comparison of clustered standard errors with "standard" standard errors and basic (cross-section) sandwich standard errors. As an additional reference, a simple clustered bootstrap covariance can be computed by `vcovBS()` (by default with `R = 250` bootstrap samples).

```
R> set.seed(0)
R> vc <- list(
+     "standard" = vcov(h_innov),
+     "basic" = sandwich(h_innov),
+     "CL-1" = vcovCL(h_innov, cluster = InstInnovation$company),
+     "boot" = vcovBS(h_innov, cluster = InstInnovation$company)
+ )
R> se <- function(vcov) sapply(vcov, function(x) sqrt(diag(x)))
R> se(vc)

                             standard      basic      CL-1      boot
count_(Intercept)           0.2249894 0.6034277 0.8944541 0.8667209
```

```
count_institutions               0.0016022 0.0024664 0.0043029 0.0041135
count_log(capital/employment)    0.0546614 0.0817540 0.1521416 0.1494889
count_log(sales)                 0.0126165 0.0322071 0.0499917 0.0612687
zero_(Intercept)                 0.1460246 0.1530406 0.2690844 0.2791141
zero_institutions                0.0013508 0.0013473 0.0020870 0.0020777
zero_log(capital/employment)     0.0333649 0.0358768 0.0648053 0.0666365
zero_log(sales)                  0.0164233 0.0165897 0.0277648 0.0295080
```

This clearly shows that the usual standard errors greatly overstate the precision of the estimators and the basic sandwich covariance are able to improve but not fully remedy the situation. The clustered standard errors are scaled up by factors between about 1.5 and 2, even compared to the basic sandwich standard errors. Moreover, the clustered and bootstrap covariances agree very well – thus highlighting the need for clustering – with `vcovBS()` being computationally much more demanding than `vcovCL()` due to the resampling.

5.2. Petersen (2009)

Petersen (2009) provides simulated benchmark data (http://www.kellogg.northwestern.edu/faculty/petersen/htm/papers/se/test_data.txt) for assessing clustered standard error estimates in the linear regression model. This data set contains a dependent variable `y` and regressor `x` for 500 `firm`s over 10 `year`s. It is frequently used in illustrations of clustered covariances (e.g., in **multiwayvcov**, see Graham *et al.* 2016) and is also available in **sandwich**. The corresponding linear model is fitted with `lm()`.

```
R> data("PetersenCL", package = "sandwich")
R> p_lm <- lm(y ~ x, data = PetersenCL)
```

One-way clustered standard errors

One-way clustered covariances for linear regression models are available in a number of different R packages. The implementations differ mainly in two aspects: (1) Whether a simple "lm" object can be supplied or (re-)estimation of a dedicated model object is necessary. (2) Which kind of bias adjustment is done by default (HC type and/or cluster adjustment).

The function `cluster.vcov()` from **multiwayvcov** (whose implementation strategy `vcovCL()` follows) can use "lm" objects directly and then applies both the HC1 and cluster adjustment by default. In contrast, **plm** and **geepack** both require re-estimation of the model and then employ HC0 without cluster adjustment by default. In **plm**, a pooling model needs to be estimated with `plm()` and in **geepack** an independence working model needs to be fitted with `geeglm()`.

The **multiwayvcov** results can be replicated as follows.

```
R> library("multiwayvcov")
R> se(list(
+    "sandwich"    = vcovCL(p_lm, cluster = PetersenCL$firm),
+    "multiwayvcov" = cluster.vcov(p_lm, cluster = PetersenCL$firm)
+  ))
```

```
          sandwich multiwayvcov
(Intercept) 0.067013    0.067013
x           0.050596    0.050596
```

And the **plm** and **geepack** results can be replicated with the following code. (Note that **geepack** does not provide a `vcov()` method for "geeglm" objects, hence the necessary code is included below.)

```
R> library("plm")
R> p_plm <- plm(y ~ x, data = PetersenCL, model = "pooling",
+   indexes = c("firmid", "year"))
R> library("geepack")
R> vcov.geeglm <- function(object) {
+     vc <- object$geese$vbeta
+     rownames(vc) <- colnames(vc) <- names(coef(object))
+     return(vc)
+ }
R> p_gee <- geeglm(y ~ x, data = PetersenCL, id = PetersenCL$firm,
+   corstr = "independence", family = gaussian)
R> se(list(
+     "sandwich" = vcovCL(p_lm, cluster = PetersenCL$firm,
+       cadjust = FALSE, type = "HC0"),
+     "plm" = vcovHC(p_plm, cluster = "group"),
+     "geepack" = vcov(p_gee)
+ ))
```

```
          sandwich      plm  geepack
(Intercept) 0.066939 0.066939 0.066939
x           0.050540 0.050540 0.050540
```

Two-way clustered standard errors

It would also be feasible to cluster the covariances with respect to both dimensions, `firm` and `year`, yielding similar but slightly larger standard errors. Again, `vcovCL()` from **sandwich** can replicate the results of `cluster.vcov()` from **multiwayvcov**. Only the default for the correction proposed by Ma (2014) is different.

```
R> se(list(
+     "sandwich" = vcovCL(p_lm, cluster = PetersenCL[, 1:2], multi0 = TRUE),
+     "multiwayvcov" = cluster.vcov(p_lm, cluster = PetersenCL[, 1:2])
+ ))
```

```
          sandwich multiwayvcov
(Intercept) 0.065066    0.065066
x           0.053561    0.053561
```

However, note that the results should be regarded with caution as cluster dimension `year` has a total of only 10 cluster. It is required by theory that each cluster dimension has many clusters (Petersen 2009; Cameron *et al.* 2011; Cameron and Miller 2015).

Driscoll and Kraay standard errors

The Driscoll and Kraay standard errors for panel data are available in `vcovSCC()` from **plm**, defaulting to a HC0-type adjustment. In **sandwich** the `vcovPL()` function can be used for replication, setting `adjust = FALSE` to match the HC0 (rather than HC1) adjustment.

```
R> se(list(
+    "sandwich" = vcovPL(p_lm, cluster = PetersenCL$firm, adjust = FALSE),
+    "plm" = vcovSCC(p_plm)
+ ))
```

```
            sandwich       plm
(Intercept) 0.024357 0.024357
x           0.028163 0.028163
```

Panel-corrected standard errors

Panel-corrected covariance a la Beck and Katz are implemented in the package **pcse** – providing the function that is also named `vcovPC()` – which can handle both balanced and unbalanced panels. For the balanced Petersen data the two `vcovPC()` functions from **sandwich** and **pcse** agree.

```
R> library("pcse")
R> se(list(
+    "sandwich" = sandwich::vcovPC(p_lm, cluster = PetersenCL$firm,
+      order.by = PetersenCL$year),
+    "pcse" = pcse::vcovPC(p_lm, groupN = PetersenCL$firm,
+      groupT = PetersenCL$year)
+ ))
```

```
            sandwich      pcse
(Intercept) 0.022201 0.022201
x           0.025276 0.025276
```

And also when omitting the last year for the first firm to obtain an unbalanced panel, the **pcse** results can be replicated. Both strategies for balancing the panel internally (pairwise vs. casewise) are illustrated in the following.

```
R> PU <- subset(PetersenCL, !(firm == 1 & year == 10))
R> pu_lm <- lm(y ~ x, data = PU)
```

and again, panel-corrected standard errors from **sandwich** are equivalent to those from **pcse**.

```
R> se(list(
+    "sandwichT" = sandwich::vcovPC(pu_lm, cluster = PU$firm,
+      order.by = PU$year, pairwise = TRUE),
+    "pcseT" = pcse::vcovPC(pu_lm, PU$firm, PU$year, pairwise = TRUE),
+    "sandwichF" = sandwich::vcovPC(pu_lm, cluster = PU$firm,
+      order.by = PU$year, pairwise = FALSE),
+    "pcseF" = pcse::vcovPC(pu_lm, PU$firm, PU$year, pairwise = FALSE)
+  ))
```

```
             sandwichT    pcseT sandwichF    pcseF
(Intercept)   0.022070 0.022070  0.022603 0.022603
x             0.025338 0.025338  0.025241 0.025241
```

6. Simulation

For a more systematic analysis, a Monte Carlo simulation is carried out to assess the performance of clustered covariances beyond linear and generalized linear models. For the linear model, there is a number of simulation studies in the literature (including Cameron *et al.* 2008; Arceneaux and Nickerson 2009; Petersen 2009; Cameron *et al.* 2011; Harden 2011; Thompson 2011; Cameron and Miller 2015; Jin 2015), far less for generalized linear models (see for example Miglioretti and Heagerty 2007) and, up to our knowledge, no larger systematic comparisons for models beyond. Therefore, we try to fill this gap by starting out with simulations of (generalized) linear models similar to the ones mentioned above and then moving on to other types of maximum likelihood regression models.

6.1. Simulation design

The main focus of the simulation is to assess the performance of clustered covariances (and related methods) at varying degrees of correlation within the clusters. The two most important parameters to control for this are the cluster correlation ρ, obviously, and the number of clusters G as bias decreases with increasing number of clusters (Green and Vavreck 2008; Arceneaux and Nickerson 2009; Harden 2011). More specifically, the cluster correlation varies from 0 to 0.9 and the number of clusters G ranges from 10 to $50, 100, \ldots, 250$.

In a first step, only balanced clusters with a low number of observations per cluster (5) are considered. All models are specified through linear predictors (with up to three regressors) but with different response distributions. A Gaussian copula is employed to introduce the cluster correlation for the different response distributions. The methods considered are the different clustered covariances implemented in **sandwich** as well as competing methods such as basic sandwich covariances (without clustering), mixed-effects models with a random intercept, or generalized estimating equations with an exchangeable correlation structure.

Linear predictor

Following Harden (2011) the linear predictor considered for the simulation is composed of three regressors that are either *correlated* with the clustering, *clustered*, or *uncorrelated*. The

model equation is given by

$$h(\mu_{ig}) = \beta_0 + \beta_1 \cdot x_{1,ig} + \beta_2 \cdot x_{2,g} + \beta_3 \cdot x_{3,ig}, \tag{25}$$

where μ_{ig} is the expectation of the response for observation i within cluster g and the link function $h(\cdot)$ depends on the model type. The regressor variables are all drawn from standard normal distributions but at different levels (cluster vs. individual observation).

$$
\begin{aligned}
x_{1,ig} &\sim & \rho_x \cdot \mathcal{N}_g(0,1) + (1 - \rho_x) \cdot \mathcal{N}_{ig}(0,1) && (26) \\
x_{2,g} &\sim & \mathcal{N}_g(0,1) && (27) \\
x_{3,ig} &\sim & \mathcal{N}_{ig}(0,1) && (28)
\end{aligned}
$$

Regressor $x_{1,ig}$ is composed of a linear combination of a random draw at cluster level ($\mathcal{N}_g$) and a random draw at individual level ($\mathcal{N}_{ig}$) while regressors $x_{2,g}$ and $x_{3,ig}$ are drawn only at cluster and individual level, respectively. Emphasis is given to the investigation of regressor $x_{1,ig}$ with correlation (default: $\rho_x = 0.25$) which is probably the most common in practice. Furthermore, by considering the extremes $\rho_x = 1$ and $\rho_x = 0$ the properties of $x_{1,ig}$ coincide with those of $x_{2,g}$ and $x_{3,ig}$, respectively.

The vector of coefficients is fixed to either one of

$$
\begin{aligned}
\beta_1 &= (0, 0.85, 0.5, 0.7)^\top && (29) \\
\beta_2 &= (0, 0.85, 0, 0)^\top && (30)
\end{aligned}
$$

which have been selected based on Harden (2011).

Response distributions

The response distributions encompass Gaussian (`gaussian`, with identity link) as the standard classical scenario as well as binary (`binomial`, with a size of one and a logit link) and Poisson (`poisson`, with log link) from the GLM exponential family. To move beyond the GLM, we also consider the beta (`betareg`, with logit link and fixed precision parameter $\phi = 10$), zero-truncated Poisson(`zerotrunc`, with log link), and zero-inflated Poisson (`zeroinfl`, with log link and fixed inflation probability $\pi = 0.3$) distributions.

Sandwich covariances

The types of covariances being compared include "standard" covariances (`standard`, without considering any heteroscedasticity or clustering/correlations), basic sandwich covariances (`basic`, without clustering), Driscoll and Kraay panel covariances (PL), Beck and Katz panel-corrected covariances (PC), and clustered covariances with HC0–HC3 adjustment (CL-0–CL-3). As further references, covariances from a clustered bootstrap (BS), a mixed-effects model with random intercept (random), and from a GEE with exchangeable correlation structure (gee) are assessed.

Outcome measure

In order to assess the validity of statistical inference based on clustered covariances, the empirical coverage rate of the 95% Wald confidence intervals (from 10,000 replications) is the outcome measure of interest. If standard errors are estimated accurately, the empirical

Label	Model	Object	Variance-covariance matrix
CL-0	(g)lm	m	`vcovCL(m, cluster = id, type = "HC0")`
CL-1	(g)lm	m	`vcovCL(m, cluster = id, type = "HC1")`
CL-2	(g)lm	m	`vcovCL(m, cluster = id, type = "HC2")`
CL-3	(g)lm	m	`vcovCL(m, cluster = id, type = "HC3")`
PL	(g)lm	m	`vcovPL(m, cluster = id, adjust = FALSE)`
PC	(g)lm	m	`vcovPC(m, cluster = id, order.by = round)`
standard	(g)lm	m	`vcov(m)`
basic	(g)lm	m	`sandwich(m)`
random	(g)lmer	m_re	`vcov(m_re)`
gee	geeglm	m_gee	`m_gee$geese$vbeta`

Table 1: Covariance matrices for responses from the exponential family in 'sim-CL.R'.

coverage should match the nominal rate of 0.95. And empirical coverages falling short of 0.95 are typically due to underestimated standard errors and would lead to inflated type I errors in partial Wald tests of the coefficients.

Simulation code

The supplementary R script 'sim-CL.R' comprises the simulation code for the data generating process described above and includes functions `dgp()`, `fit()`, and `sim()`. While `dgp()` specifies the data generating process and generates a data frame with (up to) three regressors `x1`, `x2`, `x3` as well as cluster dimensions `id` and `round`. `fit()` is responsible for the model estimation as well as computation of the covariance matrix estimate and the empirical coverage. The function `sim()` sets up all factorial combinations of the specified scenarios and loops over the fits for each scenario (using multiple cores for parallelization).

Table 1 shows exemplarily how the different types of covariances are calculated for responses from the exponential family. A pooled or marginal model (`m`), a random effects model (`m_re`, using **lme4**, Bates *et al.* 2015), and a GEE with an exchangeable correlation structure (`m_gee`, using **geepack**, Halekoh *et al.* 2005) are fitted. For the other (non-GLM) responses, the functions `betareg()` (from **betareg**, Cribari-Neto and Zeileis 2010), `zerotrunc()` (from **countreg**, Zeileis and Kleiber 2017), and `zeroinfl()` (from **pscl**/**countreg**, Zeileis *et al.* 2008) are used.

6.2. Results

Based on the design discussed above, the simulation study investigates the performance of clustered covariances for the following settings.

- Experiment I: Different types of regressors for a Gaussian response distribution.

- Experiment II: Different GLM response distributions.

- Experiment III: Response distributions beyond the GLM.

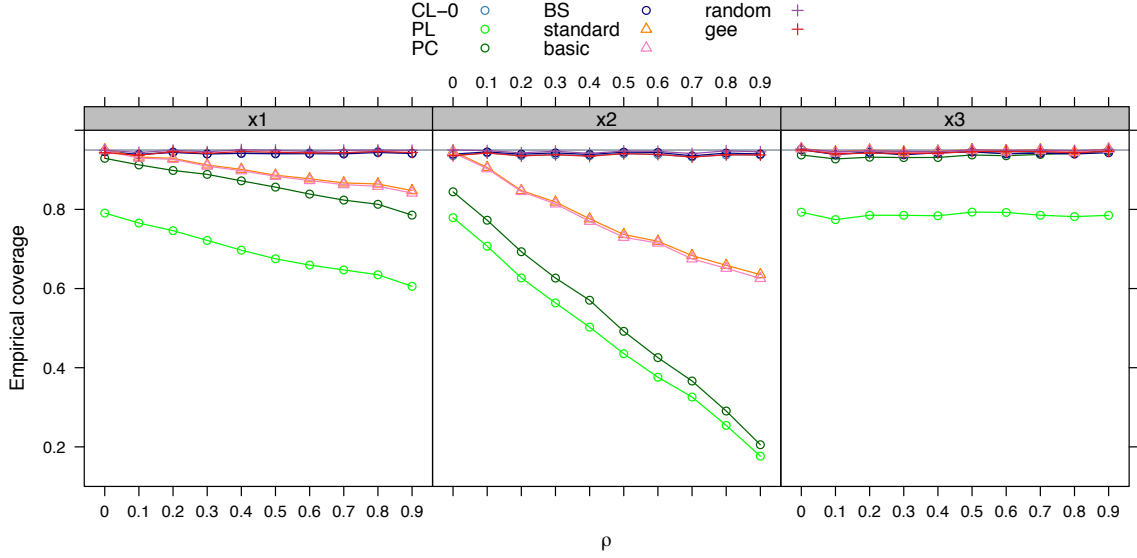- Experiment IV: GLMs with HC0–HC3 bias corrections.

Figure 1: Experiment I. Gaussian response with $G = 100$ (balanced) clusters of 5 observations each. Regressor `x1` is correlated ($\rho_x = 0.25$), `x2` clustered, and `x3` uncorrelated. The coverage (from 10,000 replications) is plotted on the y-axis against the cluster correlation ρ on the x-axis. The horizontal reference line indicates the nominal coverage of 0.95.

Experiment I

Figure 1 shows the results from Experiment I and plots the empirical coverage probabilities (from 10,000 replications) on the y-axis for the coefficients of the correlated regressor `x1`, the clustered regressor `x2`, and the uncorrelated regressor `x3` against the cluster correlation ρ on the y-axis.

While for the uncorrelated regressor `x3` all methods – except the Driscoll and Kraay PL estimator – perform well and yield satisfactory coverage rates, the picture is different for the correlated and clustered regressors `x1` and `x2`. With increasing cluster correlation ρ the performance of those methods deteriorate that either do not account for the clustering at all (i.e., "standard" covariance and basic sandwich covariance) or that treat the data as panel data (i.e., PL and PC).

The reason for the poor performance of the panel data covariances is the low number of 5 observations per cluster. This has already been documented in the literature: In a Monte-Carlo study, Driscoll and Kraay (1998) use a minimum of 20–25 observations per cluster and Hoechle (2007) notes that the PC estimator can be quite imprecise if the crosss-sectional dimension is large compared to the time dimension. As shown in Appendix A, the performance improves if an exponentially decaying AR(1) correlation structure is employed instead of the exchangeable structure and if the number of observations per cluster increases.

As the effects of regressor `x1` are in between the effects of the clustered regressor `x2` and the uncorrelated regressor `x3`, the following simulation experiments focus on the situation with a single correlated regressor `x1`.

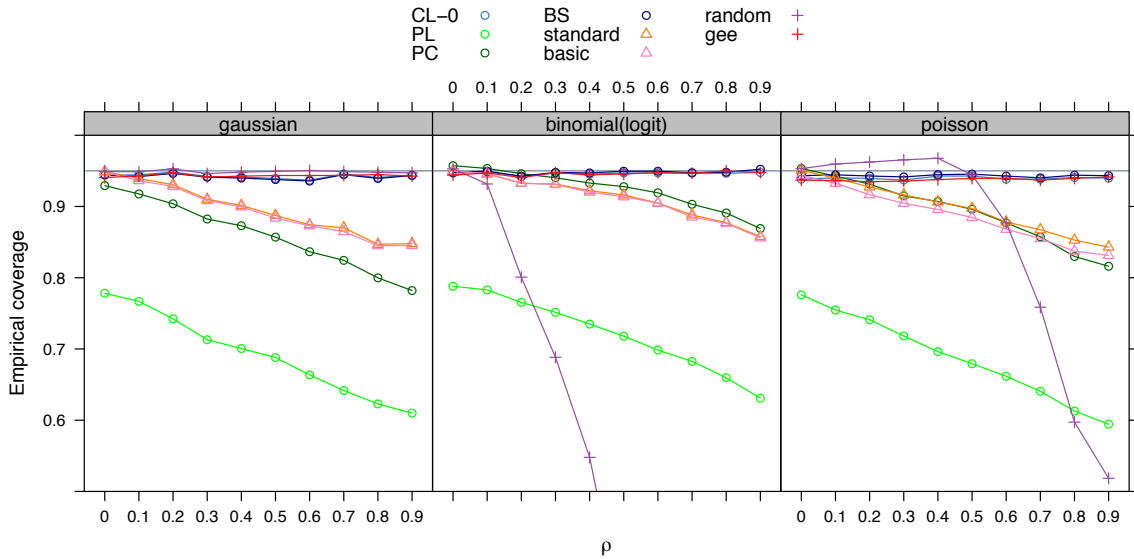Figure 2: Experiment II. Exponential family response distributions with $G = 100$ (balanced) clusters of 5 observations each. The only regressor `x1` is correlated ($\rho_x = 0.25$). The coverage (from 10,000 replications) is plotted on the y-axis against the cluster correlation ρ (from a Gaussian copula) on the x-axis. The horizontal reference line indicates the nominal coverage of 0.95.

Experiment II

Figure 2 illustrates the results from Experiment II. The settings are mostly analogous to Experiment I with two important differences: (1) GLMs with Gaussian/binomial/Poisson response distribution are used. (2) There is only one regressor (`x1`, correlated with $\rho_x = 0.25$).

Overall, the results for binomial and Poisson response are very similar to the Gaussian case in Experiment I. Thus, this confirms that clustered covariances also work well with GLMs.

The only major difference between the linear Gaussian and nonlinear binomial/Poisson cases is the performance of the mixed-effects models with random intercept. While in linear models the marginal (or "population-averaged") approach employed with clustered covariances leads to analogous models compared to mixed-effects models, this is not the case in nonlinear models. With nonlinear links, mixed-effects models correspond to "conditional" rather than "marginal" models and for obtaining marginal expectations the random effects have to be integrated out (see Molenberghs, Kenward, Verbeke, Iddi, and Efendi 2013; Fitzmaurice 2014). Consequently, fixed effects have to be interpreted differently and their confidence intervals do not contain the population-averaged effects, thus leading to the results in Experiment II.

Experiment III

Figure 3 shows the outcome of Experiment III whose settings are similar to the previous Experiment I. But now more general response distributions beyond the classic GLM framework are employed, revealing that the clustered covariances from `vcovCL()` indeed also work well in this setup. Again, the performance of the non-clustered covariances deteriorates with increasing cluster correlation. For the zero-truncated and zero-inflated Poisson distribution the
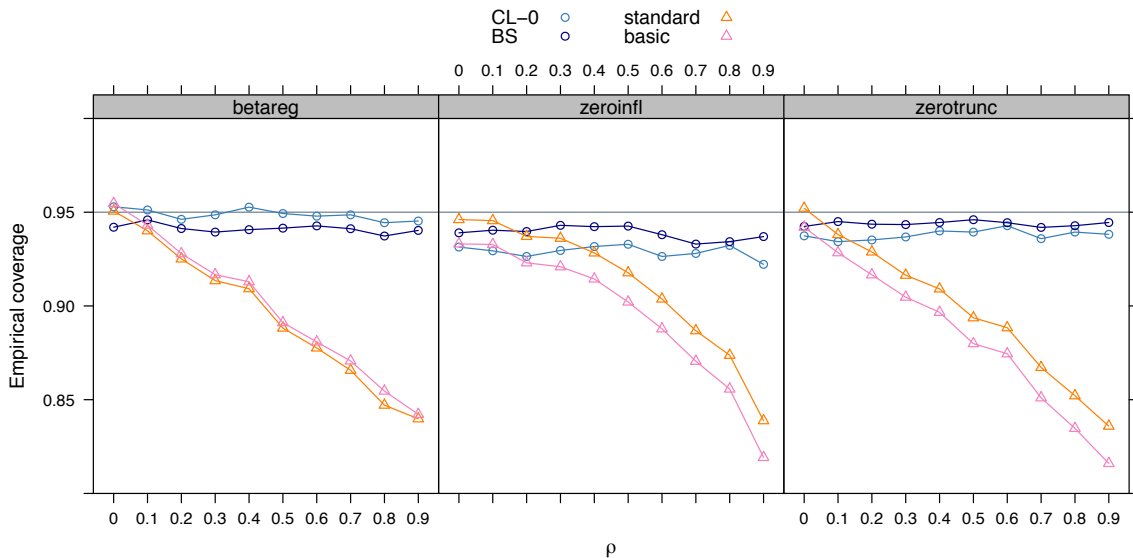
Figure 3: Experiment III. Response distributions beyond the GLM (beta regression, zero-truncated Poisson, and zero-inflated Poisson) with $G = 100$ (balanced) clusters of 5 observations each. The only regressor x1 is correlated ($\rho_x = 0.25$). The coverage (from 10,000 replications) is plotted on the y-axis against the cluster correlation ρ (from a Gaussian copula) on the x-axis. The horizontal reference line indicates the nominal coverage of 0.95.

empirical coverage rate is slightly lower than 0.95. However, given that this does not depend on the extent of the correlation ρ this is more likely due to the quality of the normal approximation in the Wald confidence interval. The clustered bootstrap covariance (BS) performs similarly to the clustered HC0 covariance but is computationally much more demanding due to the need for resampling and refitting the model (here with R = 250 bootstrap samples).

Experiment IV

Figure 4 depicts the findings of Experiment IV. The y-axis represents again the empirical coverage from 10,000 replications, but in contrast to the other simulation experiments, the number of clusters G is plotted on the x-axis, ranging from 10 to 250 clusters. Gaussian, binomial and Poisson responses are compared with each other, with the focus on clustered standard errors with HC0–HC3 types of bias correction. (Recall that HC2 and HC3 require blockwise components of the full hat matrix and hence are at the moment only available for lm() and glm() fits, see Section 4.1.)

In most cases, all of the standard errors are underestimated for $G = 10$ clusters (except clustered standard errors with HC3 bias correction for the binomial and Poisson response). As found in previous studies for clustered HC0/HC1 covariances (Arceneaux and Nickerson 2009; Petersen 2009; Harden 2011; Cameron and Miller 2015, among others), the larger the number of clusters G, the better the coverage and the less standard errors are underestimated. It can be observed that in our study about 50–100 clusters are enough for sufficiently accurate coverage rates.

Additionally, it can be observed that the higher the number of clusters, the less the different
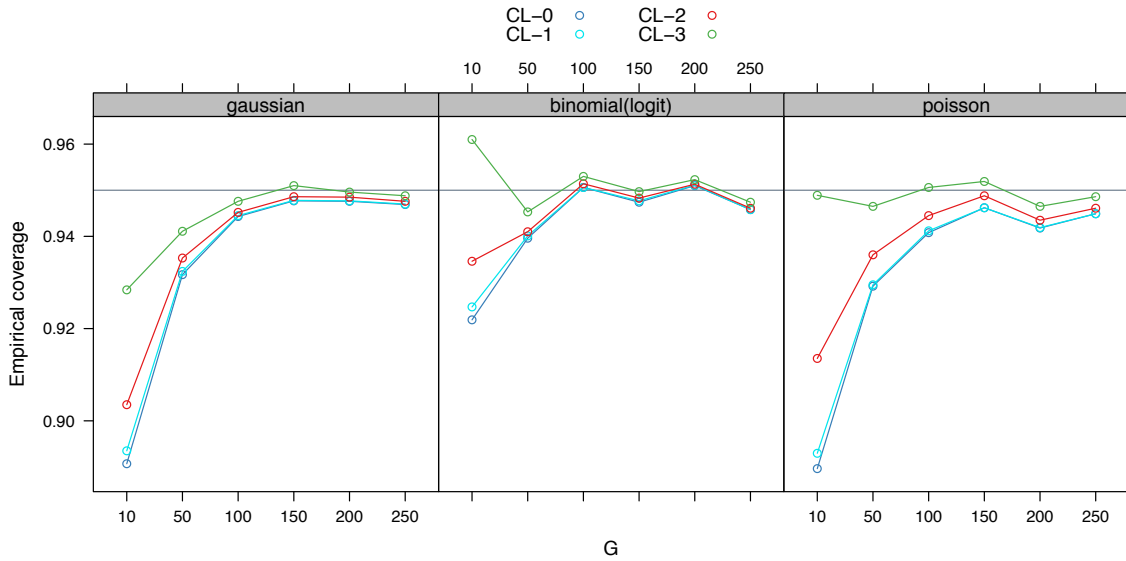
Figure 4: Experiment IV. Exponential family response distributions with cluster correlation $\rho = 0.25$ (from a Gaussian copula). The only regressor `x1` is correlated ($\rho_x = 0.25$). The coverage (from 10,000 replications) on the y-axis for different types of bias adjustment (HC0–HC3) is plotted against the number of clusters G on the x-axis. The number of clusters increases with $G = 10, 50, \ldots, 250$ while the number of observations per cluster is fixed at 5. The horizontal reference line indicates the nominal coverage of 0.95.

types of HC bias correction differ. However, for a small number of clusters, the HC3 correction works best, followed by HC2, HC1 and HC0. This is also consistent with the findings for cross-sectional data, e.g., Long and Ervin (2000) suggest to use HC3 in the linear model for small samples with less than 250 observations.

7. Summary

While previous versions of the **sandwich** package already provided a flexible object-oriented implementation of covariances for cross-section and time series data, the corresponding functions for clustered and panel data have only been added recently (in version 2.4-0 of the package). Compared to previous implementations in R that were somewhat scattered over several packages, the implementation in **sandwich** offers a wide range of "flavors" of clustered covariances and, most importantly, is applicable to any model object that provides methods to extract the `estfun()` (estimating functions; observed score matrix) and `bread()` (inverse Hessian). Therefore, it is possible to apply the new functions `vcovCL()`, `vcovPL()`, and `vcovPC()` to models beyond linear regression. A thorough Monte Carlo assesses the performance of these functions in regressions beyond the standard linear Gaussian scenario, e.g., for exponential family distributions and beyond and for the less frequently used HC2 and HC3 adjustments. This shows that clustered covariances work reasonably well in the models investigated but some care is needed when applying panel estimators (`vcovPL()` and `vcovPC()`) in panel data with "short" panels and/or non-decaying autocorrelations.

Computational details

The packages **sandwich**, **countreg**, **geepack**, **lattice**, **lme4**, **lmtest**, **multiwayvcov**, **plm** and **pscl** are required for the applications in this paper. For replication of the simulation study, the supplementary R script `sim-CL.R` is provided along with the corresponding results `sim-CL.rda`.

R version 3.4.1 has been used for computations. Package versions that have been employed are **sandwich** 2.4–0, **countreg** 0.2–0, **geepack** 1.2–1, **lattice** 0.20–35, **lme4** 1.1–13, **lmtest** 0.9–35, **multiwayvcov** 1.2.3, **plm** 1.6–5, and **pscl** 1.4.9 have been used.

R itself and all packages (except **countreg**) used are available from CRAN at `https://CRAN.R-project.org/`. **countreg** is available from R-Forge at `https://R-Forge.R-project.org/projects/countreg/`.

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A. Simulation results for panel data with AR(1) correlations

As observed in Figures 1–2, the estimators for panel covariances (PL and `PC`) have problems with the "short" panels of only 5 observations per cluster. To assess whether the estimators perform correctly in those situations they were designed for, we take a closer look at (a) "longer" panels (with up to 50 observations per cluster), and (b) an exponentially decaying autoregressive (AR) correlation structure of order 1 instead of an exchangeable correlation structure.

Figure 5 shows the results from a supplementary simulation experiment that is analogous to Experiment I. The two differences are: (1) The cluster correlation $\rho = 0.25$ is fixed and the number of observations per cluster is increased from 5 up to 50. (2) Additionally, an AR(1) correlation structure is considered. Somewhat surprisingly, the standard clustered HC0 covariance performs satisfactorily in all scenarios and better than the panel estimators (PL and PC). The latter approach the desired coverage of 0.95 when the panels become longer
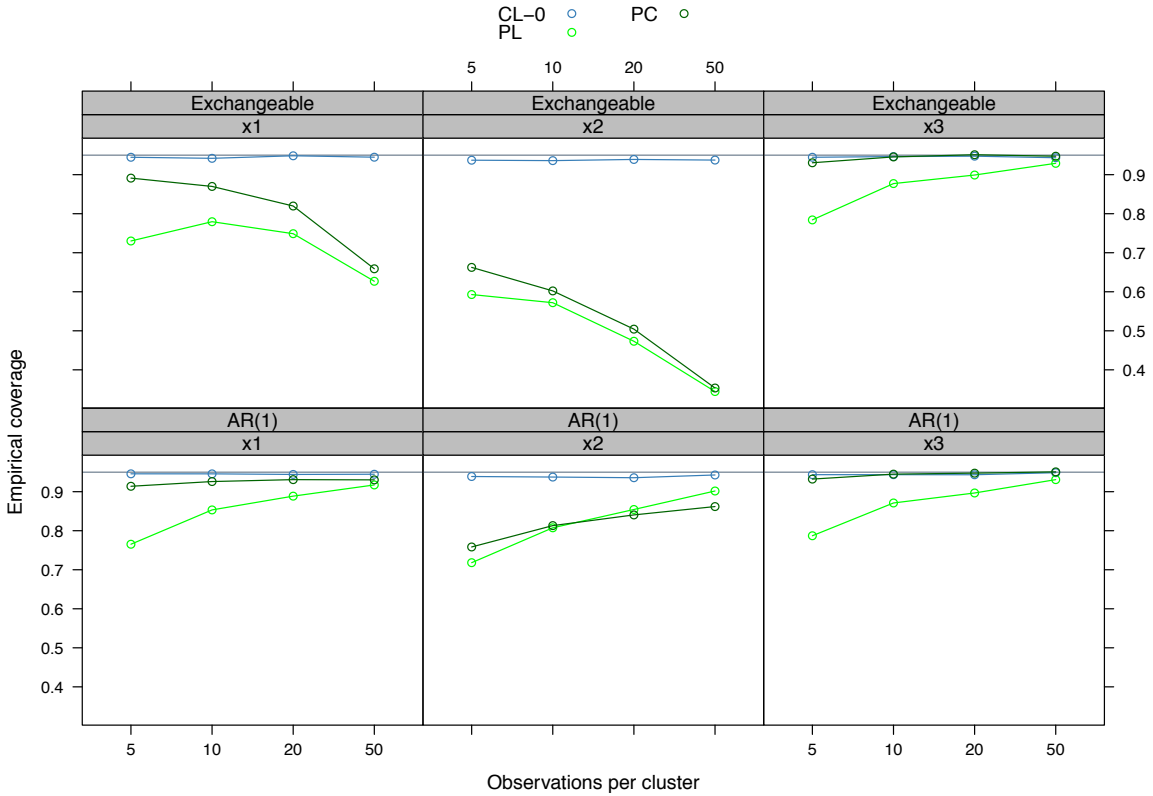

Figure 5: Supplementary simulation experiment. Gaussian response with $G = 100$ (balanced) clusters of 5, 10, 20, or 50 observations each. Regressor `x1` is correlated ($\rho_x = 0.25$), `x2` clustered, and `x3` uncorrelated. Either an exchangeable cluster correlation of $\rho = 0.25$ or an exponentially decaying AR(1) correlation structure with autoregressive coefficient $\rho = 0.25$ is used. The coverage (from 10,000 replications) is plotted on the y-axis against the number of observations per cluster on the x-axis. The horizontal reference line indicates the nominal coverage of 0.95.
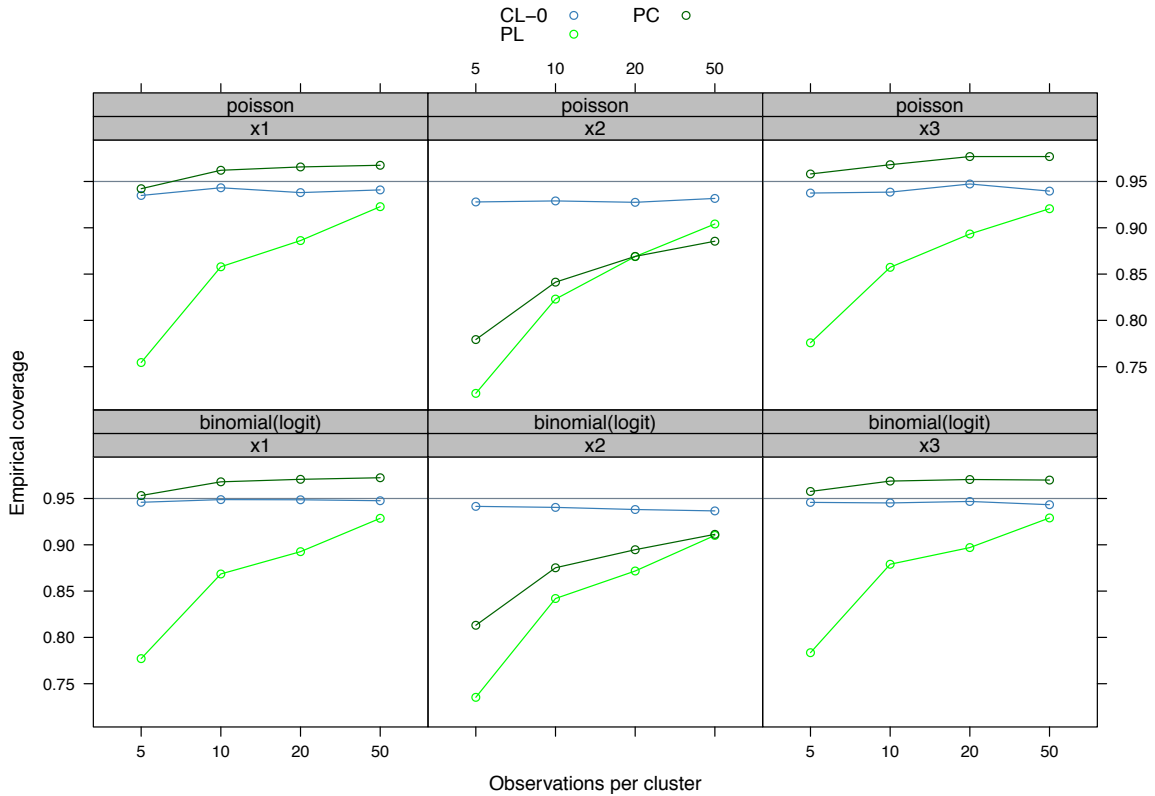
Figure 6: Supplementary simulation experiment. Poisson and binomial response with $G = 100$ (balanced) clusters of 5, 10, 20, or 50 observations each. Regressor x1 is correlated ($\rho_x = 0.25$), x2 clustered, and x3 uncorrelated. An exponentially decaying AR(1) correlation structure with autoregressive coefficient $\rho = 0.25$ is used. The coverage (from 10,000 replications) is plotted on the y-axis against the number of observations per cluster on the x-axis. The horizontal reference line indicates the nominal coverage of 0.95.

(i.e., the number of observations per cluster increases) and the correlation structure is AR(1). However, in case of an exchangeable correlation structure and correlated/clustered regressors, the coverage even decreases for longer panels. The reason for this is that the panel covariance estimators are based on the assumption that correlations are dying out, which is the case for an AR(1) structure, but not for an exchangeable correlation structure.

Additionally, Figure 6 brings out that the AR(1) findings are not limited to the Gaussian case but can be confirmed for binomial and Poisson GLMs as well.

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Various Versatile Variances: An Object-Oriented Implementation of Clustered Covariances in R

Abstract

Clustered covariances or clustered standard errors are very widely used to account for correlated or clustered data, especially in economics, political sciences, or other social sciences. They are employed to adjust the inference following estimation of a standard least-squares regression or generalized linear model estimated by maximum likelihood. Although many publications just refer to "the" clustered standard errors, there is a surprisingly wide variety of clustered covariances, particularly due to different flavors of bias corrections. Furthermore, while the linear regression model is certainly the most important application case, the same strategies can be employed in more general models (e.g. for zero-inflated, censored, or limited responses).

In R, functions for covariances in clustered or panel models have been somewhat scattered or available only for certain modeling functions, notably the (generalized) linear regression model. In contrast, an object-oriented approach to "robust" covariance matrix estimation – applicable beyond `lm()` and `glm()` – is available in the **sandwich** package but has been limited to the case of cross-section or time series data. Now, this shortcoming has been corrected in **sandwich** (starting from version 2.4.0): Based on methods for two generic functions (`estfun()` and `bread()`), clustered and panel covariances are now provided in `vcovCL()`, `vcovPL()`, and `vcovPC()`. These are directly applicable to models from many packages, e.g., including **MASS**, **pscl**, **countreg**, **betareg**, among others. Some empirical illustrations are provided as well as an assessment of the methods' performance in a simulation study.