Abstract: This study addresses a fundamental, yet overlooked, gap between the standard theory and empirical practices in the OLS regression $y = X\beta + u$. To fill it, introducing a new concept “accommodation”, this paper formulates a novel conceptual framework for developing our own model selection process in empirical modelling for given $(y, X)$ with collinearity in $X$. With no use of $y$, the new process enables us to find a class of effective and collinearity-resilient models. In fact, it directly controls not only the sampling variance of each OLSE, which includes Variance Inflation Factor, but also the individual power property of each t-test on regression coefficient, which includes what we call “Power Deflation Factor” as a collinearity factor. This framework will give an ordering on the set of all the sub-models in terms of efficiency and collinearity. And to materialize our model selection process, two computational algorithms are proposed.

Consequently, it will provide an advance model-screening process and serve as an empirical platform for pre-selecting a class of effective models that well accommodate $y$ with both collinearity and inefficiency controlled in advance. In such a class of models, we can freely use such statistical measures and procedures with use of $y$ as OLS estimation, $t$-value, coefficient of determination, stepwise model selection, etc.

It is shown that in terms of predictive sampling variance of the $k$-th OLSE, the lower bound attains if and only if the mean of the explanatory vector $x_k$ is 0 and $x_i'x_k = 0$ ($j\neq k$). Also without using $y$, two algorithms for finding models with collinearity controlled are proposed, so that frequently used model selection procedures can be effectively used. However, in Kariya, Kurata and Hayashi (2022, JFSSA conference) since $t$-statistics are shown to be correlated, the stepwise model selection procedures are ineffective as they stand.

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