

# Revisiting the Synthetic Control Estimator\*

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## Abstract

We analyze the conditions under which the Synthetic Control (SC) estimator is unbiased. We show that the SC estimator is generally biased if treatment assignment is correlated with time-varying unobserved confounders, even when the number of pre-treatment periods goes to infinity and in settings where one should expect to have an almost perfect pre-treatment fit. While we also show that a modified version of the SC method can substantially improve relative to standard methods, our results suggest that researchers should be more careful in interpreting the identification assumptions required for this method.

**Keywords:** synthetic control; difference-in-differences; policy evaluation; linear factor model

**JEL Codes:** C13; C21; C23

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# 1 Introduction

In a series of influential papers, [Abadie and Gardeazabal \(2003\)](#), [Abadie et al. \(2010\)](#), and [Abadie et al. \(2015\)](#) proposed the Synthetic Control (SC) method as an alternative to estimate treatment effects in comparative case studies when there is only one treated unit. The main idea of the SC method is to use the pre-treatment periods to estimate weights such that a weighted average of the control units reconstructs the pre-treatment outcomes of the treated unit, and then use these weights to compute the counterfactual of the treated unit in case it were not treated. According to [Athey and Imbens \(2017\)](#), “*the simplicity of the idea, and the obvious improvement over the standard methods, have made this a widely used method in the short period of time since its inception*”, making it “*arguably the most important innovation in the policy evaluation literature in the last 15 years*”. As one of the main advantages of the method, [Abadie et al. \(2010\)](#) derive conditions under which the SC estimator would allow for confounding unobserved characteristics with effects that vary with time, as long as we can fit a long set of pre-intervention periods.<sup>1</sup>

In this paper, we analyze the conditions under which the SC estimator is unbiased in a linear factor model setting. In a model with “stationary” common factors, we show that the SC weights converge in probability to weights that do *not*, in general, reconstruct the factor loadings of the treated unit when the number of pre-treatment periods ( $T_0$ ) goes to infinity.<sup>2,3</sup> This happens because the SC weights converge to weights that simultaneously attempt to match the factor loadings of the treated unit *and* to minimize the variance of a linear combination of the transitory shocks. Therefore, weights that reconstruct the factor loadings of the treated unit will not generally be the solution to this problem, even if such weights exist. While, as argued in [Doudchenko and Imbens \(2016\)](#), in many SC applications  $T_0$  may not be large enough to justify large- $T_0$  asymptotics, our results should be interpreted as the SC weights not converging to weights that reconstruct the factor loadings of the treated unit *even when  $T_0$  is large*. We also show that the SC weights are biased estimators for weights that reconstruct the factor loadings of the treated unit when  $T_0$  is finite. Moreover, based on our Monte Carlo (MC) simulation results, the SC weights should be, on average, even farther from weights that reconstruct the factor loadings of the treated unit when  $T_0$  is small.

As a consequence, the SC estimator is, in general, biased if treatment assignment is correlated with the unobserved heterogeneity, even when the number of pre-treatment periods goes to infinity.<sup>4</sup> The intuition is

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<sup>1</sup>[Abadie et al. \(2010\)](#) derive this result based on a linear factor model for the potential outcomes. However, they point out that the SC estimator can be useful in more general contexts.

<sup>2</sup>We refer to “stationary” in quotation marks because we only need the assumption that pre-treatment averages of the first and second moments of the common factors converge when the number of pre-treatment periods goes to infinity for this result.

<sup>3</sup>We focus on the SC specification that uses all pre-treatment periods as economic predictors. [Ferman et al. \(2017\)](#) provide conditions under which the SC estimator using this specification is asymptotically equivalent to SC estimators using alternative specifications such that the number of pre-treatment periods used as predictors goes to infinity with  $T_0$ . We also consider the case of the average of the pre-treatment periods and the average of the pre-treatment periods plus other covariates as predictors in [Appendix A.5](#).

<sup>4</sup>We define the asymptotic bias as the difference between the expected value of the asymptotic distribution and the parameter

the following: if the fact that unit 1 was treated after period  $T_0$  is informative about the common factors, then we would need a SC unit that was affected in exactly the same way by these common factors as the treated unit, but did not receive the treatment. This would be attained with weights that reconstruct the factor loadings of the treated units. However, the fact that the SC weights do not converge, in general, to weights that reconstruct the factor loadings of the treated unit implies that the distribution of the SC estimator will still depend on the common factors, implying in a biased estimator when selection depends on the unobserved heterogeneity.<sup>5</sup> These results do not rely on the fact the SC unit is constrained to convex combinations of control units, which implies that they also apply to the panel data approach suggested in [Hsiao et al. \(2012\)](#).

One important implication of the SC restriction to convex combinations of the control units is that the SC estimator may be biased even if treatment assignment is only correlated with time-invariant unobserved variables, which is essentially the identification assumption of the difference-in-differences (DID) model. We therefore recommend a slight modification in the SC method where we demean the data using information from the pre-intervention period, and then construct the SC estimator using the demeaned data.<sup>6</sup> If selection into treatment is only correlated with time-invariant common factors, then this demeaned SC estimator is unbiased. Assuming further that time-varying common factors are stationary, we also guarantee that this demeaned SC estimator is asymptotically more efficient than DID. If selection into treatment is correlated with time-varying common factors, then both the demeaned SC and the DID estimators would be asymptotically biased. We show that the asymptotic bias of the demeaned SC estimator is lower than the bias of DID for a particular class of linear factor models.<sup>7</sup> Overall, while we show that the SC method is, in general, asymptotically biased if treatment assignment is correlated with time-varying confounders, it can still provide important improvement over DID, even if a close-to-perfect pre-treatment match is not achieved. Our results from Monte Carlo (MC) simulations suggest that such improvement can be attained even when a perfect pre-treatment match is not attained and/or  $T_0$  is small.<sup>8</sup>

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of interest. We show in Appendix [A.4](#) that, in this “stationary” setting, the limit of the expected value converges to the expected value of the asymptotic distribution of the SC estimator.

<sup>5</sup>[Ando and Sävje \(2013\)](#) point out that the SC estimator can be biased if the weights do not reconstruct the factor loadings of the treated unit. They argue that this may be the case if there is no set of weights that reconstructs the factor loadings of the treated unit with a weighted average of the factor loadings of the control units. However, they do not analyze in detail the minimization problem that is used to estimate the SC weights. In contrast, we show that this minimization problem inherently leads to weights that do not reconstruct the factor loadings of the treated unit, *even if such weights exist*. Moreover, we show that this potential problem persists even when the number of pre-treatment periods is large.

<sup>6</sup>Demeaning the data before applying the SC estimator is equivalent to a generalization of the SC method suggested in [Doudchenko and Imbens \(2016\)](#) which includes an intercept parameter in the minimization problem to estimate the SC weights.

<sup>7</sup>This result is only valid for a particular set of linear factor models. Outside this set of linear factor models, we provide a very specific example in which the asymptotic bias of the SC can be larger. This might happen when selection into treatment depends on common factors with low variance and a simple average of the control units provides a good approximation for the factor loadings associated with these common factors.

<sup>8</sup>We also provide in Appendix [A.5.4](#) an instrumental variables estimator for the SC weights that generates an asymptotically unbiased SC estimator under additional assumptions on the error structure, which would be valid if, for example, the idiosyncratic error is serially uncorrelated *and* all the common factors are serially correlated.

Note that our results for models with “stationary” common factors are not as conflicting with the results in [Abadie et al. \(2010\)](#) as it might appear at first glance. The asymptotic bias of the SC estimator, in this case, goes to zero when the variance of the transitory shocks is small, in which case one should expect to have a close-to-perfect pre-treatment match and, therefore, [Abadie et al. \(2010\)](#) would recommend using the SC method.<sup>9</sup> When a subset of the common factors is non-stationary, however, we show that the asymptotic bias may not go to zero even in situations where one would expect a close-to-perfect pre-treatment fit. In a model with a combination of  $I(1)$  common factors and/or deterministic polynomial trends in addition to  $I(0)$  common factors, we show that the demeaned SC weights will converge to weights that reconstruct the factor loadings associated to the non-stationary common trends of the treated unit, but that will generally fail to reconstruct the factor loadings associated with the  $I(0)$  common factors.<sup>10</sup> Therefore, in this setting, non-stationary common trends will not generate asymptotic bias in the demeaned SC estimator, but we need that treatment assignment is uncorrelated with the  $I(0)$  common factors to guarantee asymptotic unbiasedness.<sup>11</sup> Importantly, this result shows that, when a subset of the common factors is non-stationary, a close-to-perfect pre-treatment match for a long set of pre-intervention periods does not guarantee that the asymptotic bias of the SC estimator is close to zero. Therefore, we recommend that researchers applying the SC method should also assess the pre-treatment fit of the SC estimator after de-trending the data.<sup>12</sup> We show that prominent SC applications that display a seemingly perfect pre-treatment fit in the original data does not provide such a perfect pre-treatment fit once the data is de-trended.

Our paper is related to a recent literature that analyzes the asymptotic properties of the SC estimator and of generalizations of the method. [Gobillon and Magnac \(2016\)](#) derive conditions under which the assumption

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<sup>9</sup>An important caveat is that the placebo test suggested in [Abadie et al. \(2010\)](#) may lead to over-rejection even when the variance of the transitory shocks is close to zero. In this case, the SC weights will closely reconstruct the factor loadings of the treated unit, which implies that the asymptotic bias will be close to zero. However, the variance of the SC estimator, which depends on a linear combination of the transitory shocks, will also be close to zero. Therefore, even a small bias may lead to over-rejection under the null in this setting. See [Ferman and Pinto \(2017\)](#) for details.

<sup>10</sup>We assume the existence of weights that perfectly reconstructs the factor loadings of the treated unit associated with the non-stationary trends. In a setting with  $\mathcal{I}(1)$  common factors, this is equivalent to assume that the vector of outcomes is cointegrated. If there were no set of weights that satisfies this condition, then the asymptotic distribution of the SC estimator would depend on the non-stationary common trends, so the SC estimator would be biased if treatment assignment is informative about such common trends. In a related paper, [Carvalho et al. \(2016\)](#) consider hypothesis testing in counterfactual analysis when data is integrated, and show that inference based on t-statistics would lead to over-rejection in the absence of a cointegration relation (they consider asymptotic results when both the number of pre and post periods goes to infinity). However, they impose an assumption such that, in a linear factor model for potential outcomes as we consider, excludes the possibility that treatment assignment is informative about common factors, so the SC estimator would be unbiased by assumption (see footnote 15 for details). In contrast, we focus on understanding conditions under which the SC estimator is unbiased exactly when treatment assignment is allowed to be informative about common factors.

<sup>11</sup>While the original SC weights (without demeaning) also converge to weights that reconstruct the factor loadings of the treated unit associated with the non-stationary common trends, they will not converge fast enough to compensate the fact that these common factors explode when  $T_0 \rightarrow \infty$ . As a consequence, the asymptotic distribution of the original SC estimator will still depend on these common factors. In contrast, the demeaned SC weights converge in probability fast enough to avoid this problem, providing another reason to demean the data before applying the SC method.

<sup>12</sup>Note that our results do not imply that one should not use the SC method when the data is non-stationary. On the contrary, we show that the SC method is very efficient in dealing with non-stationary trends. The only caveat is that measures of pre-intervention fit could be misleading as diagnostic tests, as they may hide important discrepancies in the factor loadings associated to stationary common factors beyond these non-stationary trends. Given that, we recommend alternative diagnostic tests. Another possibility would be to apply the SC method on a transformation of the data that makes it stationary.

of perfect match in [Abadie et al. \(2010\)](#) can be satisfied when both the number of pre-treatment periods *and* the number of control units go to infinity.<sup>13</sup> [Xu \(2017\)](#) proposes an alternative to the SC method in which in a first step he estimates the factor loadings, and then in a second step he constructs the SC unit to match the estimated factor loadings of the treated unit. This method also requires a large number of both control units and pre-treatment units, so that the factor loadings are consistently estimated. Differently from [Gobillon and Magnac \(2016\)](#) and [Xu \(2017\)](#), we consider the case with a finite number of control units and let the number of pre-intervention periods go to infinity. We show that, in this case, the SC estimator can be asymptotically biased when  $T_0 \rightarrow \infty$  even when the pre-treatment fit is almost perfect.<sup>14</sup> [Carvalho et al. \(2015\)](#) and [Carvalho et al. \(2016\)](#) also propose an alternative method that is related to the SC estimator, and derive conditions under which their estimator yields a consistent estimator. However, in a linear factor model as the one we consider, their assumptions would essentially exclude the possibility that treatment assignment is correlated with the unobserved heterogeneity.<sup>15</sup> Finally, building on the results from our paper, [Powell \(2017\)](#) proposes a 2-step estimation in which the SC unit is constructed based on the fitted values of the outcomes on unit-specific time trends. Note, however, that we also show that the demeaned SC method is already very efficient in controlling for polynomial time trends, so the possibility of asymptotic bias in the SC estimator would come from correlation between treatment assignment and common factors beyond such time trends, which would not generally be captured in the strategy proposed in [Powell \(2017\)](#).<sup>16</sup>

The remainder of this paper proceeds as follows. We start [Section 2](#) with a brief review of the SC estimator. We highlight in this section that we rely on different assumptions and consider different asymptotics than [Abadie et al. \(2010\)](#). In [Section 3](#), we show that, in a model such that the first and second moments of the common factors converge, the SC estimator is, in general, asymptotically biased. In [Section 4](#), we contrast the SC estimator with the DID estimator, and propose the demeaned SC estimator. In [Section 5](#), we consider a setting in which pre-treatment averages of the common factor diverge, and we show that, in

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<sup>13</sup>They require that the matching variables (factor loadings and exogenous covariates) of the treated units belong to the support of the matching variables of control units. In this case, the SC estimator would be equivalent to the interactive effect methods they recommend.

<sup>14</sup>[Wong \(2015\)](#) considers the asymptotic properties of the SC estimator when  $T_0$  goes to infinity while holding the number of control units constant in a stationary setting. He argues that the SC estimator would be asymptotically unbiased. However, the conditions we find such that the SC estimator is asymptotically biased also lead to an asymptotically biased estimator in his settings (details available upon request).

<sup>15</sup>Their main assumption is that the outcomes of the control units are independent of treatment assignment. However, in our setting, if we assume that transitory shocks are uncorrelated with the treatment assignment, then the potential outcomes of the treated unit being correlated with treatment assignment implies that treatment assignment is correlated with the common factors. If this is the case, then it cannot be that the outcomes of the control units are independent of the treatment assignment. In an extension, [Carvalho et al. \(2015\)](#) consider the case in which the intervention also affects the control units. They model that as a structural change in the common factors after the treatment, in which case they find that their estimator would be biased. Note, however, that they do not treat such change in the common factors as selection on unobservables. Instead, they consider this as a case in which the intervention *affects* all units.

<sup>16</sup>In fact, the 2-step procedure proposed in [Powell \(2017\)](#) can exacerbate the bias of the SC estimator if there is a correlation between treatment assignment and stationary common factors. For example, consider the case in which the variance of the transitory shocks is close to zero, so that the bias of the demeaned SC estimator is also close to zero. Since the procedure proposed in [Powell \(2017\)](#) essentially discards all variation beyond the time trends, it will generally fail to provide weights that match the factor loadings of these stationary common factors, leading to a biased estimator.

this case, the SC estimator can be asymptotically biased even if we have a close-to-perfect pre-treatment match. We revisit the applications in [Abadie and Gardeazabal \(2003\)](#), [Abadie et al. \(2010\)](#), and [Abadie et al. \(2015\)](#) in light of these results. In [Section 6](#), we present a particular class of linear factor models in which we consider the asymptotic properties of the SC estimator and Monte Carlo simulations with finite  $T_0$ . We conclude in [Section 7](#).

## 2 Base Model

Suppose we have a balanced panel of  $J + 1$  units indexed by  $i$  observed on  $t = 1, \dots, T$  periods. We want to estimate the treatment effect of a policy change that affected only unit  $j = 1$  from period  $T_0 + 1 \leq T$  to  $T$ . The potential outcomes are given by:

$$\begin{cases} y_{it}(0) = \delta_t + \lambda_t \mu_i + \varepsilon_{it} \\ y_{it}(1) = \alpha_{it} + y_{it}(0) \end{cases} \quad (1)$$

where  $\delta_t$  is an unknown common factor with constant factor loadings across units,  $\lambda_t$  is a  $(1 \times F)$  vector of common factors,  $\mu_i$  is a  $(F \times 1)$  vector of unknown factor loadings, and the error terms  $\varepsilon_{it}$  are unobserved transitory shocks. We only observe  $y_{it} = d_{it}y_{it}(1) + (1 - d_{it})y_{it}(0)$ , where  $d_{it} = 1$  if unit  $i$  is treated at time  $t$ . Since we hold the number of units  $(J + 1)$  fixed and look at asymptotics when the number of pre-treatment periods goes to infinity, we treat the vector of unknown factor loads  $(\mu_i)$  as fixed and the common factors  $(\lambda_t)$  as random variables. In order to simplify the exposition of our main results, we consider the model without observed covariates  $Z_i$ . In [Appendix Section A.5.2](#) we consider the model with covariates.

An important feature of our setting is that the SC estimator is only well defined if it actually happened that one unit received treatment in a given period. We define  $D(j, T_0)$  as a dummy variable equal to 1 if unit  $j$  is treated after  $T_0$  while all other units do not receive treatment.<sup>17</sup> [Assumption 1](#) makes it clear that the sample a researcher observes when considering the SC estimator is always conditional on the fact that one unit was treated in a given period. Without loss of generality, we consider that unit 1 is treated.

**Assumption 1 (conditional sample)** We observe a realization of  $\{y_{1t}, \dots, y_{J+1,t}\}$  for  $t = 1, \dots, T$  conditional on  $D(1, T_0) = 1$ .

We also impose that the treatment assignment is not informative about the first moment of the transitory shocks.

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<sup>17</sup>That is, one can think of  $D(j, T_0)$  as a product between two indicator variables, one for the event that the treated unit is unit  $j$ , and the other one that the treatment starts after  $T_0$ .

**Assumption 2 (transitory shocks)**  $\mathbb{E}[\varepsilon_{jt}|D(1, T_0)] = \mathbb{E}[\varepsilon_{jt}] = 0$

Assumption 2 implies that transitory shocks are mean-independent from the treatment assignment. However, we still allow for the possibility that the treatment assignment to unit 1 is correlated with the unobserved common factors. More specifically, we allow for  $\mathbb{E}[\lambda_t|D(1, T_0)] \neq \mathbb{E}[\lambda_t]$ . To better understand the implications of this possibility, suppose that the treatment is more likely to happen in unit  $j$  at time  $t$  if  $\lambda_t\mu_j$  is high, and let  $\lambda_t^1$  be a common factor that strongly affects unit 1.<sup>18</sup> Under these conditions, the fact that unit 1 is treated after  $T_0$  is informative about the common factor  $\lambda_t^1$ , because one should expect  $\mathbb{E}[\lambda_t^1|D(1, T_0) = 1] > \mathbb{E}[\lambda_t^1]$ . Note that we allow for dependence between treatment assignment and common factors both before and after the start of the treatment. So we can consider, for example, a case in which treatment is triggered in unit 1 by a sequence of positive shocks on  $\lambda_t\mu_1$  even before  $T_0$ .

In order to present the main intuition of the SC estimator, we assume that there exists a stable linear combination of the control units that absorbs all time correlated shocks of unit 1,  $\lambda_t\mu_1$ . Note, however, that this assumption is not necessary for any of our main results. Following the original SC papers, we restrict to convex combinations of the control units. We relax these constraints in Section 4.

**Assumption 3 (existence of weights)**

$$\exists \mathbf{w}^* \in \mathbb{R}^J \mid \mu_1 = \sum_{j \neq 1} w_j^* \mu_j, \sum_{j \neq 1} w_j^* = 1, \text{ and } w_j^* \geq 0$$

There is no guarantee that there is only one set of weights that satisfies Assumption 3, so we define  $\Phi = \{\mathbf{w} \in \mathbb{R}^J \mid \mu_1 = \sum_{j \neq 1} w_j \mu_j, \sum_{j \neq 1} w_j = 1, \text{ and } w_j \geq 0\}$  as the set of weights that satisfy this condition. For all our main results, it may be that assumption 3 does not hold, which implies  $\Phi = \emptyset$ .

If we knew  $\mathbf{w}^* \in \Phi$ , then we could consider an infeasible SC estimator using these weights,  $\hat{\alpha}_{1t}^* = y_{1t} - \sum_{j \neq 1} w_j^* y_{jt}$ . For a given  $t > T_0$ , we would have that:

$$\hat{\alpha}_{1t}^* = y_{1t} - \sum_{j \neq 1} w_j^* y_{jt} = \alpha_{1t} + \left( \varepsilon_{1t} - \sum_{j \neq 1} w_j^* \varepsilon_{jt} \right) \quad (2)$$

Therefore, under Assumption 2, we have that  $\mathbb{E}[\hat{\alpha}_{1t}^*|D(1, T_0) = 1] = \alpha_{1t}$ , which implies that this infeasible SC estimator is unbiased. Note that we have to consider the expected value of  $\hat{\alpha}_{1t}^*$  conditional on  $D(1, T_0) = 1$ , since we only observe a conditional sample (Assumption 1). Intuitively, the infeasible SC estimator constructs a SC unit for the counterfactual of  $y_{1t}$  that is affected in the same way as unit 1 by each of the common factors (that is,  $\mu_1 = \sum_{j \neq 1} w_j^* \mu_j$ ), but did not receive treatment. Therefore, the only difference between

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<sup>18</sup>That is, the factor loading of unit 1 associated with this common factor,  $\mu_1^1$ , is large.

unit 1 and this SC unit, beyond the treatment effect, would be given by the transitory shocks, which we assumed are not related to the treatment assignment. This guarantees that a SC estimator, using these infeasible weights, provides an unbiased estimator.

It is important to note that [Abadie et al. \(2010\)](#) do not make any assumption on the existence of weights that reconstruct the factor loadings of the treated unit. Instead, they consider that there is a set of weights that satisfies  $y_{1t} = \sum_{j \neq 1} w_j^* y_{jt}$  for all  $t \leq T_0$ . While subtle, this reflects a crucial difference between our setting and the setting considered in the original SC papers. [Abadie et al. \(2010\)](#) and [Abadie et al. \(2015\)](#) consider the properties of the SC estimator conditional on having a good pre-intervention fit. As stated in [Abadie et al. \(2015\)](#), they “do not recommend using this method when the pretreatment fit is poor or the number of pretreatment periods is small”. [Abadie et al. \(2010\)](#) provide conditions under which  $y_{1t} = \sum_{j \neq 1} w_j^* y_{jt}$  for all  $t \leq T_0$  (for large  $T_0$ ) implies that Assumption 3 holds approximately. In this case, the bias of the SC estimator would be bounded by a function that goes to zero when  $T_0$  increases. We depart from the original SC setting in that we do not condition on having a perfect pre-intervention fit. The motivation to analyze the SC method in our setting is that, even if Assumption 3 is valid, in a model with only “stationary” factors the probability that we find a perfect pre-intervention fit goes to zero when  $T_0$  increases, unless the variance of the transitory shocks is equal to zero. Still, we show that the SC method can provide important improvement over the DID estimator even if the pre-intervention fit is imperfect. Moreover, we also show in Section 5 that, if a subset of the common factors is non-stationary, then the SC estimator may be asymptotically biased even if the pre-treatment fit is almost perfect.

In order to implement their method, [Abadie et al. \(2010\)](#) recommend a minimization problem using the pre-intervention data to estimate the SC weights. They define a set of  $K$  predictors where  $X_1$  is a  $(K \times 1)$  vector containing the predictors for the treated unit and  $X_0$  is a  $(K \times J)$  matrix of economic predictors for the control units.<sup>19</sup> The SC weights are estimated by minimizing  $\|X_1 - X_0 \mathbf{w}\|_V$  subject to  $\sum_{i=2}^{J+1} w_j = 1$  and  $w_j \geq 0$ , where  $V$  is a  $(K \times K)$  positive semidefinite matrix. They discuss different possibilities for choosing the matrix  $V$ , including an iterative process where  $V$  is chosen such that the solution to the  $\|X_1 - X_0 \mathbf{w}\|_V$  optimization problem minimizes the pre-intervention prediction error. In other words, let  $\mathbf{Y}_1^P$  be a  $(T_0 \times 1)$  vector of pre-intervention outcomes for the treated unit, while  $\mathbf{Y}_0^P$  be a  $(T_0 \times J)$  matrix of pre-intervention outcomes for the control units. Then the SC weights would be chosen as  $\hat{\mathbf{w}}(V^*)$  such that  $V^*$  minimizes  $\|\mathbf{Y}_1^P - \mathbf{Y}_0^P \hat{\mathbf{w}}(V)\|$ .

We focus on the case where one includes all pre-intervention outcome values as economic predictors. In this case, the matrix  $V$  that minimizes the second step of the nested optimization problem would be the

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<sup>19</sup>Predictors can be, for example, linear combinations of the pre-intervention values of the outcome variable or other covariates not affected by the treatment.



identity matrix (see [Kaul et al. \(2015\)](#) and [Doudchenko and Imbens \(2016\)](#)), so the optimization problem suggested by [Abadie et al. \(2010\)](#) to estimate the weights simplifies to:

$$\hat{\mathbf{w}} = \underset{\mathbf{w} \in W}{\operatorname{argmin}} \frac{1}{T_0} \sum_{t=1}^{T_0} \left[ y_{1t} - \sum_{j \neq 1} w_j y_{jt} \right]^2 \quad (3)$$

where  $W = \{\hat{\mathbf{w}} \in \mathbb{R}^J | w_j \geq 0 \text{ and } \sum_{j \neq 1} w_j = 1\}$ .

[Ferman et al. \(2017\)](#) provide conditions under which the SC estimator using all pre-treatment outcomes as predictors will be asymptotically equivalent when  $T_0 \rightarrow \infty$  to any alternative SC estimator such that the number of pre-treatment outcomes used as predictors goes to infinity with  $T_0$ .<sup>20</sup> Therefore, our results are also valid for these SC specifications under these conditions. In [Appendix A.5](#) we also consider SC estimators using (1) the average of the pre-intervention outcomes as predictor, and (2) other time-invariant covariates in addition to the average of the pre-intervention outcomes as predictors.

### 3 Asymptotic Bias with “stationary” common factors

We start assuming that pre-treatment averages of the first and second moments of the common factors and the transitory shocks converge. Let  $\epsilon_t = (\epsilon_{1t}, \dots, \epsilon_{J+1,t})$ .

**Assumption 4 (convergence of pre-treatment averages)**  $\frac{1}{T_0} \sum_{t=1}^{T_0} \lambda_t \xrightarrow{p} \omega_0$ ,  $\frac{1}{T_0} \sum_{t=1}^{T_0} \epsilon_t \xrightarrow{p} 0$ ,  $\frac{1}{T_0} \sum_{t=1}^{T_0} \lambda_t' \lambda_t \xrightarrow{p} \Omega_0$  positive semi-definite,  $\frac{1}{T_0} \sum_{t=1}^{T_0} \epsilon_t \epsilon_t' \xrightarrow{p} \sigma_\epsilon^2 I_{J+1}$ , and  $\frac{1}{T_0} \sum_{t=1}^{T_0} \epsilon_t \lambda_t \xrightarrow{p} 0$ .

We make the assumption  $\frac{1}{T_0} \sum_{t=1}^{T_0} \epsilon_t \epsilon_t' \xrightarrow{p} \sigma_\epsilon^2 I_{J+1}$  in order to simplify the exposition of our results. However, this assumption can be easily replaced by  $\frac{1}{T_0} \sum_{t=1}^{T_0} \epsilon_t \epsilon_t' \xrightarrow{p} \Sigma$  for any positive definite  $(J+1) \times (J+1)$  matrix  $\Sigma$ . Note that [assumption 4](#) would be satisfied if the processes  $\epsilon_t$  and  $\lambda_t$  are weakly stationary and second order ergodic in the pre-treatment period conditional on  $D(1, T_0) = 1$ , and  $\epsilon_t$  and  $\lambda_t$  are independent. However, such assumption would be too restrictive and would not allow for important possibilities in the treatment selection process. Recall that [assumption 2](#) allows for  $\mathbb{E}[\lambda_t | D(1, T_0)] \neq \mathbb{E}[\lambda_t]$ , even for  $t < T_0$ , which will happen if treatment assignment to unit 1 is correlated with common factors before  $T_0$ . In this case, it would be too restrictive to impose the assumption that, conditional on  $D(1, T_0) = 1$ ,  $\lambda_t$  is stationary, even if only for the pre-treatment periods.

We show first the convergence of  $\hat{\mathbf{w}}$ .

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<sup>20</sup>[Ferman et al. \(2017\)](#) show that this will be true if we assume that, for any subsequence  $\{t_k\}_{k \in \mathbb{N}}$  with  $t_k > t_{k-1}$ , pre-treatment averages of second moments of the outcomes converge in probability to the same values.

**Proposition 1** Under assumptions 1, 2 and 4, we have that  $\hat{\mathbf{w}} \xrightarrow{P} \bar{\mathbf{w}}$  where  $\mu_1 \neq \sum_{j \neq 1} \bar{w}_j \mu_j$ , unless  $\sigma_\varepsilon^2 = 0$  or  $\exists \mathbf{w} \in \Phi | \mathbf{w} \in \underset{\mathbf{w} \in W}{\operatorname{argmin}} \left\{ \sum_{j \neq 1} (w_j)^2 \right\}$

**Proof.** Details in Appendix A.1.1 ■

The intuition of Proposition 1 is that we can treat the SC weights as an M-estimator, so we have that  $\hat{\mathbf{w}}$  will converge in probability to  $\bar{\mathbf{w}}$  such that:

$$\bar{\mathbf{w}} = \underset{\mathbf{w} \in W}{\operatorname{argmin}} \left\{ \sigma_\varepsilon^2 \left( 1 + \sum_{j \neq 1} (w_j)^2 \right) + \left( \mu_1 - \sum_{j \neq 1} w_j \mu_j \right)' \Omega_0 \left( \mu_1 - \sum_{j \neq 1} w_j \mu_j \right) \right\} \quad (4)$$

which is the probability limit of the M-estimator objective function (equation 3).

Note that this objective function has two parts. The first one reflects that different choices of weights will generate different weighted averages of the idiosyncratic shocks  $\varepsilon_{it}$ . In this simpler case, if we consider the specification that restricts weights to sum one, then this part would be minimized when we set all weights equal to  $\frac{1}{J}$ .<sup>21</sup> The second part reflects the presence of common factors  $\lambda_t$  that would remain after we choose the weights to construct the SC unit. If assumption 3 is satisfied, then we can set this part equal to zero by choosing  $\mathbf{w}^* \in \Phi$ . Now start from  $\mathbf{w}^* \in \Phi$  and move in the direction of weights that minimize the first part of this expression. Since  $\mathbf{w}^* \in \Phi$  minimizes the second part, there is only a second order loss in doing so. On the contrary, since we are moving in the direction of weights that minimize the first part, there is a first order gain in doing so. This will always be true, unless  $\sigma_\varepsilon^2 = 0$  or  $\exists \mathbf{w} \in \Phi$  such that  $\mathbf{w} \in \underset{\mathbf{w} \in W}{\operatorname{argmin}} \left\{ \sum_{j \neq 1} (w_j)^2 \right\}$ . Therefore, the SC weights will not generally converge to weights that reconstruct the factor loadings of the treated unit. Note that it may be that  $\Phi = \emptyset$ , in which case Proposition 1 trivially holds.

For a given  $t > T_0$ , the SC estimator will be given by:

$$\hat{\alpha}_{1t} = y_{1t} - \sum_{j \neq 1} \hat{w}_j y_{jt} \xrightarrow{d} \alpha_{1t} + \left( \varepsilon_{1t} - \sum_{j \neq 1} \bar{w}_j \varepsilon_{jt} \right) + \lambda_t \left( \mu_1 - \sum_{j \neq 1} \bar{w}_j \mu_j \right) \quad (5)$$

Note that  $\hat{\alpha}_{1t}$  converges in distribution to the parameter we want to estimate ( $\alpha_{1t}$ ) plus linear combinations of contemporaneous transitory shocks and common factors. Therefore, the SC estimator will be asymptotically unbiased if, conditional on the fact that unit 1 was treated in period  $t$ , the expected values of these linear combinations of transitory shocks and common factors are equal to zero.<sup>22</sup> More specifically, we need that  $\mathbb{E}[\varepsilon_{1t} - \sum_{j \neq 1} \bar{w}_j \varepsilon_{jt} | D(1, T_0) = 1] = 0$  and  $\mathbb{E}[\lambda_t (\mu_1 - \sum_{j \neq 1} \bar{w}_j \mu_j) | D(1, T_0) = 1] = 0$ . While

<sup>21</sup>If we do not impose this restriction, then this part would be minimized setting all weights equal to zero, and our main argument would remain valid.

<sup>22</sup>We consider the definition of asymptotic unbiasedness as the expected value of the asymptotic distribution of  $\hat{\alpha}_{1t} - \alpha_{1t}$  equal to zero. An alternative definition is that  $\mathbb{E}[\hat{\alpha}_{1t} - \alpha_{1t}] \rightarrow 0$ . We show in Appendix A.4 that these two definitions are equivalent in this setting under standard assumptions.

the first equality is guaranteed by Assumption 2, the second one may not hold if treatment assignment is correlated with the unobserved heterogeneity.

Since  $\mu_1 \neq \sum_{j \neq 1} \bar{w}_j \mu_j$ , the SC estimator will only be asymptotically unbiased, in general, if we impose an additional assumption that  $E[\lambda_t^k | D(1, T_0) = 1] = 0$  for all common factors  $k$  such that  $\mu_1^k \neq \sum_{j \neq 1} \bar{w}_j \mu_j^k$ . In order to better understand the intuition behind this result, we consider a special case in which, unconditionally,  $\lambda_t$  is stationary and the pre-treatment averages of the conditional process converge in probability to the unconditional expectations.<sup>23</sup> In this case, we can assume, without loss of generality, that  $\omega_0^1 = \mathbb{E}[\lambda_t^1] = 1$  and  $\omega_0^k = \mathbb{E}[\lambda_t^k] = 0$  for  $k > 0$ . Therefore, the SC estimator will only be asymptotically unbiased if the weights turn out to recover unit 1 fixed effect (that is,  $\mu_1^1 = \sum_{j \neq 1} \mu_j^1$ ) and treatment assignment is uncorrelated with time-varying unobserved common factors.

While, as argued in Doudchenko and Imbens (2016), many SC applications does not have a large number of pre-treatment periods to justify large- $T_0$  asymptotics, our results should be interpreted as the SC weights not converging to weights that reconstruct the factor loadings of the treated unit *even when  $T_0$  is large*. In Appendix A.2, we show that, with finite  $T_0$ , the SC weights will be biased estimators for  $\mathbf{w}^*$ . The intuition for this result is that the SC method uses the vector of control outcomes as a proxy for the vector common factors. That is, we can write the potential outcome of the treated unit as a linear combination of the control units using a set of weights  $\mathbf{w}^* \in \Phi$ . However, in this case the control outcomes will be, by construction, correlated with the error in this model. The intuition is that the transitory shocks would behave as a measurement error in these proxy variables, which leads to bias. In Section 6, we show that, in our MC simulations, the SC weights are, on average, even further from weights that reconstruct the factor loadings of the treated unit when  $T_0$  is finite.

It is important to note that the discrepancy of our results with the results from Abadie et al. (2010) arises because we rely on different assumptions. Abadie et al. (2010) consider the properties of the SC estimator conditional on having a perfect fit in the pre-treatment period in the data at hand. They do not consider the asymptotic properties of the SC estimator when  $T_0$  goes to infinity. Instead, they provide conditions under which the SC estimator is bounded by a term that goes to zero when  $T_0$  increases, *if the pre-treatment fit is perfect*. Note that our results are not as conflicting with the results in Abadie et al. (2010) as they may appear at first glance. In a model with “stationary” common factors, the probability that one would actually have a dataset at hand such that the SC weights provide a close-to-perfect pre-intervention fit with a moderate  $T_0$  is close to zero, unless the variance of the transitory shocks is small. Therefore, our results agree with the theoretical results in Abadie et al. (2010) in that the asymptotic bias of the SC estimator should

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<sup>23</sup>This allows for correlation between common factors and treatment assignment prior to  $T_0$ , but limits this dependence in the sense that this dependence becomes irrelevant for the pre-treatment average once we consider a long history before treatment.

be small in situations where one would expect to have a close-to-perfect fit for a large  $T_0$ . An important caveat is that the placebo test suggested in [Abadie et al. \(2010\)](#) may lead to over-rejection even when the variance of the transitory shocks is close to zero. In this case, the asymptotic bias of the SC estimator will be close to zero. However, the variance of the SC estimator, which depends on a linear combination of the transitory shocks, will be close to zero as well. Therefore, even a small bias may lead to over-rejection under the null in this setting (see [Ferman and Pinto \(2017\)](#) for details). Moreover, in [Section 5](#) we show that the SC estimator may remain biased even in settings where one would expect a close-to-perfect pre-treatment fit if we have non-stationary common factors.

In [Appendix A.5](#) we consider alternative specifications used in the SC method to estimate the weights. In particular, we consider the specification that uses the pre-treatment average of the outcome variable as predictor, and the specification that uses the pre-treatment average of the outcome variable and other time-invariant covariates as predictors. In both cases, we show that the objective function used to calculate the weights converge in probability to a function that can, in general, have multiple minima. If  $\Phi$  is non-empty, then  $\mathbf{w} \in \Phi$  will be one solution. However, there might be  $\mathbf{w} \notin \Phi$  that also minimizes this function, so there is no guarantee that the SC weights in these specifications will converge in probability to weights in  $\Phi$ .

## 4 Comparison to DID & alternative SC estimators

Our results from [Session 3](#) show that the SC estimator can be asymptotically biased even in situations where the DID estimator is unbiased. In contrast to the SC estimator, the DID estimator for the treatment effect in a given post-intervention period  $t > T_0$ , under [Assumption 4](#), would be given by:

$$\begin{aligned} \hat{\alpha}_{1t}^{DID} &= y_{1t} - \frac{1}{J} \sum_{j \neq 1} y_{jt} - \frac{1}{T_0} \sum_{\tau=1}^{T_0} \left[ y_{1\tau} - \frac{1}{J} \sum_{j \neq 1} y_{j\tau} \right] \\ &\xrightarrow{d} \alpha_{1t} + \varepsilon_{1t} - \frac{1}{J} \sum_{j \neq 1} \varepsilon_{jt} + (\lambda_t - \omega_0) \left( \mu_1 - \frac{1}{J} \sum_{j \neq 1} \mu_j \right) \end{aligned} \quad (6)$$

Therefore, the DID estimator will be asymptotically unbiased if  $\mathbb{E}[\lambda_t | D(1, T_0) = 1] = \omega_0$ , which means that the fact that unit 1 is treated after period  $T_0$  is not informative about the first moment of the common factors relative to their pre-treatment averages. Intuitively, the unit fixed effects control for any difference in unobserved variables that remain constant (in expectation) before and after the treatment. Moreover, the DID allows for arbitrary correlation between treatment assignment and  $\delta_t$  (which is captured by the time effects). However, the DID estimator will be asymptotically biased if the fact that unit 1 is treated after period  $T_0$  is informative about variations in the common factors relative to their pre-treatment mean.

As an alternative to the standard SC estimator, we suggest a modification in which we calculate the pre-treatment average for all units and demean the data. This is equivalent to a generalization of the SC method suggested in [Doudchenko and Imbens \(2016\)](#) which includes an intercept parameter in the minimization problem to estimate the SC weights. The demeaned SC estimator is given by  $\hat{\alpha}_{1t}^{SC'} = y_{1t} - \sum_{j \neq 1} \hat{w}_j^{SC'} y_{jt} - (\bar{y}_1 - \sum_{j \neq 1} \hat{w}_j^{SC'} \bar{y}_j)$ , where  $\bar{y}_j$  is the pre-treatment average of unit  $j$ , and the weights  $\hat{\mathbf{w}}^{SC'} = \{\hat{w}_j^{SC'}\}_{j=2}^{J+1}$  are given by:

$$\hat{\mathbf{w}}^{SC'} = \underset{\mathbf{w} \in W}{\operatorname{argmin}} \frac{1}{T_0} \sum_{t=1}^{T_0} \left[ y_{1t} - \sum_{j \neq 1} w_j y_{jt} - \left( \bar{y}_1 - \sum_{j \neq 1} w_j \bar{y}_j \right) \right]^2 \quad (7)$$

**Proposition 2** Under assumptions [1](#), [2](#) and [4](#), we have that  $\hat{\mathbf{w}}^{SC'} \xrightarrow{P} \bar{\mathbf{w}}^{SC'}$  where  $\mu_1 \neq \sum_{j \neq 1} \bar{w}_j^{SC'} \mu_j$ , unless  $\sigma_\varepsilon^2 = 0$  or  $\exists \mathbf{w} \in \Phi | \mathbf{w} \in \underset{\mathbf{w} \in W}{\operatorname{argmin}} \left\{ \sum_{j \neq 1} (w_j)^2 \right\}$ . Moreover:

$$\hat{\alpha}_{1t}^{SC'} \xrightarrow{d} \alpha_{1t} + \left( \varepsilon_{1t} - \sum_{j \neq 1} \bar{w}_j^{SC'} \varepsilon_{jt} \right) + (\lambda_t - \omega_0) \left( \mu_1 - \sum_{j \neq 1} \bar{w}_j^{SC'} \mu_j \right) \quad (8)$$

**Proof.**

See details in [Appendix A.1.2](#) ■

Therefore, the demeaned SC estimator is asymptotically unbiased under the same conditions as the DID estimator. Note that, under the DID assumptions, both estimators would be unbiased even for finite  $T_0$ . Under the stronger assumption that the conditional process  $z_t = (\varepsilon_{1t}, \dots, \varepsilon_{J+1,t}, \lambda_t')$  is stationary, we can also assure that the demeaned SC estimator is asymptotically more efficient than DID. Note that stationarity of the conditional process  $\lambda_t$  for  $t = 1, \dots, T$  implies that both the demeaned SC and the DID estimators are unbiased.

**Assumption 4' (stationarity)** The process  $z_t = (\varepsilon_{1t}, \dots, \varepsilon_{J+1,t}, \lambda_t')$ , conditional on  $D(1, T_0) = 1$ , is weakly stationary and second-order ergodic for  $t = 1, \dots, T$ .

**Proposition 3** Under assumptions [1](#), [2](#) and [4'](#), the demeaned SC estimator ( $\hat{\alpha}_{1t}^{SC'}$ ) is more efficient than the DID estimator ( $\hat{\alpha}_{1t}^{DID}$ ).

**Proof.**

See details in [Appendix A.1.3](#) ■

The intuition of this result is the following. For any  $t > T_0$ , we have that:

$$a.var(\hat{\alpha}_{1t}^{SC'} - \alpha_{1t}) = E \left[ \left( \varepsilon_{1t} - \sum_{j \neq 1} \bar{w}_j^{SC'} \varepsilon_{jt} \right) + \tilde{\lambda}_t \left( \tilde{\mu}_1 - \sum_{j \neq 1} \bar{w}_j^{SC'} \tilde{\mu}_j \right) \middle| D(1, T_0) = 1 \right]^2 \quad (9)$$

while:

$$a.var(\hat{\alpha}_{1t}^{DID} - \alpha_{1t}) = E \left[ \left( \varepsilon_{1t} - \sum_{j \neq 1} \frac{1}{J} \varepsilon_{jt} \right) + \tilde{\lambda}_t \left( \tilde{\mu}_1 - \sum_{j \neq 1} \frac{1}{J} \tilde{\mu}_j \right) \middle| D(1, T_0) = 1 \right]^2 \quad (10)$$

where  $\tilde{\lambda}_t$  and  $\tilde{\mu}_j$  exclude the time-invariant common factor if there is one. We show in Appendix [A.1.3](#) that the demeaned SC weights converge to weights that minimize a function  $\Gamma(\mathbf{w})$  such that  $\Gamma(\bar{\mathbf{w}}^{SC'}) = a.var(\hat{\alpha}_{1t}^{SC'} - \alpha_{1t})$  and  $\Gamma(\{\frac{1}{J}, \dots, \frac{1}{J}\}) = a.var(\hat{\alpha}_{1t}^{DID} - \alpha_{1t})$ . Therefore, it must be that the variance of the demeaned SC estimator is weakly lower than the variance of the DID estimator. Notice that this result relies on stationarity of the common factors for both pre- and post-intervention periods. Under assumption [4](#), if we had that  $var(\lambda_t) \neq \Omega_0$  for  $t > T_0$ , then it would not be possible to guarantee that the demeaned SC estimator is more efficient than DID, even if both estimators are asymptotically unbiased.

If treatment assignment is correlated with time-varying common factors, then both the demeaned SC and the DID estimators will be asymptotically biased. In general, it is not possible to rank these two estimators in terms of their bias. We provide in Appendix [A.3](#) an example in which the DID bias can be smaller than the bias of the SC. This might happen when selection into treatment depends on common factors with low variance, and it happens that a simple average of the controls provides a good match for the factor loadings associated with these common factors. We show in Section [6](#) a particular class of linear factor models in which the asymptotic bias of the demeaned SC estimator will always be lower.

In addition to including an intercept, [Doudchenko and Imbens \(2016\)](#) also consider the possibility of relaxing the non-negative and the adding-up constraints in the SC model. We show in Appendix [A.5.3](#) that our main result that the SC estimator will be asymptotically biased if there is selection on time-varying unobservables still apply if we relax these conditions.<sup>24</sup> Notice that the panel data approach suggested in [Hsiao et al. \(2012\)](#) is essentially the same as the SC estimator using all outcome lags as predictors and relaxing the no-intercept, adding-up, and non-negativity constraints. Therefore, our result on asymptotic bias is also valid for the [Hsiao et al. \(2012\)](#) estimator. Note also that relaxing the adding-up constraint implies that the SC estimator may be biased if the time effect  $\delta_t$  is correlated with the treatment assignment.

We also present in Appendix [A.5.4](#) an instrumental variables estimator for the SC weights that generates

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<sup>24</sup>In this case, since we do not constraint the weights to sum 1, we need to adjust assumption [4](#) so that it also includes convergence of the pre-treatment averages of the first and second moments of  $\delta_t$ .

an asymptotically unbiased SC estimator under additional assumptions on the error structure, which would be valid if, for example, the idiosyncratic error is serially uncorrelated and all the common factors are serially correlated. The main idea is that, under these assumptions, one could use the lag outcome of the control units as instrumental variables to estimate parameters that reconstruct the factor loadings of the treated unit.

## 5 Model with “explosive” common factors

We consider now the case in which the first and second moments of a subset of the common factors diverge.

We modify the model to:

$$\begin{cases} y_{it}(0) = \lambda_t \mu_i + \gamma_t \theta_i + \varepsilon_{it} \\ y_{it}(1) = \alpha_{it} + y_{it}(0) \end{cases} \quad (11)$$

where  $\lambda_t$  is a  $(1 \times F_0)$  vector of  $I(0)$  common factors, and  $\gamma_t$  is a  $(1 \times F_1)$  vector of common factors that are  $\mathcal{I}(1)$  and/or polynomial time trends  $t^f$ , while  $\mu_i$  and  $\theta_i$  are the vectors of factor loadings associated with these common factors. Note that the time effect  $\delta_t$  can be either included in vector  $\lambda_t$  or  $\gamma_t$ . We modify assumption 4.

**Assumption 4'' (stochastic processes)** Conditional on  $D(1, T_0) = 1$ , the process  $z_t = (\varepsilon_{1t}, \dots, \varepsilon_{J+1,t}, \lambda_t)$  is  $I(0)$  and weakly stationary with finite fourth moments in the pre-treatment periods, while the components of  $\gamma_t$  are  $I(1)$  and/or polynomial time trends  $t^f$  in the pre-treatment periods.

We also modify assumption 3 to state that there are weights that reconstruct the factor loadings of unit 1 associated with the non-stationary common trends.

**Assumption 3' (existence of weights)**

$$\exists \mathbf{w}^* \in W \mid \theta_1 = \sum_{j \neq 1} w_j^* \theta_j$$

where  $W$  is the set of possible weights given the constraints on the weights the researcher is willing to consider. For example, [Abadie et al. \(2010\)](#) suggest  $W = \{\mathbf{w} \in \mathbb{R}^J \mid \sum_{j \neq 1} w_j^* = 1, \text{ and } w_j^* \geq 0\}$ , while [Hsiao et al. \(2012\)](#) allows for  $W = \mathbb{R}^J$ . Let  $\Phi_1$  be the set of weights in  $W$  that reconstruct the factor loadings of unit 1 associated with the  $I(1)$  common factors. Assumption 3' implies that  $\Phi_1 \neq \emptyset$ .

Note that, in a setting in which  $\gamma_t$  is a vector of  $I(1)$  common factors, assumption 3' implies that the vector of outcomes  $\mathbf{y}_t = (y_{1t}, \dots, y_{J+1,t})'$  is co-integrated. Importantly, differently from our results in Session

3, assumption 3' is key for our results in this section. Note, however, that we do *not* need to assume existence of weights in  $\Phi_1$  that also reconstruct the factor loadings of unit 1 associated with the  $I(0)$  common factors, so it may be that  $\Phi = \emptyset$ , where  $\Phi$  is the set of weights that reconstruct *all* factor loadings.

**Proposition 4** Under assumptions 1, 2, 3', and 4'', we have that:

$$\hat{\alpha}_{1t}^{SC'} \xrightarrow{d} \alpha_{1t} + \left( \varepsilon_{1t} - \sum_{j \neq 1} \bar{w}_j \varepsilon_{jt} \right) + (\lambda_t - \omega_0) \left( \mu_1 - \sum_{j \neq 1} \bar{w}_j \mu_j \right)$$

where  $\mu_1 \neq \sum_{j \neq 1} \bar{w}_j \mu_j$ , unless  $\sigma_\varepsilon^2 = 0$  or  $\exists \mathbf{w} \in \Phi | \mathbf{w} \in \operatorname{argmin}_{\mathbf{w} \in W} \left\{ \sum_{j \neq 1} (w_j)^2 \right\}$

**Proof.**

Details in Appendix A.1.4. ■

Proposition 4 has two important implications. First, if assumption 3' is valid, then the asymptotic distribution of the demeaned SC estimator does not depend on the non-stationary common trends. The intuition of this result is the following. The demeaned SC weights will converge to weights that reconstruct the factor loadings of the treated unit associated with the non-stationary common trends. Interestingly, while  $\hat{\mathbf{w}}$  will generally be only  $\sqrt{T_0}$ -consistent when  $\Phi_1$  is not a singleton, we show that there are linear combinations of  $\hat{\mathbf{w}}$  that will converge at a faster rate, implying that  $\gamma_t(\theta_1 - \sum_{j \neq 1} \hat{w}_j \theta_j) \xrightarrow{p} 0$  despite the fact that  $\gamma_t$  explodes when  $T_0 \rightarrow \infty$ . Therefore, such non-stationary common trends will not lead to asymptotic bias in the SC estimator. Second, the demeaned SC estimator will be biased if there is correlation between treatment assignment and the  $I(0)$  common factors. The intuition is that  $\hat{\mathbf{w}}$  will converge in probability to weights in  $\Phi_1$  that minimize the second moment of the  $I(0)$  process  $u_t = y_{1t} - \sum_{j \neq 1} w_j y_{jt} - a = \lambda_t(\mu_1 - \sum_{j \neq 1} w_j \mu_j) + (\varepsilon_{1t} - \sum_{j \neq 1} w_j \varepsilon_{jt}) - a$ . Following the same arguments as in Proposition 1,  $\hat{\mathbf{w}}$  will not eliminate the  $I(0)$  common factors, unless we have that  $\sigma_\varepsilon^2 = 0$  or it coincides that there is a  $\mathbf{w} \in \Phi$  that also minimizes the linear combination of transitory shocks.

Note that the result that the asymptotic distribution of the SC estimator does not depend on the non-stationary common trends depends crucially on assumption 3'. If there were no linear combination of the control units that reconstruct the factor loadings of the treated unit associated to the non-stationary common trends, then the asymptotic distribution of the SC estimator would depend on these common trends, which might lead to bias in the SC estimator.

The results from Proposition 4 remain valid when we relax the adding-up and/or the non-negativity constraints, with minor variations in the conditions for unbiasedness.<sup>25</sup> However, these results are not valid

<sup>25</sup>Relaxing the adding-up constraint makes the estimator biased if  $\delta_t$  is correlated with treatment assignment and if it is  $I(0)$ . If  $\delta_t$  is  $I(1)$ , then the weights will converge to sum one even when such restriction is not imposed, so this would not



when we consider the no-intercept constraint, as the original SC estimator does. When the intercept is not included, it remains true that  $\widehat{\mathbf{w}} \xrightarrow{p} \bar{\mathbf{w}} \in \Phi_1$ . However, in this case, the weights will not converge fast enough to compensate the fact that  $\gamma_t$  explodes. See an example in Appendix A.6.2. This provides another reason to use the demeaned instead of the original SC estimator.

An important feature of this setting is that, as  $T_0 \rightarrow \infty$ , the pre-treatment fit will become close to perfect, which is the case in which Abadie et al. (2010) recommend that the SC method should be used. As a measure of goodness of pre-treatment fit, we consider a pre-treatment normalized mean squared error index, as suggested in Ferman et al. (2017):

$$\tilde{R}^2 = 1 - \frac{\frac{1}{T_0} \sum_{t=1}^{T_0} (y_{1t} - \widehat{y}_{1t})^2}{\frac{1}{T_0} \sum_{t=1}^{T_0} (y_{1t} - \bar{y}_1)^2} \quad (12)$$

where  $\widehat{y}_{1t}$  is the outcome of the SC unit and  $\bar{y}_1 = \frac{\sum_{t=1}^{T_0} y_{1t}}{T_0}$ . This measure is always lower than one, and it is close to one when the pre-treatment fit is close to perfect.<sup>26</sup> Note that, in this setting with non-stationary common trends, the numerator will converge to the variance of an  $I(0)$  process, while the denominator will diverge as  $T_0 \rightarrow \infty$ . Therefore, in these cases, we show that the SC estimator can be asymptotically biased *even conditional on a close-to-perfect pre-treatment fit*.<sup>27</sup>

Our results show that, in a setting with non-stationary trends, a seemingly perfect pre-treatment fit might hide important possibilities for asymptotic bias in the SC method. While this perfect pre-treatment fit would be indicative that the SC estimator was able to eliminate potential bias coming from correlations between treatment assignment and non-stationary common factors, this would not guarantee unbiasedness if there is a correlation between treatment assignment and common factors beyond such non-stationary trends. Therefore, we recommend that researchers should also present the pre-treatment fit after eliminating non-stationary trends as a diagnosis test for the SC estimator. To illustrate this point, we consider the three influential applications presented in Abadie and Gardeazabal (2003), Abadie et al. (2010) and Abadie et al. (2015). We present in Figure 1.A the per capita GDP time series for the Basque Country and for other Spanish regions, while in Figure 1.B we replicate Figure 1 from Abadie and Gardeazabal (2003), which displays per capita GDP of the Basque Country contrasted with the per capita GDP of a synthetic control

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generate bias. Including or not the non-negative constraint does not alter the conditions for unbiasedness, although it may be that assumption 3' is valid in a model without the non-negativity constraints, but not valid in a model with these constraints.

<sup>26</sup>Differently from the  $R^2$  measure, this measure can be negative, which would suggest a poor pre-treatment fit.

<sup>27</sup>Note that, in their proof, Abadie et al. (2010) assume that there exists a constant  $\bar{\lambda}$  such that  $|\lambda_t^f| \leq \bar{\lambda}$  for all  $t = 1, \dots, T$  and  $f = 1, \dots, F$ , where  $\lambda_t = (\lambda_t^1, \dots, \lambda_t^F)$  is the vector of common factors. Under this and other additional assumptions, they show that the bias of the SC estimator can be bounded by a function that depends on  $\bar{\lambda}$  and  $T_0$  if we have a perfect match in the pre-treatment outcomes. In order to guarantee that this function goes to zero when  $T_0$  increases, however, we need to assume that the condition on  $\bar{\lambda}$  remains valid when  $T_0$  increases. This will not be the case if some components of  $\lambda_t$  increase without bound when  $T_0$  increases. Therefore, our result does not contradict the result from Abadie et al. (2010) on the bias of the SC estimator.

unit constructed to provide a counterfactual for the Basque Country without terrorism. The pre-treatment fit in this case is seemingly perfect, with an  $\tilde{R}^2 = 0.99$ . However, the per capita GDP series is clearly non-stationary, with all regions displaying similar trends before the intervention. Therefore, based on our results presented in Propositions 4, despite the seemingly perfect pre-treatment fit, it may still be that the SC estimator is biased if there is a correlation between treatment assignment and common factors beyond this non-stationary trend.

In order to assess this possibility, we consider two different ways to de-trend the data, so we can have a better assessment on whether factor loadings associated with stationary common factors are well matched. In both cases, we subtract the outcome of the treated and control units by constant terms  $\{a_t\}_{t=1}^T$ . Note that, under the adding-up constraint ( $\sum_{j \neq 1} w_j = 1$ ), the SC weights and the SC estimator will be numerically the same whether we estimate with the original data or with  $\tilde{y}_{jt} = y_{jt} - a_t$ . We first subtract the average of the control units at time  $t$  ( $a_t = \frac{1}{J} \sum_{j \neq 1} y_{jt}$ ) for both treated and control units. Therefore, if the non-stationarity comes from a common factor  $\delta_t$  that affects every unit in the same way, then the series  $\tilde{y}_{jt} = y_{jt} - \frac{1}{J} \sum_{j' \neq 1} y_{j't}$  would not display non-stationary trends. As shown in Figure 1.C, in this case, the treated and SC units do not display a non-stationary trend, and the pre-treatment fit for this de-trended series would not be as good as in the previous case, with an  $\tilde{R}^2 = 0.65$ . We get similar results if we de-trend by fitting a polynomial  $a(t)$  to the synthetic control series, with an  $\tilde{R}^2 = 0.67$  (Figure 1.D).<sup>28</sup>

We consider in Figure 2 the application in Abadie et al. (2010), who estimate the effects of California's tobacco control program. This empirical application also presents a seemingly perfect pre-treatment fit, with an  $\tilde{R}^2 = 0.96$ , but with a highly non-stationary trend. Our first strategy to de-trend the data by subtracting the controls' average outcomes still leads to a non-stationary series, suggesting that the non-stationary common factors cannot be resumed into a simple time effect  $\delta_t$ . When we consider a polynomial  $a(t)$ , then the pre-treatment fit for the de-trended series is very low. However, note also that there is not much variation in the de-trended series in the pre treatment relative to the difference in the treated and synthetic control units in the post treatment, which suggests that most of the common variation that the SC estimator aims to control for comes from these non-stationary trends. Therefore, such low  $\tilde{R}^2$  should not necessarily be interpreted as relevant possibilities for asymptotic bias in the SC estimator. Finally, we consider in Figure 3 the study on the economic impact of the 1990 German reunification on West Germany, by Abadie et al. (2015). Again, this application displays a seemingly perfect pre-treatment fit ( $\tilde{R}^2 = 0.99$ ), but a more modest pre-treatment fit when we de-trend the data using a time polynomial ( $\tilde{R}^2 = 0.70$ ).

Overall, these results suggest that, in these applications, the SC estimator probably worked reasonably

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<sup>28</sup>We used a polynomial of order 5 to fit the entire time series of the synthetic control unit (including both pre- and post-periods). Then we consider the de-trended series  $\tilde{y}_{jt} = y_{jt} - \hat{a}(t)$ .

well in constructing a counterfactual for the treated unit, as either the pre-treatment fit is reasonably good even after we de-trend the series (although not as good as when we consider the original series), or there is not much variation left in the de-trended series. However, our results point out that the diagnosis based on the pre-treatment fit for non-stationary series should be considered with caution, as they may hide discrepancies in common factors beyond these non-stationary trends that may lead to asymptotic bias in the SC estimator. Indeed, in two of the three applications we considered, there is still some significant variation beyond the non-stationary trends for the treated unit that is only partially captured by the SC unit.

Importantly, note that our results do not imply that one should not use the SC method when the data is non-stationary. On the contrary, we show that the SC method is very efficient in dealing with non-stationary trends. Indeed, in these three applications, the seemingly perfect pre-treatment fit when we consider the outcomes in level suggest that the method is being highly successful in taking into account non-stationary trends, which is an important advantage of the method relative to alternatives such as DID. The only caveat is that measures of pre-intervention fit could be misleading as diagnostic tests, as they may hide important discrepancies in the factor loadings associated to the stationary common factors. Another possibility would be to apply the SC method on a transformation of the data that makes it stationary. In this case, however, the estimator would not be numerically the same as the estimator using the original data.

## 6 Particular Class of Linear Factor Models & Monte Carlo Simulations

We consider now in detail the implications of our results for a particular class of linear factor models in which all units are divided into groups that follow different times trends.<sup>29</sup> We present both theoretical and MC simulation results for these models. In Section 6.1 we consider the case with stationary common factors, while in Section 6.2 we consider a case in which there are both  $I(1)$  and  $I(0)$  common factors.

### 6.1 Model with stationary common factors

We consider first a model in which the  $J + 1$  units are divided into  $K$  groups, where for each  $j$  we have that:

$$y_{jt}(0) = \delta_t + \lambda_t^k + \varepsilon_{jt} \tag{13}$$

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<sup>29</sup>Monte Carlo simulations using this model was also studied in detail in [Ferman et al. \(2017\)](#) and in [Ferman and Pinto \(2017\)](#).

for some  $k = 1, \dots, K$ . We assume that  $\frac{1}{T_0} \sum_{t=1}^{T_0} \lambda_t^k \xrightarrow{P} 0$ ,  $\frac{1}{T_0} \sum_{t=1}^{T_0} (\lambda_t^k)^2 \xrightarrow{P} 1$ ,  $\frac{1}{T_0} \sum_{t=1}^{T_0} \varepsilon_{jt} \xrightarrow{P} 0$ , and  $\frac{1}{T_0} \sum_{t=1}^{T_0} \varepsilon_{jt}^2 \xrightarrow{P} \sigma_\varepsilon^2$ .

### 6.1.1 Asymptotic Results

Consider first an extreme case in which  $K = 2$ , so the first half of the  $J + 1$  units follows the parallel trend given by  $\lambda_t^1$ , while the other half follows the parallel trend given by  $\lambda_t^2$ . In this case, the SC estimator should only assign positive weights to units in the first group.

We calculate, for this particular class of linear factor models, the asymptotic proportion of misallocated weights of the SC estimator using all pre-treatment lags as economic predictors. From the minimization problem 4, we have that, when  $T_0 \rightarrow \infty$ , the proportion of misallocated weights converges to:

$$\gamma_2(\sigma_\varepsilon^2, J) = \sum_{j=\frac{J+1}{2}+1}^{J+1} \bar{w}_j = \frac{J+1}{J^2 + 2 \times J \times \sigma_\varepsilon^2 - 1} \times \sigma_\varepsilon^2 \quad (14)$$

where  $\gamma_K(\sigma_\varepsilon^2, J)$  is the proportion of misallocated weights when the  $J + 1$  groups are divided in  $K$  groups.

We present in Figure 4.A the relationship between asymptotic misallocation of weights, variance of the transitory shocks, and number of control units. Note that, for a fixed  $J$ , the proportion of misallocated weights converges to zero when  $\sigma_\varepsilon^2 \rightarrow 0$ , while this proportion converges to  $\frac{J+1}{2J}$  (the proportion of misallocated weights of DID) when  $\sigma_\varepsilon^2 \rightarrow \infty$ . This is consistent with the results we have in Section 3. Moreover, note that, for a given  $\sigma_\varepsilon^2$ , the proportion of misallocated weights converges to zero when the number of control units goes to infinity. This is consistent with [Gobillon and Magnac \(2016\)](#), who derive support conditions so that the assumptions in [Abadie et al. \(2010\)](#) for unbiasedness are satisfied when both  $T_0$  and  $J$  go to infinity.

Note that, in this example, the SC estimator converges to:

$$\hat{\alpha}_{1t} \xrightarrow{d} \alpha_{1t} + \left( \varepsilon_{1t} - \sum_{j \neq 1} \bar{w}_j \varepsilon_{jt} \right) + \lambda_t^1 \times \gamma_2(\sigma_\varepsilon^2, J) - \lambda_t^2 \times \gamma_2(\sigma_\varepsilon^2, J) \quad (15)$$

so the potential bias due to correlation between treatment assignment and common factors (for example,  $\mathbb{E}[\lambda_t^1 | D(1, T_0) = 1] \neq 0$  for  $t > T_0$ ) will directly depend on the proportion of misallocated weights.

We consider now another extreme case in which the  $J + 1$  units are divided into  $K = \frac{J+1}{2}$  groups that follow the same parallel trend. In other words, in this case each unit has a pair that follows its same parallel trend, while all other units follow different parallel trends. The proportion of misallocated weights converges

to:

$$\gamma_{\frac{J+1}{2}}(\sigma_\varepsilon^2, J) = \sum_{j=3}^{J+1} \bar{w}_j = \frac{J-1}{2 + \sigma_\varepsilon^2 + (1 + \sigma_\varepsilon^2)(J-1)} \times \sigma_\varepsilon^2 \quad (16)$$

We present the relationship between misallocation of weights, variance of the transitory shocks, and number of control units in Figure 4.B. Note that, again, the proportion of misallocated weights converges to zero when  $\sigma_\varepsilon^2 \rightarrow 0$  and to the proportion of misallocated weights of DID when  $\sigma_\varepsilon^2 \rightarrow \infty$  (in this case,  $\frac{J-1}{J}$ ). Differently from the previous case, however, for a given  $\sigma_\varepsilon^2$ , the proportion of misallocated weights converges to  $\frac{\sigma_\varepsilon^2}{1+\sigma_\varepsilon^2}$  when  $J \rightarrow \infty$ . Therefore, the SC estimator would remain asymptotically biased even when the number of control units is large. This happens because, in this model, the number of common factors increases with  $J$ , so the conditions derived in [Gobillon and Magnac \(2016\)](#) are not satisfied.

Finally, note that, in both cases, the proportion of misallocated weights is always lower than the proportion of misallocated weights of DID. Therefore, in this particular class of linear factor models, the asymptotic bias of the SC estimator will always be lower than the asymptotic bias of DID. However, this is not a general result, as we show in [Appendix A.3](#).

### 6.1.2 Monte Carlo Simulations

The results presented in [Section 6.1.1](#) are based on large- $T_0$  asymptotics. We now consider, in MC simulations, the finite  $T_0$  properties of the SC estimator, both unconditional and conditional on a good pre-treatment fit. We present Monte Carlo (MC) simulation results using a data generating process (DGP) based on [equation 13](#). We consider in our MC simulations  $J+1 = 20$ ,  $\lambda_t^k$  normally distributed following an AR(1) process with 0.5 serial correlation parameter,  $\varepsilon_{jt} \sim N(0, \sigma_\varepsilon^2)$ , and  $T - T_0 = 10$ . We also impose that there is no treatment effect, i.e.,  $y_{jt} = y_{jt}(0) = y_{jt}(1)$  for each time period  $t \in \{1, \dots, T\}$ . We consider variations in DGP in the following dimensions:

- The number of pre-intervention periods:  $T_0 \in \{5, 20, 50, 100\}$ .
- The variance of the transitory shocks:  $\sigma_\varepsilon^2 \in \{0.1, 0.5, 1\}$ .
- The number of groups with different  $\lambda_t^k$ :  $K = 2$  (2 groups of 10) or  $K = 10$  (10 groups of 2)

For each simulation, we calculate the SC estimator that uses all pre-treatment outcome lags as economic predictors, and calculate the proportion of misallocated weights. We also evaluate whether the SC method provides a good pre-intervention fit and calculate the proportion of misallocated weights conditional on a good pre-intervention fit. In order to determine that the SC estimator provided a good fit, we consider a

pre-treatment normalized mean squared error index, presented in equation 12. For each scenario, we generate 20,000 simulations.

In columns 1 to 3 of Table 1, we present the proportion of misallocated weights when  $K = 10$  for different values of  $T_0$  and  $\sigma_\varepsilon^2$ . Consistent with our analytical results from Section 6.1.1, the misallocation of weights is increasing with the variance of the transitory shocks. With  $T_0 = 100$ , the proportion of misallocated weights is close to the theoretical values, while the proportion of misallocated weights is substantially higher when  $T_0$  is small. We present in columns 4 to 6 of Table 1 the probability that the SC method provides a good fit when we define good fit as  $\tilde{R}^2 > 0.8$ . As expected, with a large  $T_0$  the SC method only provides a good pre-intervention fit if the variance of the transitory shock is low. If the variance of the transitory shocks is higher, then the probability that the SC method provides a good match is approximately zero, unless the number of pre-treatment periods is rather low. These results suggest that, in a model with stationary factors, the SC estimator would only provide a close-to-perfect pre-treatment fit with a moderate number of pre-treatment periods if the variance of the transitory shocks is low, in which case the bias of the SC estimator would be relatively small. With  $T_0 = 20$  and  $\sigma_\varepsilon^2 = 0.5$  or  $\sigma_\varepsilon^2 = 1$ , the probability of having a good fit is, respectively, equal to 1.3% and 0.1%. Interestingly, when we condition on having a good pre-treatment fit the proportion of misallocated weights reduces but still remains quite high (goes from 50% to 33% when  $\sigma_\varepsilon^2 = 0.5$  and from 65% to 45% when  $\sigma_\varepsilon^2 = 1$ ). These results are presented in Table 1, columns 7 to 9. In Appendix Table A.1 we replicate Table 1 using a more stringent definition of good fit, which is equal to one if  $\tilde{R}^2 > 0.9$ . In this case, conditioning has a larger effect in reducing the discrepancy of factor loadings between the treated and the SC units, but at the expense of having a lower probability of accepting that the pre-treatment fit is good. These results suggest that, with stationary data, the SC estimator would only provide a close-to-perfect match with a moderate  $T_0$ , and therefore be close to unbiased, when the variance of the transitory shocks converges to zero. In Appendix Table A.2 we also consider the case with 2 groups of 10 units each ( $K = 2$ ). All results are qualitatively the same.

Note that, in this particular class of linear factor models, the proportion of misallocated weights is always lower than the proportion of misallocated weights of the DID estimator, which implies a lower bias if treatment assignment is correlated with common factors. This is true even when the pre-treatment match is not perfect and when the number of pre-treatment periods is very small. From Section 4, we also know that, if common factors are stationary for both pre- and post-treatment periods, then a demeaned SC estimator is unbiased and has a lower asymptotic variance than DID. Since this DGP has no time-invariant factor, this is true for the standard SC estimator as well. We present in Table 2 the DID/SC ratio of standard errors. With  $T_0 = 100$ , the DID standard error is 2.4 times higher than the SC standard errors when  $\sigma_\varepsilon^2 = 0.1$ . When  $\sigma_\varepsilon^2$  is higher, the advantage of the SC estimator is reduced, although the DID standard error is still 1.3 (1.1) times

higher when  $\sigma_\varepsilon^2$  is equal to 0.5 (1). This is expected given that, in this model, the SC estimator converges to the DID estimator when  $\sigma_\varepsilon^2 \rightarrow \infty$ . More strikingly, the variance of the SC estimator is lower than the variance of DID even when the number of pre-treatment periods is small. These results suggest that the SC estimator can still improve relative to DID even when the number of pre-treatment periods is not large and when the pre-treatment fit is not perfect, situations in which [Abadie et al. \(2015\)](#) suggest the method should not be used. However, a very important qualification of this result is that, in these cases, the SC estimator requires stronger identification assumptions than stated in the original SC papers. More specifically, it is generally asymptotically biased if treatment assignment is correlated with time-varying confounders.

## 6.2 Model with “explosive” common factors

We consider now a model in which a subset of the common factors is  $I(1)$ . We consider the following DGP:

$$y_{jt}(0) = \delta_t + \lambda_t^k + \gamma_t^r + \varepsilon_{jt} \quad (17)$$

for some  $k = 1, \dots, K$  and  $r = 1, \dots, R$ . We maintain that  $\lambda_t^k$  is stationary, while  $\gamma_t^r$  follows a random walk.

### 6.2.1 Asymptotic results

Based on our results from Section 5 the SC weights will converge to weights in  $\Phi_1$  that minimize the second moment of the  $I(0)$  process that remains after we eliminate the  $I(1)$  common factor. Consider the case  $K = 10$  and  $R = 2$ . Therefore, units  $j = 2, \dots, 10$  follow the same non-stationary path  $\gamma_t^1$  as the treated unit, although only unit  $j = 2$  also follows the same stationary path  $\lambda_t^1$  as the treated unit. In this case, asymptotically, all weights would be allocated among units 2 to 10, eliminating the relevance of the  $I(1)$  common factor. However, the allocation of weights within these units will not assign all weights to unit 2, so the  $I(0)$  common factor will remain relevant.

### 6.2.2 Monte Carlo simulations

In our MC simulations, we maintain that  $\lambda_t^k$  is normally distributed following an AR(1) process with 0.5 serial correlation parameter, while  $\gamma_t^r$  follows a random walk. We consider the case  $K = 10$  and  $R = 2$ .

The proportion of misallocated weights (in this case, weights not allocated to unit 2) is very similar to the proportion of misallocated weights in the stationary case (columns 1 to 3 of Table 3). If we consider the misallocation of weights only for the  $I(1)$  factors, then the misallocation of weights is remarkably low with moderate  $T_0$ , even when the variance of the transitory shocks is high (columns 4 to 6 of Table 3). The reason is that, with a moderate  $T_0$ , the  $I(1)$  common factors dominate the transitory shocks, so the SC method

is extremely efficient selecting control units that follow the same non-stationary trend as the treated unit. For the same reason, the probability of having a dataset with a close-to-perfect pre-treatment fit is also very high if a subset of the common factors is  $I(1)$  (columns 7 to 9 of Table 3). Finally, we show in columns 10 to 12 of Table 3 that conditioning on a close-to-perfect match makes virtually no difference in the proportion of misallocated weights for the stationary factor.

These results suggest that the SC method works remarkably well to control for  $I(1)$  common factors. In this scenario, one would usually have a close-to-perfect fit, and there would be virtually no bias associated to the  $I(1)$  factors. However, we might have a substantial misallocation of weights for the  $I(0)$  common factors *even conditional on a close-to-perfect pre-treatment match*. Taken together, these results suggest that the SC method provides substantial improvement relative to DID in this scenario, as the SC estimator is extremely efficient in capturing the  $I(1)$  factors. Also, if the DID and SC estimators are unbiased, then the variance of the DID relative to the variance of the SC estimator would be substantially higher, as presented in Table 4. However, one should be aware that, in this case, the identification assumption only allows for correlation of treatment assignment with the  $I(1)$  factors. Still, this potential bias of the SC estimator due to a correlation between treatment assignment and the  $I(0)$  common shocks, in this particular class of linear factor models, would be lower than the bias of DID.

## 7 Conclusion

In this paper, we revisit the theory behind the SC method. We consider the asymptotic properties of the SC estimator when the number of pre-treatment periods goes to infinity in a linear factors model. If the model has “stationary” common factors, in the sense that pre-treatment averages of the first and second moments of the common factors converge, then we show that the SC estimator is biased if treatment assignment is correlated with unobserved confounders, even when weights that reconstruct the factor loadings of the treated unit exist and when  $T_0 \rightarrow \infty$ . Our simulation results suggest that the bias may be larger when  $T_0$  is finite. The asymptotic bias goes to zero when the variance of the transitory shocks goes to zero, which is exactly the case in which one would expect to find a good pre-treatment fit. Therefore, our results, under these conditions on the common factors, are consistent with the results in Abadie et al. (2010). However, if pre-treatment averages of a subset of the common factors diverge, then we show that the SC estimator can be asymptotically biased even conditional on a close-to-perfect pre-treatment match.

Despite these caveats, we show that a demeaned SC estimator can substantially improve relative to the DID estimator, even if the pre-treatment fit is not close to perfect and if  $T_0$  is not large. This is particularly true when a subset of the common factors is non-stationary, as it allows treatment assignment



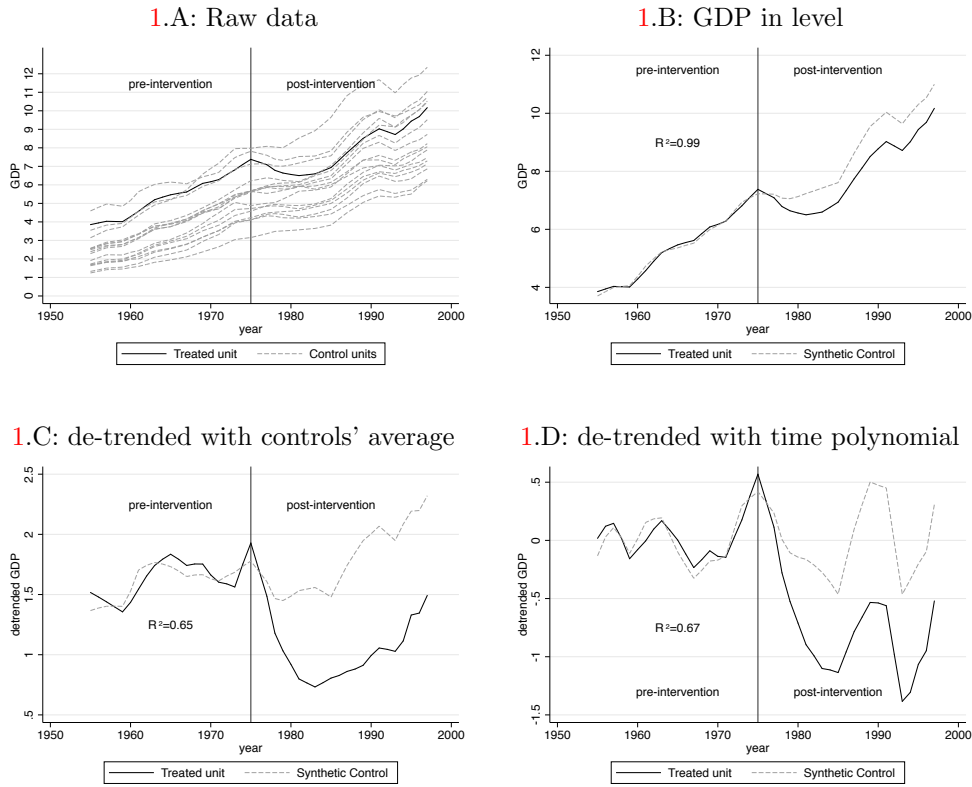
to be correlated with common factors that diverge. However, our results show that researchers should be more careful in interpreting the identification assumptions required for the SC method. Moreover, we suggest that, in addition to the standard graph comparing treated and SC units, researchers should also present a graph comparing the treated and SC units after de-trending the data, so that it is possible to assess whether there might be relevant possibilities for bias arising due to a correlation between treatment assignment and common factors beyond non-stationary trends.

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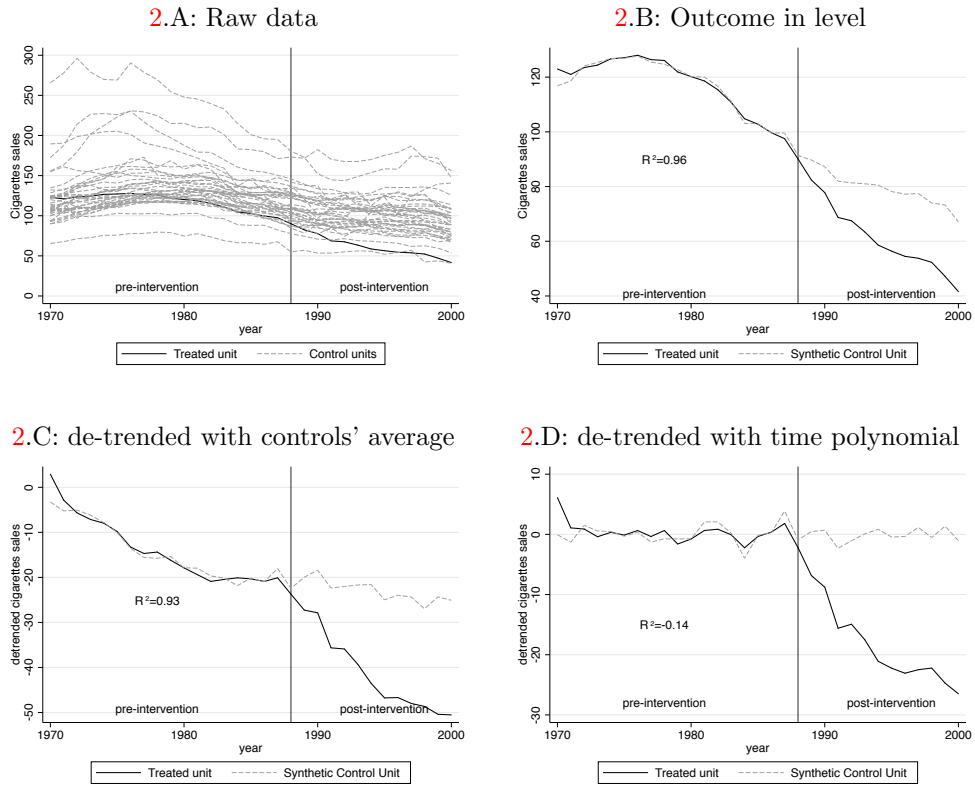
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Figure 1: [Abadie and Gardeazabal \(2003\)](#) application



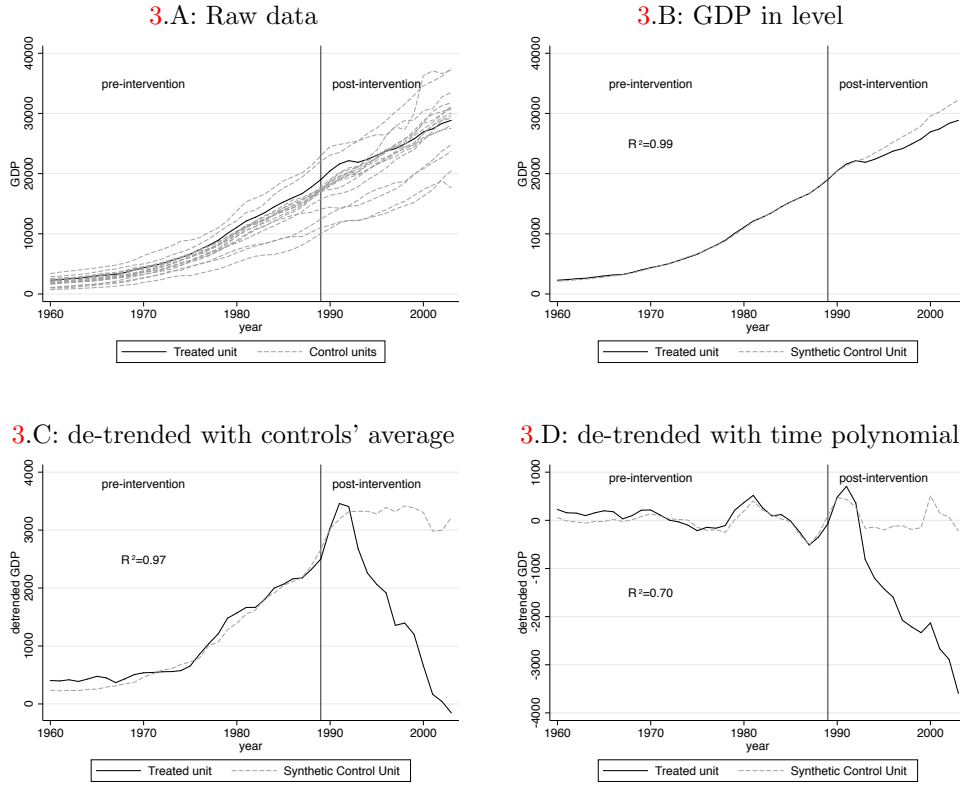
Notes: Figure A presents time series for the treated and for the control units used in the empirical application in [Abadie and Gardeazabal \(2003\)](#). In Figure B we present the time series for the treated and for the SC units. In Figure C we present the same information as in Figure B after subtracting the control groups' averages for each time period. In Figure D we present the same information as in Figure B after subtracting a time trend estimated by fitting a 5th order polynomial on the SC series. Figures B to D we also report the measure of pre-treatment fit defined in equation 12.

Figure 2: [Abadie et al. \(2010\)](#) application



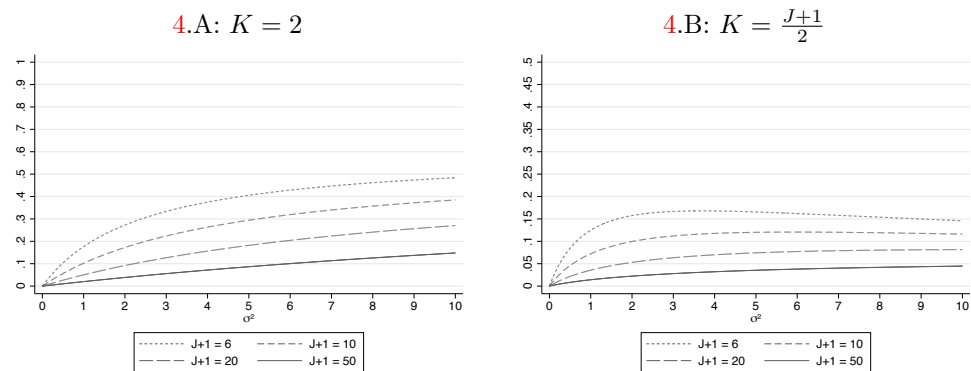
Notes: Figure A presents time series for the treated and for the control units used in the empirical application in [Abadie et al. \(2010\)](#). In Figure B we present the time series for the treated and for the SC units. In Figure C we present the same information as in Figure B after subtracting the control groups' averages for each time period. In Figure D we present the same information as in Figure B after subtracting a time trend estimated by fitting a 5th order polynomial on the SC series. Figures B to D we also report the measure of pre-treatment fit defined in equation 12.

Figure 3: [Abadie et al. \(2015\)](#) application



Notes: Figure A presents time series for the treated and for the control units used in the empirical application in [Abadie et al. \(2015\)](#). In Figure B we present the time series for the treated and for the SC units. In Figure C we present the same information as in Figure B after subtracting the control groups' averages for each time period. In Figure D we present the same information as in Figure B after subtracting a time trend estimated by fitting a 5th order polynomial on the SC series. Figures B to D we also report the measure of pre-treatment fit defined in equation 12.

Figure 4: Asymptotic Misallocation of Weights



Notes: these figures present the asymptotic misallocation of weights of the SC estimator as a function of the variance of the transitory shocks for different numbers of control units. Figures 4.A presents results when there are 2 groups of  $\frac{J+1}{2}$  units each, while Figure 4.B presents results when there are  $\frac{J+1}{2}$  groups of 2 units each. The misallocation of weights is defined as the proportion of weight allocated to units that do not belong to the group of treated unit.

Table 1: **Misallocation of weights and probability of perfect match - stationary model**

	Misallocation of weights			Probability of perfect match ( $\tilde{R}^2 > 0.8$ )			Misallocation conditional on perfect match		
	$\sigma_\varepsilon^2 = 0.1$	$\sigma_\varepsilon^2 = 0.5$	$\sigma_\varepsilon^2 = 1$	$\sigma_\varepsilon^2 = 0.1$	$\sigma_\varepsilon^2 = 0.5$	$\sigma_\varepsilon^2 = 1$	$\sigma_\varepsilon^2 = 0.1$	$\sigma_\varepsilon^2 = 0.5$	$\sigma_\varepsilon^2 = 1$
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
$T_0 = 5$	0.418 [0.002]	0.714 [0.002]	0.807 [0.002]	0.729 [0.003]	0.510 [0.004]	0.469 [0.004]	0.425 [0.003]	0.743 [0.003]	0.833 [0.002]
$T_0 = 20$	0.197 [0.001]	0.495 [0.001]	0.653 [0.001]	0.639 [0.003]	0.013 [0.001]	0.001 [0.000]	0.174 [0.001]	0.331 [0.008]	0.445 [0.040]
$T_0 = 50$	0.150 [0.000]	0.415 [0.001]	0.573 [0.001]	0.701 [0.003]	0.000 [0.000]	0.000 [0.000]	0.137 [0.000]	- -	- -
$T_0 = 100$	0.130 [0.000]	0.384 [0.001]	0.539 [0.001]	0.766 [0.003]	0.000 [0.000]	0.000 [0.000]	0.122 [0.000]	- -	- -

Notes: this table presents MC simulations results from a stationary model. We consider the SC estimator that uses all pre-treatment outcome lags as economic predictors for a given  $(T_0, \sigma_\varepsilon^2)$ . In all simulations, we set  $J + 1 = 20$  and  $K = 10$ , which means that the 20 units are divided into 10 groups of 2 units that follow the same common factor  $\lambda_t^k$ . Columns 1 to 3 present the proportion of misallocated weights, which is given by the sum of weights allocated to units 3 to 20. Columns 4 to 6 present the probability that the pre-treatment match is close to perfect, defined as a  $\tilde{R}^2 > 0.8$ . Columns 7 to 9 present the proportion of misallocated weights conditional on a perfect match.

Table 2: **DID/SC ratio of standard errors - stationary model**

	$\sigma_\varepsilon^2 = 0.1$	$\sigma_\varepsilon^2 = 0.5$	$\sigma_\varepsilon^2 = 1$
	(1)	(2)	(3)
$T_0 = 5$	1.585 [0.011]	1.082 [0.007]	1.005 [0.005]
$T_0 = 20$	2.232 [0.014]	1.231 [0.005]	1.074 [0.003]
$T_0 = 50$	2.327 [0.010]	1.294 [0.005]	1.101 [0.004]
$T_0 = 100$	2.389 [0.012]	1.314 [0.005]	1.123 [0.003]

Notes: this table presents MC simulations results from a stationary model as in Table 1. We present the ratio of standard errors of the DID estimator vs. the SC estimator for different  $(T_0, \sigma_\varepsilon^2)$  scenarios.

Table 3: **Misallocation of weights and probability of perfect match - non-stationary model**

	Misallocation of weights			Misallocation of weights (non-stationary factors)		
	$\sigma_\varepsilon^2 = 0.1$	$\sigma_\varepsilon^2 = 0.5$	$\sigma_\varepsilon^2 = 1$	$\sigma_\varepsilon^2 = 0.1$	$\sigma_\varepsilon^2 = 0.5$	$\sigma_\varepsilon^2 = 1$
	(1)	(2)	(3)	(4)	(5)	(6)
$T_0 = 5$	0.372 [0.002]	0.661 [0.002]	0.762 [0.002]	0.107 [0.001]	0.192 [0.002]	0.232 [0.002]
$T_0 = 20$	0.176 [0.001]	0.441 [0.001]	0.589 [0.001]	0.029 [0.000]	0.069 [0.001]	0.095 [0.001]
$T_0 = 50$	0.136 [0.001]	0.373 [0.001]	0.518 [0.001]	0.015 [0.000]	0.036 [0.000]	0.050 [0.000]
$T_0 = 100$	0.120 [0.000]	0.346 [0.001]	0.489 [0.001]	0.009 [0.000]	0.022 [0.000]	0.030 [0.000]

	Probability of perfect match ( $\tilde{R}^2 > 0.8$ )			Misallocation conditional on perfect match		
	$\sigma_\varepsilon^2 = 0.1$	$\sigma_\varepsilon^2 = 0.5$	$\sigma_\varepsilon^2 = 1$	$\sigma_\varepsilon^2 = 0.1$	$\sigma_\varepsilon^2 = 0.5$	$\sigma_\varepsilon^2 = 1$
	(7)	(8)	(9)	(10)	(11)	(12)
$T_0 = 5$	0.846 [0.003]	0.618 [0.003]	0.542 [0.004]	0.377 [0.002]	0.683 [0.003]	0.784 [0.003]
$T_0 = 20$	0.984 [0.001]	0.556 [0.004]	0.296 [0.003]	0.175 [0.001]	0.427 [0.002]	0.571 [0.003]
$T_0 = 50$	1.000 [0.000]	0.835 [0.003]	0.550 [0.004]	0.136 [0.001]	0.371 [0.001]	0.515 [0.001]
$T_0 = 100$	1.000 [0.000]	0.973 [0.001]	0.822 [0.003]	0.120 [0.000]	0.346 [0.001]	0.487 [0.001]

Notes: this table presents MC simulations results from a model with non-stationary and stationary common factors. We consider the SC estimator that uses all pre-treatment outcome lags as economic predictors for a given  $(T_0, \sigma_\varepsilon^2, K)$ . In all simulations, we set  $J + 1 = 20$ ,  $K = 10$  (which means that the 20 units are divided into 10 groups of 2 units each that follow the same stationary common factor  $\lambda_t^k$ ) and  $R = 2$  (which means that the 20 units are divided into 2 groups of 10 units each that follow the same non-stationary common factor  $\gamma_t^r$ ). Columns 1 to 3 present the proportion of misallocated weights, which is given by the sum of weights allocated to units 3 to 20. Columns 4 to 6 present the proportion of misallocated weights considering only the non-stationary common factor, which is given by the sum of weights allocated to units 11 to 20. Columns 7 to 9 present the probability that the pre-treatment match is close to perfect, defined as a  $\tilde{R}^2 > 0.8$ . Columns 10 to 12 present the proportion of misallocated weights conditional on a perfect match. Standard errors in brackets.



Table 4: **DID/SC ratio of standard errors - non-stationary model**

	$\sigma_\varepsilon^2 = 0.1$	$\sigma_\varepsilon^2 = 0.5$	$\sigma_\varepsilon^2 = 1$
	(1)	(2)	(3)
$T_0 = 5$	2.072 [0.016]	1.263 [0.007]	1.115 [0.005]
$T_0 = 20$	4.374 [0.029]	2.155 [0.011]	1.680 [0.010]
$T_0 = 50$	6.649 [0.040]	3.190 [0.021]	2.420 [0.016]
$T_0 = 100$	9.462 [0.057]	4.494 [0.027]	3.369 [0.022]

Notes: this table presents MC simulations results from a non-stationary model as in Table 3. We present the ratio of standard errors of the DID estimator vs. the SC estimator for different  $(T_0, \sigma_\varepsilon^2)$  scenarios. Standard errors in brackets.

# A Supplemental Appendix: Revisiting the Synthetic Control Estimator (For Online Publication)

## A.1 Proof of the Main Results

### A.1.1 Proposition 1

**Proof.**

Let  $\mathbf{y}_{0t} = (y_{2t}, \dots, y_{J+1,t})'$ ,  $\varepsilon_{0t} = (\varepsilon_{2t}, \dots, \varepsilon_{J+1,t})'$ , and  $\mu_0 = (\mu_2, \dots, \mu_{J+1})$ . The SC weights  $\widehat{\mathbf{w}} \in \mathbb{R}^J$  are given by:

$$\widehat{\mathbf{w}} = \arg \min_{\mathbf{w} \in W} \frac{1}{T_0} \sum_{t_0=1}^T (y_{1t} - \mathbf{y}'_{0t} \mathbf{w})^2 \quad (18)$$

where  $W = \{\mathbf{w} \in \mathbb{R}^J | w_j \geq 0 \text{ and } \sum_{j \neq 1} w_j = 1\}$ .<sup>30</sup>

Under assumptions 1 and 4', the objective function  $\widehat{Q}_{T_0}(\mathbf{w}) \equiv \frac{1}{T_0} \sum_{t_0=1}^T (y_{1t} - \mathbf{y}'_{0t} \mathbf{w})^2$  converges pointwise in probability to:

$$Q_0(\mathbf{w}) \equiv \sigma_\varepsilon^2 (1 + \mathbf{w}' \mathbf{w}) + (\mu_1 - \mu_0 \mathbf{w})' \Omega_0 (\mu_1 - \mu_0 \mathbf{w}) \quad (19)$$

which is a continuous and strictly convex function. Therefore,  $Q_0(\mathbf{w})$  is uniquely minimized over  $W$ , and we define its minimum as  $\bar{\mathbf{w}} \in W$ .

We show that this convergence in probability is uniform over  $\mathbf{w} \in W$ . Define  $\tilde{y}_{1t} = y_{1t} - \delta_t$  and  $\tilde{\mathbf{y}}_{0t} = \mathbf{y}_{0t} - \delta_t \mathbf{i}$ , where  $\mathbf{i}$  is a  $J \times 1$  vector of ones. For any  $\mathbf{w}', \mathbf{w} \in W$ , using the mean value theorem, we can find a  $\tilde{\mathbf{w}} \in W$  such that:

$$\left| \widehat{Q}_{T_0}(\mathbf{w}') - \widehat{Q}_{T_0}(\mathbf{w}) \right| = \left| 2 \left( \frac{1}{T_0} \sum_{t=1}^{T_0} \tilde{\mathbf{y}}_{0t} \tilde{y}_{1t} - \frac{1}{T_0} \sum_{t=1}^{T_0} \tilde{\mathbf{y}}_{0t} \tilde{\mathbf{y}}'_{0t} \tilde{\mathbf{w}} \right) \cdot (\mathbf{w}' - \mathbf{w}) \right| \quad (20)$$

$$\leq \left[ \left( 2 \left\| \frac{1}{T_0} \sum_{t=1}^{T_0} \tilde{\mathbf{y}}_{0t} \tilde{y}_{1t} \right\| + \left\| \frac{1}{T_0} \sum_{t=1}^{T_0} \tilde{\mathbf{y}}_{0t} \tilde{\mathbf{y}}'_{0t} \right\| \times \|\tilde{\mathbf{w}}\| \right) \|\mathbf{w}' - \mathbf{w}\| \right]^{\frac{1}{2}} \quad (21)$$

Define  $B_{T_0} = 2 \left\| \frac{1}{T_0} \sum_{t=1}^{T_0} \tilde{\mathbf{y}}_{0t} \tilde{y}_{1t} \right\| + \left\| \frac{1}{T_0} \sum_{t=1}^{T_0} \tilde{\mathbf{y}}_{0t} \tilde{\mathbf{y}}'_{0t} \right\| \times C$ . Since  $W$  is compact,  $\|\tilde{\mathbf{w}}\|$  is bounded, so we can find a constant  $C$  such that  $\left| \widehat{Q}_{T_0}(\mathbf{w}') - \widehat{Q}_{T_0}(\mathbf{w}) \right| \leq B_{T_0} (\|\mathbf{w}' - \mathbf{w}\|)^{\frac{1}{2}}$ . Since  $\tilde{y}_{1t} \tilde{\mathbf{y}}_{0t}$  and  $\tilde{\mathbf{y}}_{0t} \tilde{\mathbf{y}}'_{0t}$  are linear combinations of cross products of  $\lambda_t$  and  $\varepsilon_{it}$ , from assumptions 1 and 4 we have that  $B_{T_0}$  converges in probability to a positive constant, so  $B_{T_0} = O_p(1)$ . Note also that  $Q_0(\mathbf{w})$  is uniformly continuous on  $W$ . Therefore, from corollary 2.2 of Newey (1991), we have that  $\widehat{Q}_{T_0}$  converges uniformly in probability to  $Q_0$ . Since  $Q_0$  is uniquely minimized at  $\bar{\mathbf{w}}$ ,  $W$  is a compact space,  $Q_0$  is continuous and  $\widehat{Q}_{T_0}$  converges uniformly to  $Q_0$ , from Theorem 2.1 of Newey and McFadden (1994),  $\widehat{\mathbf{w}}$  exists with probability approaching one and  $\widehat{\mathbf{w}} \xrightarrow{p} \bar{\mathbf{w}}$ .

Now we show that  $\bar{\mathbf{w}}$  does not generally reconstruct the factor loadings. Note that  $Q_0$  has two parts. The first one reflects that different choices of weights will generate different weighted averages of the idiosyncratic shocks  $\varepsilon_{it}$ . In this simpler case, this part would be minimized when we set all weights equal to  $\frac{1}{J}$ . Let the  $J \times 1$  vector  $\mathbf{j}_J = (\frac{1}{J}, \dots, \frac{1}{J})' \in W$ . The second part reflects the presence of common factors  $\lambda_t$  that would remain after we choose the weights to construct the SC unit. This part is minimized if we choose a  $\mathbf{w}^* \in \Phi = \{\mathbf{w} \in W | \mu_1 = \mu_0 \mathbf{w}\}$ . Suppose that we start at  $\mathbf{w}^* \in \Phi$  and move in the direction of  $\mathbf{j}_J$ , with  $\mathbf{w}(\Delta) = \mathbf{w}^* + \Delta(\mathbf{j}_J - \mathbf{w}^*)$ . Note that, for all  $\Delta \in [0, 1]$ , these weights will continue to satisfy the constraints of the minimization problem. If we consider the derivative of function 19 with respect to  $\Delta$  at  $\Delta = 0$ , we have that:

$$\Gamma'(\mathbf{w}^*) = 2\sigma_\varepsilon^2 \left( \frac{1}{J} - \mathbf{w}^{*'} \mathbf{w}^* \right) < 0 \text{ unless } \mathbf{w}^* = \mathbf{j}_J \text{ or } \sigma_\varepsilon^2 = 0$$

Therefore,  $\mathbf{w}^*$  will not, in general, minimize  $Q_0$ . This implies that, when  $T_0 \rightarrow \infty$ , the SC weights will converge in probability to weights  $\bar{\mathbf{w}}$  that does not reconstruct the factor loadings of the treated unit, unless it turns out that  $\mathbf{w}^*$  also minimizes the variance of this linear combination of the idiosyncratic errors or if  $\sigma_\varepsilon^2 = 0$ . ■

### A.1.2 Proposition 2

**Proof.**

<sup>30</sup>If the number of control units is greater than the number of pre-treatment periods, then the solution to this minimization problem might not be unique. However, since we consider the asymptotics with  $T_0 \rightarrow \infty$ , then we guarantee that, for large enough  $T_0$ , the solution will be unique.

The demeaned SC estimator is given by  $\widehat{\mathbf{w}}^{\text{SC}'} = \underset{\mathbf{w} \in W}{\operatorname{argmin}} \widehat{Q}'_{T_0}(\mathbf{w})$ , where:

$$\begin{aligned} \widehat{Q}'_{T_0}(\mathbf{w}) &= \frac{1}{T_0} \sum_{t=1}^{T_0} \left( y_{1t} - \mathbf{y}'_{0t} \mathbf{w} - \left( \frac{1}{T_0} \sum_{t=1}^{T_0} y_{1t} - \frac{1}{T_0} \sum_{t=1}^{T_0} \mathbf{y}'_{0t} \mathbf{w} \right) \right)^2 \\ &= \widehat{Q}_{T_0}(\mathbf{w}) - \left( \frac{1}{T_0} \sum_{t=1}^{T_0} y_{1t} - \frac{1}{T_0} \sum_{t=1}^{T_0} \mathbf{y}'_{0t} \mathbf{w} \right)^2 \end{aligned} \quad (22)$$

Note that  $\widehat{Q}'_{T_0}(\mathbf{w})$  converges pointwise in probability to:

$$Q'_0(\mathbf{w}) \equiv \sigma_\varepsilon^2 (1 + \mathbf{w}' \mathbf{w}) + (\mu_1 - \mu_0 \mathbf{w})' (\Omega_0 - \omega'_0 \omega_0) (\mu_1 - \mu_0 \mathbf{w}) \quad (23)$$

where  $\Omega_0 - \omega'_0 \omega_0$  is positive semi-definite, so  $Q'_0(\mathbf{w})$  is a continuous and convex function.

The proof that  $\widehat{\mathbf{w}}^{\text{SC}'} \xrightarrow{p} \bar{\mathbf{w}}^{\text{SC}'}$  where  $\bar{\mathbf{w}}^{\text{SC}'}$  will generally not reconstruct the factor loadings of the treated unit follows exactly the same steps as the proof of Proposition 1. Therefore:

$$\hat{\alpha}_{1t}^{\text{SC}'} = y_{1t} - \mathbf{y}_{0t} \widehat{\mathbf{w}}^{\text{SC}'} - \left[ \frac{1}{T_0} \sum_{t'=1}^{T_0} y_{1t'} - \frac{1}{T_0} \sum_{t'=1}^{T_0} \mathbf{y}'_{0t'} \widehat{\mathbf{w}}^{\text{SC}'} \right] \xrightarrow{d} \alpha_{1t} + (\varepsilon_{1t} - \varepsilon'_{0t} \bar{\mathbf{w}}^{\text{SC}'}) + (\lambda_t - \omega_0) (\mu_1 - \mu_0 \bar{\mathbf{w}}^{\text{SC}'}) \quad (24)$$

■

### A.1.3 Proposition 3

**Proof.**

Under assumption 4', we have that  $\lambda_t$  conditional on  $D(1, T_0) = 1$  is stationary. Therefore, without loss of generality we can assume that the first common factor is time invariant while the other common factors are such that  $\mathbb{E}[\lambda_t | D(1, T_0) = 1] = 0$  for all  $t$ . We define  $\tilde{\lambda}_t$  and  $\tilde{\mu}_j$  as the common factors and factor loadings excluding the time-invariant common factor. Therefore from Proposition 2:

$$\hat{\alpha}_{1t}^{\text{SC}'} \xrightarrow{d} \alpha_{1t} + (\varepsilon_{1t} - \varepsilon'_{0t} \bar{\mathbf{w}}^{\text{SC}'}) + \tilde{\lambda}_t (\tilde{\mu}_1 - \tilde{\mu}_0 \bar{\mathbf{w}}^{\text{SC}'}) \quad (25)$$

which implies that:

$$a.\text{var}(\hat{\alpha}_{1t}^{\text{SC}'} - \alpha_{1t}) = E \left[ (\varepsilon_{1t} - \varepsilon'_{0t} \bar{\mathbf{w}}^{\text{SC}'} + \tilde{\lambda}_t (\tilde{\mu}_1 - \tilde{\mu}_0 \bar{\mathbf{w}}^{\text{SC}'}) | D(1, T_0) = 1 \right]^2 \quad (26)$$

Let the  $J \times 1$  vector  $\mathbf{j}_J = (\frac{1}{J}, \dots, \frac{1}{J})'$ . Then we also have that:

$$a.\text{var}(\hat{\alpha}_{1t}^{\text{DID}} - \alpha_{1t}) = E \left[ (\varepsilon_{1t} - \varepsilon'_{0t} \mathbf{j}_J) + \tilde{\lambda}_t (\tilde{\mu}_1 - \tilde{\mu}_0 \mathbf{j}_J) | D(1, T_0) = 1 \right]^2 \quad (27)$$

Now note that, under assumptions 1, 2 and 4':

$$Q'_0(\mathbf{w}) = E \left[ (\varepsilon_{1t} - \varepsilon'_{0t} \mathbf{w}) + \tilde{\lambda}_t (\tilde{\mu}_1 - \tilde{\mu}_0 \mathbf{w}) | D(1, T_0) = 1 \right]^2$$

where  $\bar{\mathbf{w}}^{\text{SC}'} = \arg \min_{\mathbf{w} \in W} Q'_0(\mathbf{w})$ . Therefore, it must be that  $a.\text{var}(\hat{\alpha}_{1t}^{\text{DID}} - \alpha_{1t}) \leq a.\text{var}(\hat{\alpha}_{1t}^{\text{SC}'} - \alpha_{1t})$ . ■

### A.1.4 Proposition 4

**Proof.**

We show this result for the case without the adding-up, non-negativity, and no intercept constraints. In Appendix A.6.1 we extend these results for the cases with the adding-up and/or non-negativity constraints. In Appendix A.6.2 we show that this result is not valid when we use the no intercept constraint.

Note first that we can re-write model 11 as:

$$\mathbf{Y}_t = \begin{bmatrix} \theta'_1 \\ \vdots \\ \theta'_{J+1} \end{bmatrix} \gamma_t + \tilde{\varepsilon}_t = \Theta \gamma_t + \tilde{\varepsilon}_t \quad (28)$$

where  $\gamma_t = (\gamma_t^1, \dots, \gamma_t^{F_1})$ , and  $\Theta$  is a  $J+1 \times F$  matrix with the factor loadings associated with  $\gamma_t$  for all units and  $\tilde{\varepsilon}_t$  is an  $\mathcal{I}(0)$  vector that includes the stationary common factors and the transitory shocks. Without loss of generality, we assume that the

elements of  $\gamma_t$  are ordered so that its first element of  $\gamma_t$  is the deterministic polynomial trend with highest power, and the last elements are the  $\mathcal{I}(1)$  common factors.

Suppose there are  $h$  linearly independent vectors  $\mathbf{b} \in \mathbb{R}^{J+1}$  such that  $\mathbf{b}'\Theta = 0$ . In this case, we can consider the triangular representation:

$$\mathbf{y}_{1t} = \Gamma' \mathbf{y}_{2t} + \mu_1^* + \mathbf{z}_t^* \quad (29)$$

where  $\mathbf{y}_{1t}$  is  $h \times 1$ ,  $\mathbf{y}_{2t}$  is  $g \times 1$ , and  $\Gamma'$  is  $h \times g$ ;  $\mathbf{z}_t^*$  is a  $h \times 1$   $\mathcal{I}(0)$  series with mean zero and  $\mu_1^*$  is an  $h \times 1$  vector of constants. Given assumption 3', we can write this representation with unit 1 in the vector  $\mathbf{y}_{1t}$ . Without loss of generality, we consider the case where  $\mathbf{y}_{1t} = (y_{1t}, \dots, y_{ht})'$  and  $\mathbf{y}_{2t} = (y_{h+1,t}, \dots, y_{J+1,t})'$ . We define the matrix  $\Theta_i^j$  as a submatrix with the lines  $i$  to  $j$  of matrix  $\Theta$ . Importantly, note that equation 29 implies that  $\Theta_1^h = \Gamma' \Theta_{h+1}^{J+1}$ .

From the definition of  $\mathbf{y}_{2t}$ , we have that  $\text{rank}(\Theta_{h+1}^{J+1}) = g$ . Otherwise, it would be possible to find another linearly independent vector  $v \in \mathbb{R}^{J+1}$  such that  $v' \mathbf{y}_{2t}$  is stationary, which contradicts the fact that the dimension of such space is  $h$ . We consider a linear transformation  $\tilde{\mathbf{y}}_{2t} \equiv A \mathbf{y}_{2t}$  for some invertible  $g \times g$  matrix  $A$  such that the matrix  $\tilde{\Theta}_{h+1}^{J+1} \equiv A \Theta_{h+1}^{J+1}$  with elements  $\tilde{\theta}_{j,f}$  has the following property: there exist integers  $1 = f_1 < \dots < f_g \leq F_1$  such that  $\tilde{\theta}_{j,f_j} \neq 0$  and  $\tilde{\theta}_{j,f} = 0$  if  $f > f_j$ . In words, this transformed vector  $\tilde{\mathbf{y}}_{2t}$  is such that its  $n^{\text{th}}$  element does not contain a common factor of higher order than the highest order common factors for any element  $j < n$  of  $\tilde{\mathbf{y}}_{2t}$ .

We show that it is possible to construct such matrix given the definition of  $\mathbf{y}_{2t}$ . We start setting  $\tilde{y}_{1,t} = y_{j,t}$  for some  $j \in \{h+1, \dots, J+1\}$  such that  $\theta_{j,1} \neq 0$ . For the second row, consider linear combinations  $b' \mathbf{y}_{2t}$  for some  $b \in \mathbb{R}^g$  and let  $\tilde{\theta}_f(b)$  be the  $f$ -component of the  $(1 \times F_1)$  row vector  $b' \Theta_{h+1}^{J+1}$ . Consider now the set of all linear combinations  $b' \mathbf{y}_{2t}$  such that  $\tilde{\theta}_1(b) = 0$ , and let  $f_2$  be the largest  $f \in \{1, \dots, F_1\}$  such that  $\tilde{\theta}_{f_2}(b) \neq 0$  for some  $b$  in this set. We pick one  $b$  such that  $\tilde{\theta}_1(b) = 0$  and  $\tilde{\theta}_{f_2}(b) \neq 0$  and set  $\tilde{y}_{2,t} = b' \mathbf{y}_{2t}$ . For the third row, we consider linear combinations of  $\mathbf{y}_{2t}$  such that  $\tilde{\theta}_f(b) = 0$  for all  $f \leq f_2$ , and choose  $\tilde{y}_{3,t}$  as a linear combination  $b' \mathbf{y}_{2t}$  such that  $\tilde{\theta}_{f_3}(b) \neq 0$ . Since,  $\text{rank}(\Theta_{h+1}^{J+1}) = g$ , we can continue this construction until we get  $\tilde{y}_{g,t} = b' \mathbf{y}_{2t}$  for a linear combination  $b$  such that  $\tilde{\theta}_f(b) = 0$  for all  $f \leq f_{g-1}$  with  $\tilde{\theta}_f(b) \neq 0$  for at least one  $f > f_{g-1}$ .

Therefore, we have that:

$$\mathbf{y}_{1t} = \Gamma' A^{-1} \tilde{\mathbf{y}}_{2t} + \mu_1^* + \mathbf{z}_t^* \quad (30)$$

Now closely following the proof of proposition 19.3 in Hamilton (1994), we consider the OLS regression:

$$z_{1t}^* = \alpha + \beta' \mathbf{z}_{2t}^* + \phi' \tilde{\mathbf{y}}_{2t} + u_t \quad (31)$$

where  $z_{1t}^*$  is the first element of  $\mathbf{z}_t^*$ , and  $\mathbf{z}_{2t}^* = (z_{2t}^*, \dots, z_{ht}^*)'$ .

Now let  $\tilde{f}_k$  be equal to the order of the polynomial common factor  $\gamma_t^{f_k}$  or equal to  $\frac{1}{2}$  is  $\gamma_t^{f_k}$  is an  $\mathcal{I}(1)$  common factor. Then OLS estimator for this model is:

$$\begin{bmatrix} \hat{\beta} - \beta \\ \hat{\alpha} \\ T_0^{\tilde{f}_1} \hat{\phi}_1 \\ \vdots \\ T_0^{\tilde{f}_g} \hat{\phi}_g \end{bmatrix} = \begin{bmatrix} \frac{\sum \mathbf{z}_{2t}^* \mathbf{z}_{2t}^{*'} }{T_0} & \frac{\sum \mathbf{z}_{2t}^*}{T_0} & \frac{\sum \mathbf{z}_{2t}^* \tilde{y}_{1,t}}{T_0^{\tilde{f}_1+1}} & \cdots & \frac{\sum \mathbf{z}_{2t}^* \tilde{y}_{g,t}}{T_0^{\tilde{f}_g+1}} \\ \frac{\sum \mathbf{z}_{2t}^{*'}}{T_0} & 1 & \frac{\sum \tilde{y}_{1,t}}{T_0^{\tilde{f}_1+1}} & \cdots & \frac{\sum \tilde{y}_{g,t}}{T_0^{\tilde{f}_g+1}} \\ \frac{\sum \tilde{y}_{1,t} \mathbf{z}_{2t}^{*'}}{T_0^{\tilde{f}_1+1}} & \frac{\sum \tilde{y}_{1,t}}{T_0^{\tilde{f}_1+1}} & \frac{\sum \tilde{y}_{1,t}^2}{T_0^{2\tilde{f}_1+1}} & \cdots & \frac{\sum \tilde{y}_{1,t} \tilde{y}_{g,t}}{T_0^{\tilde{f}_1+\tilde{f}_g+1}} \\ \vdots & \vdots & \vdots & \ddots & \vdots \\ \frac{\sum \tilde{y}_{g,t} \mathbf{z}_{2t}^{*'}}{T_0^{\tilde{f}_g+1}} & \frac{\sum \tilde{y}_{g,t}}{T_0^{\tilde{f}_g+1}} & \frac{\sum \tilde{y}_{g,t} \tilde{y}_{1,t}}{T_0^{\tilde{f}_1+\tilde{f}_g+1}} & \cdots & \frac{\sum \tilde{y}_{g,t}^2}{T_0^{2\tilde{f}_g+1}} \end{bmatrix}^{-1} \times \begin{bmatrix} T_0^{-1} \sum \mathbf{z}_{2t}^* u_t \\ T_0^{-1} \sum u_t \\ T_0^{-(1+\tilde{f}_1)} \sum \tilde{y}_{1,t} u_t \\ \vdots \\ T_0^{-(1+\tilde{f}_g)} \sum \tilde{y}_{g,t} u_t \end{bmatrix} \quad (32)$$

Suppose that  $\tilde{y}_{jt}$  has non-negative coefficients for at least one polynomial common factor for  $j = 1, \dots, g'$ , while  $\tilde{y}_{jt}$  has non-negative coefficients only for  $\mathcal{I}(1)$  common factors for  $j = g' + 1, \dots, g$ . We start showing that the first matrix in the right hand side of equation 32 converges to a matrix that is almost surely non-singular. Note that the terms  $T_0^{-1} \sum \mathbf{z}_{2t}^*$  and  $T_0^{-(\tilde{f}_j+1)} \sum \mathbf{z}_{2t}^* \tilde{y}_{j,t}$  converge in probability to zero, while  $T_0^{-1} \sum \mathbf{z}_{2t}^* \mathbf{z}_{2t}^{*'} \xrightarrow{P} \mathbb{E}[\mathbf{z}_{2t}^* \mathbf{z}_{2t}^{*'}]$ . Also, for  $j \in \{1, \dots, g'\}$ ,  $\sum \tilde{y}_{j,t}$  is dominated by  $\sum \tilde{\theta}_{j,f_j} t^{\tilde{f}_j}$ , which implies that  $T_0^{-(\tilde{f}_j+1)} \sum \tilde{y}_{j,t} \xrightarrow{P} \tilde{\theta}_{j,f_j} / (\tilde{f}_j + 1)$ . Similarly, for  $(i, j) \in \{1, \dots, g'\}$ ,  $\sum \tilde{y}_{j,t} \tilde{y}_{i,t}$  is dominated by  $\sum \tilde{\theta}_{j,f_j} \tilde{\theta}_{i,f_i} t^{\tilde{f}_i + \tilde{f}_j}$ , which implies that  $T_0^{-(\tilde{f}_j + \tilde{f}_i + 1)} \sum \tilde{y}_{j,t} \tilde{y}_{i,t} \xrightarrow{P} \tilde{\theta}_{j,f_j} \tilde{\theta}_{i,f_i} / (\tilde{f}_i + \tilde{f}_j + 1)$ . Finally, the terms that include interactions with  $\tilde{y}_{j,t}$  for  $j \in \{g' + 1, \dots, g\}$  will converge in law to functions of an  $(g - g')$ -dimensional Brownian motion (with exception of those interacted with  $\mathbf{z}_{2t}^*$ , which, in this case, converge in probability to zero).<sup>31</sup> Putting these results

<sup>31</sup>See the proof of proposition 19.3 in Hamilton (1994) for details.

together, we have that:

$$\begin{bmatrix} \frac{\sum \mathbf{z}_{2t}^* \mathbf{z}_{2t}'}{T_0} & \frac{\sum \mathbf{z}_{2t}^*}{T_0} & \frac{\sum \mathbf{z}_{2t}^* \tilde{y}_{1,t}}{T_0^{\bar{f}_1+1}} & \cdots & \frac{\sum \mathbf{z}_{2t}^* \tilde{y}_{g,t}}{T_0^{\bar{f}_g+1}} \\ \frac{\sum \mathbf{z}_{2t}^*}{T_0} & 1 & \frac{\sum \tilde{y}_{1,t}}{T_0^{\bar{f}_1+1}} & \cdots & \frac{\sum \tilde{y}_{g,t}}{T_0^{\bar{f}_g+1}} \\ \frac{\sum \tilde{y}_{1,t} \mathbf{z}_{2t}'}{T_0^{\bar{f}_1+1}} & \frac{\sum \tilde{y}_{1,t}}{T_0^{\bar{f}_1+1}} & \frac{\sum \tilde{y}_{1,t}^2}{T_0^{2\bar{f}_1+1}} & \cdots & \frac{\sum \tilde{y}_{1,t} \tilde{y}_{g,t}}{T_0^{\bar{f}_1+\bar{f}_g+1}} \\ \vdots & \vdots & \vdots & \ddots & \vdots \\ \frac{\sum \tilde{y}_{g,t} \mathbf{z}_{2t}'}{T_0^{\bar{f}_g+1}} & \frac{\sum \tilde{y}_{g,t}}{T_0^{\bar{f}_g+1}} & \frac{\sum \tilde{y}_{g,t} \tilde{y}_{1,t}}{T_0^{\bar{f}_1+\bar{f}_g+1}} & \cdots & \frac{\sum \tilde{y}_{g,t}^2}{T_0^{2\bar{f}_g+1}} \end{bmatrix} \xrightarrow{L_t} \begin{bmatrix} \mathbb{E}[\mathbf{z}_{2t}^* \mathbf{z}_{2t}']_{h \times h} & \mathbf{0}_{h \times (g'+1)} & \mathbf{0}_{h \times (g-g')} \\ \mathbf{0}_{(g'+1) \times h} & \mathbf{C}_{(g'+1) \times (g'+1)} & \mathbf{D}'_{(g'+1) \times (g-g')} \\ \mathbf{0}_{(g-g') \times h} & \mathbf{D}_{(g-g') \times (g'+1)} & \mathbf{E}_{(g-g') \times (g-g')} \end{bmatrix} \equiv \mathbf{V} \quad (33)$$

where  $\mathbf{C}$  is a non-random matrix with the limits of the terms  $T_0^{-(\bar{f}_j+\bar{f}_i+1)} \sum \tilde{y}_{j,t} \tilde{y}_{i,t}$  and  $T_0^{-(\bar{f}_i+1)} \sum \tilde{y}_{i,t}$  for  $(i, j) \in \{1, \dots, g'\}$ ,  $\mathbf{E}$  is a random matrix for where the terms  $T_0^{-(\bar{f}_j+\bar{f}_i+1)} \sum \tilde{y}_{j,t} \tilde{y}_{i,t}$  for  $(i, j) \in \{g'+1, \dots, g\}$  converge in law, and  $\mathbf{D}$  is a random matrix for where the terms  $T_0^{-(\bar{f}_j+\bar{f}_i+1)} \sum \tilde{y}_{j,t} \tilde{y}_{i,t}$  and  $T_0^{-(\bar{f}_j+1)} \sum \tilde{y}_{j,t}$  for  $i \in \{1, \dots, g'+1\}$  and  $j \in \{g'+1, \dots, g\}$  converge in law. Note that  $\mathbb{E}[\mathbf{z}_{2t}^* \mathbf{z}_{2t}']$  is non-singular by definition of  $\mathbf{z}_{2t}^*$ . It is also easy to show that  $\mathbf{C}$  is non-singular.<sup>32</sup> Following the proof of Proposition 19.3 in Hamilton (1994), we also have that  $\mathbf{E}$  is nonsingular with probability one. Therefore, we have that  $\mathbf{V}$  is non-singular with probability one.<sup>33</sup>

Now we show that the second matrix in the right hand side of equation 32 converges in probability to zero. In this case, note that  $\sum \tilde{y}_{j,t} u_t$  for  $j = g'+1, \dots, g$  is dominated by terms  $\sum \xi_t u_t$  where  $\xi_t$  is  $\mathcal{I}(1)$ , which implies that  $T_0^{-\frac{3}{2}} \sum \tilde{y}_{j,t} u_t \xrightarrow{P} 0$ . For  $j \in \{1, \dots, g'\}$ , note that  $\sum \tilde{y}_{j,t} u_t$  is dominated by a term  $\sum t^{\bar{f}_j} u_t$ . Therefore,  $T_0^{-(1+\bar{f}_j)} \sum \tilde{y}_{j,t} u_t$  converges in probability to zero. Finally, we also have that  $T^{-1} \sum u_t$  and  $T^{-1} \sum \mathbf{z}_{2t}^* u_t$  converge in probability to zero. Therefore,  $\hat{\alpha} \xrightarrow{P} 0$ ,  $\hat{\beta} \xrightarrow{P} \beta$ , and  $T^{\bar{f}_i} \hat{\phi}'_i \xrightarrow{P} 0$ . From equations 30 and 31, we have that OLS estimator of  $y_{1t}$  on a constant and  $y_{2t}, \dots, y_{ht}, \tilde{y}_{h+1,t}, \dots, \tilde{y}_{J+1,t}$  is given by  $(\hat{\beta}' \hat{\phi}' + [1 \ \hat{\beta}'] \Gamma' A^{-1})$ .<sup>34</sup> This implies that the OLS estimator of  $y_{1t}$  on a constant and  $y_{2t}, \dots, y_{J+1,t}$  is given by  $\hat{\mathbf{w}}' = (\hat{\beta}' \hat{\phi}' A + [1 \ \hat{\beta}'] \Gamma')$ .

We are interested in the limiting distribution of  $\hat{\alpha}_{1t}$ , which is the effect of the treatment  $t - T_0$  periods after the treatment started ( $t > T_0$ ). Note that:

$$\begin{aligned} \hat{\alpha}_{1t}^{\text{SC}'} &= \alpha_{1t} + \lambda_t \left( \mu_1 - \sum_{j \neq 1} \hat{w}_j \mu_j \right) + \gamma_t \left( \theta_1 - \sum_{j \neq 1} \hat{w}_j \theta_j \right) + \left( \varepsilon_{1t} - \sum_{j \neq 1} \hat{w}_j \varepsilon_{jt} \right) \\ &\quad - \frac{1}{T_0} \sum_{t'=1}^{T_0} \left[ \lambda_{t'} \left( \mu_1 - \sum_{j \neq 1} \hat{w}_j \mu_j \right) + \gamma_{t'} \left( \theta_1 - \sum_{j \neq 1} \hat{w}_j \theta_j \right) + \left( \varepsilon_{1t'} - \sum_{j \neq 1} \hat{w}_j \varepsilon_{jt'} \right) \right] \end{aligned} \quad (34)$$

For the term  $\gamma_t \left( \theta_1 - \sum_{j \neq 1} \hat{w}_j \theta_j \right)$ , note that:

$$\begin{aligned} \sum_{j \neq 1} \hat{w}_j \theta_j &= \begin{bmatrix} \Theta_2^{h'} & \Theta_{h+1}^{J+1'} \end{bmatrix} \hat{\mathbf{w}} = \begin{bmatrix} \Theta_2^{h'} & \Theta_{h+1}^{J+1'} \end{bmatrix} \left[ A' \hat{\phi} + \Gamma \begin{bmatrix} 1 \\ -\hat{\beta} \end{bmatrix} \right] \\ &= \Theta_2^{h'} \hat{\beta} + \Theta_{h+1}^{J+1'} A' \hat{\phi} + \Theta_{h+1}^{J+1'} \Gamma \begin{bmatrix} 1 \\ -\hat{\beta} \end{bmatrix} \\ &= \Theta_2^{h'} \hat{\beta} + \Theta_{h+1}^{J+1'} A' \hat{\phi} + \Theta_1^{h'} \begin{bmatrix} 1 \\ -\hat{\beta} \end{bmatrix} = \theta_1 + \Theta_{h+1}^{J+1'} A' \hat{\phi} \end{aligned} \quad (35)$$

<sup>32</sup>When  $\bar{\theta}_j, \bar{f}_j \neq 0$  and  $0 < f_1 < \dots < f_{g'}$ , which will be the case by construction, it is possible to diagonalize this matrix. For each row  $j = 2, \dots, g'+1$ , we can subtract it by row 1 multiplied by  $\frac{\bar{\theta}_j}{1+\bar{f}_j}$ , and then divide that by  $\frac{-\bar{f}_j}{1+\bar{f}_j}$ . This will result in a matrix with the same entries as the original one, except that rows 2 to  $g'+1$  in the first column will be equal to zero. Then for each row  $j = 3, \dots, g'+1$  we can subtract it by row 2 multiplied by  $\frac{\bar{\theta}_j}{\bar{\theta}_1} \frac{1+2\bar{f}_1}{1+\bar{f}_1+\bar{f}_j}$ , and then divide it by  $-\frac{\bar{f}_j-\bar{f}_1}{1+\bar{f}_1+\bar{f}_j}$ . This will transform rows 3 to  $g'+1$  in column 2 to zero. Continuing this procedure, we have an upper triangular matrix with diagonal elements different from zero.

<sup>33</sup>Note that  $\det(\mathbf{V}) = \det(\mathbb{E}[\mathbf{z}_{2t}^* \mathbf{z}_{2t}']) \det(\mathbf{C} - \mathbf{D}' \mathbf{E}^{-1} \mathbf{D}) \det(\mathbf{E})$ . We have that  $\det(\mathbb{E}[\mathbf{z}_{2t}^* \mathbf{z}_{2t}']) \neq 0$  and that  $\det(\mathbf{E}) \neq 0$  with probability one (which also implies that  $\mathbf{E}^{-1}$  exists with probability one). Therefore, we only need that  $\det(\mathbf{C} - \mathbf{D}' \mathbf{E}^{-1} \mathbf{D}) \neq 0$  to guarantee that  $\mathbf{V}$  is non-singular. Since  $\mathbf{C}$  is non-singular, the realizations of  $\mathbf{D}' \mathbf{E}^{-1} \mathbf{D}$  such that  $\mathbf{C} - \mathbf{D}' \mathbf{E}^{-1} \mathbf{D}$  is singular will have measure zero, which implies that  $\mathbf{V}$  is non-singular with probability one.

<sup>34</sup>Those are the estimators associated with  $\mathbf{z}_{2t}^*$  and  $\tilde{\mathbf{y}}_{2t}$ . The estimator for the constant is given by  $\hat{\alpha} + [1 \ -\hat{\beta}'] \mu_1^*$ .

Let  $\Lambda = \text{diag}(T_0^{a_1}, \dots, T_0^{a_F})$ , where  $a_k$  is defined such that  $\gamma_{T_0}^k T_0^{-a_k}$  converge either to a constant (when  $\gamma_t^k$  is a deterministic time trend) or to a distribution (when  $\gamma_t^k$  is an  $\mathcal{I}(1)$  common factor). Then:

$$\gamma_t \left( \theta_1 - \sum_{j \neq 1} \hat{w}_j \theta_j \right) = -\gamma_t \Theta_{h+1}^{J+1'} A' \hat{\phi} = -\gamma_t \Lambda^{-1} \Lambda \Theta_{h+1}^{J+1'} A' \hat{\phi} \quad (36)$$

If  $\gamma_t = t^k$ , then  $\gamma_t = (T_0 + (t - T_0))^k$ , which implies that  $T_0^{-k} \gamma_t = (1 + \frac{(t-T_0)}{T_0})^k \rightarrow 1$  when  $T_0 \rightarrow \infty$ . If  $\gamma_t$  is  $\mathcal{I}(1)$ , then  $\gamma_t = \gamma_{T_0} + \sum_{t'=T_0+1}^t \eta_{t'}$ , which implies that  $T_0^{-\frac{1}{2}} \gamma_t$  converges in distribution to a normal variable when  $T_0 \rightarrow \infty$ . Using the properties of  $A \Theta_{h+1}^{J+1'}$ , we also have that the  $n^{\text{th}}$  row of  $\Lambda \Theta_{h+1}^{J+1'} A' \hat{\phi}$  will be given by  $T_0^{a_n}$  multiplied by a linear combination of elements  $\hat{\phi}_j$  such that  $f_j \geq a_n$ . Therefore, the random variables  $\hat{\phi}_j$  that are present in row  $n$  converge to zero at a faster rate than  $T_0^{a_n}$ , so  $\Lambda \Theta_{h+1}^{J+1'} A' \hat{\phi} \xrightarrow{p} 0$ . That is, we show that the SC weights will converge to weights that reconstruct the factor loadings of the treated unit associated with the non-stationary common factors, and the convergence in this case will be fast enough to compensate the fact that the non-stationary factors explode. Similarly, we have that  $\frac{1}{T_0} \sum_{t'=1}^{T_0} \gamma_{t'} (\theta_1 - \sum_{j \neq 1} \hat{w}_j \theta_j) \xrightarrow{p} 0$ .

Finally, by definition of  $u_t$  in equation 31, the OLS estimator converges to weights that minimize  $E[u_t^2]$  subject to  $\mathbf{w} \in \Phi_1$ , where  $u_t = \lambda_t (\mu_1 - \sum_{j \neq 1} w_j \mu_j) + (\varepsilon_{1t} - \sum_{j \neq 1} w_j \varepsilon_{jt}) - c$ . Therefore, the proof that  $\hat{\mathbf{w}} \xrightarrow{p} \bar{\mathbf{w}} \notin \Phi$  is essentially the same as the proof of Proposition 1.

Combining these results, we have that:

$$\hat{\alpha}_{1t} \xrightarrow{d} \alpha_{1t} + \left( \varepsilon_{1t} - \sum_{j \neq 1} \bar{w}_j \varepsilon_{jt} \right) + (\lambda_t - \omega_0) \left( \mu_1 - \sum_{j \neq 1} \bar{w}_j \mu_j \right) \quad (37)$$

where  $\omega_0 = \text{plim}_{T_0 \rightarrow \infty} \frac{1}{T_0} \sum_{t'=1}^{T_0} \lambda_{t'}$ . ■

## A.2 Case with finite $T_0$

We consider here the case with  $T_0$  fixed. For weights  $\{w_j^*\}_{j \neq 1} \in \Phi$ , note that:

$$y_{1t} = \sum_{j=1}^{J+1} w_j^* y_{jt} + \eta_t, \text{ for } t \leq T_0, \text{ where } \eta_t = \varepsilon_{1t} - \sum_{j=1}^{J+1} w_j^* \varepsilon_{jt} \quad (38)$$

Since  $\sum_{j=2}^{J+1} w_j^* = 1$ , we can write:

$$\tilde{y}_{1t} = \sum_{j=1}^J w_j^* \tilde{y}_{jt} + \eta_t \quad (39)$$

where  $\tilde{y}_{jt} = y_{jt} - y_{J+1,t}$ . The SC weights will be given by the OLS regression in 39 with the non-negativity constraints. We ignore for now the non-negativity constraints. If we let  $\tilde{y}_{0t} = (\tilde{y}_{2t}, \dots, \tilde{y}_{Jt})'$ ,  $\mathbf{w}_0^* = (w_2^*, \dots, w_J^*)'$  and  $\hat{\mathbf{w}}_0 = (\hat{w}_2, \dots, \hat{w}_J)'$ , then we have that  $\hat{\mathbf{w}}_0 = \left( \sum_{t=1}^{T_0} \tilde{y}_{0t} \tilde{y}_{0t}' \right)^{-1} \sum_{t=1}^{T_0} \tilde{y}_{0t} \tilde{y}_{1t}$ . We assume that  $T_0$  is large enough so that  $\sum_{t=1}^{T_0} \tilde{y}_{0t} \tilde{y}_{0t}'$  has full rank. Therefore:

$$\mathbb{E}[\hat{\mathbf{w}}_0 | \tilde{y}_{0,1}, \dots, \tilde{y}_{0,T_0}] = \mathbf{w}_0^* + \left( \sum_{t=1}^{T_0} \tilde{y}_{0t} \tilde{y}_{0t}' \right)^{-1} \sum_{t=1}^{T_0} \tilde{y}_{0t} \mathbb{E}[\eta_t | \tilde{y}_{0,1}, \dots, \tilde{y}_{0,T_0}] \quad (40)$$

By definition of  $\eta_t$ , we have that  $\mathbb{E}[\eta_t | \tilde{y}_{0,1}, \dots, \tilde{y}_{0,T_0}] \neq 0$ , which implies that  $\hat{\mathbf{w}}_0$  is a biased estimator of  $\mathbf{w}_0^*$ . Intuitively, the transitory shocks behave as a measurement error when we use the control outcomes as a proxy for the common factors. Considering the non-negativity constraints would affect the distribution of  $\hat{\mathbf{w}}_0$  because, with finite  $T_0$ , there will be a positive probability that the solution to the unrestricted OLS problem will not satisfy the non-negativity constraints. However, this would not change the conclusion that  $\hat{\mathbf{w}}_0$  is a biased estimator of  $\mathbf{w}_0^*$ .

## A.3 Example: SC Estimator vs DID Estimator

We provide an example in which the asymptotic bias of the SC estimator can be higher than the asymptotic bias of the DID estimator. Assume we have 1 treated and 4 control units in a model with 2 common factors. For simplicity, assume that there is no additive fixed effects and that  $\mathbb{E}[\lambda_t] = 0$ . We have that the factor loadings are given by:

$$\mu_1 = \begin{pmatrix} 1 \\ 1 \end{pmatrix}, \mu_2 = \begin{pmatrix} 0.5 \\ 1 \end{pmatrix}, \mu_3 = \begin{pmatrix} 1.5 \\ 1 \end{pmatrix}, \mu_4 = \begin{pmatrix} 0.5 \\ 0 \end{pmatrix}, \mu_5 = \begin{pmatrix} 1.5 \\ 1 \end{pmatrix} \quad (41)$$

Note that the linear combination  $0.5\mu_2 + w_1^3\mu_3 + w_1^5\mu_5 = \mu_1$  with  $w_1^3 + w_1^5 = 0.5$  satisfy assumption 3. Note also that DID equal weights would set the first factor loading to 1, which is equal to  $\mu_1^1$ , but the second factor loading would be equal to  $0.75 \neq \mu_1^2$ . We want to show that the SC weights would improve the construction of the second factor loading but it will distort the combination for the first factor loading. If we set  $\sigma_\varepsilon^2 = \mathbb{E}[(\lambda_t^1)^2] = \mathbb{E}[(\lambda_t^2)^2] = 1$ , then the factor loadings of the SC unit would be given by  $(1.038, 0.8458)$ . Therefore, there is small loss in the construction of the first factor loading and a gain in the construction of the second factor loading. Therefore, if selection into treatment is correlated with the common shock  $\lambda_t^1$ , then the SC estimator would be more asymptotically biased than the DID estimator.

## A.4 Definition: Asymptotically Unbiased

We now show that the expected value of the asymptotic distribution will be the same as the limit of the expected value of the SC estimator in the setting described in Section 3. Let  $\gamma$  be the expected value of the asymptotic distribution of  $\hat{\alpha}_{1t} - \alpha_{1t}$ . Therefore, we have that:

$$\begin{aligned}\mathbb{E}[\hat{\alpha}_{1t} - \alpha_{1t}] &= \gamma + E \left[ \sum_{j \neq 1} (\bar{w}_j - \hat{w}_j) \varepsilon_{jt} \right] + E \left[ \lambda_t \sum_{j \neq 1} (\bar{w}_j - \hat{w}_j) \mu_j \right] \\ &= \gamma + \sum_{j \neq 1} E [(\bar{w}_j - \hat{w}_j) \varepsilon_{jt}] + \sum_{j \neq 1} E [\lambda_t (\bar{w}_j - \hat{w}_j)] \mu_j\end{aligned}$$

Therefore:

$$|E [(\bar{w}_j - \hat{w}_j) \varepsilon_{jt}]| \leq E [ |(\bar{w}_j - \hat{w}_j) \varepsilon_{jt}| ] \leq \sqrt{E [(\bar{w}_j - \hat{w}_j)^2] E [(\varepsilon_{jt})^2]}$$

Now note that  $\hat{w}_j$  is a consistent estimator for  $\bar{w}_j$  and the random variable  $(\bar{w}_j - \hat{w}_j)^2$  is bounded, because  $W$  is compact. Therefore, the sequence  $(\bar{w}_j - \hat{w}_j)^2$  is asymptotically uniformly integrable, which implies that  $E [(\bar{w}_j - \hat{w}_j)^2] \rightarrow 0$ . If we also assume that  $\varepsilon_{it}$  and  $\lambda_t^f$  for all  $f = 1, \dots, F$  have finite variance, then  $\mathbb{E}[\hat{\alpha}_{1t} - \alpha_{1t}] \rightarrow \gamma$  when  $T_0 \rightarrow \infty$ .

## A.5 Alternatives specifications and alternative estimators

### A.5.1 Average of pre-intervention outcome as economic predictor

We consider now another very common specification in SC applications, which is to use the average pre-treatment outcome as the economic predictor. Note that if one uses only the average pre-treatment outcome as the economic predictor then the choice of matrix  $V$  would be irrelevant. In this case, the minimization problem would be given by:

$$\begin{aligned}\{\hat{w}_j\}_{j \neq 1} &= \operatorname{argmin}_{w \in W} \left[ \frac{1}{T_0} \sum_{t=1}^{T_0} \left( y_{1t} - \sum_{j \neq 1} w_j y_{jt} \right) \right]^2 \\ &= \operatorname{argmin}_{w \in W} \left[ \frac{1}{T_0} \sum_{t=1}^{T_0} \left( \varepsilon_{1t} - \sum_{j \neq 1} w_j \varepsilon_{jt} + \lambda_t \left( \mu_1 - \sum_{j \neq 1} w_j \mu_j \right) \right) \right]^2\end{aligned}\quad (42)$$

where  $W = \{\{w_j\}_{j \neq 1} \in \mathbb{R}^J | w_j \geq 0 \text{ and } \sum_{j \neq 1} w_j = 1\}$ .

Therefore, under assumptions 1, 2 and 4, the objective function converges in probability to:

$$\Gamma(\mathbf{w}) = \left[ E[\lambda_t | D(1, T_0) = 1] \left( \mu_1 - \sum_{j \neq 1} w_j \mu_j \right) \right]^2\quad (43)$$

Assuming that there is a time-invariant common factor (that is,  $\lambda_t^1 = 1$  for all  $t$ ) and that the pre-treatment average of the conditional process  $\lambda_t$  converges to  $\mathbb{E}[\lambda_t^k] = 0$  for  $k > 1$ , the objective function collapses to:

$$\Gamma(\mathbf{w}) = \left[ \left( \mu_1^1 - \sum_{j \neq 1} w_j \mu_j^1 \right) \right]^2\quad (44)$$

Therefore, even if we assume that there exists at least one set of weights that reproduces all factor loadings (Assumption 3), the objective function will only look for weights that approximate the first factor loading. This is problematic because it might be that assumption 3 is satisfied, but there are weights  $\{\hat{w}_j\}_{j \neq 1} \notin \Phi$  that satisfy  $\mu_1^1 = \sum_{j \neq 1} \hat{w}_j \mu_j^1$ . In this case, there is no guarantee that the SC control method will choose weights that are close to the correct ones. This result is consistent with

the Monte Carlo simulations in [Ferman et al. \(2017\)](#), who show that this specification performs particularly bad in allocating the weights correctly.

### A.5.2 Adding other covariates as predictors

Most SC applications that use the average pre-intervention outcome value as economic predictor also consider other time invariant covariates as economic predictors. Let  $Z_i$  be a  $(R \times 1)$  vector of observed covariates (not affected by the intervention). Model 49 changes to:

$$\begin{cases} y_{it}(0) = \delta_t + \theta_t Z_i + \lambda_t \mu_i + \varepsilon_{it} \\ y_{it}(1) = \alpha_{it} + y_{it}(0) \end{cases} \quad (45)$$

We also modify assumption 3 so that the weights reproduce both  $\mu_1$  and  $Z_1$ .

**Assumption 3'' (existence of weights)**

$$\exists \mathbf{w} \in W \mid \mu_1 = \sum_{j \neq 1} w_j^* \mu_j, Z_1 = \sum_{j \neq 1} w_j^* Z_j$$

Let  $X_1$  be an  $(R + 1 \times 1)$  vector that contains the average pre-intervention outcome and all covariates for unit 1, while  $X_0$  is a  $(R + 1 \times J)$  matrix that contains the same information for the control units. For a given  $V$ , the first step of the nested optimization problem suggested in [Abadie et al. \(2010\)](#) would be given by:

$$\hat{\mathbf{w}}(V) \in \operatorname{argmin}_{\mathbf{w} \in W} \|X_1 - X_0 \mathbf{w}\|_V \quad (46)$$

where  $W = \{\{w_j\}_{j \neq 1} \in \mathbb{R}^J \mid w_j \geq 0 \text{ and } \sum_{j \neq 1} w_j = 1\}$ . Assuming again that there is a time-invariant common factor (that is,  $\lambda_t^1 = 1$  for all  $t$ ) and that the pre-treatment average of the unconditional process  $\lambda_t$  converges to  $\mathbb{E}[\lambda_t^k] = 0$  for  $k > 1$ , objective function of this minimization problem converges to  $\|\bar{X}_1 - \bar{X}_0 \mathbf{w}\|_V$ , where:

$$\bar{X}_1 - \bar{X}_0 \mathbf{w} = \begin{bmatrix} \mathbb{E}[\theta_t | D(1, T_0) = 1] \left( Z_1 - \sum_{j \neq 1} w_j Z_j \right) + \left( \mu_1^1 - \sum_{j \neq 1} w_j \mu_j^1 \right) \\ \left( Z_1^1 - \sum_{j \neq 1} w_j Z_j^1 \right) \\ \vdots \\ \left( Z_1^R - \sum_{j \neq 1} w_j Z_j^R \right) \end{bmatrix} \quad (47)$$

Similarly to the case with only the average pre-intervention outcome value as economic predictor, it might be that assumption 3'' is satisfied, but there are weights  $\{\tilde{w}_j\}_{j \neq 1}$  that satisfy  $\mu_1^1 = \sum_{j \neq 1} \tilde{w}_j \mu_j^1$  and  $Z_1 = \sum_{j \neq 1} \tilde{w}_j Z_j$ , although  $\mu_1^k \neq \sum_{j \neq 1} \tilde{w}_j \mu_j^k$  for some  $k > 1$ . Therefore, there is no guarantee that an estimator based on this minimization problem would converge to weights that satisfy assumption 3'' for any given matrix  $V$ .

The second step in the nested optimization problem is to choose  $V$  such that  $\hat{\mathbf{w}}(V)$  minimizes the pre-intervention prediction error. Note that this problem is essentially given by:

$$\hat{\mathbf{w}} = \operatorname{argmin}_{\mathbf{w} \in \tilde{W}} \left[ \frac{1}{T_0} \sum_{t=1}^{T_0} \left( y_{1t} - \sum_{j \neq 1} w_j y_{jt} \right) \right]^2 \quad (48)$$

where  $\tilde{W} \subseteq W$  is the set of  $\mathbf{w}$  such that  $\mathbf{w}$  is the solution to problem 46 for some positive semidefinite matrix  $V$ . Similarly to the SC estimator that includes all pre-treatment outcomes, there is no guarantee that this minimization problem will choose weights that satisfy assumption 3'' even when  $T_0 \rightarrow \infty$ . More specifically, if the variance of  $\varepsilon_{it}$  is large, then the SC estimator would tend to choose weights that are uniform across the control units in detriment of weights that satisfy assumption 3''. Therefore, it is not possible to guarantee that this SC estimator would be asymptotically unbiased. MC simulation results in [Ferman et al. \(2017\)](#) confirm that this SC specification systematically misallocates more weight than alternatives that use a large number of pre-treatment outcome lags as predictors.

### A.5.3 Relaxing constraints on the weights

If we assume that  $W = \mathbb{R}^J$  instead of the compact set  $\{\hat{\mathbf{w}} \in \mathbb{R}^J \mid w_j \geq 0 \text{ and } \sum_{j \neq 1} w_j = 1\}$ , then we can still guarantee consistency of the SC weights. The only difference is that we also need to assume convergence of the pre-treatment averages of  $\delta_t$ . In Proposition 1 this was not necessary because the adding-up restriction implies that  $\delta_t$  was always eliminated. Consider



the model:

$$y_{it}(0) = \dot{\lambda}_t \dot{\mu}_i + \varepsilon_{it} \quad (49)$$

where  $\dot{\lambda}_t = (\delta_t, \lambda_t)$  and  $\dot{\mu}_i = (1, \mu_i)'$ . We modify assumption 4' to include assumptions on the convergence of  $\delta_t$ .

**Assumption 4'''' (convergence of pre-treatment averages)**  $\frac{1}{T_0} \sum_{t=1}^{T_0} \dot{\lambda}_t \xrightarrow{P} \dot{\omega}_0$ ,  $\frac{1}{T_0} \sum_{t=1}^{T_0} \dot{\lambda}'_t \dot{\lambda}_t \xrightarrow{P} \dot{\Omega}_0$ ,  $\frac{1}{T_0} \sum_{t=1}^{T_0} \varepsilon_{jt} \xrightarrow{P} 0$ ,  $\frac{1}{T_0} \sum_{t=1}^{T_0} \varepsilon_{jt}^2 \xrightarrow{P} \sigma_\varepsilon^2$ , and that  $\varepsilon_{jt} \perp \dot{\lambda}_s$  for all  $s, t$  and for all  $j$ .

Note first that, under assumptions 1 and 4''''', the objective function converges in probability to:

$$\widehat{Q}_{T_0}(\mathbf{w}) \xrightarrow{P} \dot{Q}_0(\mathbf{w}) \equiv \sigma_\varepsilon^2(1 + \mathbf{w}'\mathbf{w}) + (\mu_1 - \mu_0\mathbf{w})' \dot{\Omega}_0 (\mu_1 - \mu_0\mathbf{w}) \quad (50)$$

where  $\dot{Q}_0(\mathbf{w})$  is continuous and strictly convex. Since  $W$  is a convex space,  $\dot{Q}_0(\mathbf{w})$  has a unique minimum that is in the interior of  $W$ . Therefore, by Theorem 2.7 of Newey and McFadden (1994),  $\widehat{\mathbf{w}}$  exists with probability approaching one and  $\widehat{\mathbf{w}} \xrightarrow{P} \mathbf{w}_0$ .

For the case  $W = \{\mathbf{w} \in \mathbb{R}^J \mid \sum_{j=2}^{J+1} w_j = 1\}$ , note that the transformed model with  $y_{1t} - y_{2t}$  as the outcome of the treated unit and  $y_{3t} - y_{2t}, \dots, y_{J+1,t} - y_{2t}$  as the outcomes of the control units is equivalent to the original model. Then we can use the same arguments on this modified model.

Consistency when we impose only the non-negativity constraint follows from the same arguments as in Appendix A.6.1.

Given that we assure convergence of  $\widehat{\mathbf{w}}$ , the fact that  $\widehat{\mathbf{w}}$  does not converge to weights that reconstruct the factor loadings of the treated unit follows from the same arguments as the proof of Proposition 1. Note that, without the adding-up constraint, it might be that the asymptotic distribution of the SC estimator depends on  $\delta_t$ .

## A.5.4 IV-Like SC Estimator

Consider again equation 38. The key problem is that  $\eta_t$  is correlated with  $y_{jt}$ , which implies that the restricted OLS estimators are biased and inconsistent. Imposing strong assumptions on the structure of the idiosyncratic error and the common factors, we show that it is possible to consider moment equations that will be equal to zero if, and only if,  $\{w_j\}_{j \neq 1} \in \Phi$ .

Let  $\mathbf{y}_{0t} = (y_{2,t}, \dots, y_{J+1,t})'$ ,  $\mu_0$  be a  $(F \times J)$  matrix with columns  $\mu_j$ ,  $\varepsilon_{0t} = (\varepsilon_{2,t}, \dots, \varepsilon_{J+1,t})$ , and  $\mathbf{w} = (w_1^2, \dots, w_1^{J+1})'$ . In this case, we can look at:

$$\begin{aligned} \mathbf{y}_{t-1}(y_{1t} - \mathbf{y}'_{0t}\mathbf{w}) &= (\mu'_0 \lambda'_{t-1} + \varepsilon_{0,t-1}) \lambda_t (\mu_1 - \mu_0\mathbf{w}) + (\mu'_0 \lambda'_{t-1} + \varepsilon_{0,t-1})(\varepsilon_{1t} - \varepsilon'_{0t}\mathbf{w}) \\ &= \mu'_0 \lambda'_{t-1} \lambda_t (\mu_1 - \mu_0\mathbf{w}) + \varepsilon_{0,t-1} \lambda_t (\mu_1 - \mu_0\mathbf{w}) + \mu'_0 \lambda'_{t-1} (\varepsilon_{1t} - \varepsilon'_{0t}\mathbf{w}) + \varepsilon_{0,t-1} (\varepsilon_{1t} - \varepsilon'_{0t}\mathbf{w}) \end{aligned} \quad (51)$$

If we assume that  $\varepsilon_{it}$  is independent across  $t$  and independent of  $\lambda_t$ , then, for  $t < T_0$ :

$$E[\mathbf{y}_{0,t-1}(y_{1t} - \mathbf{y}'_{0t}\mathbf{w})] = \mu'_0 E[\lambda'_{t-1} \lambda_t] (\mu_1 - \mu_0\mathbf{w}) \quad (52)$$

Therefore, if the  $(J \times F)$  matrix  $\mu'_0 E[\lambda'_{t-1} \lambda_t]$  has full rank, then the moment conditions equal to zero if, and only if,  $\mathbf{w} \in \Phi$ . One particular case in which this assumption is valid is if  $\lambda_t^f$  and  $\lambda_t^{f'}$  are uncorrelated and  $\lambda_t^f$  is serially correlated for all  $f = 1, \dots, F$ . Intuitively, under these assumptions, we can use the lagged outcome values of the control units as instrumental variables for the control units' outcomes.<sup>35</sup> Assumption 4' guarantees that the pre-treatment averages of the moment conditions, which are based on the conditional process  $z_{jt}$  converge in probability to the unconditional moment conditions. One challenge to analyze this method is that there might be multiple solutions to the moment condition. Based on the results in Chernozhukov et al. (2007), it is possible to consistently estimate this set. Therefore, it is possible to generate an IV-like SC estimator that is, under additional assumptions, asymptotically unbiased.

## A.6 Extensions on Proposition 4

### A.6.1 Relaxing the adding-up and non-negativity constraints

To show that this result is also valid for the case with adding-up constraint we just have to consider the OLS regression of  $y_{1t} - y_{2t}$  on a constant and  $y_{3t} - y_{2t}, \dots, y_{J+1,t} - y_{2t}$ . Under assumption 3', this transformed model is also cointegrated, so we can apply our previous result.

<sup>35</sup>The idea of SC-IV is very similar to the IV estimator used in dynamic panel data. In the dynamic panel models, lags of the outcome are used to deal with the endogeneity that comes from the fact the idiosyncratic errors are correlated with the lagged depend variable included in the model as covariates. The number of lags that can be used as instruments depends on the serial correlation of the error terms.

We now consider the case with the non-negative constraints. We prove the case  $W = \{\mathbf{w} \in \mathbb{R}^J \mid w_j \geq 0\}$ . Including an adding-up constraint then follows directly from a change in variables as we did for the case without non-negative constraints.

We first show that  $\widehat{\mathbf{w}} \xrightarrow{P} \bar{\mathbf{w}}$  where  $\bar{\mathbf{w}}$  minimizes  $\mathbb{E}[u_t^2]$  subject to  $\mathbf{w} \in \Phi_1 \cap W$ . Suppose that  $\bar{\mathbf{w}} \in \text{int}(W)$ . This implies that  $\bar{\mathbf{w}} \in \text{int}(\Phi_1 \cap W)$  relative to  $\Phi_1$ . By convexity of  $E[u_t^2]$ ,  $\bar{\mathbf{w}}$  also minimizes  $E[u_t^2]$  subject to  $\Phi_1$ . We know that OLS without the non-negativity constraints converges in probability to  $\bar{\mathbf{w}}$ . Let  $\widehat{\mathbf{w}}_u$  be the OLS estimator without the non-negativity constraints and  $\widehat{\mathbf{w}}_r$  be the OLS estimator with the non-negativity constraint. Since  $\bar{\mathbf{w}} \in \text{int}(W)$ , then it must be that, for all  $\varepsilon > 0$ ,  $Pr(|\widehat{\mathbf{w}}_u - \bar{\mathbf{w}}| > \varepsilon) = 0$  with probability approaching to 1 (w.p.a.1). Since  $\widehat{\mathbf{w}}_u = \widehat{\mathbf{w}}_r$  when  $\widehat{\mathbf{w}}_u \in \text{int}(W)$  (due to convexity of the OLS objective function), these two estimators are asymptotically equivalent.

Consider now the case in which  $\bar{\mathbf{w}}$  is on the boundary of  $W$ . This means that  $\bar{w}_j = 0$  for at least one  $j$ . Let  $A = \{j \mid w_j^* = 0\}$ . Note first that  $\bar{\mathbf{w}}$  also minimizes  $E[u_t^2]$  subject to  $\mathbf{w} \in \Phi \cap \{\mathbf{w} \mid w_j = 0 \forall j \in A\}$ . That is, if we impose the restriction  $w_j = 0$  for all  $j$  such that  $\bar{w}_j = 0$ , then we would have the same minimizer, even if we ignore the other non-negative constraints. Suppose there is an  $\widehat{\mathbf{w}} \neq \bar{\mathbf{w}}$  that minimizes  $E[u_t^2]$  subject to  $\mathbf{w} \in \Phi \cap \{\mathbf{w} \mid w_j = 0 \forall j \in A\}$ . By convexity of the objective function and the fact that  $\bar{\mathbf{w}}$  is in the interior of  $\Phi \cap W \cap \{\mathbf{w} \mid w_j = 0 \forall j \in A\}$  relative to  $\Phi \cap \{\mathbf{w} \mid w_j = 0 \forall j \in A\}$ , there must be  $\mathbf{w}' \in \Phi \cap W \cap \{\mathbf{w} \mid w_j = 0 \forall j \in A\} \subset \Phi \cap W$  that attains a lower value in the objective function than  $\bar{\mathbf{w}}$ . However, this contradicts the fact that  $\bar{\mathbf{w}} \in \Phi \cap W$  is the minimum.

Now let  $\widehat{\mathbf{w}}'$  be the OLS estimator subject to  $\{\mathbf{w} \mid w_j = 0 \forall j \in A\}$ . We have that  $\widehat{\mathbf{w}}'$  is consistent for  $\bar{\mathbf{w}}$  (Lemma ??). Now we show that  $\widehat{\mathbf{w}}'$  is asymptotically equivalent to  $\widehat{\mathbf{w}}''$ , the OLS estimator subject to  $\{\mathbf{w} \mid w_j \geq 0 \forall j \in A\}$ . We prove the case in which  $A = \{j\}$  (there is only one restriction that binds). The general case follows by induction. Suppose these two estimators are not asymptotically equivalent. Then there is  $\varepsilon > 0$  such that  $\text{LimPr}(|\widehat{\mathbf{w}}' - \widehat{\mathbf{w}}''| > \varepsilon) \neq 0$ . There are two possible cases.

First, suppose that  $\text{LimPr}(|\widehat{w}_j''| > \varepsilon') = 0$  for all  $\varepsilon' > 0$  (that is, the OLS subject to  $\{\mathbf{w} \mid w_j \geq 0 \forall j \in A\}$  converges in probability to  $\bar{\mathbf{w}}$  such that  $\bar{w}_j = 0$ ). However, since the two estimators are not asymptotically equivalent, for all  $T'_0$ , we can always find a  $T_0 > T'_0$  such that, with positive probability,  $|\widehat{\mathbf{w}}' - \widehat{\mathbf{w}}''| > \varepsilon$ . Since  $\{\mathbf{w} \mid w_j = 0 \forall j \in A\} \subset \{\mathbf{w} \mid w_j \geq 0 \forall j \in A\}$  and  $\widehat{\mathbf{w}}' \neq \widehat{\mathbf{w}}''$ , then  $Q_{T_0}(\widehat{\mathbf{w}}'') < Q_{T_0}(\widehat{\mathbf{w}}')$ , where  $Q_{T_0}()$  is the OLS objective function. Now using the continuity of the OLS objective function and the fact that  $\widehat{w}_j''$  converges in probability to zero, we can always find  $T'_0$  such that there will be a positive probability that  $Q_{T_0}(\widehat{\mathbf{w}}'' - e_j \widehat{w}_j'') < Q_{T_0}(\widehat{\mathbf{w}}')$ . Since  $\widehat{\mathbf{w}}'' - e_j \widehat{w}_j'' \in \{\mathbf{w} \mid w_j = 0 \forall j \in A\}$ , this contradicts  $\widehat{\mathbf{w}}'$  being OLS subject to  $\{\mathbf{w} \mid w_j = 0 \forall j \in A\}$ .

Alternatively, suppose that there exists  $\varepsilon' > 0$  such that  $\text{LimPr}(|\widehat{w}_j''| > \varepsilon') \neq 0$ . This means that, for all  $T'_0$ , we can find  $T_0 > T'_0$  such that there is a positive probability that the solution to OLS on  $\{\mathbf{w} \mid w_j \geq 0 \forall j \in A\}$  is in an interior point  $\widehat{\mathbf{w}}''$  with  $\widehat{w}_j'' > \varepsilon' > 0$ . By convexity of  $Q_{T_0}()$ , this would imply that  $\widehat{\mathbf{w}}''$  is also the solution to the OLS without any restriction. However, this contradicts the fact that OLS without non-negativity restriction is consistent (see proof of Proposition 4).

Finally, we show that  $\widehat{\mathbf{w}}''$  and  $\widehat{\mathbf{w}}_r$  are asymptotically equivalent. Note that  $\bar{\mathbf{w}}$  is in the interior of  $W$  relative to  $\{\mathbf{w} \mid w_j \geq 0 \forall j \in A\}$ . Therefore, w.p.a.1,  $\widehat{\mathbf{w}}'' \in W$ , which implies that  $\widehat{\mathbf{w}}'' = \widehat{\mathbf{w}}_r$ .

We still need to show that linear combinations of  $\widehat{\mathbf{w}}^r$  converge fast enough to reconstruct the factor loadings of the treated unit associated with the non-stationary common factors, so that  $\gamma_t(\theta_1 - \sum_{j \neq 1} \widehat{w}_j^r \theta_j) \xrightarrow{P} 0$ . Let  $Q_{T_0}()$  be the OLS objective function, and let  $\widetilde{W} = \{\widetilde{\mathbf{w}}_1, \dots, \widetilde{\mathbf{w}}_{2^J}\}$  be the set of all possible OLS estimators when we consider some of the non-negative constraints as equality and ignore the other ones. Let  $\widetilde{W}' \subset \widetilde{W}$  be the set of estimators in  $\widetilde{W}$  such that all non-negative constraints are satisfied. Then we know that  $\widehat{\mathbf{w}}^r = \underset{\mathbf{w} \in \widetilde{W}'}{\text{argmin}} Q_{T_0}(\mathbf{w})$ .

Suppose first that, for any of the  $2^J$  combinations of restrictions, there is at least one  $\mathbf{w} \in \Phi_1$  that satisfy these restrictions. In this case, we know from the first part of the proof that  $\gamma_t(\theta_1 - \sum_{j \neq 1} \widehat{w}_j^h \theta_j) \xrightarrow{P} 0$  for all  $h = 1, \dots, 2^J$ , where  $\widetilde{\mathbf{w}}_h = (\widehat{w}_1^h, \dots, \widehat{w}_{j+1}^h)'$ . Moreover, since  $\widetilde{W}$  is finite, then this convergence is uniform in  $\widetilde{W}$ . Therefore, it must be that  $\gamma_t(\theta_1 - \sum_{j \neq 1} \widehat{w}_j^r \theta_j) \xrightarrow{P} 0$ . Suppose now that for the combination of restrictions considered for  $\widetilde{\mathbf{w}}_h$ , with  $h \in \{1, \dots, 2^J\}$ , there is no  $\mathbf{w} \in \Phi_1$  that satisfies these restrictions. Since the parameter space with this combination of restrictions is closed, then  $\exists \eta > 0$  such that  $\|\theta_1 - \sum_{j \neq 1} w_j \theta_j\| > \eta$  for all  $\mathbf{w}$  that satisfy this combinations of restrictions.<sup>36</sup> Therefore,  $Q_{T_0}(\widetilde{\mathbf{w}}_h)$  diverge when  $T_0 \rightarrow \infty$ , implying that, w.p.a.1,  $\widehat{\mathbf{w}}^r \neq \widetilde{\mathbf{w}}_h$ .

## A.6.2 Example with no intercept

We consider now a very simple example to show that it is not possible to guarantee that  $\gamma_t(\theta_1 - \sum_{j \neq 1} \widehat{w}_j \theta_j) \xrightarrow{P} 0$  if we do not include the intercept. Consider the case in which there are only one treated and one control unit, and  $y_{1t} = \mu_1 + t + u_{1t}$  while  $y_{2t} = \mu_2 + t + u_{2t}$ . We consider a regression of  $y_{1t}$  on  $y_{2t}$  without the intercept. Note that  $y_{1t} = (\mu_1 - \mu_2) + y_{2t} + u_{1t} - u_{2t} = \mu + y_{2t} + u_t$ . Then we have that:

$$\hat{\beta} = \frac{\sum_{t=1}^{T_0} y_{2t} y_{1t}}{\sum_{t=1}^{T_0} y_{2t}^2} = 1 + \frac{\sum_{t=1}^{T_0} (\mu \mu_2 + \mu t + \mu u_{2t} + \mu_2 u_t + t u_t + u_t u_{2t})}{\sum_{t=1}^{T_0} (t^2 + \mu_2^2 + u_{2t}^2 + \text{"cross terms"})} \quad (53)$$

<sup>36</sup>Otherwise, there would be  $\mathbf{w} \in \Phi_1$  that satisfies this combination of restrictions.

which implies that:

$$T(\hat{\beta} - 1) = \frac{\frac{1}{T^2} \sum_{t=1}^{T_0} (\mu\mu_2 + \mu t + \mu u_{2t} + \mu_2 u_t + t u_t + u_t u_{2t})}{\frac{1}{T^3} \sum_{t=1}^{T_0} (t^2 + \mu_2^2 + u_{2t}^2 + \text{“cross terms”})} \xrightarrow{P} \frac{\frac{1}{2}\mu}{\frac{1}{3}} \quad (54)$$

Therefore, while  $\hat{\beta} \xrightarrow{P} 1$ , it does not converge fast enough so that  $T(\hat{\beta} - 1) \xrightarrow{P} 0$ , except when  $\mu_1 = \mu_2$ .

## A.7 Appendix Tables

Table A.1: Misallocation of weights and probability of perfect match - alternative definition of perfect match

	Misallocation of weights			Probability of perfect match ( $\tilde{R}^2 > 0.9$ )			Misallocation conditional on perfect match		
	$\sigma_\varepsilon^2 = 0.1$ (1)	$\sigma_\varepsilon^2 = 0.5$ (2)	$\sigma_\varepsilon^2 = 1$ (3)	$\sigma_\varepsilon^2 = 0.1$ (4)	$\sigma_\varepsilon^2 = 0.5$ (5)	$\sigma_\varepsilon^2 = 1$ (6)	$\sigma_\varepsilon^2 = 0.1$ (7)	$\sigma_\varepsilon^2 = 0.5$ (8)	$\sigma_\varepsilon^2 = 1$ (9)
$T_0 = 5$	0.418 [0.002]	0.714 [0.002]	0.807 [0.002]	0.490 [0.004]	0.319 [0.003]	0.296 [0.003]	0.448 [0.003]	0.771 [0.003]	0.848 [0.003]
$T_0 = 20$	0.197 [0.001]	0.495 [0.001]	0.653 [0.001]	0.128 [0.002]	0.000 [0.000]	0.000 [0.000]	0.143 [0.002]	- -	- -
$T_0 = 50$	0.150 [0.000]	0.415 [0.001]	0.573 [0.001]	0.032 [0.001]	0.000 [0.000]	0.000 [0.000]	0.102 [0.002]	- -	- -
$T_0 = 100$	0.130 [0.000]	0.384 [0.001]	0.539 [0.001]	0.005 [0.000]	0.000 [0.000]	0.000 [0.000]	0.088 [0.003]	- -	- -

Notes: this table replicates the results from Table 1 using a more stringent definition of perfect match.

Table A.2: Misallocation of weights and probability of perfect match - stationary model ( $K = 2$ )

	Misallocation of weights			Probability of perfect match ( $\tilde{R}^2 > 0.8$ )			Misallocation conditional on perfect match		
	$\sigma_\varepsilon^2 = 0.1$ (1)	$\sigma_\varepsilon^2 = 0.5$ (2)	$\sigma_\varepsilon^2 = 1$ (3)	$\sigma_\varepsilon^2 = 0.1$ (4)	$\sigma_\varepsilon^2 = 0.5$ (5)	$\sigma_\varepsilon^2 = 1$ (6)	$\sigma_\varepsilon^2 = 0.1$ (7)	$\sigma_\varepsilon^2 = 0.5$ (8)	$\sigma_\varepsilon^2 = 1$ (9)
$T_0 = 5$	0.092 [0.001]	0.199 [0.001]	0.266 [0.002]	0.842 [0.003]	0.631 [0.003]	0.555 [0.004]	0.086 [0.001]	0.198 [0.002]	0.268 [0.002]
$T_0 = 20$	0.066 [0.000]	0.140 [0.001]	0.191 [0.001]	0.921 [0.002]	0.167 [0.003]	0.030 [0.001]	0.063 [0.000]	0.100 [0.002]	0.121 [0.004]
$T_0 = 50$	0.053 [0.000]	0.110 [0.000]	0.155 [0.001]	0.987 [0.001]	0.024 [0.001]	0.000 [0.000]	0.052 [0.000]	0.066 [0.003]	- -
$T_0 = 100$	0.044 [0.000]	0.095 [0.000]	0.134 [0.000]	0.999 [0.000]	0.001 [0.000]	0.000 [0.000]	0.044 [0.000]	- -	- -

Notes: this table replicates the results from Table 1 using a DGP with  $K = 2$ .