The variance of β_{GMM} is asymptotically obtained as follows:

$$
\begin{aligned}
\mathrm{V}(\beta_{GMM}) &= \mathrm{E}\Big((\beta_{GMM} - \mathrm{E}(\beta_{GMM}))(\beta_{GMM} - \mathrm{E}(\beta_{GMM}))'\Big) \approx \mathrm{E}\Big((\beta_{GMM} - \beta)(\beta_{GMM} - \beta)'\Big) \\
&= \mathrm{E}\Big((X'Z(Z'\Omega Z)^{-1}Z'X)^{-1}X'Z(Z'\Omega Z)^{-1}Z'u((X'Z(Z'\Omega Z)^{-1}Z'X)^{-1}X'Z(Z'\Omega Z)^{-1}Z'u)'\Big) \\
&= \mathrm{E}\Big((X'Z(Z'\Omega Z)^{-1}Z'X)^{-1}X'Z(Z'\Omega Z)^{-1}Z'uu'Z(Z'\Omega Z)^{-1}Z'X(X'Z(Z'\Omega Z)^{-1}Z'X)^{-1}\Big) \\
&\approx (X'Z(Z'\Omega Z)^{-1}Z'X)^{-1}X'Z(Z'\Omega Z)^{-1}Z'\mathrm{E}(uu')Z(Z'\Omega Z)^{-1}Z'X(X'Z(Z'\Omega Z)^{-1}Z'X)^{-1} \\
&= \sigma^2(X'Z(Z'\Omega Z)^{-1}Z'X)^{-1}.
\end{aligned}
$$

Note that $\beta_{GMM} \longrightarrow \beta$ implies $\mathrm{E}(\beta_{GMM}) \longrightarrow \beta$ in the 1st line.

$\approx$ in the 4th line indicates that Z and X are treated as exogenous variables although they are stochastic.

We assume that $\mathrm{E}(uu') = \sigma^2\Omega$ from the 4th line to the 5th line.

- We derive the asymptotic distribution of β_{GMM}.

From the central limit theorem,

$$\frac{1}{\sqrt{n}}Z'u \longrightarrow N(0,\ \sigma^2 M_{z\Omega z}).$$

Accordingly, β_{GMM} is asymptotically distributed as:

$$\begin{aligned}\sqrt{n}(\beta_{GMM}-\beta) &= \Big((\frac{1}{n}X'Z)(\frac{1}{n}Z'\Omega Z)^{-1}(\frac{1}{n}Z'X)\Big)^{-1}(\frac{1}{n}X'Z)(\frac{1}{n}Z'\Omega Z)^{-1}(\frac{1}{\sqrt{n}}Z'u)\\ &\longrightarrow N(0,\ \sigma^2(M_{xz}M_{z\Omega z}^{-1}M'_{xz})^{-1}).\end{aligned}$$

Practically, we use: $\beta_{GMM} \sim N\Big(\beta,\ s^2(X'Z(Z'\Omega Z)^{-1}Z'X)^{-1}\Big)$,

where $s^2 = \dfrac{1}{n-k}(y - X\beta_{GMM})'\Omega^{-1}(y - X\beta_{GMM})$.

We may use n instead of $n-k$.

Identically and Independently Distributed Errors:

- If $u_1, u_2, \cdots, u_n$ are mutually independent and u_i is distributed with mean zero and

variance σ^2, the mean and variance of u^* are given by:

$$\mathrm{E}(u^*) = 0 \quad \text{and} \quad \mathrm{V}(u^*) = \mathrm{E}(u^* u^{*\prime}) = \sigma^2 Z'Z.$$

Using GLS, GMM is obtained as:

$$\beta_{GMM} = (X^{*\prime}(Z'Z)^{-1}X^*)^{-1}X^{*\prime}(Z'Z)^{-1}y^* = \Big(X'Z(Z'Z)^{-1}Z'X\Big)^{-1}X'Z(Z'Z)^{-1}Z'y.$$

- We derive the asymptotic distribution of β_{GMM}.

From the central limit theorem,

$$\frac{1}{\sqrt{n}}Z'u \longrightarrow N(0, \sigma^2 M_{zz}).$$

Accordingly, β_{GMM} is distributed as:

$$\sqrt{n}(\beta_{GMM} - \beta) = \Big((\frac{1}{n}X'Z)(\frac{1}{n}Z'Z)^{-1}(\frac{1}{n}Z'X)\Big)^{-1}(\frac{1}{n}X'Z)(\frac{1}{n}Z'Z)^{-1}(\frac{1}{\sqrt{n}}Z'u)$$
$$\longrightarrow\ N\Big(0,\ \sigma^2(M_{xz}M_{zz}^{-1}M_{xz}')^{-1}\Big).$$

Practically, for large n we use the following distribution:

$$\beta_{GMM} \sim N\Big(\beta, s^2(X'Z(Z'Z)^{-1}Z'X)^{-1}\Big),$$

where $s^2 = \dfrac{1}{n-k}(y - X\beta_{GMM})'(y - X\beta_{GMM})$.

- The above GMM is equivalent to 2SLS.

X: $n \times k$, $\quad Z$: $n \times r$, $\quad r > k$.

Assume:

$$\frac{1}{n}X'u = \frac{1}{n}\sum_{i=1}^{n} x_i' u_i \longrightarrow \mathrm{E}(x'u) \neq 0,$$

$$\frac{1}{n}Z'u = \frac{1}{n}\sum_{i=1}^{n} z_i' u_i \longrightarrow \mathrm{E}(z'u) = 0.$$

Regress X on Z, i.e., $X = Z\Gamma + V$ by OLS, where Γ is a $r \times k$ unknown parameter matrix and V is an error term,

Denote the predicted value of X by $\hat{X} = Z\hat{\Gamma} = Z(Z'Z)^{-1}Z'X$, where $\hat{\Gamma} = (Z'Z)^{-1}Z'X$.

Review — IV estimator: Consider the regression model is:

$$y = X\beta + u,$$

Assumption: $\mathrm{E}(X'u) \neq 0$ and $\mathrm{E}(Z'u) = 0$.

The $n \times k$ matrix Z is called the instrumental variable (IV).

The IV estimator is given by:

$$\beta_{IV} = (Z'X)^{-1}Z'y,$$

- Note that 2SLS is equivalent to IV in the case of $Z = \hat{X}$, where this Z is different from the previous Z.

This Z is a $n \times k$ matrix, while the previous Z is a $n \times r$ matrix.

Z in the IV estimator is replaced by $\hat{X}$.

Then,

$$\beta_{2SLS} = (\hat{X}'X)^{-1}\hat{X}'y = \left(X'Z(Z'Z)^{-1}Z'X\right)^{-1}X'Z(Z'Z)^{-1}Z'y = \beta_{GMM}.$$

GMM is interpreted as the GLS applied to MM.