Identifying Peer Effects on Student Academic Effort

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May 14, 2023

Abstract

Peer influences on academic outcomes are often studied using GPA as a proxy variable for students' academic effort. We show that this may bias the peer effects when the network includes isolated students. This is because GPA depends on unobserved factors that do not influence isolated and non-isolated students in the same way. To resolve this issue, we propose an identification strategy that distinguishes unobserved shocks exerted on GPA without influencing the effort from unobserved students' preference shocks. Applying our approach to Add Health data shows that the peer effect estimate using standard approaches is biased downward.

Keywords: Social networks, Peer effects, Academic achievement, Nonparametric methods
JEL classification: C14, C31, J24

1   Introduction

Over the last two decades, there has been a growing interest in the impact of peers on educational outcomes (Sacerdote, 2011). Peer effects may involve a social multiplier effect; therefore, knowing whether students are influenced by their friends and the size of this influence is crucial for evaluating policies aimed at inducing changes in academic achievement (Manski, 1993). As students cannot control their academic achievement directly, but rather through their effort levels, peer influences take root from academic effort and not from academic achievement. However, because the effort is unobserved in general, most studies use the grade point average (GPA) as a proxy variable. Such an approximation disregards that the GPA is not solely influenced by the effort but also by many factors, including unobserved student and school characteristics.

In this paper, we develop a structural model with social interactions, where students decide on their academic effort, taking into account that of their peers (friends). We introduce a complementary between students' and peers' efforts. We also present a trade-off between GPA, which increases student payoff, and effort, which results in disutility (Boucher and Fortin, 2016). Without using a proxy for student academic effort, we show that the model allows for identifying peer effects on academic effort and we provide an interpretation of the effects in terms of GPA. We also show that the size of the effect may differ from that estimated using the GPA as a proxy. Our identification strategy consists of controlling for two types of unobserved GPA shocks to disentangle peer effects on academic effort from other common effects captured by the GPA. First, we account for common shocks that directly influence GPA, such as improvements in teaching quality, irrespective of the effort level. These shocks result in a GPA increase for the same level of effort and do not involve a social multiplier effect. Second, we account for common shocks affecting students' preferences, such as sensitization to caring more about academic achievement. These shocks impact both academic effort and GPA.

We show that standard approaches using GPA as a proxy for student academic effort result in biased estimates of peer effects when some students in the network do not have friends. Specifically, we derive from the structural model a reduced-form equation for GPA that differs from the classical linear-in-means peer effect specification. We demonstrate that students who have friends are not affected by both types of GPA shocks in the same way as those who do not have friends. Shocks that directly influence GPA, irrespective of the effort level, do not involve a social multiplier effect, whereas preference shocks that affect effort and GPA may imply a social multiplier effect within students with friends. Standard approaches using GPA as a proxy do not disentangle the two types of shock, and therefore, lead to biased estimates of peer effects when the network includes students who have no friends. We show that this bias can be interpreted as a first-order bias because of an omission of explanatory variables (Theil, 1957; Frisch and Waugh, 1933).

We extend the estimation strategy to the case of endogenous networks and present an empirical analysis using the National Longitudinal Study of Adolescent Health (Add Health) data.[1] We find that increasing the average GPA of peers by one point leads to a 0.856 point increase in students' GPA. In contrast, the standard linear-in-means model using GPA as a proxy for student academic effort estimates this effect at 0.507. We also find that the network is endogenous. Controlling for endogeneity reduces the bias of the standard linear-in-means model.

The network endogeneity occurs because we do not observe some student characteristics, such as intellectual quotient (IQ), that can influence students' likelihood to form links with others and their GPA. We control for those unobserved characteristics using a two-stage estimation approach. Our method is nonparametric as in Johnsson and Moon (2021). We impose no parametric restrictions regarding the way the unobserved characteristics affect GPA. Our approach is similar to generalized additive models (GAM), widely employed in the nonparametric regression literature (see Hastie, 2017).

Our model also controls for unobserved school heterogeneity. In particular, the two types of unobserved GPA shocks are introduced at the school level as common shocks. This feature of the model renders the well-known *reflection problem* more complex.[2] In the case of the standard linear-in-means model, Bramoullé et al. (2009) find straightforward conditions under which the reflection problem is fixed. Their conditions involve the network structure and can be readily tested in practice. We extend their identification analysis to our framework under similar conditions. Our main condition is that the network has at least two students separated by a link of distance three, which is slightly stronger than the identification condition of Bramoullé et al. (2009).

Furthermore, our econometric model is characterized by a composite disturbance term, as students do not choose their GPA directly. This raises additional challenges in identifying the error term distribution parameters. Moreover, the presence of unobserved school heterogeneity and students with no friends makes it challenging to specify a likelihood function for the model (Lee et al., 2010). To address this issue, we propose a multi-stage estimation strategy that combines the general method of moments (GMM) and quasi-maximum likelihood (QML) approaches (Kelejian and Prucha, 1998; Lee, 2004). Our approach yields a consistent estimator of the peer effects.

Our model can also be used to study peer influence on other outcomes that depend on exerted effort. An example is the body mass index (BMI), which cannot be directly chosen (e.g., Fortin and Yazbeck, 2015). People need to exert effort, such as developing healthy diet habits or engaging in physical exercise to improve their BMI. Peer influences are more related to effort than BMI. Another example is peer effects on a worker's effort (e.g., Cornelissen et al., 2017). The observed outcome is

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[1] Add Health data set comprises 22% of students without friends, including 11% who are not fully isolated, in the sense that they are friends of others.

[2] The reflection problem arises when one cannot disentangle endogenous peer effects from exogenous contextual peer effects (Manski, 1993)

generally worker's productivity, whereas peer effects take source in the effort.

Related Literature

This paper contributes to the extensive literature on social interaction models. Manski (1993) proposes a model in which an agent's action is a linear function of the average action of their group. Ballester et al. (2006) analyze a noncooperative game with linear-quadratic utilities, in which each player decides how much effort they exert. In a similar game, Calvó-Armengol et al. (2009) use GPA as a proxy for the exerted effort. We contribute to this literature by proposing a structural model in which students choose an effort level taking into account their peers' efforts. We disentangle unobserved common shocks that directly impact GPA without affecting the effort from unobserved common shocks that impact both academic effort and GPA.

Our paper is closest to Fruehwirth (2013) who also assumes that peer effects take source in academic effort. Our study differs from her framework in two ways. First, we allow students to have no friends, and we show that this setting implies a different econometric model. In our application using the Add Health data, there are 22% of students without friends, including 11% who are not fully isolated because they are friends of others. We find that the peer effect estimate obtained using a standard linear-in-means model is 1.6 times lower than that obtained through our approach. Second, as friends are self-nominated in the Add Health data, we control for network endogeneity, and we find a slight decrease in the peer effect estimate.

Our paper makes a valuable contribution to the econometric literature on peer effects (De Paula, 2017; Kline and Tamer, 2020). A key challenge in this field is the reflection problem (Manski, 1993). Many studies propose to fix this problem using group size variation, whereas others impose conditions on the network structure (Davezies et al., 2009; Lee, 2007; Bramoullé et al., 2009; Rose, 2017). We study the reflection problem in a setting where the GPA is influenced by various types of common shocks at the school level and where students are allowed to have no peers. Our analysis is similar to that of Houndetoungan (2022) for nonlinear models, although here we account for unobserved heterogeneity across schools. As in Bramoullé et al. (2009), our main identification condition involves the network structure and can be readily tested in practice.

The paper also contributes to the econometric literature on peer effects by addressing the network endogeneity issue. We allow for unobserved attributes to influence students' likelihood to form links with others and their GPA (Goldsmith-Pinkham and Imbens, 2013; Hsieh and Lee, 2016; Johnsson and Moon, 2021). Whereas many studies impose a strong parametric restriction between unobserved attributes and the peer effect model, we use a nonparametric approach to connect the GPA to these attributes. Our approach is similar to the control function method used by Johnsson and Moon (2021),

but it is adaptable to complex models, even those with nonlinear specifications. Specifically, we employ tensor products of cubic B-splines, which are used in GAM, to establish a smooth function between the unobserved attributes and GPA (Hastie, 2017).

Finally, the paper contributes to the large suite of empirical literature on peer effects on education outcome (e.g., Sacerdote, 2001; Zimmerman, 2003; Hanushek et al., 2003; Zabel, 2008; Calvó-Armengol et al., 2009; Carrell et al., 2009; Lin, 2010; Sacerdote, 2011; Black et al., 2013; Burke and Sass, 2013; Hatami et al., 2015; Marotta, 2017; Dickerson et al., 2018; Fruehwirth and Gagete-Miranda, 2019; Gagete-Miranda, 2020; Norris, 2020; Boucher et al., 2022a). Most of those studies use GPA as a proxy variable for academic effort. In our empirical application using the Add Health data set, we control for several sources of common school-level shocks by allowing peer influence to stem from academic effort instead of GPA. This setting leads to a different econometric model because the network includes students without friends. Our findings suggest that increasing the average GPA of peers by one point leads to a 0.856 point increase in students' GPA, controlling for network endogeneity. In contrast, the peer effect estimate obtained using the standard linear-in-means model, which assumes peer effects take root in GPA, is 1.6 times lower.

The remainder of the paper is organized as follows. Section 2 presents the microeconomic foundations of the model using a network game in which students decide their academic effort. Section 3 describes the econometric model and addresses the identification and estimation of the parameters. Section 4 presents our empirical analysis using Add Health data. Section 5 concludes this paper.

2   The Structural Model

We consider S schools and denote by $n_s \geqslant 3$ the number of students in the s-th, $s \in \{1, \ldots, S\}$. Let n be the total number of students, i.e., $n = \sum_{s=1}^{S} n_s$. Throughout, we use the subscript s, i denotes the i-th student in the school s. Let $y_{s,i}$ be the GPA and $\mathbf{x}_{s,i}$ be a K-vector of observable student characteristics. Students interact in their school through a directed network that can be represented by an $n_s \times n_s$ adjacency matrix $\mathbf{A}_s = [a_{s,ij}]_{ij}$, where $a_{s,ij} = 1$ if student j is a $i's$ friend and $a_{s,ij} = 0$ otherwise. We assume that $a_{s,ii} = 0$ for all i and s so that students cannot interact with themselves. In addition, we only consider within-school interactions; students only interact with peers from their school and have no peers in other schools (see Calvó-Armengol et al., 2009). Finally, we define the social interaction matrix $\mathbf{G}_s = [g_{s,ij}]_{ij}$ as the row-normalized adjacent matrix $\mathbf{A}_s$, i.e., $g_{s,ij} = 1/n_{s,i}$ if j is a i's friend and $g_{s,ij} = 0$ otherwise, where $n_{s,i}$ is the number of friends of i.

Student i chooses their effort $e_{s,i}$, which in turn implies their GPA (Boucher and Fortin, 2016). We assume that the effort is observed by peers (for example, each student knows how much effort their friends put into their academic success). Student GPA is linked to their effort $e_{s,i}$, observable charac-

teristics $\mathbf{x}_{s,i}$, and a random term $\eta_{s,i}$ that captures unobservable characteristics.[3] The relationship is given by the production equation

$$y_{s,i} = \alpha_{0,s} + \delta_0 e_{s,i} + \mathbf{x}'_{s,i}\boldsymbol{\theta}_0 + \eta_{s,i}, \tag{1}$$

where $\delta_0 > 0$ and $\alpha_{0,s}$, $\boldsymbol{\theta}_0$ are unknown parameters. The positive sign of δ_0 has support in the education literature and suggests that an increase in effort would increase GPA (see e.g., Plant et al., 2005; Brint and Cantwell, 2010). The parameter $\alpha_{0,s}$ captures unobserved school heterogeneity in GPA as fixed effects. We are aware that the use of a linear production function is restrictive. Although the microfoundation can be generalized to a nonlinear or nonparametric production function (Fruehwirth, 2013), the resulting econometric model may be complex, especially when the model controls for unobserved school heterogeneity. The effort exerted and the GPA obtained provide students with a benefit that we describe using a payoff function. As in Boucher and Fortin (2016) and Calvó-Armengol et al. (2009), we assume a linear-quadratic payoff function given by

$$u_{s,i}(e_{s,i}, \mathbf{e}_{s,-i}, y_{s,i}) = \underbrace{(c_{0,s} + \mathbf{x}'_{s,i}\boldsymbol{\beta}_0 + \mathbf{g}_{s,i}\mathbf{X}_s\boldsymbol{\gamma}_0 + \varepsilon_{s,i})y_{s,i} - \frac{e^2_{s,i}}{2}}_{\text{private sub-payoff}} + \underbrace{\lambda_0 e_{s,i}\mathbf{g}_{s,i}\mathbf{e}_s}_{\text{social sub-payoff}}, \tag{2}$$

where $\mathbf{X}_s = (\mathbf{x}_{s,1}, \ldots, \mathbf{x}_{s,n_s})'$, $\mathbf{g}_{s,i}$ is the i-th row of $\mathbf{G}_s$, $\mathbf{e}_{s,-i} = (e_{s,1}, \ldots, e_{s,i-1}, e_{s,i}, \ldots, e_{s,n})'$, $\mathbf{e}_s = (e_{s,1}, \ldots, e_{s,n_s})'$, the term $\mathbf{g}_{s,i}\mathbf{e}_s$ is the average peers' effort, and $c_{0,s}$, $\boldsymbol{\beta}_0$, $\boldsymbol{\gamma}_0$ are unknown parameters. The parameter λ_0 captures the endogenous peer effects. The payoff function (2) is separable into two components: a private sub-payoff and a social sub-payoff. The term $(c_{0,s} + \mathbf{x}'_{s,i}\boldsymbol{\beta}_0 + \mathbf{g}_{s,i}\mathbf{X}_s\boldsymbol{\gamma}_0 + \varepsilon_{s,i})$ represents the benefit enjoyed per unit of GPA achieved, where $\varepsilon_{s,i}$ is the student type (observable by all students). This benefit accounts for student observed heterogeneity, as it depends on $\mathbf{x}_{s,i}$ and peer group average characteristics $\mathbf{g}_{s,i}\mathbf{X}_s$ called *contextual variables* (see Manski, 1993). The benefit also accounts for school unobserved heterogeneity through the parameter $c_{0,s}$. The second component of the private sub-payoff, $e^2_{s,i}/2$ is the cost of exerting an effort to achieve a specific GPA. The social sub-payoff $\lambda_0 e_{s,i}\mathbf{g}_{s,i}\mathbf{e}_s$ implies that an increase in the average peer group's effort $\mathbf{g}_{s,i}\mathbf{e}_s$ influences student i's marginal payoff if $\lambda_0 \neq 0$. When $\lambda_0 > 0$, the payoff function (2) implies complementary between students' and peers' efforts, whereas $\lambda_0 < 0$ suggests a substitute in the efforts.

The parameters $\alpha_{0,s}$ and $c_{0,s}$ control for unobserved shocks at the school level. In terms of policy implications, they are conceptually different, and this needs to be discussed. First, $\alpha_{0,s}$ captures unobserved shocks on GPA without affecting student effort.[4] This includes shocks on teaching quality and school management, which would influence GPA regardless of student effort. Besides, the parameter

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[3]Whether or not the random term $\eta_{s,i}$ is observed by i or by the peers does not matter in the game.

[4]This type of shock does not influence the effort because the GPA is unbounded. An increase in $\alpha_{0,s}$ necessarily results in a higher GPA, and thus a higher payoff, regardless of the effort level. If we consider a framework in which the GPA is bounded, an increase in $\alpha_{0,s}$ may decrease the effort for the students with a high GPA close to the upper bound (Fruehwirth, 2013). Such a framework would lead to a more complicated econometric model. However, this will not change the fact that an increase in $\alpha_{0,s}$ does not have the same implication as an increase in $c_{0,s}$.

$c_{0,s}$ captures shocks on student preferences, especially on the marginal payoff. For instance, sensitizing students to be more aware of their academic achievement could influence the marginal payoff. Such a shock can be captured by $c_{0,s}$ and would influence effort and GPA. We show that $\alpha_{0,s}$ and $c_{0,s}$ do not impact GPA in the same way (see Section 3.1).

By replacing $y_{s,i}$ of Equation (2) with its expression in Equation (1), we obtain a payoff function that does not depend on GPA (see Appendix A.1). This new payoff function characterizes a static game with complete information, in which students simultaneously choose their effort as to maximize their payoff. The students' best response function can be expressed as

$$e_{s,i} = \delta_0 c_{0,s} + \lambda_0 \mathbf{g}_{s,i}\mathbf{e}_s + \delta_0 \mathbf{x}'_{s,i}\boldsymbol{\beta}_0 + \delta_0 \mathbf{g}_{s,i}\mathbf{X}_s\boldsymbol{\gamma}_0 + \delta_0 \varepsilon_{s,i}. \tag{3}$$

In Equation (3), students' levels of effort are expressed as a function of the average effort of peers $\mathbf{g}_{s,i}\mathbf{e}_s$, observed students' characteristics $\mathbf{x}_{s,i}$, and the average characteristics of peers $\mathbf{g}_{s,i}\mathbf{X}_s$ (contextual variables). The parameter λ_0 represents the impact of peers on a student's effort level. A positive value for λ_0 indicates that a student's effort level increases if their peers put in more effort. This is similar to the effect of coworkers on an individual's productivity in a workplace (Cornelissen et al., 2017). Furthermore, Equation (3) shows that the optimal effort level (and thus the resulting GPA) is influenced by shocks at the school level (on $c_{0,s}$) that affect student preferences. However, shocks that are directly exerted on GPA through the parameter $\alpha_{0,s}$ do not impact the effort.

The best response function (3) in a matrix form can be expressed as $\mathbf{e}_s = \delta_0 c_{0,s}\mathbf{1}_{n_s} + \lambda_0 \mathbf{G}_s\mathbf{e}_s + \delta_0 \mathbf{X}_s\boldsymbol{\beta}_0 + \delta_0 \mathbf{G}_s\mathbf{X}_s\boldsymbol{\gamma}_0 + \delta_0 \boldsymbol{\varepsilon}_s$, where $\boldsymbol{\varepsilon}_s = (\varepsilon_{s,1}, \ldots, \varepsilon_{s,n_s})'$ and $\mathbf{1}_{n_s}$ is an n_s-vector of ones. A solution of this equation in $\mathbf{e}_s$ is the game's Nash equilibrium (NE). As $\mathbf{G}_s$ is row-normalized, the NE is unique if the following restriction holds (see Appendix A.1).

Assumption 2.1. $|\lambda_0| < 1$.

The condition $|\lambda_0| < 1$ means that students do not increase (in absolute value) their effort greater than the increase in the effort of their peers. Put differently, when the average effort of a student's friends increases by one, the increase/decrease in the student's effort is less than one.

3 The Econometric Model and Identification Strategy

If the effort were observed, we could estimate the peer effect parameter from Equation (3) using the general method of moments (GMM) approach. As we do not observe the effort, the equation cannot be estimated directly. We derive from this equation an estimable equation based on GPA.

3.1 Reduced-Form Equation of GPA

From Equation (1), we express the effort as a function of GPA and replace this expression in Equation (3) (see Appendix A.2). The reduced-form equation of GPA is

$$y_{s,i} = \kappa_{s,i} + \lambda_0 \mathbf{g}_{s,i} \mathbf{y}_s + \mathbf{x}'_{s,i} \tilde{\boldsymbol{\beta}}_0 + \mathbf{g}_{s,i} \mathbf{X}_s \tilde{\boldsymbol{\gamma}}_0 + (\boldsymbol{\omega}_{s,i} - \lambda_0 \mathbf{g}_{s,i}) \boldsymbol{\eta}_s + \delta_0^2 \varepsilon_{s,i}, \tag{4}$$

where $\kappa_{s,i} = \delta_0^2 c_{0,s} + (1 - \lambda_0 \mathbf{g}_{s,i} \mathbf{1}_{n_s}) \alpha_{0,s}$, $\tilde{\boldsymbol{\beta}}_0 = \delta_0^2 \boldsymbol{\beta}_0 + \boldsymbol{\theta}_0$, $\tilde{\boldsymbol{\gamma}}_0 = \delta_0^2 \boldsymbol{\gamma}_0 - \lambda_0 \boldsymbol{\theta}_0$, and $\boldsymbol{\omega}_{s,i}$ is a row-vector of dimension n_s in which all the elements are equal to zero, except the i-th element, which is one. The specification used in the literature (by assuming that students directly choose their GPA) is similar to Equation (3) where the effort $e_{s,i}$ is replaced by $y_{s,i}$ and the vector of effort $\mathbf{e}$ is replaced by the vector of GPA, $\mathbf{y}_s = (y_{s,1}, \ldots, y_{s,n_s})'$. We will refer to this specification as the *standard model*. Some significant differences emerge when comparing the standard model to Equation (4).

Let $\hat{\mathcal{V}}_s$ be the subsample of students of the school s who have friends and $\bar{\mathcal{V}}_s$ be the subsample of students of the school s who have no friends. As $\mathbf{G}_s$ is row-normalized, we have $\mathbf{g}_{s,i} \mathbf{1}_{n_s} = 1$ if $i \in \hat{\mathcal{V}}_s$ and $\mathbf{g}_{s,i} \mathbf{1}_{n_s} = 0$ otherwise. Thus, $\kappa_{s,i} = \bar{\kappa}_{0,s}$ if $i \in \bar{\mathcal{V}}_s$ and $\kappa_{s,i} = \hat{\kappa}_{0,s}$ if $i \in \hat{\mathcal{V}}_s$, where $\bar{\kappa}_{0,s} = \delta_0^2 c_{0,s} + \alpha_{0,s}$ and $\hat{\kappa}_{0,s} = \delta_0^2 c_{0,s} + (1 - \lambda_0) \alpha_{0,s}$. One important difference between the standard model and our framework is that the standard model has a single intercept term per school. In Equation (4), $\kappa_{s,i}$ controls for unobserved school-level heterogeneity depending on whether the student i has friends or not, as in Boucher et al. (2022b). We have $\hat{\kappa}_{0,s} = \bar{\kappa}_{0,s}$ if and only if $\alpha_{0,s} = 0$, $\lambda_0 = 0$, or if every student has friends. These conditions may not be verified in many settings.

The above discussion suggests that the econometric model must control whether students have friends or not. However, what matters in the structural model is distinguishing between school-level shocks exerted on GPA without influencing the effort and school-level preference shocks. To understand why this is equivalent to controlling whether students have friends or not, it is necessary to examine the implications of each shock. As per Equations (3) and (4), an increase in $\alpha_{0,s}$ (e.g., by improving teaching quality) suggests an increase in GPA without affecting effort. Importantly, this increase does not depend on whether the student has friends and does not involve a social multiplier effect.[5] In contrast, if the peer effects are strong such that $\delta_0^2 / (1 - \lambda_0) > 1$, a preference shock on $c_{0,s}$ could result in a social multiplier effect on GPA. This social multiplier effect is only present among students who have friends. Thus, the distinction between the two types of shocks is essentially captured by the student's social status, i.e., whether they have friends or not. Therefore, distinguishing between both shocks is equivalent to including $\kappa_{s,i}$ as a regressor in the model.

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[5]Equation (4) suggests that the variation in $\mathbf{y}_s$, denoted $\Delta^\alpha \mathbf{y}_s$, following an increase $\Delta \alpha_{0,s}$ in $\alpha_{0,s}$ is such that $\Delta^\alpha \mathbf{y}_s = (\mathbf{I}_{n_s} - \lambda_0 \mathbf{G}_s) \mathbf{1}_{n_s} \Delta \alpha_{0,s} + \lambda_0 \mathbf{G}_s \Delta^\alpha \mathbf{y}_s$. This implies that $\Delta^\alpha \mathbf{y}_s = \mathbf{1}_{n_s} \Delta \alpha_{0,s}$. Hence, the increase in $\alpha_{0,s}$ results in the same increase in GPA.

The classical model has a single intercept per school to account for common shocks. Such a specification raises a variable omission problem that can result in biased estimations of peer effects if the network includes students without peers. The sign of the bias is that of the partial correlation between the omitted term in the standard model, which is $-\lambda_0\alpha_{s,0}\mathbf{g}_{s,i}\mathbf{1}_{n_s}$, and the average peers' GPA (Theil, 1957; Frisch and Waugh, 1933). For instance, $\mathbf{g}_{s,i}\mathbf{1}_{n_s} = 0$ implies that $\mathbf{g}_{s,i} = 0$, and thus $\mathbf{g}_{s,i}\mathbf{y}_s = 0$. Also, if $\mathbf{g}_{s,i}\mathbf{1}_{n_s} = 1$ and the GPA is nonnegative, then $\mathbf{g}_{s,i}\mathbf{y}_s \geqslant 0$. As a result, the partial correlation is likely to have the sign of $-\lambda_0\alpha_{s,0}$ in most cases. This suggests that peer effects estimated using the standard model would be biased downward if $\lambda_0\alpha_{s,0} > 0$.

Another difference between the standard model and Equation (4) is that the standard model does not take into account the term $(\boldsymbol{\omega}_{s,i} - \lambda_0\mathbf{g}_{s,i})\boldsymbol{\eta}_s$.[6] However, we should point out that this second difference does not involve inconsistent estimates if $\boldsymbol{\eta}_s$ is independent of $\mathbf{G}_s$. Indeed, even in the case of correlated effects, estimating the model without controlling for the correlated effects leads to a consistent estimator (Kelejian and Prucha, 1998). As a result, we can get a consistent (but inefficient) estimator of the peer effects by ignoring the term $(\boldsymbol{\omega}_{s,i} - \lambda_0\mathbf{g}_{s,i})\boldsymbol{\eta}_s$.

3.2   Identification and Estimation

As the effort $e_{s,i}$ is not observed, we cannot identify all the parameters of the structural model. The parameter δ_0 cannot be identified because it only appears in Equation (4) through a product with other parameters. Similarly, $\boldsymbol{\theta}_0$ and $\boldsymbol{\gamma}_0$ cannot be identified separately, as they only appear in the equation through $\tilde{\boldsymbol{\gamma}}_0 = \delta_0^2\boldsymbol{\gamma}_0 - \lambda_0\boldsymbol{\theta}_0$. Consequently, we set the following identification restrictions.

Restriction 3.1 (Identification restrictions). $\delta_0 = 1$ *and* $\boldsymbol{\theta}_0 = 0$.

This non-identification problem limits the implementation of some counterfactual analyses. Specifically, Equation (4) suggests that increasing $c_{0,s}$ by $\Delta c_{0,s}$ (preference shocks) leads to an increase of $\delta_0^2\Delta c_{0,s}(\mathbf{I}_{n_s} - \lambda_0\mathbf{G}_s)^{-1}\mathbf{1}_{n_s}$ in $\mathbf{y}_s$. The effect of the increase in $c_{0,s}$ on the GPA depends on δ_0, and involves a social multiplier effect only when $\delta_0^2/(1 - \lambda_0) > 1$, i.e., if λ_0 or δ_0 is sufficiently large. Unfortunately, identifying δ_0 requires additional data and goes beyond the scope of this paper. Under Condition 3.1, Equation (4) can be expressed as

$$y_{s,i} = \kappa_{s,i} + \lambda_0\mathbf{g}_{s,i}\mathbf{y}_s + \mathbf{x}'_{s,i}\boldsymbol{\beta}_0 + \mathbf{g}_{s,i}\mathbf{X}_s\boldsymbol{\gamma}_0 + (\boldsymbol{\omega}_{s,i} - \lambda_0\mathbf{g}_{s,i})\boldsymbol{\eta}_s + \varepsilon_{s,i}, \tag{5}$$

where $\kappa_{s,i} = \bar{\kappa}_{0,s}$ if $i \in \bar{\mathcal{V}}_s$ and $\kappa_{s,i} = \hat{\kappa}_{0,s}$ if $i \in \hat{\mathcal{V}}_s$. Let $\hat{n}_s$ be the number of students in the school s with peers and $\bar{n}_s$ be the number of students in the school s without peers. Let also $\hat{\boldsymbol{\ell}}_s = \mathbf{G}_s\mathbf{1}_{n_s}$,

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[6]Note that this term captures heterogeneity in a slightly different manner than that of correlated effects (see Manski, 1993).

$\bar{\ell}_s = \mathbf{1}_{n_s} - \hat{\ell}_s$. Equation (5) can be written in a matrix form at the school level as

$$\mathbf{y}_s = \bar{\kappa}_{0,s}\bar{\ell}_s + \hat{\kappa}_{0,s}\hat{\ell}_s + \lambda_0 \mathbf{G}_s \mathbf{y}_s + \mathbf{X}_s \boldsymbol{\beta}_0 + \mathbf{G}_s \mathbf{X}_s \boldsymbol{\gamma}_0 + (\mathbf{I}_{n_s} - \lambda_0 \mathbf{G}_s)\boldsymbol{\eta}_s + \boldsymbol{\varepsilon}_s,. \tag{6}$$

The number of unknown parameters to be estimated in Equation (6) grows to infinity with the number of schools. This issue is known as an incidental parameter problem and leads to inconsistent estimators (Lancaster, 2000). A common approach to consistently estimate the model is to eliminate the fixed effects $\bar{\kappa}_{0,s}$ and $\hat{\kappa}_{0,s}$. To do so, we define $\mathbf{J}_s := \mathbf{I}_{n_s} - \dfrac{1}{\bar{n}_s}\bar{\ell}_s\bar{\ell}_s' - \dfrac{1}{\hat{n}_s}\hat{\ell}_s\hat{\ell}_s'$ and impose by convention that $\dfrac{1}{\bar{n}_s}\bar{\ell}_s\bar{\ell}_s' = 0$ if $\bar{n}_s = 0$, and that $\dfrac{1}{\hat{n}_s}\hat{\ell}_s\hat{\ell}_s' = 0$ if $\hat{n}_s = 0$. As $\mathbf{J}_s\bar{\ell}_s = \mathbf{J}_s\hat{\ell}_s = 0$, one can eliminate the term $\bar{\kappa}_{0,s}\bar{\ell}_s + \hat{\kappa}_{0,s}\hat{\ell}_s$ by premultiplying each term of Equation (6) by the matrix $\mathbf{J}_s$.[7] This implies that

$$\mathbf{J}_s\mathbf{y}_s = \lambda_0 \mathbf{J}_s \mathbf{G}_s \mathbf{y}_s + \mathbf{J}_s \mathbf{X}_s \boldsymbol{\beta}_0 + \mathbf{J}_s \mathbf{G}_s \mathbf{X}_s \boldsymbol{\gamma}_0 + \mathbf{J}_s(\mathbf{I}_{n_s} - \lambda_0 \mathbf{G}_s)\boldsymbol{\eta}_s + \mathbf{J}_s\boldsymbol{\varepsilon}_s. \tag{7}$$

Before we present the identification conditions, we impose some restrictions for the econometric analysis.

Assumption 3.1. *The process* $(\eta_{s,i}, \ \varepsilon_{s,i})'$ *is independent and centered conditionally on* $\mathbf{G}_s$ *and* $\mathbf{X}_s$, *where* $\mathbb{E}(\eta_{s,i}^2|\mathbf{G}_s, \mathbf{X}_s) = \sigma_{\eta0}^2 > 0$, $\mathbb{E}(\varepsilon_{s,i}^2|\mathbf{G}_s, \mathbf{X}_s) = \sigma_{\epsilon0}^2 > 0$, $\mathbb{E}(\varepsilon_{s,i}\eta_{s,i}|\mathbf{G}_s, \mathbf{X}_s) = \rho_0\sigma_{\eta0}\sigma_{\epsilon0}$, *and* $|\rho| \leqslant 1$.

Assumption 3.2. $\mathbf{G}_s$ *is uniformly bounded in column sum.*

Assumption 3.1 implies that $\mathbf{X}_s$ and $\mathbf{G}_s$ are exogenous with respect to $\boldsymbol{\eta}_s$ and $\boldsymbol{\varepsilon}_s$. This suggests that there is no omission of important variables in $\mathbf{X}_s$, which are captured by $\boldsymbol{\eta}_s$ and $\boldsymbol{\varepsilon}_s$. We later relax this assumption in our approach to controlling for network endogeneity by allowing for $\mathbf{X}_s$ and $\mathbf{G}_s$ to depend on $\boldsymbol{\eta}_s$ and $\boldsymbol{\varepsilon}_s$ through unobserved factors to the econometrician (see Section 3.3). Assumption 3.1 also accounts for the correlation between $\eta_{s,i}$ and $\varepsilon_{s,i}$. This is important because $\eta_{s,i}$ and $\varepsilon_{s,i}$ are related to the same student. The parameter ρ_0 measures the correlation between $\eta_{s,i}$ and $\varepsilon_{s,i}$. We impose no restrictions on the joint distribution of $(\eta_{s,i}, \ \varepsilon_{s,i})$.

In our asymptotic analysis, we assume that S grows to infinity. However, we allow for n_s not to be necessarily bounded (the network may be dense or sparse). If both S and n_s tend to infinity, Assumption 3.2 rules out the cases where the sum of certain columns of $\mathbf{G}_s$ is unbounded. For instance, if the outdegree of a student j (the number of students who have j as a peer) grows to infinity with n_s, Assumption 3.2 ensures that the total influence of j in the network, which can be measured by the sum of the j-th column of $\mathbf{G}_s$, is "limited." As $\mathbf{G}_s$ is row-normalized, this means that students who have j as a friend also have many other friends; thus, the average influence of j vanishes asymptotically (see Lee, 2004).

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[7]By premultiplying each term by $\mathbf{J}_s$, we consider Equation (6) in deviation to the average within the student group, i.e., $\bar{\mathcal{V}}_s$ or $\hat{\mathcal{V}}_s$. This eliminates the parameters $\bar{\kappa}_{0,s}$ and $\hat{\kappa}_{0,s}$.

The parameters to be estimated are $\boldsymbol{\psi}_0 := (\lambda_0,\ \boldsymbol{\beta}_0',\ \boldsymbol{\gamma}_0')'$, $\sigma_{\eta 0}$, $\sigma_{\epsilon 0}$, and ρ_0. We impose the following assumption for the parameter identification.

Assumption 3.3. *(i) $\lambda_0 \neq 0$ and $\lambda_0 \boldsymbol{\beta}_0 + \boldsymbol{\gamma}_0 \neq 0$; (ii) There are students in the network separated by a link of distance three.*

Assumption 3.3 deals with the reflection problem and allows for identifying $\sigma_{\eta 0}$, $\sigma_{\epsilon 0}$, and ρ_0. Bramoullé et al. (2009) set similar identification conditions. However, their approach cannot be used in our framework because they assume that every agent in the network has peers. We extend this identification analysis to a broader context, including the possibility of some students having no peers. The restriction $\lambda_0 \neq 0$ of Condition (i) is necessary for identifying $\sigma_{\eta 0}$, $\sigma_{\epsilon 0}$, and ρ_0. If $\lambda_0 = 0$, the disturbance of Equation (7) would be $\mathbf{J}_s \boldsymbol{\eta}_s + \mathbf{J}_s \boldsymbol{\varepsilon}_s$, and one cannot disentangle $\sigma_{\eta 0}$, $\sigma_{\epsilon 0}$, and ρ_0. The second half of Condition (i) is equivalent to saying that GPA is influenced by at least one contextual variable (see Equation A.7). With several characteristics in $\mathbf{X}_s$, this condition can be satisfied. Moreover, Condition (ii) is easy to verify in practice. A weaker version of this condition, as set by Bramoullé et al. (2009), is that $\mathbf{I}_{n_s}$, $\mathbf{G}_s$, $\mathbf{G}_s^2$, and $\mathbf{G}_s^3$ are linearly independent.

As we know the structure of the variance of the disturbance terms $\boldsymbol{v}_s := \mathbf{J}_s(\mathbf{I}_{n_s} - \lambda_0 \mathbf{G}_s)\boldsymbol{\eta}_s + \mathbf{J}_s \boldsymbol{\varepsilon}_s$, it would be more efficient to estimate the model using a quasi-maximum likelihood (QML) approach. However, as we allow students to have no peers, it is difficult to express $\mathbf{J}_s \mathbf{y}_s$ or $\mathbf{H}_s \mathbf{y}_s$ for some matrix $\mathbf{H}_s$ not depending on unknown parameters, as a function that depends on neither $\mathbf{y}_s$, nor the fixed effects.[8] Such an equation is needed to write the likelihood to be maximized (see Lee et al., 2010). We propose a sequential estimation strategy that combines the GMM and QML methods. The GMM approach (first stage) is used to obtain a consistent estimator of $\boldsymbol{\psi}_0$; the QML approach (second stage) is then used to obtain a consistent estimator of $(\sigma_{\eta 0}^2,\ \sigma_{\epsilon 0}^2,\ \rho_0)$.

First stage

At the first step, we estimate $\boldsymbol{\psi}_0$ using a standard GMM approach. It is well known that the regressor $\mathbf{J}_s \mathbf{G}_s \mathbf{y}_s$ is endogenous in Equation (7). A natural instrument for addressing this endogeneity is $\mathbf{J}_s \mathbf{G}_s^2 \mathbf{X}_s$ (see Kelejian and Prucha, 1998; Bramoullé et al., 2009). Indeed, by premultiplying each term of Equation (6) by $\mathbf{J}_s \mathbf{G}_s$, one can notice that $\mathbf{J}_s \mathbf{G}_s^2 \mathbf{X}_s$ and $\mathbf{J}_s \mathbf{G}_s \mathbf{y}_s$ are correlated. Because $\mathbf{J}_s \mathbf{G}_s^2 \mathbf{X}_s$ does not enter Equation (7) as a regressor and is exogenous with respect to $\boldsymbol{\eta}_s$ and $\boldsymbol{\varepsilon}_s$, it can be used as an external instrument for $\mathbf{J}_s \mathbf{G}_s \mathbf{y}_s$. Let $\hat{\boldsymbol{\psi}}$ be the GMM estimator of $\boldsymbol{\psi}_0$.

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[8] From Equation (6), we have $\mathbf{J}_s \mathbf{y}_s = \mathbf{J}_s(\mathbf{I}_{n_s} - \lambda_0 \mathbf{G}_s)^{-1}(\bar{\kappa}_{0,s}\bar{\boldsymbol{\ell}}_s + \hat{\kappa}_{0,s}\hat{\boldsymbol{\ell}}_s + \mathbf{X}_s \boldsymbol{\beta}_0 + \mathbf{G}_s \mathbf{X}_s \boldsymbol{\gamma}_0 + \boldsymbol{v}_s)$. In the case where every student has peers, $\hat{\boldsymbol{\ell}}_s = \mathbf{G}_s \mathbf{1}_{n_s} = \mathbf{1}_{n_s}$ and $\bar{\boldsymbol{\ell}}_s = \mathbf{1}_{n_s} - \hat{\boldsymbol{\ell}}_s = 0$, which implies that $\bar{\kappa}_{0,s}\bar{\boldsymbol{\ell}}_s + \hat{\kappa}_{0,s}\hat{\boldsymbol{\ell}}_s = \hat{\kappa}_{0,s}\mathbf{1}_{n_s}$; thus, $\mathbf{J}_s \mathbf{y}_s = \mathbf{J}_s(\mathbf{I}_{n_s} - \lambda_0 \mathbf{G}_s)^{-1}(\mathbf{X}_s \boldsymbol{\beta}_0 + \mathbf{G}_s \mathbf{X}_s \boldsymbol{\gamma}_0 + \boldsymbol{v}_s)$. Indeed, $\mathbf{J}_s(\mathbf{I}_{n_s} - \lambda_0 \mathbf{G}_s)^{-1}\mathbf{1}_{n_s} = 0$ because $(\mathbf{I}_{n_s} - \lambda_0 \mathbf{G}_s)^{-1}\mathbf{1}_{n_s} = \frac{1}{1-\lambda_0}\mathbf{1}_{n_s}$. When the network includes students without peers, $\bar{\kappa}_{0,s}\bar{\boldsymbol{\ell}}_s + \hat{\kappa}_{0,s}\hat{\boldsymbol{\ell}}_s$ is not proportional to $\mathbf{1}_{n_s}$, making it challenging to express $\mathbf{J}_s \mathbf{y}_s$ as a function that does not depend on $\mathbf{y}_s$, $\bar{\kappa}_{0,s}$, and $\hat{\kappa}_{0,s}$.

Proposition 3.1. *Under Condition 3.1 and Assumptions 2.1–3.3 and A.1 (stated in Appendix A.3), $\boldsymbol{\psi}_0$ is globally identified, $\hat{\boldsymbol{\psi}}$ is a consistent estimator of $\boldsymbol{\psi}_0$, and $\sqrt{n}(\hat{\boldsymbol{\psi}} - \boldsymbol{\psi}_0) \xrightarrow{d} \mathcal{N}\big(0, \lim_{n\to\infty} n\, \mathbb{V}(\hat{\boldsymbol{\psi}})\big)$.*

The consistency and asymptotic normality of $\hat{\boldsymbol{\psi}}$ are directly derived from Kelejian and Prucha (1998).[9] For now, we cannot estimate $\mathbb{V}(\hat{\boldsymbol{\psi}})$, as it depends on unknown parameters $\sigma_{\epsilon 0}^2$, $\sigma_{\eta 0}^2$, and ρ_0. In the case where the school's size is bounded as S grows to infinity, the variance can be estimated using a robust estimator *à la* White (1980) that does not require estimating $\sigma_{\epsilon 0}^2$, $\sigma_{\eta 0}^2$, and ρ_0.

The identification of $\boldsymbol{\psi}_0$ is similar to the identification analysis in Houndetoungan (2022). Below, we provide an intuition behind this approach and a formal proof in Appendix A.3. Figure 1 presents an example in which Condition (ii) of Assumption 3.3 is verified (i_1 and i_2 are separated by a link of distance three). The reflection problem arises when $\mathbb{E}(\mathbf{J}_s \mathbf{G}_s \mathbf{y}_s | \mathbf{G}_s, \mathbf{X}_s)$ is perfectly collinear with $\mathbf{J}_s \mathbf{X}_s$ and $\mathbf{J}_s \mathbf{G}_s \mathbf{X}_s$. Therefore, for all $i \in \hat{\mathcal{V}}_s$, $\mathbb{E}(\mathbf{g}_{s,i} \mathbf{y}_s - \hat{\bar{y}}_s | \mathbf{G}_s, \mathbf{X}_s) = (\mathbf{x}'_{s,i} - \hat{\bar{\mathbf{x}}}'_s)\dot{\boldsymbol{\beta}} + (\mathbf{g}_{s,i} \mathbf{X}'_s - \hat{\bar{\mathbf{x}}}'_s)\dot{\boldsymbol{\gamma}}$, where $\hat{\bar{y}}_s$, $\hat{\bar{\mathbf{x}}}_s$, and $\hat{\bar{\mathbf{x}}}_s$ are respectively the averages of $\mathbf{g}_{s,i} \mathbf{y}_s$, $\mathbf{x}_{s,i}$, and $\mathbf{g}_{s,i} \mathbf{X}_s$ in $\hat{\mathcal{V}}_s$, and $\dot{\boldsymbol{\beta}}$, $\dot{\boldsymbol{\gamma}}$ are unknown parameters. If we take the previous equation in difference between i_2 and i_4, we have $\mathbb{E}(\mathbf{g}_{s,i_2} \mathbf{y}_s - \mathbf{g}_{s,i_4} \mathbf{y}_s | \mathbf{G}_s, \mathbf{X}_s) = (\mathbf{x}'_{s,i_2} - \mathbf{x}'_{s,i_4})\dot{\boldsymbol{\beta}} + (\mathbf{g}_{s,i_2} \mathbf{X}'_s - \mathbf{g}_{s,i_4} \mathbf{X}'_s)\dot{\boldsymbol{\gamma}}$. As i_3 is i_4's only friend and i_4 is i_2's only friend, this implies $y_{i_4}^e - y_{i_3}^e = (\mathbf{x}'_{s,i_2} - \mathbf{x}'_{s,i_4})\dot{\boldsymbol{\beta}} + (\mathbf{x}'_{s,i_4} - \mathbf{x}'_{s,i_3})\dot{\boldsymbol{\gamma}}$, where $y_i^e = \mathbb{E}(y_{s,i} | \mathbf{G}_s, \mathbf{X}_s)$ for all s and i. An interpretation of the latest equation is that $y_{i_4}^e - y_{i_3}^e$ is independent of $\mathbf{x}_{s,i_1}$. Put differently, an increase in $\mathbf{x}_{s,i_1}$ has either no impact on $y_{i_3}^e$ and $y_{i_4}^e$ or the same impact on $y_{i_3}^e$ and $y_{i_4}^e$. The first implication is not possible because $\mathbf{x}_{s,i_1}$ is a contextual variable for i_3 and Condition (i) of Assumption 3.3 implies that GPA is influenced by at least one contextual variable. Moreover, $\mathbf{x}_{s,i_1}$ cannot influence $y_{i_3}^e$ and $y_{i_4}^e$ in the same way because i_1 is a direct friend of i_3 and not directly linked to i_4. Therefore, $\mathbb{E}(\mathbf{J}_s \mathbf{G}_s \mathbf{y}_s | \mathbf{G}_s, \mathbf{X}_s)$ cannot be a linear combination of $\mathbf{J}_s \mathbf{X}_s$ and $\mathbf{J}_s \mathbf{G}_s \mathbf{X}_s$.
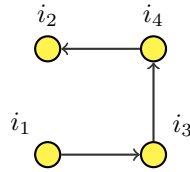

Figure 1: Solving the reflection problem

Note: $\rightarrow$ means that the node on the left side is a friend of the node on the right side.

Second stage

At the second stage, we estimate $(\sigma_{\eta 0}^2,\ \sigma_{\epsilon 0}^2,\ \rho_0)$ using a QML approach, where the dependent variable is the vector of the residuals from the first stage.[10] Specifically, we define $\hat{\boldsymbol{v}}_s := \mathbf{J}_s \mathbf{y}_s - \mathbf{J}_s [\mathbf{G}_s \mathbf{y}_s,\ \mathbf{X}_s,\ \mathbf{G}_s \mathbf{X}_s]\hat{\boldsymbol{\psi}}$. The likelihood of $\hat{\boldsymbol{v}}_s$ is based on a multivariate normal distribution with

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[9]See also Hansen (1982) for formal results on the large sample properties of GMM estimators.

[10]The estimator of $(\sigma_{\eta 0}^2,\ \sigma_{\epsilon 0}^2,\ \rho_0)$ is only used to compute the variance of $\hat{\boldsymbol{\psi}}$. As pointed out above, if the school's size is bounded as S grows to infinity, the variance can be estimated using a robust approach that does not require estimating $(\sigma_{\eta 0}^2,\ \sigma_{\epsilon 0}^2,\ \rho_0)$. However, this restriction implies a sparse network, which may not be the case in some frameworks. For example, our approach to control for network endogeneity in Section 3.3 assumes a dense network.

mean and covariance matrix equal to those of $\boldsymbol{v}_s = \mathbf{J}_s(\mathbf{I}_{n_s} - \lambda_0 \mathbf{G}_s)\boldsymbol{\eta}_s + \mathbf{J}_s\boldsymbol{\varepsilon}_s$, where λ_0 is replaced by its first-stage estimator $\hat{\lambda}$. Importantly, we do not require $\boldsymbol{v}_s$ to be actually normally distributed. However, the log-likelihood cannot be written directly because the transformation we apply to eliminate the fixed effects $\hat{\kappa}_s$ and $\bar{\kappa}_s$ makes the covariance matrix $\mathbb{E}(\boldsymbol{v}_s\boldsymbol{v}_s'|\mathbf{G}_s)$ singular (for example, we have $\mathbf{1}_{n_s}'\boldsymbol{v}_s = 0$). We can use a similar approach to that of Lee et al. (2010) to address the issue. Let $[\mathbf{F}_s,\ \bar{\boldsymbol{\ell}}_s/\sqrt{\bar{n}_s},\ \hat{\boldsymbol{\ell}}_s/\sqrt{\hat{n}_s}]$ be the orthonormal matrix of $\mathbf{J}_s$, where the columns in $\mathbf{F}_s$ are eigenvectors of $\mathbf{J}_s$ corresponding to the eigenvalue one.[11] To ease the notational burden, we assume the school s has students in both $\bar{\mathcal{V}}_s$ and $\hat{\mathcal{V}}_s$. We have $\mathbf{F}_s\mathbf{F}_s' = \mathbf{J}_s$ and $\mathbf{F}_s'\mathbf{F}_s = \mathbf{I}_{n_s-2}$. As $\mathbf{F}_s$ does not depend on unknown parameters, maximizing the log-likelihood of $\hat{\boldsymbol{v}}_s$ is equivalent to maximizing that of $\mathbf{F}_s'\hat{\boldsymbol{v}}_s$.[12] The log-likelihood of $\mathbf{F}_s'\hat{\boldsymbol{v}}_s$ is given by

$$\hat{L}(\sigma_\eta^2, \sigma_\epsilon^2, \rho) = -\sum_{s=1}^{S} \frac{n_s-2}{2} \log(\sigma_\epsilon^2) - \frac{1}{2}\sum_{s=1}^{S}\log|\boldsymbol{\Omega}_s(\hat{\lambda},\tau,\rho)| - \sum_{s=1}^{S}\frac{1}{2\sigma_\epsilon^2}\hat{\boldsymbol{v}}_s'\mathbf{F}_s\boldsymbol{\Omega}_s^{-1}(\hat{\lambda},\tau,\rho)\mathbf{F}_s'\hat{\boldsymbol{v}}_s, \quad (8)$$

where σ_η, σ_ϵ, and ρ denote arbitrary values of $\sigma_{0\eta}$, $\sigma_{0\epsilon}$, and ρ_0, $\boldsymbol{\Omega}_s(\hat{\lambda},\tau,\rho) = \mathbf{I}_{n_s-2} + \tau^2\mathbf{F}_s'\mathbf{W}_s\mathbf{W}_s'\mathbf{F}_s + \rho\tau\mathbf{F}_s'(\mathbf{W}_s + \mathbf{W}_s')\mathbf{F}_s$, $\mathbf{W}_s = \mathbf{I}_{n_s} - \hat{\lambda}\mathbf{G}_s$, and $\tau = \sigma_\eta/\sigma_\epsilon$. The first-order conditions of the maximization of (8) imply that σ_ϵ^2 can be substituted with $\tilde{\sigma}_\epsilon^2(\tau,\rho) = \sum_{s=1}^{S}\frac{\hat{\boldsymbol{v}}_s'\mathbf{F}_s\boldsymbol{\Omega}_s^{-1}(\hat{\lambda},\tau,\rho)\mathbf{F}_s'\hat{\boldsymbol{v}}_s}{n-2S}$. This leads to a concentrated log-likelihood that does not depend on σ_ϵ^2.

Let $\tilde{\sigma}_\epsilon^{2*}(\tau,\rho) = \frac{\sigma_{\epsilon 0}^2}{n-2S}\sum_{s=1}^{S}\text{Tr}\left(\boldsymbol{\Omega}_s^{-1}(\lambda_0,\tau,\rho)\boldsymbol{\Omega}_{0,s}\right)$, where $\boldsymbol{\Omega}_{0,s} = \boldsymbol{\Omega}_s(\lambda_0,\tau_0,\rho_0)$. One can show that $\tilde{\sigma}_\epsilon^2(\tau,\rho)$ and $\tilde{\sigma}_\epsilon^{2*}(\tau,\rho)$ are asymptotically equivalent (see Appendix A.4). We set the following assumption for the identification of $(\sigma_{\epsilon 0}^2,\ \tau_0,\ \rho_0)$.

Assumption 3.4. *For all* $(\tau,\rho) \neq (\tau_0,\ \rho_0)$, $\lim_{n\to\infty}(\sum_{s=1}^{S}(\log|\tilde{\sigma}_\epsilon^{2*}(\tau,\rho)\boldsymbol{\Omega}_s(\lambda_0,\tau,\rho)| - \log|\sigma_{\epsilon 0}^2\boldsymbol{\Omega}_{0,s}|)/n \neq 0$.

The intuition of Assumption 3.4 is as follows. After replacing σ_ϵ^2 with $\tilde{\sigma}_\epsilon^2(\tau,\rho)$ in Equation (8), the variable part of the concentrated log-likelihood is proportional to $\frac{1}{n}\sum_{s=1}^{S}\log|\tilde{\sigma}_\epsilon^2(\tau,\rho)\boldsymbol{\Omega}_s(\hat{\lambda},\tau,\rho)|$, which is asymptotically equivalent to $\frac{1}{n}\sum_{s=1}^{S}\log|\tilde{\sigma}_\epsilon^{2*}(\tau,\rho)\boldsymbol{\Omega}_s(\hat{\lambda},\tau,\rho)|$. Assumption 3.4 implies that the value of $\frac{1}{n}\sum_{s=1}^{S}\log|\tilde{\sigma}_\epsilon^{2*}(\tau,\rho)\boldsymbol{\Omega}_s(\hat{\lambda},\tau,\rho)|$ at $(\tau_0,\ \rho_0)$ cannot be reached at another point as S grows to infinity. This assumption adapts Assumption 9 of Lee (2004) or Assumption 5.1 of Lee et al. (2010) to our framework.[13] Let $(\hat{\sigma}_\eta^2,\ \hat{\tau},\ \hat{\rho})$ be the QML estimator of $(\sigma_{\varepsilon 0}^2,\ \tau_0,\ \rho_0)$. We establish the following result.

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[11]The eigenvalues of $\mathbf{J}_s$ are zero and one. The multiplicity of the eigenvalue one is $n_r - 2$ if the school s has students in both $\bar{\mathcal{V}}_s$ and $\hat{\mathcal{V}}_s$, and $n_r - 1$ if s has students in either $\bar{\mathcal{V}}_s$ or $\hat{\mathcal{V}}_s$.

[12]Unlike for $\boldsymbol{v}_s$, the covariance matrix of $\mathbf{F}_s'\boldsymbol{v}_s$ is not singular. Indeed, $\mathbb{E}(\mathbf{F}_s'\boldsymbol{v}_s\boldsymbol{v}_s'\mathbf{F}_s|\mathbf{G}_s) = \mathbf{F}_s'\mathbf{J}_s\mathbb{E}(\tilde{\boldsymbol{v}}_s\tilde{\boldsymbol{v}}_s'|\mathbf{G}_s)\mathbf{J}_s\mathbf{F}_s$, where $\tilde{\boldsymbol{v}}_s = (\mathbf{I}_{n_s} - \lambda_0\mathbf{G}_s)\boldsymbol{\eta}_s + \boldsymbol{\varepsilon}_s$. For any $n_s - 2$ vector $\mathbf{u}_s \neq 0$, $\mathbf{u}_s'\mathbf{F}_s'\mathbf{J}_s\mathbb{E}(\tilde{\boldsymbol{v}}_s\tilde{\boldsymbol{v}}_s'|\mathbf{G}_s)\mathbf{J}_s\mathbf{F}_s\mathbf{u}_s > 0$ because $\mathbf{J}_s\mathbf{F}_s\mathbf{u}_s = \mathbf{F}_s\mathbf{u}_s \neq 0$ and $\mathbb{E}(\tilde{\boldsymbol{v}}_s\tilde{\boldsymbol{v}}_s'|\mathbf{G}_s)$ is positive definite (except for special cases where $\boldsymbol{\eta}_s$ and $\boldsymbol{\varepsilon}_s$ are collinear).

[13]Although we cannot connect Assumption 3.4 to the fundamental elements of the model, we can explain why the covariance matrix of $\boldsymbol{v}_s$ conditionally on $\mathbf{G}_s$ captures much nonlinearity to allow identifying $(\sigma_{\epsilon 0}^2,\ \tau_0,\ \rho_0)$. As shown in online Appendix (OA) S.1.3, a crucial requirement for identification is that $\mathbf{J}_s$, $\mathbf{J}_s(\mathbf{G}_s + \mathbf{G}_s')\mathbf{J}_s$, and $\mathbf{J}_s\mathbf{G}_s\mathbf{G}_s'\mathbf{J}_s$ are linearly independent. This holds under the following two conditions: (1) there are four students who have friends in a certain school, those students are not directly linked and only two of them have common friends; (2) there are four students who have friends in a certain school and only two of them are linked. We present an example of a common network structure under which the conditions are verified (see Figure S.1).

Proposition 3.2. *Under Proposition 3.1 and Assumptions 3.4, A.2, and A.3, $(\sigma_{\epsilon 0}^2,\ \tau_0,\ \rho_0)$ is globally identified, and $(\hat{\sigma}_\eta^2,\ \hat{\tau},\ \hat{\rho})$ is a consistent estimator of $(\sigma_{\epsilon 0}^2,\ \tau_0,\ \rho_0)$.*

We can now consistently estimate $\lim_{n\to\infty} n\,\mathbb{V}(\hat{\boldsymbol{\psi}})$ using the estimator $(\hat{\sigma}_\eta^2,\ \hat{\tau},\ \hat{\rho})$.

Let $\tilde{\mathbf{X}}_s = \mathbf{J}_s[\mathbf{X}_s,\ \mathbf{G}_s\mathbf{X}_s]$, $\mathbf{R}_s = [\mathbf{J}_s\mathbf{G}_s\mathbf{y}_s,\ \tilde{\mathbf{X}}_s]$, $\mathbf{Z}_s = [\mathbf{J}_s\mathbf{G}_s^2\mathbf{X}_s,\ \tilde{\mathbf{X}}_s]$, $\mathbf{R}'\mathbf{Z} = \sum_{s=1}^{S} \mathbf{R}_s'\mathbf{Z}_s$, $\mathbf{Z}'\mathbf{Z} = \sum_{s=1}^{S} \mathbf{Z}_s'\mathbf{Z}_s$, and $\check{\mathbf{\Omega}} = \sum_{s=1}^{S} \mathbf{Z}_s'\mathbf{F}_s\mathbf{\Omega}_s(\lambda_0,\tau_0,\rho_0)\mathbf{F}_s'\mathbf{Z}_s$. Let also $\mathbf{B}_0 = \text{plim}(\mathbf{R}'\mathbf{Z})(\mathbf{Z}'\mathbf{Z})^{-1}(\mathbf{R}'\mathbf{Z})'/n$ (this exists by Assumption A.1), where plim stands for the limit in probability as n grows to infinity. We assume that $\text{plim}(\mathbf{R}'\mathbf{Z})(\mathbf{Z}'\mathbf{Z})^{-1}\check{\mathbf{\Omega}}(\mathbf{Z}'\mathbf{Z})^{-1}(\mathbf{R}'\mathbf{Z})'/n$ exists and is denoted by $\mathbf{D}_0$. It follows that $\lim_{n\to\infty} n\,\mathbb{V}(\hat{\boldsymbol{\psi}}) = \sigma_{\epsilon 0}^2 \mathbf{B}_0^{-1}\mathbf{D}_0\mathbf{B}_0^{-1}$. We get a consistent estimator of the variance by replacing $\sigma_{\epsilon 0}^2$, $\sigma_{\eta 0}^2$, and ρ_0 with their estimator, and $\mathbf{B}_0$ and $\mathbf{D}_0$ with their empirical counterpart.

3.3 Extension to Endogenous Networks

In practice, the assumption of an exogenous network may not hold because of some students' characteristics that we do not observe. For example, the intellectual quotient (IQ) and the sociability level of the student may not be included in $\mathbf{X}_s$ because they are not available in the data set. These variables being likely to explain the GPA would therefore be captured by the error terms $\boldsymbol{\eta}_s$ and $\boldsymbol{\varepsilon}_s$. The network is endogenous (i.e., it depends on $\boldsymbol{\eta}_s$ and $\boldsymbol{\varepsilon}_s$) if it also depends on IQ or sociability level. The problem of network endogeneity can then be regarded as an omission of important factors in the design matrix $\mathbf{X}_s$ that can explain both GPA and network. This also suggests that $\mathbf{X}_s$ may be endogenous because $\mathbf{X}_s$ is likely to be correlated to IQ or sociability level.

To address network endogeneity, we control for the omitted factors in $\mathbf{X}_s$ that explain the network. We use a two-stage estimation method similar to the control function approach proposed by Johnsson and Moon (2021). We first estimate the unobserved factors using a network formation model. In the second stage, we control for the estimated factors in the peer effect model.

We consider a network formation model with degree heterogeneity (see Graham, 2017; Dzemski, 2019; Yan et al., 2019).[14] For two students i and j in the same school s, the conditional probability to observe a link from j to i (i.e., i declares that j is a friend) can be defined as

$$P_{s,ij} := \mathbb{P}(a_{s,ij} = 1|\ddot{\mathbf{x}}_{s,ij}, \ddot{\boldsymbol{\beta}}_0, \mu_{0,s,i}^{in}, \mu_{0,s,i}^{out}) = \Phi(\ddot{\mathbf{x}}_{s,ij}'\ddot{\boldsymbol{\beta}}_0 + \mu_{0,s,i}^{in} + \mu_{0,s,j}^{out}), \tag{9}$$

where $\ddot{\mathbf{x}}_{s,ij}$ is a vector of observed dyad-specific variables (e.g., $\ddot{\mathbf{x}}_{s,ij}$ may contain the distance between students i and j's characteristics), $\ddot{\boldsymbol{\beta}}_0$ is an unknown parameter, $\mu_{0,s,i}^{in}$ and $\mu_{0,s,j}^{out}$ are unobserved attributes, and Φ is either the normal or logistic distribution function depending on whether the network formation model follows a probit or logit model. The term $\ddot{\mathbf{x}}_{s,ij}'\ddot{\boldsymbol{\beta}}_0$ is a measure of social

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[14]See De Paula (2020) for a recent review.

distance between students i and j that drives the homophily of linking decisions. Equation (9) implies that the matrix of link probabilities $\mathbf{P}_s := [P_{s,ij}]_{ij}$ is nonsymmetric. For any i, $\mu_{0,s,i}^{in}$ only influences the probabilities for other students to be i's friends, whereas $\mu_{0,s,i}^{out}$ only influences the probabilities for i to be another students' friend.

Equation (9) includes two parameters $\mu_{0,s,i}^{in}$ and $\mu_{0,s,j}^{out}$ for each pair $(i,\ j)$. This implies more than $2n_s(n_s - 1)$ parameters to be estimated per school. Yan et al. (2019) show that the standard logit estimators of $\mu_{0,s,i}^{in}$ and $\mu_{0,s,j}^{out}$ are consistent if the network is dense.[15] In this logit model, $\mu_{0,s,i}^{in}$ and $\mu_{0,s,j}^{out}$ are treated as fixed effects, i.e., they can be correlated to the observed dyad-specific variables. We refer the interested reader to Yan et al. (2019) for a formal discussion of the model, including its identification and consistent estimation. Alternatively, a Bayesian probit model based on the data augmentation technique can be used to simulate the posterior distributions of $\mu_{0,s,i}^{in}$ and $\mu_{0,s,j}^{out}$ (see Albert and Chib, 1993). However, this approach treats $\mu_{0,s,i}^{in}$ and $\mu_{0,s,j}^{out}$ as random effects.[16]

The problem of network endogeneity occurs because the adjacency matrix is dependent on $\boldsymbol{\eta}_s$ and $\boldsymbol{\varepsilon}_s$ through $\mu_{0,s,i}^{in}$ and $\mu_{0,s,i}^{out}$. We impose the following assumption regarding how $\mu_{0,s,i}^{in}$ and $\mu_{0,s,i}^{out}$ are related to $\boldsymbol{\eta}_s$ and $\boldsymbol{\varepsilon}_s$.

Assumption 3.5. $\eta_{s,i} = h_\eta(\mu_{0,s,i}^{in}, \mu_{0,s,i}^{out}) + \eta_{s,i}^*$ and $\varepsilon_{s,i} = h_\epsilon(\mu_{0,s,i}^{in}, \mu_{0,s,i}^{out}) + \varepsilon_{s,i}^*$, where $\eta_{s,i}^*$ and $\varepsilon_{s,i}^*$ are new error terms independent of $(\mu_{0,s,1}^{in}, \ldots, \mu_{0,s,n_s}^{in})'$ and $(\mu_{0,s,1}^{out}, \ldots, \mu_{0,s,n_s}^{out})'$, and h_η and h_ϵ are smooth functions. We also adapt Assumptions 3.1 and A.3 to $\eta_{s,i}^*$ and $\varepsilon_{s,i}^*$.

As in Johnsson and Moon (2021), we control for any smooth function of $\mu_{0,s,i}^{in}$ and $\mu_{0,s,i}^{out}$ to link $\eta_{s,i}$ and $\varepsilon_{s,i}$ to the new error terms $\eta_{s,i}^*$ and $\varepsilon_{s,i}^*$. Assumption 3.5 is weak, as it mainly requires that $\mathbf{E}(\eta_{s,i}|\mu_{0,s,i}^{in}, \mu_{0,s,i}^{out})$ and $\mathbf{E}(\varepsilon_{s,i}|\mu_{0,s,i}^{in}, \mu_{0,s,i}^{out})$ exist and are smooth functions in $\mu_{0,s,i}^{in}$ and $\mu_{0,s,i}^{out}$. By replacing $\eta_{s,i}$ and $\varepsilon_{s,i}$ in Equation (7) with their expression in Assumption 3.5, we have

$$\mathbf{J}_s\mathbf{y}_s = \lambda\mathbf{J}_s\mathbf{G}_s\mathbf{y}_s + \mathbf{J}_s\mathbf{X}_s\boldsymbol{\beta}_0 + \mathbf{J}_s\mathbf{G}_s\mathbf{X}_s\boldsymbol{\gamma}_0 + \mathbf{J}_s(\mathbf{h}_s^\eta + \mathbf{h}_s^\epsilon - \lambda\mathbf{G}_s\mathbf{h}_s^\eta) + \mathbf{J}_s(\mathbf{I}_{n_s} - \lambda\mathbf{G}_s)\boldsymbol{\eta}_s^* + \mathbf{J}_s\boldsymbol{\varepsilon}_s^*, \quad (10)$$

where $\mathbf{h}_s^\eta$ and $\mathbf{h}_s^\epsilon$ are the vectors of $h_\eta(\mu_{0,s,i}^{in}, \mu_{0,s,i}^{out})$'s and $h_\epsilon(\mu_{0,s,i}^{in}, \mu_{0,s,i}^{out})$'s at the school level. The main issue about Equation (10) is that $\mathbf{h}_s^\eta$ and $\mathbf{h}_s^\epsilon$ are unknown. In a similar model, Johnsson and Moon (2021) use a control function approach to eliminate these variables from the equation. Their approach consists of subtracting the influence of $\mu_{0,s,i}^{in}$ and $\mu_{0,s,i}^{out}$ from the other variables of the equation using a nonparametric method. Given the complexity of the disturbance structure and the presence of school heterogeneity, it would be challenging to apply the same technique to our framework.

A similar approach to that of Johnsson and Moon (2021) is to replace $\mathbf{h}_s^\eta$ and $\mathbf{h}_s^\epsilon$ with nonparametric approximations. Specifically, we approximate $\mathbf{h}_s^\eta$ and $\mathbf{h}_s^\epsilon$ using tensor products of cubic B-splines.

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[15]Assuming that the network is dense requires each school's size to increase to infinity with the number of schools.

[16]We present a Gibbs sampler to simulate the posterior distributions of $\mu_{0,s,i}^{in}$ and $\mu_{0,s,j}^{out}$ in OA S.2.

This approach is widely used in nonparametric regressions and consists of approximating any smooth function by a combination of piecewise cubic polynomials called *basis* (where the "B" of B-spline comes from). The polynomials are defined such that the approximation fits the function well everywhere on its support. The advantage of this method is that it is straightforward and can be easily applied to complex models (see Hastie, 2017). The baseline idea of this approach stems from the Weierstrass theorem, which states that any real-valued continuous function defined on a compact can be *well approximated* using polynomials.[17]

Controlling for endogeneity results in plugging new regressors (i.e., the bases of the polynomials) into the initial specification. Therefore, identification and consistency results established in Section 3.2 still hold if the new matrix of explanatory variables verifies the regulatory conditions set in Assumption A.1 and A.3. In contrast, the asymptotic normality becomes more complicated and cannot be generalized without new restrictions. The asymptotic properties of the estimator of $\boldsymbol{\psi}_0$ under endogenous networks depend on the uncertainty related to the estimation of $\mu_{0,s,i}^{in}$ and $\mu_{0,s,i}^{out}$ in the first stage. In general, one needs the first-stage estimator to converge as fast as possible so that its approximation error does not influence the second-stage estimator asymptotically (see Appendix A.5). For instance, this restriction is set in the Lipschitz condition of Assumption 8 in Johnsson and Moon (2021) and in Assumption S.1 of Houndetoungan (2022). Alternatively, a bootstrap approach can be used to approximate the asymptotic distribution of the second-stage estimator accounting for the uncertainty of the first stage.

4 Empirical Analysis

In this section, we present an empirical illustration of the model using a unique and now widely used data set provided by the National Longitudinal Study of Adolescent Health (Add Health).[18]

4.1 Data

We use the Wave I in-school Add Health data, collected between September 1994 and April 1995, which gathered national representative information on 7th–12th graders in the US. The surveyed sample comprises 90,118 students from 145 middle, junior high, and high schools. The data provides information on the social and demographic characteristics of students as well as their friendship links (i.e., best friends, up to 5 females and up to 5 males), education level, occupation of parents, etc.

We remove observations with missing data from the data set. The sample used for our empirical

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[17]Our approach is flexible and can accommodate many smooth functions h_η and h_ϵ. For instance, $\mathbf{h}s^\eta + \mathbf{h}s^\epsilon - \lambda \mathbf{G}s\mathbf{h}s^\eta$ is approximated using a combination of up to 390 piecewise polynomial functions, which also account for the interactions between $\mu_{0,s,i}^{in}$ and $\mu_{0,s,j}^{out}$. We replace $\mu_{0,s,i}^{in}$ and $\mu_{0,s,i}^{out}$ with their estimator from the first stage (see Appendix A.5).

[18]The data are available on the website https://addhealth.cpc.unc.edu/documentation/study-design/.

analysis has 68,430 students from 141 schools. The number of students per school ranges from 18 to 2,027, with an average of 485. On average, each student had 3.4 friends (1.6 male friends and 1.9 female friends). Moreover, there are 14,900 (22%) students who have no peers, including 7,655 (11%) who are not fully isolated, i.e., they are friends of others. This feature of the data set is important to illustrate our model. Only 1% of students nominate 10 friends. This suggests that the top coding issue resulting from students' inability to nominate more than 10 friends can be ignored, as shown by Boucher and Houndetoungan (2022).

The dependent variable, GPA, is the average grade of four subjects: mathematics, science, English/language arts, and history or social science. It is calculated on the basis of students' grades (A, B, C, and D or lower) obtained in the four subjects. We re-coded these grades as A = 4; B = 3; C = 2; and D = 1. We control for several other potential factors that can influence GPA (Duncan et al., 2001; Lin, 2010). These factors include sex, age, whether the student is Hispanic, race, whether the student lives with both parents, the number of years spent at their current school by the student, whether the student is a school club member, mother's education, and mother's profession. We also control for contextual variables associated with the factors, i.e., the average of friends' control variables.

Table 1 defines the variables included in the empirical analysis and presents the data summary. The average GPA is 2.8 and the average friend's GPA is 2.2. The average age of the students is about 15 years, they have attended their current school for 2.5 years on average. The sample includes 48.7% boys, 16.4% Hispanics, 64.7% whites, and 16.8% Black. Asians account for 7%, and 9.5% of the sample are of other races. About 74.1% of the students live with both parents. The highest education level achieved is high school (HS) for about 30.6% of the student's mothers, beyond HS for 16.9% of the mothers, and less than HS for 41.9% of the mothers. As for mothers' occupations, Add Health provides a detailed list with more than 15 categories. We combine these occupations into four broader categories along with a missing indicator. Specifically, 20.2% of the students' mothers work in professional occupations (such as teachers, doctors, lawyers, and executives), 20% are homemakers or do not work, and 43.5% hold other jobs.

As an important feature of the model is to control for whether students have friends on not, we also present a data summary in the subsample of students who have no friends. The average GPA is slightly lower than that of students who have friends. We also notice that students who have no peers are often from small minorities, such as Hispanics, Blacks, and Asians.

Table 1: Variables and summary statistics

| Variable | Definition | Own characteristics | | | | Average friend's characteristics | |
| | | All students | | Without peers | | | |
		Mean	SD	Mean	SD	Mean	SD
GPA	Average grade in mathematics, science, English or language arts, and history or social science	2.813	0.806	2.705	0.834	2.246	1.287
Gender							
(Male)	1 if male; 0 otherwise	0.487	0.500	0.582	0.493	0.359	0.339
Female	1 if female; 0 otherwise	0.513	0.500	0.418	0.493	0.423	0.359
Age	Student's age in year	15.074	1.680	15.364	1.656	11.760	6.355
Hispanic	1 if Hispanic; 0 otherwise	0.164	0.370	0.228	0.420	0.117	0.262
Race							
(White)	1 if White; 0 otherwise	0.647	0.478	0.550	0.498	0.525	0.449
Black	1 if Black; 0 otherwise	0.168	0.374	0.205	0.404	0.126	0.302
Asian	1 if Asian; 0 otherwise	0.070	0.254	0.085	0.279	0.052	0.176
Other	1 if the student's race is not in the list above; 0 otherwise	0.095	0.293	0.120	0.325	0.067	0.177
Lives with both parents	1 if the student lives with both of their parents; 0 otherwise	0.741	0.438	0.691	0.462	0.596	0.398
Year in school	Number of years spent in the current school	2.506	1.422	2.361	1.351	2.042	1.511
Member of a club	1 if the student is a member of one of the school's clubs	0.937	0.243	0.877	0.328	0.743	0.412
Mother's education							
(High)	1 if mother's education is high school; 0 otherwise	0.450	0.306	0.461	0.282	0.241	0.284
< High	1 if mother's education is greater than high school; 0 otherwise	0.169	0.375	0.191	0.393	0.119	0.222
> High	1 if mother's education is less than high school; 0 otherwise	0.484	0.419	0.493	0.376	0.349	0.345
Missing	1 if mother's education is missing; 0 otherwise	0.106	0.308	0.151	0.358	0.073	0.167
Mother's job							
Professional	1 if mother is a doctor, lawyer, scientist, teacher, executive, director, and the like; 0 otherwise	0.202	0.402	0.172	0.377	0.173	0.240
(Stay home)	1 if mother is a homemaker, retired, or does not work; 0 otherwise	0.206	0.405	0.214	0.410	0.153	0.229
Other	1 if mother's job is not in the list above; 0 otherwise	0.435	0.496	0.406	0.491	0.346	0.322
Missing	1 if mother's job is missing; 0 otherwise	0.157	0.364	0.208	0.406	0.110	0.203

This table presents the mean and the standard deviation (SD) of the variables used in the empirical analysis. The columns corresponding to "All students" are the mean and the SD in the sample. The next two columns indicate the mean and the SD in the subsample of students having no friends. The last two columns refer to the contextual variables. For the non-numeric variables, the category in parentheses is excluded from the econometric model to allow for identification.

4.2 Estimation Results

In this section, we present our empirical results on Add Health data.[19]

4.2.1 Assuming an Exogenous Network

We first assume that the network is exogenous (see Table 2). We estimate the model with school fixed effects given by Equation (7). We also consider a specification without school heterogeneity. In this case, we include a new explanatory dummy variable that takes one if the student has friends and zero otherwise. Including this variable disentangles the GPA shock parameter $\alpha_{0,s}$ from the preference shock parameter $c_{0,s}$. In addition, we estimate a classical linear-in-means peer effect model, controlling for school heterogeneity as fixed effects and then without controlling for it.

The statistics of the weak instrument test suggest that the specifications do not suffer from a weak instrument issue. However, Models 1–3 suffer from an overidentification issue, which is addressed when we allow for additional heterogeneity in Model 4 (the main model). Estimation results for Model 4 imply that increasing the average GPA of peers by one point results in a 0.856 point increase in students' GPA. This finding is aligned with the empirical literature (Sacerdote, 2011) highlighting the importance of peers as determinants of student performance. The peer effect estimate in our specification is larger by over 1.6 times the size of the coefficient in the classical models (0.502 in Model 1 without unobserved school heterogeneity and 0.507 in Model 3 when we allow for unobserved school heterogeneity). As argued in Section 3.1, the classical specification leads to a biased estimate of peer effects because it does not distinguish between the common shock parameters $\alpha_{0,s}$ and $c_{0,s}$. This distinction is important, as it deeply affects the causal interpretation of peer effects.[20]

School fixed effects do not appear to significantly influence the endogenous peer effect parameter. The estimates are similar for Models 1 and 3 (based on the standard specification) and for Models 2 and 4 (based on our proposed specification). It is worth mentioning that the parameter associated with the dummy variable "Has friends" in Model 3 is not the shift in the GPA for students having friends. In Equation (4), the coefficient associated with this variable is $-\lambda_0\alpha_{s,0}$. On the one hand, its significance suggests the presence of common shocks that directly affect GPA, irrespective of effort. Those shocks are captured by $\alpha_{s,0}$. On the other hand, the negative estimate means that $\lambda_0\alpha_{s,0} > 0$, which is in line with the negative bias of Models 1 and 3. Indeed, as argued in Section 3.1, peer effects estimated using standard models would be biased downward if $\lambda_0\alpha_{s,0} > 0$.

The intuition of this bias is as follows. The standard model only accounts for preference shocks. It wrongly considers direct shocks to GPA without influencing the effort as preference shocks leading to a

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[19]Replication codes can be found at https://github.com/ahoundetoungan/PeerEffectsEffort.

[20]As pointed out above, it is challenging to compute the social multiplier effect associated with the estimate 0.856 because we do not identify δ_0^2.

social multiplier effect. This overestimates the impact of direct shocks. Since co-movements in students' and peers' GPA are either peer effects or common shock effects at the school level, overestimating one type of effect reduces the second type of effect.

We also find that several students' own characteristics and contextual variables influence their GPA. Female students score 0.165 grade points higher than male students. Older students tend to do worse, and students who have been in the current school for longer periods tend to do better. Black and students of other races score 0.121, and 0.026 points lower than white students, respectively, whereas Asian students score 0.194 points higher than white students. Hispanics also fare worse than non-Hispanics. Students who participate in club activities and who live with both parents score 0.138 and 0.091 points higher, respectively. Mother's education is an important determinant of student GPA, and the relationship is positive. Specifically, children of mothers having less than a high school education score 0.068 points lower than those of high-school-graduate mothers, whereas children of mothers who have an education beyond high school achieve 0.124 points higher. Compared with students whose mothers do not work, children of teachers, lawyers, or other professional job holders are more successful, whereas children of other job holders have lower grades.

The coefficients are significant for a number of contextual variables. In particular, students who have relatively more female peers tend to perform worse than students who have male peers. This result suggests that a higher fraction of girls among a student's peers could provide a greater distraction for teenage boys. Coleman (1966) argued that there may be a distraction inherent in mixed-gender educational settings for adolescents. He pointed to the strong emphasis on "rating and dating" in American high school culture, with mixed peer groups having a negative effect on the achievement of both girls and boys. For example, a student's GPA decreases when their peers are Asian, participate in club activities, and when their peers' mother's job is professional. On the contrary, the student's GPA rises with the mean age of their peers, or when their peers are Black and Hispanic.

4.2.2 Controlling for Network Endogeneity

Figure 2 shows the 95% confidence interval of the peer effect estimates after controlling for network endogeneity. We approximate $h_\eta(.)$ and $h_\epsilon(.)$ using cubic B-spline curves allowing interactions between the spline bases (tensor products of cubic B-splines). This leads to additional explanatory variables we then plug into the model. These variables are globally significant, suggesting that the network is endogenous.[21] However, in our model, the endogeneity does not significantly influence the peer effect estimate. This result is robust to the number of knots used for the cubic B-spline approximation. It also supports many other findings on the Add Health data arguing that the endogeneity of the network

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[21]Full tables for some specifications including the case of the Bayesian random model are presented in Appendix B (see Tables B.1–B.3).

Table 2: Estimation results

	Model 1		Model 2		Model 3		Model 4	
	Coef	Sd Err	Coef	Sd Err	Coef	Sd Err	Coef	Sd Err
Peer Effects	0.502	0.025	0.832	0.038	0.507	0.028	0.856	0.044
Has friends			−2.569	0.132				
Own effects								
Female	0.183	0.006	0.168	0.006	0.176	0.006	0.165	0.006
Age	0.007	0.003	−0.042	0.003	−0.015	0.003	−0.043	0.003
Hispanic	−0.110	0.010	−0.111	0.010	−0.101	0.010	−0.091	0.010
Race								
Black	−0.144	0.012	−0.159	0.012	−0.131	0.012	−0.121	0.013
Asian	0.206	0.013	0.189	0.014	0.218	0.013	0.194	0.014
Other	−0.024	0.011	−0.026	0.011	−0.026	0.011	−0.026	0.011
Lives with both parents	0.116	0.008	0.099	0.007	0.107	0.007	0.091	0.008
Years in school	0.023	0.003	0.027	0.003	0.033	0.003	0.027	0.003
Member of a club	0.166	0.013	0.148	0.012	0.157	0.012	0.138	0.012
Mother's education								
< High	−0.076	0.009	−0.071	0.009	−0.076	0.009	−0.068	0.009
> High	0.163	0.007	0.133	0.008	0.151	0.007	0.124	0.008
Missing	0.032	0.013	0.025	0.012	0.031	0.012	0.026	0.012
Mother's job								
Professional	0.044	0.009	0.036	0.009	0.039	0.009	0.032	0.009
Other	−0.041	0.007	−0.037	0.008	−0.040	0.007	−0.037	0.008
Missing	−0.083	0.011	−0.075	0.011	−0.078	0.011	−0.070	0.011
Contextual effects								
Female	−0.138	0.012	−0.130	0.012	−0.108	0.012	−0.123	0.013
Age	−0.067	0.003	0.030	0.004	−0.073	0.004	0.024	0.006
Hispanic	0.033	0.016	0.097	0.018	0.050	0.017	0.087	0.020
Race								
Black	−0.001	0.015	0.104	0.017	−0.007	0.015	0.070	0.020
Asian	−0.051	0.019	−0.136	0.022	−0.043	0.021	−0.135	0.027
Other	−0.048	0.020	−0.003	0.021	−0.046	0.020	−0.001	0.022
Lives with both parents	−0.040	0.017	−0.016	0.018	−0.040	0.016	−0.019	0.018
Years in school	0.003	0.004	−0.020	0.004	0.028	0.004	−0.009	0.006
Member of a club	−0.175	0.029	−0.081	0.028	−0.142	0.028	−0.084	0.029
Mother's education								
< High	−0.044	0.017	0.031	0.018	−0.050	0.016	0.025	0.019
> High	0.062	0.016	−0.024	0.020	0.027	0.017	−0.032	0.021
Missing	−0.057	0.025	−0.026	0.026	−0.070	0.024	−0.031	0.026
Mother's job								
Professional	−0.058	0.018	−0.029	0.019	−0.056	0.018	−0.034	0.020
Other	−0.131	0.014	−0.026	0.016	−0.105	0.014	−0.022	0.016
Missing	−0.144	0.022	0.005	0.024	−0.116	0.021	0.008	0.024
σ_η^2			0.295				0.286	
σ_ϵ^2	0.515		0.086		0.503		0.046	
ρ			0.305				0.605	
Weak instrument F	141		80		209		122	
Sargan test prob.	0.000		0.016		0.000		0.223	

Models 1 and 2 do not control for school heterogeneity, but Model 2 controls for heterogeneity associated with having peers. Model 3 includes a single fixed effect per school (classical model), and Model 4 is our structural model. The columns "Coef" report the coefficient estimates followed by their corresponding standard errors in the columns "Sd Err". Models 1 and 3 have a single disturbance. The statistic of the weak instrument test and the p-value of Sargan's overidentifying test are reported in the last two rows.

does not involve a substantial bias in the peer effects (e.g., Hsieh and Lee, 2016; Hsieh and Lin, 2017; Houndetoungan, 2022). As in those studies, the peer effect estimate decreases slightly (from 0.856 to 0.820). This decline occurs because of unobserved attributes such as IQ that are positively linked to GPA. For instance, an exogenous shock to IQ would simultaneously influence students' and peers' GPA and could be mistakenly considered as peer effects. The specification with endogenous network separates peer effects from these co-movements in GPA.

In the case of the standard model, controlling for network endogeneity significantly increases the peer effect estimate from 0.507 to 0.692. Importantly, this also resolves the problem of overidentification when the unobserved attributes are estimated using a fixed-effect logit model, and the functions $h_\eta(.)$ and $h_\epsilon(.)$ are approximated by tensor products of cubic B-splines (see Table B.2). The overidentification issue arises because of the endogeneity of the network, which appears more concerning when student efforts are approximated by GPA. Nevertheless, the increase in the peer effect estimate is at odds with popular evidence that peer effect estimates tend to decrease after controlling for network endogeneity. The intuition of the increase is as follows. The standard approach biases the peer effect estimate because it does not distinguish between the common shock parameters $\alpha_{0,s}$ and $c_{0,s}$. We show that one way to distinguish between the shocks is to control for whether the students have friends or not. Addressing network endogeneity can also solve this issue (or at least reduces the bias) because it is equivalent to controlling for student attributes that influence their likelihood of forming links. These attributes are likely to be correlated to whether the student has friends or not. The increased peer effect estimate can then be explained by the standard approach biasing the peer effects downward, and controlling for network endogeneity is a means of reducing this bias.
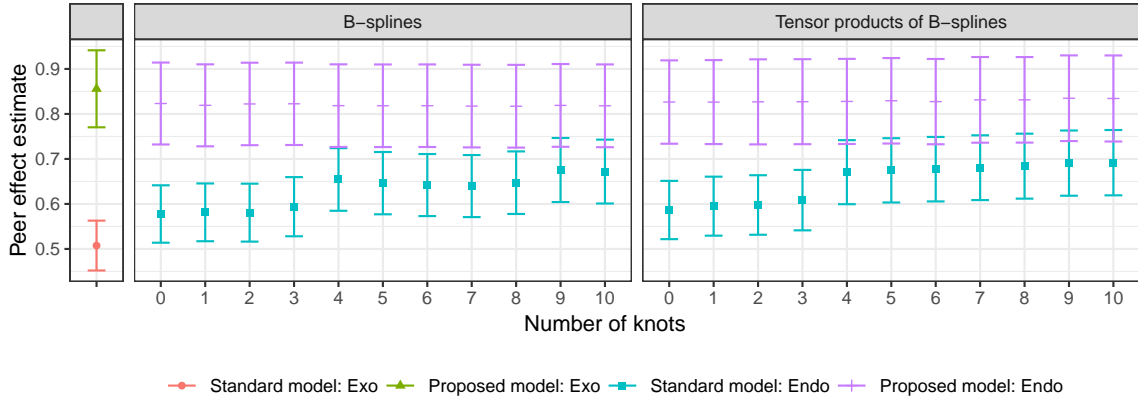

Figure 2: Peer effect estimates after controlling for network endogeneity

Note: This figure shows the 95% confidence interval of the peer effect estimates. The first column presents the estimates when we assume that the network is exogenous (Exo). The second and third columns present the estimates after controlling for the network endogeneity (Endo). We approximate $h_\eta(.)$ and $h_\epsilon(.)$ using cubic B-splines (second column) and the tensor products of cubic B-splines (third column). The unobserved attributes are estimated using a logit model with individual fixed effects. We define the nodes to evenly space the range of the estimators of $\mu_{0,s,i}^{in}$ and $\mu_{0,s,i}^{out}$.

4.2.3 Excluding "Fully Isolated" Students

The Add Health data set comprises 22% students without friends, including 11% who are not fully isolated (in the sense that they are friends of others because the adjacency matrix is directed), and 11% who have no friends and are not others' friends ("fully isolated" students). We construct a new subsample by excluding the "fully isolated" students from the sample. The new subsample includes 61,185 students from 139 schools. Using this sample, we estimate the proposed structural model and the standard peer effect model, which approximates student effort by GPA. We examine the two situations where the network is exogenous and endogenous.

Excluding the 22% isolated students from the sample will generate missing values in the network because the students who are not fully isolated are friends of others. As shown by Boucher and Houndetoungan (2022), this can result in a biased estimate of peer effects. Moreover, our structural model is equivalent to the standard linear-in-means specification when the network does not include isolated students. In contrast, the exclusion of the "fully isolated" students allows conducting a robustness analysis, as it does not involve a missing network data issue.

Figure 2 shows the 95% confidence interval of the peer effect estimates.[22] The estimate of the peer effect parameter using our structural model without controlling for network endogeneity is 0.878, which is close to the previous estimate (0.856) using the full sample. Moreover, the estimate using the standard linear-in-means model increases from 0.507 for the full sample to 0.561. This increase can be explained by the reduced proportion of isolated students. Indeed, the larger the proportion of isolated students, the greater the bias of the standard approach.

The peer effect estimate using the structural model decreases slightly to 0.854 after controlling for network endogeneity, whereas the estimate using the standard linear-in-means model increases to 0.728. The increase in the estimate using the standard approach has the same interpretation as that of the full sample. The bias of the standard approach is smaller than that obtained for the full sample. However, the difference is not substantial, suggesting that the bias is more likely because of isolated students who are friends of others than "fully isolated" students. Overall, the results are similar to those presented in Figure 2.

5   Conclusion

This paper proposes a peer effect model in which students choose their level of effort and receive a corresponding GPA. Unlike standard models used in the literature to estimate peer effects on GPA, our model accounts for two types of common shocks at the school level. We introduce common shocks

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[22]Full tables for some specifications are presented in Appendix B (see Tables B.4–B.5).
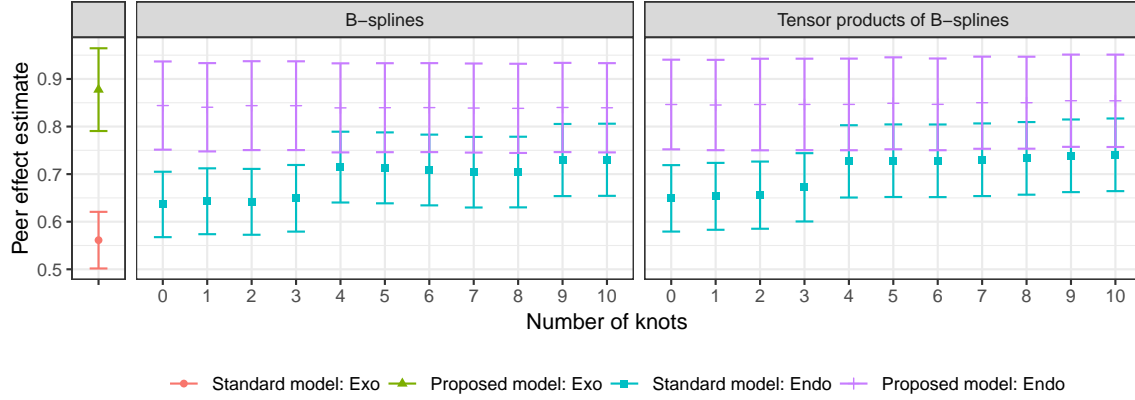
Figure 3: Peer effect estimates excluding "fully isolated" students

Note: This figure shows the 95% confidence interval of the peer effect estimates for the data excluding "fully isolated" students. The first column presents the estimates when we assume that the network is exogenous (Exo). The second and third columns present the estimates after controlling for network endogeneity (Endo). We approximate $h_\eta(.)$ and $h_\epsilon(.)$ using cubic B-splines (second column) and tensor products of cubic B-splines (third column). The unobserved attributes are estimated using a logit model with individual fixed effects. We define the nodes to evenly space the range of the estimators of $\mu_{0,s,i}^{in}$ and $\mu_{0,s,i}^{out}$.

that directly influence the GPA, irrespective of the effort level, and common shocks affecting students' preferences.

We show that both shocks do not have the same impact on GPA. Shocks exerted directly on the GPA without influencing academic effort do not involve a social multiplier, whereas preference shocks may involve a social multiplier effect. We also show that failure to disentangle both shocks results in a biased estimate of peer influence on GPA. Accounting for the difference between the shocks is equivalent to controlling for student heterogeneity on the basis of whether they have friends or not.

Our model leads to an econometric specification that raises identification issues. This occurs in particular because of the presence of unobserved school heterogeneity and students with no peers in the network. We establish the identification under straightforward conditions that can be verified in practice. We propose a multi-stage estimation strategy that combines the GMM and QML approaches. Our approach yields a consistent estimator, and we establish asymptotic normality. We also extend the estimation strategy and examine the case of endogenous networks.

We present an empirical analysis using Add Health data. We find that increasing the average GPA of peers by one point results in a 0.856 point increase in a student's GPA. The peer effect estimate obtained using standard models is 1.6 times lower than that obtained from our proposed approach. Controlling for network endogeneity in the standard models reduces the bias.

Our framework is general and can be used to study peer effects on outcomes that cannot be directly controlled. An example is body mass index (BMI), which cannot be directly chosen. People need to exert effort, such as developing healthy diet habits, engaging in physical exercise, and avoiding fast

food, to improve their BMI. Peer influence is more related to effort than BMI. Another example is peer effects on workers' efforts. The observed outcome is generally the worker's productivity, whereas peer effects stem from the effort.

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A   Appendix: Proofs

A.1   Uniqueness of the Nash Equilibrium

By replacing the GPA with its expression given by Equation (1), we get a new payoff function $\hat{u}_{s,i}(e_{s,i}, \mathbf{e}_{s,-i})$ that does not depend on the GPA. The new payoff function is

$$\hat{u}_{s,i}(e_{s,i}, \mathbf{e}_{s,-i}) = (c_{0,s} + \mathbf{x}'_{s,i}\boldsymbol{\beta}_0 + \mathbf{g}_{s,i}\mathbf{X}_s\boldsymbol{\gamma}_0 + \varepsilon_{s,i})(\alpha_{0,s} + \mathbf{x}'_{s,i}\boldsymbol{\theta}_0 + \delta_0 e_{s,i} + \eta_{s,i}) - \frac{e^2_{s,i}}{2} + \lambda_0 e_{s,i}\mathbf{g}_{s,i}\mathbf{e}_s. \quad \text{(A.1)}$$

The first-order condition of the maximization of $\hat{u}_{s,i}(e_{s,i}, \mathbf{e}_{s,-i})$ with respect to the effort $e_{s,i}$ gives

$$e_{s,i} = \delta_0 c_{0,s} + \lambda_0 \mathbf{g}_{s,i}\mathbf{e}_s + \delta_0 \mathbf{x}'_{s,i}\boldsymbol{\beta}_0 + \delta_0 \mathbf{g}_{s,i}\mathbf{X}_s\boldsymbol{\gamma}_0 + \delta_0 \varepsilon_{s,i}. \quad \text{(A.2)}$$

If we write Equation (A.2) at the school level, we get the best response functions of all students:

$$\mathbf{e}_s = \delta_0 c_{0,s}\mathbf{1}_{n_s} + \lambda_0 \mathbf{G}_s\mathbf{e}_s + \delta_0 \mathbf{X}_s\boldsymbol{\beta}_0 + \delta_0 \mathbf{G}_s\mathbf{X}_s\boldsymbol{\gamma}_0 + \delta_0 \boldsymbol{\varepsilon}_s, \quad \text{(A.3)}$$

where $\mathbf{1}_{n_s}$ is an n_s-vector of ones and $\boldsymbol{\varepsilon}_s = (\varepsilon_{s,1}, \ldots, \varepsilon_{s,n_s})'$. Equation (A.3) is a system of n_s linear equations in the effort. This system has a unique solution if $|\mathbf{I}_{n_s} - \lambda_0 \mathbf{G}_s| \neq 0$, where $\mathbf{I}_{n_s}$ is the $n_s \times n_s$ identity matrix. The condition $|\mathbf{I}_{n_s} - \lambda_0 \mathbf{G}_s| \neq 0$ is equivalent to saying that 1 is not an eigenvalue for $\lambda_0 \mathbf{G}_s$. As $\mathbf{G}_s$ is a row-normalized matrix, the eigenvalues of $\lambda_0 \mathbf{G}_s$ are in the closed interval $[-|\lambda_0|, |\lambda_0|]$.[23] Thus, if $|\lambda_0| < 1$, then $|\mathbf{I}_{n_s} - \lambda_0 \mathbf{G}_s| \neq 0$ and the solution of Equation (A.3) is

$$\mathbf{e}_s = (\mathbf{I}_{n_s} - \lambda_0 \mathbf{G}_s)^{-1}(\delta_0 c_{0,s}\mathbf{1}_{n_s} + \delta_0 \mathbf{X}_s\boldsymbol{\beta}_0 + \delta_0 \mathbf{G}_s\mathbf{X}_s\boldsymbol{\gamma}_0 + \delta_0 \boldsymbol{\varepsilon}_s). \quad \text{(A.4)}$$

As a result, the game described by the payoff function (A.1) has a unique NE given by (A.4).

A.2   Reduced form equation of the GPA

Let $\boldsymbol{\eta}_s = (\eta_{s,1}, \ldots, \eta_{s,n_s})'$ be the vector of the idiosyncratic error terms in Equation (1). Let also $\mathbf{y}_s = (y_{s,1}, \ldots, y_{s,n_s})'$ be the GPAs' vector. From Equation (1), we have $e_{s,i} = (y_{s,i} - \alpha_{0,s} - \mathbf{x}'_{s,i}\boldsymbol{\theta}_0 - \eta_{s,i})/\delta_0$. By replacing this expression in Equation (A.2), we get

$$\frac{y_{s,i} - \alpha_{0,s} - \mathbf{x}'_{s,i}\boldsymbol{\theta}_0 - \eta_{s,i}}{\delta_0} = \frac{\lambda_0 \mathbf{g}_{s,i}(\mathbf{y}_s - \alpha_{0,s}\mathbf{1}_{n_s} - \mathbf{X}_s\boldsymbol{\theta}_0 - \boldsymbol{\eta}_s)}{\delta_0} + \delta_0(c_{0,s} + \mathbf{x}'_{s,i}\boldsymbol{\beta}_0 + \mathbf{g}_{s,i}\mathbf{X}_s\boldsymbol{\gamma}_0 + \varepsilon_{s,i}),$$

$$y_{s,i} = \kappa_{s,i} + \lambda_0 \mathbf{g}_{s,i}\mathbf{y}_s + \mathbf{x}'_{s,i}\tilde{\boldsymbol{\beta}}_0 + \mathbf{g}_{s,i}\mathbf{X}_s\tilde{\boldsymbol{\gamma}}_0 + (\boldsymbol{\omega}_{s,i} - \lambda_0 \mathbf{g}_{s,i})\boldsymbol{\eta}_s + \delta_0^2 \varepsilon_{s,i},$$

---

[23]This is a direct implication of the Gershgorin circle theorem (Horn and Johnson, 2012).

where $\kappa_{s,i} = \delta_0^2 c_{0,s} + (1 - \lambda_0 \mathbf{g}_{s,i} \mathbf{1}_{n_s}) \alpha_{0,s}$, $\tilde{\boldsymbol{\beta}}_0 = \delta_0^2 \boldsymbol{\beta}_0 + \boldsymbol{\theta}_0$, $\tilde{\boldsymbol{\gamma}}_0 = \delta_0^2 \boldsymbol{\gamma}_0 - \lambda_0 \boldsymbol{\theta}_0$, and $\boldsymbol{\omega}_{s,i}$ is a row-vector of dimension n_s in which all the elements are equal to zero except the i-th element, which is one.

A.3   Proof of Proposition 3.1

We show that the reflection problem is addressed under Conditions (i) and (ii) of Assumption 3.3. Assume that $\mathbb{E}(\mathbf{J}_s \mathbf{G}_s \mathbf{y}_s | \mathbf{G}_s, \mathbf{X}_s)$ is perfectly collinear with $\mathbf{J}_s \mathbf{X}_s$ and $\mathbf{J}_s \mathbf{G}_s \mathbf{X}_s$. For any $i \in \hat{\mathcal{V}}_s$, we have $\mathbb{E}(\mathbf{g}_{s,i} \mathbf{y}_s - \hat{\bar{y}}_s | \mathbf{G}_s, \mathbf{X}_s) = (\mathbf{x}'_{s,i} - \hat{\mathbf{x}}'_s)\dot{\boldsymbol{\beta}} + (\mathbf{g}_{s,i} \mathbf{X}'_s - \hat{\bar{\mathbf{x}}}'_s)\dot{\boldsymbol{\gamma}}$, where $\hat{\bar{y}}_s$, $\hat{\mathbf{x}}_s$, and $\hat{\bar{\mathbf{x}}}_s$ are the respectively averages of $\mathbf{g}_{s,i} \mathbf{y}_s$, $\mathbf{x}_{s,i}$, and $(\mathbf{g}_{s,i} \mathbf{X}_s)'$ within $\hat{\mathcal{V}}_s$, and $\dot{\boldsymbol{\beta}}$, $\dot{\boldsymbol{\gamma}}$ are unknown parameters. Taking the previous equation in difference between two students i_1, j from $\hat{\mathcal{V}}_s$ implies

$$\bar{y}^e_{s,i_1} - \bar{y}^e_{s,j} = (\mathbf{x}'_{s,i_1} - \mathbf{x}'_{s,j})\dot{\boldsymbol{\beta}} + (\bar{\mathbf{x}}'_{s,i_1} - \bar{\mathbf{x}}'_{s,j})\dot{\boldsymbol{\gamma}}, \tag{A.5}$$

where $\bar{y}^e_{s,i} = \mathbb{E}(\mathbf{g}_{s,i} \mathbf{y}_s | \mathbf{G}_s, \mathbf{X}_s)$ and $\bar{\mathbf{x}}'_{s,i} = \mathbf{g}_{s,i} \mathbf{X}_s$ for all i. Assume that j is i_1's friend and that an increase in $\mathbf{x}_l$ for any l that is separated from i_1 by a link of distance three. Such an l exists by Condition (ii) of Assumption 3.3. As j is i_1's friend, l cannot be j's friend, otherwise, it would be possible to find a path of distance two from l to i_1. Thus, an increase in any $\mathbf{x}_l$ has no influence on $\mathbf{x}'_{s,i_1}$, $\mathbf{x}'_{s,j}$, $\bar{\mathbf{x}}'_{s,i_1}$, and $\bar{\mathbf{x}}'_{s,j}$. Therefore, Equation (A.5) implies that

$$\Delta^l \bar{y}^e_{s,i_1} = \Delta^l \bar{y}^e_{s,j}, \tag{A.6}$$

where the operator Δ^l measures the variation after the increase in $\mathbf{x}_l$.

We will now show that the condition $\Delta^l \bar{y}^e_{s,i_1} = \Delta^l \bar{y}^e_{s,j}$ for all j who is i_1's friend is not possible. By applying the operator Δ^l to every term of Equation (6), we have $\Delta^l \mathbf{y}_s = \lambda_0 \mathbf{G}_s (\Delta^l \mathbf{y}_s) + (\Delta^l \mathbf{X}_s)\boldsymbol{\beta}_0 + \mathbf{G}_s(\Delta^l \mathbf{X}_s)\boldsymbol{\gamma}_0$. With some rearrangements, we can rewrite this as

$$\Delta^l \mathbf{y}_s = (\Delta^l \mathbf{X}_s)\boldsymbol{\beta}_0 + \sum_{k=0}^{\infty} \lambda_0^k \mathbf{G}_s^{k+1}(\Delta^l \mathbf{X}_s)(\lambda_0 \boldsymbol{\beta}_0 + \boldsymbol{\gamma}_0). \tag{A.7}$$

Equation (A.7) implies the GPA is influenced by the contextual variables if and only if $\lambda_0 \boldsymbol{\beta}_0 + \boldsymbol{\gamma}_0 \neq 0$. By premultiplying (A.7) by $\mathbf{g}_{s,i_1}$ and taking the expectation conditional on $\mathbf{G}_s$ and $\mathbf{X}_s$, we have

$$\Delta^l \bar{y}^e_{s,i_1} = \mathbf{g}_{s,i_1} \sum_{k=1}^{\infty} \lambda_0^k \mathbf{G}_s^{k+1}(\Delta^l \mathbf{X}_s)(\lambda_0 \boldsymbol{\beta}_0 + \boldsymbol{\gamma}_0). \tag{A.8}$$

because $\mathbf{g}_{s,i_1}(\Delta^l \mathbf{X}_s) = 0$ and $\mathbf{g}_{s,i_1} \mathbf{G}_s(\Delta^l \mathbf{X}_s) = 0$ (since l is separated from i_1 by a link of distance three, l is not i_1's friend, nor i_1's friend's friend).

Besides, by premultiplying each term of Equation (A.7) by $\lambda_0 \mathbf{G}_s$, we have $\sum_{k=1}^{\infty} \lambda_0^k \mathbf{G}_s^{k+1}(\Delta^l \mathbf{X}_s)(\lambda_0 \boldsymbol{\beta}_0 + \boldsymbol{\gamma}_0) = \lambda_0 \mathbf{G}_s \Delta^l \mathbf{y}_s - \lambda_0 \mathbf{G}_s(\Delta^l \mathbf{X}_s)\boldsymbol{\beta}_0$. By replacing the previous equation in (A.8), we get $\Delta^l \bar{y}^e_{s,i_1} = $

$\lambda_0 \mathbf{g}_{s,i_1} \mathbf{G}_s \Delta^l \mathbf{y}_s$ since $\mathbf{g}_{s,i_1} \mathbf{G}_s (\Delta^l \mathbf{X}_s) = 0$. As $\mathbf{G}_s \Delta^l \mathbf{y}_s = (\Delta^l \bar{y}_{s,1}^e, \ldots, \Delta^l \bar{y}_{s,n_s}^e)'$, the term $\mathbf{g}_{s,i_1} \mathbf{G}_s \Delta^l \mathbf{y}_s$ is the average of $\Delta^l \bar{y}_{s,j}^e$ among students j who are i_1's friends, i.e., $\mathbf{g}_{s,i_1} \mathbf{G}_s \Delta^l \mathbf{y}_s = \Delta^l \bar{y}_{s,i_1}^e$ because $\Delta^l \bar{y}_{s,j}^e = \Delta^l \bar{y}_{s,i_1}^e$ if j is i_1's friend (Equation (A.6)). This is impossible, as it would imply $\Delta^l \bar{y}_{s,i_1}^e = \lambda_0 \Delta^l \bar{y}_{s,i_1}^e$. Indeed, $\lambda_0 \neq 1$ by Assumption 2.1, and $\Delta^l \bar{y}_{s,i_1}^e \neq 0$ because $\lambda_0 \boldsymbol{\beta}_0 + \boldsymbol{\gamma}_0 \neq 0$ (Equation (A.7)). As a result, the model does not suffer from the reflection problem.

Let $\tilde{\mathbf{X}}_s = \mathbf{J}_s [\mathbf{X}_s, \ \mathbf{G}_s \mathbf{X}_s]$, $\mathbf{R}_s = [\mathbf{J}_s \mathbf{G}_s \mathbf{y}_s, \ \tilde{\mathbf{X}}_s]$, $\mathbf{Z}_s = [\mathbf{J}_s \mathbf{G}_s^2 \mathbf{X}_s, \ \tilde{\mathbf{X}}_s]$, $\mathbf{R}'\mathbf{Z} = \sum_{s=1}^S \mathbf{R}_s' \mathbf{Z}_s$, and $\mathbf{Z}'\mathbf{Z} = \sum_{s=1}^S \mathbf{Z}_s' \mathbf{Z}_s$. We set the following identification condition.

Assumption A.1. *The matrices $\mathbf{R}'\mathbf{Z}/n$ and $\mathbf{Z}'\mathbf{Z}/n$ converge to full rank matrices as S grows to infinity. Moreover, $\sum_{s=1}^S \mathbf{Z}_s'((\mathbf{I}_{n_s} - \lambda_0 \mathbf{G}_s)\boldsymbol{\eta}_s + \boldsymbol{\varepsilon}_s)/n = o_p(1)$.*

The first half of Assumption A.1 suggests that the columns of design matrix $\mathbf{R} = [\mathbf{R}_1', \ldots, \mathbf{R}_S']'$ and those of the instrument matrix $\mathbf{Z} = [\mathbf{Z}_1', \ldots, \mathbf{Z}_S']'$ are linearly independent for large S. The second condition of the assumption comes from the exogeneity of $\mathbf{X}_s$ and $\mathbf{G}_s$ with respect to $\boldsymbol{\eta}_s$ and ε_s. Under Condition 3.1 and Assumptions 2.1, 3.1, 3.3, and A.1, the design matrix of Equation (7) is full rank for large n, and the identification of $\boldsymbol{\psi}_0$ follows.

A.4   Proof of Proposition 3.2

The log-likelihood can be written as

$$\hat{L}(\sigma_\eta^2, \sigma_\epsilon^2, \rho) = -\sum_{s=1}^S \frac{n_s - 2}{2} \log(\sigma_\epsilon^2) - \frac{1}{2} \sum_{s=1}^S \log|\boldsymbol{\Omega}_s(\hat{\lambda}, \tau, \rho)| - \sum_{s=1}^S \frac{1}{2\sigma_\epsilon^2} \hat{\boldsymbol{v}}_s' \mathbf{F}_s \boldsymbol{\Omega}_s^{-1}(\hat{\lambda}, \tau, \rho) \mathbf{F}_s' \hat{\boldsymbol{v}}_s,$$

where σ_η, σ_ϵ, and ρ denote arbitrary values of $\sigma_{0\eta}$, $\sigma_{0\epsilon}$, and ρ_0, $\boldsymbol{\Omega}_s(\hat{\lambda}, \tau, \rho) = \mathbf{I}_{n_s-2} + \tau^2 \mathbf{F}_s' \mathbf{W}_s \mathbf{W}_s' \mathbf{F}_s + \rho\tau \mathbf{F}_s'(\mathbf{W}_s + \mathbf{W}_s')\mathbf{F}_s$, $\mathbf{W}_s = \mathbf{I}_{n_s} - \hat{\lambda} \mathbf{G}_s$, and $\tau = \sigma_\eta/\sigma_\epsilon$.

We also define the following log-likelihood by replacing $\hat{\boldsymbol{v}}_s$ and $\hat{\lambda}$ in $\hat{L}(\sigma_\eta^2, \sigma_\epsilon^2, \rho)$ with their true value:

$$L(\sigma_\eta^2, \sigma_\epsilon^2, \rho) = -\sum_{s=1}^S \frac{n_s - 2}{2} \log(\sigma_\epsilon^2) - \frac{1}{2} \sum_{s=1}^S \log|\boldsymbol{\Omega}_s(\lambda_0, \tau, \rho)| - \sum_{s=1}^S \frac{1}{2\sigma_\epsilon^2} \boldsymbol{v}_s' \mathbf{F}_s \boldsymbol{\Omega}_s^{-1}(\lambda_0, \tau, \rho) \mathbf{F}_s' \boldsymbol{v}_s.$$

Let $\pi_{\min}(.)$ be the smallest eigenvalue and $\pi_{\max}(.)$ be the largest eigenvalue. The operator $\|.\|_2$ applied to a matrix is the operator norm induced by the ℓ^2-norm. We also denote by $\boldsymbol{\Theta}$ the space of $(\sigma_\eta^2, \ \sigma_\epsilon^2, \ \rho)$.

The proof is done in several steps.

Step 1

We show that $\frac{1}{n-2S}(\hat{L}(\sigma_\eta^2, \sigma_\epsilon^2, \rho) - L(\sigma_\eta^2, \sigma_\epsilon^2, \rho))$ converges in probability to zero uniformly in $\boldsymbol{\Theta}$. This proof would imply that we can focus on $L(\sigma_\eta^2, \sigma_\epsilon^2, \rho)$ for the identification and consistency instead of $\hat{L}(\sigma_\eta^2, \sigma_\epsilon^2, \rho)$. To do so, we set the following assumptions.

Assumption A.2. *(i)* $\boldsymbol{\Theta}$ *is a compact subset of* $\mathbb{R}^3$ *and (ii)* $\lim_{S\to\infty} \pi_{\min}(\boldsymbol{\Omega}_s(\hat{\lambda}, \tau, \rho)) > 0$ *for any s.*

Assumption A.3. *(i)* $\mathbb{E}(\eta_{s,i}^4|\mathbf{G}_s, \mathbf{X}_s)$, $\mathbb{E}(\varepsilon_{s,i}^4|\mathbf{G}_s, \mathbf{X}_s)$, *and* $\mathbb{E}(\eta_{s,i}^2\varepsilon_{s,i}^2|\mathbf{G}_s, \mathbf{X}_s)$ *exist; (ii)* $\max_{s,i}|\eta_{s,i}| = O_p(1)$, $\max_{s,i}|\varepsilon_{s,i}| = O_p(1)$, *and* $\max_{s,i}\|\mathbf{x}_{s,i}\|_2 = O_p(1)$.

Condition (i) of Assumption A.2 is required in many econometric models. It allows for generalizing pointwise convergences to uniform convergences. Condition (ii) of Assumption A.2 generalizes the nonsingularity of the matrix $\boldsymbol{\Omega}_s(\hat{\lambda}, \tau, \rho)$ to large samples (when S grows to infinity). Assumption A.3 sets further conditions regarding the distribution of $(\eta_{s,i}, \ \varepsilon_{s,i})'$ and ensures that $\mathbf{x}_{s,i}$ and the i-th component of $\boldsymbol{v}_s$ are bounded.

Because $\mathbf{G}_s$ is row-normalized and bounded in column sum (Assumption 3.2), then for all τ and ρ, $\tilde{\boldsymbol{\Omega}}_s(\hat{\lambda}, \tau, \rho) := \mathbf{I}_{n_s} + \tau^2\mathbf{W}_s\mathbf{W}_s' + \rho\tau(\mathbf{W}_s + \mathbf{W}_s')$ is also absolutely bounded in both row and column sums. This implies that $\pi_{\max}(\tilde{\boldsymbol{\Omega}}_s(\hat{\lambda}, \tau, \rho)) < \infty$.[24] Moreover, as $\boldsymbol{\Omega}_s(\hat{\lambda}, \tau, \rho) = \mathbf{F}_s'\tilde{\boldsymbol{\Omega}}_s(\hat{\lambda}, \tau, \rho)\mathbf{F}_s$, we have $\pi_{\max}(\boldsymbol{\Omega}_s(\hat{\lambda}, \tau, \rho)) \leqslant \pi_{\max}(\tilde{\boldsymbol{\Omega}}_s(\hat{\lambda}, \tau, \rho)) < \infty$. Thus, $\frac{1}{n-2S}\sum_{s=1}^S \log|\boldsymbol{\Omega}_s(\hat{\lambda}, \tau, \rho)| < \infty$ for all σ_η^2, σ_ϵ^2, and ρ. As a result, $\frac{1}{n-2S}\sum_{s=1}^S \log|\boldsymbol{\Omega}_s(\hat{\lambda}, \tau, \rho)| - \frac{1}{n-2S}\sum_{s=1}^S \log|\boldsymbol{\Omega}_s(\lambda_0, \tau, \rho)| = o_p(1)$ (because the determinant is continuous).

Besides, $\hat{\boldsymbol{v}}_s = \boldsymbol{v}_s + \Delta\hat{\boldsymbol{v}}_s$, where $\Delta\hat{\boldsymbol{v}}_s = \mathbf{R}_s(\boldsymbol{\psi}_0 - \hat{\boldsymbol{\psi}})$. As $\max_{s,i}\|\mathbf{x}_{s,i}\|_2 = O_p(1)$ and $(\boldsymbol{\psi}_0 - \hat{\boldsymbol{\psi}}) = O_p(n^{-1/2})$, then each component of $\Delta\hat{\boldsymbol{v}}_s$ is $O_p(n^{-1/2})$ and $\|\Delta\hat{\boldsymbol{v}}_s\|_2 = O_p((n_s/n)^{1/2})$. On the other hand, as $\max_{s,i}|\eta_{s,i}| = O_p(1)$ and $\max_{s,i}|\varepsilon_{s,i}| = O_p(1)$, we have $\|\boldsymbol{v}_s\|_2 = O_p(n_s^{1/2})$. We also have

$$\hat{\boldsymbol{v}}_s'\mathbf{F}_s\boldsymbol{\Omega}_s^{-1}(\hat{\lambda}, \tau, \rho)\mathbf{F}_s'\hat{\boldsymbol{v}}_s = \boldsymbol{v}_s'\mathbf{F}_s\boldsymbol{\Omega}_s^{-1}(\hat{\lambda}, \tau, \rho)\mathbf{F}_s'\boldsymbol{v}_s + 2\Delta\hat{\boldsymbol{v}}_s'\mathbf{F}_s\boldsymbol{\Omega}_s^{-1}(\hat{\lambda}, \tau, \rho)\mathbf{F}_s'\boldsymbol{v}_s + \Delta\hat{\boldsymbol{v}}_s'\mathbf{F}_s\boldsymbol{\Omega}_s^{-1}(\hat{\lambda}, \tau, \rho)\mathbf{F}_s'\Delta\hat{\boldsymbol{v}}_s.$$

The submultiplicativity property of the operator norm implies that $\sum_{s=1}^S|\Delta\hat{\boldsymbol{v}}_s'\mathbf{F}_s\boldsymbol{\Omega}_s^{-1}(\hat{\lambda}, \tau, \rho)\mathbf{F}_s'\boldsymbol{v}_s| = O_p(n^{1/2})$ and $\sum_{s=1}^S|\Delta\hat{\boldsymbol{v}}_s'\mathbf{F}_s\boldsymbol{\Omega}_s^{-1}(\hat{\lambda}, \tau, \rho)\mathbf{F}_s'\Delta\hat{\boldsymbol{v}}_s| = O_p(1)$ because $\|\mathbf{F}_s\|_2 = 1$ and $\|\boldsymbol{\Omega}_s^{-1}(\hat{\lambda}, \tau, \rho)\|_2 = O_p(1)$ (Assumption A.2). Thus, $\frac{1}{n-2S}(\hat{\boldsymbol{v}}_s'\mathbf{F}_s\boldsymbol{\Omega}_s^{-1}(\hat{\lambda}, \tau, \rho)\mathbf{F}_s'\hat{\boldsymbol{v}}_s - \boldsymbol{v}_s'\mathbf{F}_s\boldsymbol{\Omega}_s^{-1}(\hat{\lambda}, \tau, \rho)\mathbf{F}_s'\boldsymbol{v}_s) = o_p(1)$. We also have $\frac{1}{n-2S}(\hat{\boldsymbol{v}}_s'\mathbf{F}_s\boldsymbol{\Omega}_s^{-1}(\hat{\lambda}, \tau, \rho)\mathbf{F}_s'\hat{\boldsymbol{v}}_s - \boldsymbol{v}_s'\mathbf{F}_s\boldsymbol{\Omega}_s^{-1}(\lambda_0, \tau, \rho)\mathbf{F}_s'\boldsymbol{v}_s) = o_p(1)$ because $\boldsymbol{v}_s'\mathbf{F}_s\boldsymbol{\Omega}_s^{-1}(\hat{\lambda}, \tau, \rho)\mathbf{F}_s'\boldsymbol{v}_s$ is a continuous function of $\hat{\lambda}$.

As a result, $\frac{1}{n}(\hat{L}(\sigma_\eta^2, \sigma_\epsilon^2, \rho) - L(\sigma_\eta^2, \sigma_\epsilon^2, \rho)) = o_p(1)$. The convergence is uniform because the log-likelihoods can be expressed as a polynomial function in $(\sigma_\eta^2, \ \sigma_\epsilon^2, \ \rho)$. We can now focus on the log-likelihood $L(\sigma_\eta^2, \sigma_\epsilon^2, \rho)$ for the identification and the consistency of $(\sigma_{\epsilon0}^2, \ \tau_0, \ \rho_0)$.

Step 2

The first-order conditions (foc) of the maximization of $L(\sigma_\eta^2, \sigma_\epsilon^2, \rho)$ imply that σ_ϵ^2 can be replaced with $\hat{\sigma}_\epsilon^2(\tau, \rho) = \sum_{s=1}^S \frac{\boldsymbol{v}_s'\mathbf{F}_s\boldsymbol{\Omega}_s^{-1}(\lambda_0, \tau, \rho)\mathbf{F}_s'\boldsymbol{v}_s}{n-2S}$. This leads to a concentrated log-likelihood given by $L_c(\tau, \rho) = -\frac{n-2S}{2}\hat{\sigma}_\epsilon^2(\tau, \rho) - \frac{1}{2}\sum_{s=1}^S \log|\boldsymbol{\Omega}_s(\lambda_0, \tau, \rho)| - \frac{n-2S}{2}$. Let $L^*(\sigma_\eta^2, \sigma_\epsilon^2, \rho) = \mathbb{E}\left(L(\sigma_\eta^2, \sigma_\epsilon^2, \rho)|\mathbf{G}_1, \ldots, \mathbf{G}_S\right)$. As

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[24]See OA S.1.1 for some basic properties used throughout the paper.

for $L(\sigma_\eta^2, \sigma_\epsilon^2, \rho)$, we can also replace σ_ϵ^2 with $\mathbb{E}\left(\hat{\sigma}_\epsilon^2(\tau, \rho)|\mathbf{G}_1, \ldots, \mathbf{G}_S\right)$.

$$\mathbb{E}(\hat{\sigma}_\epsilon^2(\tau, \rho)|\mathbf{G}_1, \ldots, \mathbf{G}_S) = \tfrac{\sigma_{\varepsilon 0}^2}{n-2S} \sum_{s=1}^S \mathbb{E}(\text{Tr}(\boldsymbol{v}_s' \mathbf{F}_s \boldsymbol{\Omega}_s^{-1}(\lambda_0, \tau, \rho) \mathbf{F}_s' \boldsymbol{v}_s)|\mathbf{G}_1, \ldots, \mathbf{G}_S),$$

$$\mathbb{E}(\hat{\sigma}_\epsilon^2(\tau, \rho)|\mathbf{G}_1, \ldots, \mathbf{G}_S) = \tfrac{\sigma_{\varepsilon 0}^2}{n-2S} \sum_{s=1}^S \mathbb{E}(\text{Tr}(\boldsymbol{\Omega}_s^{-1}(\lambda_0, \tau, \rho) \mathbf{F}_s' \boldsymbol{v}_s \boldsymbol{v}_s' \mathbf{F}_s)|\mathbf{G}_1, \ldots, \mathbf{G}_S),$$

$$\mathbb{E}(\hat{\sigma}_\epsilon^2(\tau, \rho)|\mathbf{G}_1, \ldots, \mathbf{G}_S) = \tfrac{\sigma_{\varepsilon 0}^2}{n-2S} \sum_{s=1}^S \text{Tr}(\boldsymbol{\Omega}_s^{-1}(\lambda_0, \tau, \rho) \mathbb{E}(\mathbf{F}_s' \boldsymbol{v}_s \boldsymbol{v}_s' \mathbf{F}_s|\mathbf{G}_1, \ldots, \mathbf{G}_S)),$$

$$\mathbb{E}(\hat{\sigma}_\epsilon^2(\tau, \rho)|\mathbf{G}_1, \ldots, \mathbf{G}_S) = \tfrac{\sigma_{\varepsilon 0}^2}{n-2S} \sum_{s=1}^S \text{Tr}(\boldsymbol{\Omega}_s^{-1}(\lambda_0, \tau, \rho) \boldsymbol{\Omega}_{0,s}). \tag{A.9}$$

We obtain the concentrated log-likelihood $L_c^*(\tau, \rho) = -\frac{n-2S}{2}\tilde{\sigma}_\epsilon^{2*}(\tau, \rho) - \frac{1}{2}\sum_{s=1}^S \log|\boldsymbol{\Omega}_s(\lambda_0, \tau, \rho)| - \frac{n-2S}{2}$, where $\tilde{\sigma}_\epsilon^{2*}(\tau, \rho) = \frac{\sigma_{\varepsilon 0}^2}{n-2S}\sum_{s=1}^S \text{Tr}\left(\boldsymbol{\Omega}_s^{-1}(\lambda_0, \tau, \rho)\boldsymbol{\Omega}_{0,s}\right)$. We show that $\frac{1}{n}(L_c(\tau, \rho) - L_c^*(\tau, \rho))$ converges to zero uniformly.

Although $\mathbb{E}\left(\hat{\sigma}_\epsilon^2(\tau, \rho)|\mathbf{G}_1, \ldots, \mathbf{G}_S\right) = \tilde{\sigma}_\epsilon^{2*}(\tau, \rho)$, we cannot directly assert that $\text{plim}\,\hat{\sigma}_\epsilon^2(\tau, \rho) = \tilde{\sigma}_\epsilon^{2*}(\tau, \rho)$. We also need to show that the variance of $\hat{\sigma}_\epsilon^2(\tau, \rho)$ converges to zero as S grows to infinity. This is especially important in our framework because the components of $\boldsymbol{v}_s$ are connected through the network and also because n_s is not necessarily bounded. This is why we impose that fourth-order moments of $\eta_{s,i}$ and $\varepsilon_{s,i}$ exist in Assumption A.3. In fact, the variance of $\hat{\sigma}_\epsilon^2(\tau, \rho)$ involves up to the fourth power of the components of $\boldsymbol{v}_s$. We provide the proof in OA S.1.2. The uniform convergence of $\frac{1}{n}(L_c(\tau, \rho) - L_c^*(\tau, \rho))$ to zero directly follows.

Step 3

To establish the identification of the consistency, we need to show $L_c^*(\tau, \rho)$ is maximized at a single point which is (τ_0, ρ_0) (see Newey and McFadden, 1994).

Let $(\boldsymbol{e}_s)_s$ be a process normally distributed of zero mean and covariance matrix $\sigma_{\epsilon 0}^2 \boldsymbol{\Omega}_s(\tau_0, \rho_0)$. Let $L^0(\sigma_\eta^2, \sigma_\epsilon^2, \rho) = -\sum_{s=1}^S \frac{n_s-2}{2}\sigma_\epsilon^2 - \frac{1}{2}\sum_{s=1}^S \log|\boldsymbol{\Omega}_s(\lambda_0, \tau, \rho)| - \sum_{s=1}^S \frac{1}{2\sigma_\epsilon^2}\boldsymbol{e}_s' \mathbf{F}_s \boldsymbol{\Omega}_s^{-1}(\lambda_0, \tau, \rho)\mathbf{F}_s'\boldsymbol{e}_s$. By Jensen's inequality, we have $\mathbb{E}(L^0(\sigma_\eta^2, \sigma_\epsilon^2, \rho) - L^0(\sigma_{\eta 0}^2, \sigma_{\epsilon 0}^2, \rho_0)|\mathbf{G}_1, \ldots, \mathbf{G}_S) \leqslant 0$. This suggests that (τ_0, ρ_0) is a local maximizer of $\text{plim}\,\frac{1}{n}L_c^*(\tau, \rho)$. The identification is guaranteed by Assumption 3.4. If (τ_0, ρ_0) is not the global maximizer, then there would be another $(\tau_+, \rho_+) \in \boldsymbol{\Theta}$, such that $\text{plim}\,\frac{1}{n}\sum_{s=1}^S \log|\tilde{\sigma}_\epsilon^{2*}(\tau_0, \rho_0)\boldsymbol{\Omega}_s(\lambda_0, \tau_0, \rho_0)| = \text{plim}\,\frac{1}{n}\sum_{s=1}^S \log|\tilde{\sigma}_\epsilon^{2*}(\tau_+, \rho_+)\boldsymbol{\Omega}_s(\lambda_0, \tau_+, \rho_+)|$, and Assumption 3.4 would be violated. As a result, (τ_0, ρ_0) is globally identified and $(\hat{\tau}, \hat{\rho})$ is a consistent estimator of (τ_0, ρ_0). The consistency of $\hat{\sigma}_\eta^2$ comes from Equation (A.9). We have $\text{plim}\,\hat{\sigma}_\epsilon^2(\hat{\tau}, \hat{\rho}) = \mathbb{E}(\hat{\sigma}_\epsilon^2(\tau_0, \rho_0)|\mathbf{G}_1, \ldots, \mathbf{G}_S) = \sigma_{\epsilon 0}^2$; thus, $\text{plim}\,\hat{\sigma}_\eta^2 = \tau_0^2 \sigma_{\epsilon 0}^2 = \sigma_{\eta 0}^2$.

A.5 Asumptotic Normality in the Case of Endogenous Networks

In the specification controlling for network endogeneity, we replace $\mu_{0,s,i}^{in}$ and $\mu_{0,s,i}^{out}$ with their estimator and replace $\mathbf{h}_s^\eta$ and $\mathbf{h}_s^\epsilon$ with cubic B-spline approximations. Let ζ be the number of knots in the splines.

The knots are points that split the support of $\mu_{0,s,i}^{in}$ and $\mu_{0,s,i}^{out}$ into intervals. The smooth functions are approximated by cubic polynomials on each interval. The case $\zeta = 0$ is equivalent to approximating h_η and h_ϵ by cubic polynomial.

The cubic B-spline approximation of each $\mathbf{h}_s^\eta$ and $\mathbf{h}_s^\epsilon$ is a linear combination of bases B_k^{in}, $B_{k'}^{out}$, where k and k' take the values $1, \ldots, \zeta + 3$, and B_k^{in} and $B_{k'}^{out}$ are piecewise polynomial functions of $\mu_{0,s,i}^{in}$ and $\mu_{0,s,i}^{out}$ respectively (for more details, see Hastie, 2017). We also include a linear combination of $B_k^{in} B_{k'}^{out}$ to account for interaction between $\mu_{0,s,i}^{in}$ and $\mu_{0,s,i}^{out}$. This more flexible approximation is known as a tensor product of the cubic B-splines. Therefore, $\mathbf{h}_s^\eta$ and $\mathbf{h}_s^\epsilon$ are approximated by combinations of $(\zeta + 3)(\zeta + 5)$ piecewise polynomial functions of $\mu_{0,s,i}^{in}$ and $\mu_{0,s,i}^{out}$. As $\mathbf{h}_s^\eta$ multiplies $\mathbf{G}_s$ in Equation (10), the case $\zeta = 10$ leads to plugging 390 new regressors in the initial specification (6).[25]

Let $\dot{\mathbf{X}}_s$ be the matrix of the additional variables (including the new contextual variables). Let also $\hat{\mathbf{R}}_s = [\mathbf{R}_s, \mathbf{J}_s \dot{\mathbf{X}}_s]$ be the new design matrix. We keep the same instrument matrix $\mathbf{J}_s \mathbf{G}_s^2 \mathbf{X}_s$ for $\mathbf{J}_s \mathbf{G}_s \mathbf{y}_s$. We define $\hat{\mathbf{Z}}_s = [\mathbf{J}_s \mathbf{G}_s^2 \mathbf{X}_s, \ \tilde{\mathbf{X}}_s, \ \mathbf{J}_s \dot{\mathbf{X}}_s]$, $\hat{\mathbf{R}}'\hat{\mathbf{Z}} = \sum_{s=1}^S \hat{\mathbf{R}}_s' \hat{\mathbf{Z}}_s$, $\hat{\mathbf{Z}}'\hat{\mathbf{Z}} = \sum_{s=1}^S \hat{\mathbf{Z}}_s' \hat{\mathbf{Z}}_s$, and $\hat{\mathbf{Z}}'\mathbf{y} = \sum_{s=1}^S \hat{\mathbf{Z}}_s' \mathbf{J}_s \mathbf{y}_s$. Let $\hat{\boldsymbol{\Gamma}}$ be the estimator of the coefficients associated with $\hat{\mathbf{R}}_s$. We have $\hat{\boldsymbol{\Gamma}} = ((\hat{\mathbf{R}}'\hat{\mathbf{Z}})(\hat{\mathbf{Z}}'\hat{\mathbf{Z}})^{-1}(\hat{\mathbf{R}}'\hat{\mathbf{Z}})')^{-1}(\hat{\mathbf{R}}'\hat{\mathbf{Z}})(\hat{\mathbf{Z}}'\hat{\mathbf{Z}})^{-1}(\hat{\mathbf{Z}}'\mathbf{y})$.

We also have $\mathbf{h}_s^\eta + \mathbf{h}_s^\epsilon - \lambda \mathbf{G}_s \mathbf{h}_s^\eta = \dot{\mathbf{X}}_s \check{\boldsymbol{\Gamma}}_0 + \hat{\boldsymbol{\mathcal{E}}}_s$ for some parameter $\check{\boldsymbol{\Gamma}}_0$, where $\hat{\boldsymbol{\mathcal{E}}}_s$ is an approximation error owing to the B-spline approximation on the one hand and on the other, $\mu_{0,s,i}^{in}$ and $\mu_{0,s,i}^{out}$ being replaced with their estimators. The regulatory assumption we need for the asymptotic normality is $\sum_{s=1}^S \hat{\mathbf{Z}}_s' \hat{\boldsymbol{\mathcal{E}}}_s / \sqrt{n} = o_p(1)$. If this holds, then $\sqrt{n}(\hat{\boldsymbol{\Gamma}} - \boldsymbol{\Gamma}_0) \xrightarrow{d} \mathcal{N}\big(0, \lim_{n \to \infty} n \mathbb{V}(\hat{\boldsymbol{\Gamma}})\big)$, where $\boldsymbol{\Gamma}_0 = (\boldsymbol{\psi}_0', \ \check{\boldsymbol{\Gamma}}_0')'$ and $\lim_{n \to \infty} n \mathbb{V}(\hat{\boldsymbol{\Gamma}}) = \sigma_{\epsilon 0}^2 \hat{\mathbf{B}}_0^{-1} \hat{\mathbf{D}}_0 \hat{\mathbf{B}}_0^{-1}$. The matrices $\hat{\mathbf{B}}_0$ and $\hat{\mathbf{D}}_0$ are defined as the original $\mathbf{B}_0$ and $\mathbf{D}_0$, where $\mathbf{R}_s$ and $\mathbf{Z}_s$ are replaced by $\hat{\mathbf{R}}_s$ and $\hat{\mathbf{Z}}_s$.

B Additional Results on the Application

Tables B.1–B.3 present the estimation results after controlling for network endogeneity in our structural model. The unobserved attributes $\mu_{0,s,i}^{in}$ and $\mu_{0,s,i}^{out}$ are estimated using a logit model with fixed effects (see Yan et al., 2019) and a Bayesian random effect model (see OA S.2). We only present the results where the number of knots (No. knots) takes the values 0, 4, 5, and 6. Because the number of plugged variables implied by the cubic B-spline approach is large, we do not show the estimates of the coefficients associated with these variables. However, the line "Endo. Wald prob." in the tables indicates the p-value of the Wald test of the global significance of these variables.

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[25]In the literature on generalized additive models, a variable selection approach is used to eliminate irrelevant explanatory variables among the new regressors. This approach requires a penalty function and tuning parameters that are chosen using cross-validation. This goes beyond the scope of this paper because most cross-validation methods need $\mu_{0,s,i}^{in}$ and $\mu_{0,s,i}^{out}$ to be independent across i, which is not the case here. In our empirical analysis, there is not much difference between the results for $\zeta = 0$ and $\zeta = 10$. Consequently, we do not really need to care about the number of new regressors.

Table B.1: Estimation results controlling for network endogeneity: fixed effect approach with B-spline approximations (full sample)

| | Sandard model | | | | Proposed structural model | | | |
| | No. knots: 0 | | No. knots: 10 | | No. knots: 0 | | No. knots: 10 | |
	Coef	Sd Err	Coef	Sd Err	Coef	Sd Err	Coef	Sd Err
Peer Effects	0.578	0.033	0.672	0.036	0.823	0.046	0.818	0.047
Own effects								
Female	0.170	0.006	0.173	0.006	0.169	0.006	0.169	0.006
Age	−0.021	0.003	−0.032	0.003	−0.043	0.003	−0.043	0.003
Hispanic	−0.102	0.010	−0.099	0.010	−0.092	0.010	−0.092	0.010
Race								
Black	−0.141	0.012	−0.123	0.012	−0.109	0.013	−0.107	0.014
Asian	0.215	0.013	0.210	0.013	0.194	0.014	0.194	0.014
Other	−0.023	0.011	−0.029	0.011	−0.031	0.011	−0.031	0.011
Lives with both parents	0.102	0.007	0.097	0.007	0.090	0.007	0.090	0.007
Years in school	0.030	0.003	0.029	0.003	0.024	0.003	0.024	0.003
Member of a club	0.184	0.012	0.151	0.013	0.144	0.013	0.150	0.014
Mother's education								
< High	−0.073	0.009	−0.068	0.009	−0.065	0.009	−0.064	0.009
> High	0.142	0.007	0.142	0.008	0.129	0.008	0.131	0.008
Missing	0.030	0.012	0.028	0.012	0.027	0.012	0.027	0.012
Mother's job								
Professional	0.036	0.009	0.035	0.009	0.031	0.009	0.030	0.009
Other	−0.040	0.007	−0.040	0.008	−0.039	0.008	−0.040	0.008
Missing	−0.077	0.011	−0.075	0.011	−0.071	0.011	−0.072	0.011
Contextual effects								
Female	−0.112	0.012	−0.108	0.012	−0.120	0.014	−0.117	0.014
Age	−0.051	0.003	−0.015	0.004	0.025	0.006	0.026	0.006
Hispanic	0.058	0.017	0.078	0.017	0.082	0.020	0.082	0.020
Race								
Black	0.015	0.016	0.048	0.017	0.072	0.020	0.076	0.020
Asian	−0.065	0.022	−0.087	0.023	−0.123	0.027	−0.121	0.028
Other	−0.040	0.020	−0.026	0.020	−0.002	0.022	−0.003	0.022
Lives with both parents	−0.035	0.016	−0.027	0.016	−0.014	0.018	−0.014	0.018
Years in school	0.017	0.004	0.003	0.005	−0.007	0.006	−0.007	0.006
Member of a club	−0.134	0.027	−0.110	0.027	−0.078	0.030	−0.094	0.031
Mother's education								
< High	−0.035	0.017	−0.008	0.017	0.024	0.019	0.024	0.019
> High	0.011	0.017	−0.012	0.018	−0.025	0.022	−0.024	0.022
Missing	−0.062	0.024	−0.049	0.024	−0.027	0.026	−0.026	0.026
Mother's job								
Professional	−0.053	0.018	−0.044	0.018	−0.034	0.019	−0.033	0.019
Other	−0.088	0.014	−0.059	0.014	−0.025	0.016	−0.026	0.016
Missing	−0.090	0.021	−0.047	0.022	0.007	0.024	0.006	0.024
σ_η^2					0.280		0.279	
σ_ϵ^2	0.505		0.510		0.057		0.059	
ρ					0.527		0.514	
Weak instrument F	157		130		119		116	
Endogeneity Wald prob.	0.000		0.000		0.000		0.000	
Sargan test prob.	0.000		0.020		0.421		0.454	

This table presents the estimation results of the proposed model after controlling for network endogeneity. The functions h_η and h_ϵ are approximated by cubic B-splines, where $\mu_{0,s,i}^{in}$ and $\mu_{0,s,i}^{out}$ are estimated using a logit model with individual fixed effects. The line "Endo. Wald prob." indicates the p-value of the Wald test of the significance of the plugged variables to control for endogeneity.

Table B.2: Estimation results controlling for network endogeneity: fixed effect approach with tensor products of B-spline approximations (full sample)

	Sandard model				Proposed structural model			
	No. knots: 0		No. knots: 10		No. knots: 0		No. knots: 10	
	Coef	Sd Err	Coef	Sd Err	Coef	Sd Err	Coef	Sd Err
Peer Effects	0.586	0.033	0.692	0.037	0.826	0.047	0.834	0.049
Own effects								
Female	0.17	0.006	0.174	0.006	0.169	0.006	0.171	0.006
Age	−0.022	0.003	−0.037	0.003	−0.043	0.003	−0.045	0.004
Hispanic	−0.102	0.01	−0.100	0.010	−0.091	0.010	−0.092	0.010
Race								
Black	−0.139	0.012	−0.113	0.013	−0.106	0.013	−0.102	0.014
Asian	0.213	0.013	0.206	0.013	0.194	0.014	0.192	0.014
Other	−0.024	0.011	−0.029	0.011	−0.031	0.011	−0.029	0.011
Lives with both parents	0.102	0.007	0.095	0.007	0.090	0.007	0.089	0.007
Years in school	0.03	0.003	0.028	0.003	0.024	0.003	0.024	0.003
Member of a club	0.185	0.012	0.154	0.013	0.147	0.013	0.157	0.014
Mother's education								
< High	−0.073	0.009	−0.066	0.009	−0.065	0.009	−0.062	0.009
> High	0.142	0.008	0.141	0.008	0.129	0.008	0.131	0.008
Missing	0.03	0.012	0.028	0.012	0.027	0.012	0.028	0.012
Mother's job								
Professional	0.036	0.009	0.034	0.009	0.031	0.009	0.031	0.009
Other	−0.04	0.007	−0.040	0.008	−0.039	0.008	−0.039	0.008
Missing	−0.076	0.011	−0.076	0.011	−0.071	0.011	−0.071	0.011
Contextual effects								
Female	−0.112	0.012	−0.107	0.012	−0.120	0.014	−0.120	0.014
Age	−0.049	0.003	−0.008	0.004	0.026	0.006	0.028	0.006
Hispanic	0.062	0.017	0.083	0.018	0.082	0.020	0.084	0.021
Race								
Black	0.017	0.016	0.046	0.017	0.071	0.020	0.082	0.020
Asian	−0.063	0.022	−0.095	0.023	−0.126	0.028	−0.127	0.028
Other	−0.037	0.02	−0.022	0.020	−0.002	0.022	−0.001	0.022
Lives with both parents	−0.035	0.016	−0.025	0.016	−0.015	0.018	−0.015	0.018
Years in school	0.017	0.004	0.003	0.005	−0.007	0.006	−0.006	0.006
Member of a club	−0.135	0.027	−0.106	0.027	−0.078	0.031	−0.094	0.032
Mother's education								
< High	−0.032	0.017	−0.002	0.017	0.025	0.019	0.025	0.019
> High	0.008	0.017	−0.016	0.018	−0.025	0.022	−0.030	0.023
Missing	−0.061	0.024	−0.046	0.024	−0.027	0.026	−0.025	0.026
Mother's job								
Professional	−0.053	0.018	−0.040	0.018	−0.034	0.019	−0.033	0.019
Other	−0.085	0.014	−0.050	0.015	−0.025	0.016	−0.022	0.016
Missing	−0.087	0.021	−0.036	0.022	0.008	0.024	0.010	0.024
σ_η^2					0.280		0.277	
σ_ϵ^2	0.506		0.511		0.055		0.056	
ρ					0.544		0.544	
Weak instrument F	115		127		115		110	
Endogeneity Wald prob.	0.000		0.000		0.000		0.000	
Sargan test prob.	0.000		0.123		0.324		0.486	

This table presents the estimation results of the proposed model after controlling for the network endogeneity. The functions h_η and h_ϵ are approximated by tensor products of cubic B-splines, where $\mu_{0,s,i}^{in}$ and $\mu_{0,s,i}^{out}$ are estimated using a logit model with individual fixed effects. The line "Endo. Wald prob." indicates the p-value of the Wald test of the significance of the plugged variables to control for endogeneity.

Table B.3: Estimation results controlling for network endogeneity: Bayesian random effect approach with B-spline approximations (full sample)

| | Sandard model | | | | Proposed structural model | | | |
| | No. knots: 0 | | No. knots: 10 | | No. knots: 0 | | No. knots: 10 | |
	Coef	Sd Err	Coef	Sd Err	Coef	Sd Err	Coef	Sd Err
Peer Effects	0.478	0.029	0.478	0.029	0.817	0.047	0.816	0.047
Own effects								
Female	0.178	0.006	0.178	0.006	0.167	0.006	0.167	0.006
Age	−0.016	0.003	−0.016	0.003	−0.044	0.003	−0.044	0.003
Hispanic	−0.101	0.01	−0.101	0.010	−0.091	0.010	−0.091	0.010
Race								
Black	−0.119	0.012	−0.120	0.012	−0.109	0.013	−0.109	0.013
Asian	0.217	0.013	0.217	0.013	0.194	0.014	0.194	0.014
Other	−0.033	0.011	−0.033	0.011	−0.033	0.011	−0.032	0.011
Lives with both parents	0.105	0.007	0.105	0.007	0.090	0.007	0.090	0.007
Years in school	0.031	0.003	0.031	0.003	0.025	0.003	0.025	0.003
Member of a club	0.168	0.012	0.167	0.012	0.152	0.012	0.151	0.012
Mother's education								
< High	−0.072	0.009	−0.072	0.009	−0.065	0.009	−0.064	0.009
> High	0.156	0.007	0.156	0.007	0.130	0.008	0.131	0.008
Missing	0.03	0.012	0.030	0.012	0.025	0.012	0.026	0.012
Mother's job								
Professional	0.036	0.009	0.036	0.009	0.031	0.009	0.031	0.009
Other	−0.044	0.007	−0.044	0.007	−0.040	0.008	−0.040	0.008
Missing	−0.081	0.011	−0.081	0.011	−0.073	0.011	−0.073	0.011
Contextual effects								
Female	−0.102	0.012	−0.101	0.012	−0.118	0.014	−0.117	0.014
Age	−0.072	0.004	−0.072	0.004	0.026	0.006	0.025	0.006
Hispanic	0.044	0.017	0.044	0.017	0.080	0.020	0.081	0.020
Race								
Black	−0.004	0.015	−0.004	0.016	0.071	0.019	0.070	0.019
Asian	−0.033	0.022	−0.033	0.022	−0.124	0.028	−0.122	0.028
Other	−0.045	0.02	−0.046	0.020	−0.004	0.022	−0.003	0.022
Lives with both parents	−0.034	0.016	−0.034	0.016	−0.012	0.018	−0.011	0.018
Years in school	0.029	0.004	0.029	0.004	−0.007	0.006	−0.007	0.006
Member of a club	−0.141	0.028	−0.140	0.028	−0.082	0.029	−0.084	0.029
Mother's education								
< High	−0.048	0.016	−0.049	0.016	0.022	0.019	0.022	0.019
> High	0.033	0.017	0.033	0.017	−0.023	0.022	−0.023	0.022
Missing	−0.063	0.024	−0.064	0.024	−0.026	0.026	−0.026	0.026
Mother's job								
Professional	−0.057	0.018	−0.057	0.018	−0.032	0.019	−0.031	0.019
Other	−0.109	0.014	−0.109	0.014	−0.025	0.016	−0.025	0.016
Missing	−0.117	0.021	−0.117	0.021	0.006	0.024	0.006	0.024
σ_η^2					0.280		0.279	
σ_ϵ^2	0.500		0.501		0.059		0.060	
ρ					0.508		0.506	
Weak instrument F	190		190		115		114	
Endogeneity Wald prob.	0.000		0.000		0.000		0.000	
Sargan test prob.	0.000		0.000		0.540		0.502	

This table presents the estimation results of the proposed model after controlling for the network endogeneity. The functions h_η and h_ϵ are approximated by cubic B-splines, where $\mu_{s,i}^{0,in}$ and $\mu_{0,s,i}^{out}$ are estimated using the Bayesian random effect model. The line "Endo. Wald prob." indicates the p-value of the Wald test of the significance of the plugged variables to control for endogeneity.

Table B.4 presents the estimation results for the data excluding "fully isolated" students and without controlling for network endogeneity. Model 3 is the standard linear-in-means model by approximating student effort by GPA, and Model 4 is based on our approach.

Table B.4: Estimation results without controlling for network endogeneity (sample excluding "fully isolated" students)

	Model 3'		Model 4'	
	Coef	Sd Err	Coef	Sd Err
Peer Effects	0.561	0.030	0.878	0.044
Own effects				
Female	0.182	0.006	0.165	0.007
Age	−0.008	0.004	−0.045	0.004
Hispanic	−0.096	0.011	−0.086	0.011
Race				
Black	−0.113	0.013	−0.102	0.015
Asian	0.199	0.014	0.173	0.015
Other	−0.030	0.011	−0.029	0.012
Lives with both parents	0.098	0.008	0.083	0.008
Years in school	0.032	0.003	0.023	0.003
Member of a club	0.169	0.013	0.150	0.013
Mother's education				
< High	−0.072	0.009	−0.062	0.009
> High	0.146	0.008	0.118	0.008
Missing	0.017	0.013	0.013	0.013
Mother's job				
Professional	0.040	0.009	0.034	0.010
Other	−0.035	0.008	−0.031	0.008
Missing	−0.070	0.012	−0.061	0.012
Contextual effects				
Female	−0.122	0.012	−0.127	0.013
Age	−0.082	0.004	0.028	0.006
Hispanic	0.049	0.017	0.086	0.021
Race				
Black	−0.010	0.017	0.055	0.021
Asian	−0.051	0.022	−0.129	0.028
Other	−0.040	0.020	−0.001	0.022
Lives with both parents	−0.047	0.016	−0.021	0.018
Years in school	0.032	0.004	−0.008	0.006
Member of a club	−0.160	0.028	−0.091	0.029
Mother's education				
< High	−0.043	0.016	0.026	0.019
> High	0.014	0.017	−0.036	0.021
Missing	−0.068	0.024	−0.031	0.026
Mother's job				
Professional	−0.062	0.018	−0.036	0.020
Other	−0.103	0.014	−0.021	0.016
Missing	−0.110	0.021	0.010	0.024
σ_η^2			0.292	
σ_ϵ^2	0.493		0.047	
ρ			0.485	
Weak instrument F	158.76		105.47	
Sargan test prob.	0.000		0.493	

Table B.5 presents the estimation results after controlling for network endogeneity using the data excluding "fully isolated" students.

Table B.5: Estimation results after controlling for network endogeneity (sample excluding "fully isolated" students)

| | Sandard model | | | | Proposed structural model | | | |
| | No. knots: 0 | | No. knots: 10 | | No. knots: 0 | | No. knots: 10 | |
	Coef	Sd Err	Coef	Sd Err	Coef	Sd Err	Coef	Sd Err
Peer Effects	0.649	0.036	0.728	0.039	0.846	0.048	0.854	0.050
Own effects								
Female	0.175	0.007	0.176	0.007	0.172	0.007	0.174	0.007
Age	−0.022	0.004	−0.035	0.004	−0.046	0.004	−0.047	0.004
Hispanic	−0.097	0.011	−0.094	0.011	−0.086	0.011	−0.086	0.011
Race								
Black	−0.116	0.014	−0.092	0.014	−0.074	0.015	−0.072	0.016
Asian	0.190	0.014	0.189	0.014	0.171	0.015	0.168	0.015
Other	−0.029	0.011	−0.031	0.011	−0.036	0.012	−0.034	0.012
Lives with both parents	0.093	0.008	0.087	0.008	0.082	0.008	0.081	0.008
Years in school	0.027	0.003	0.024	0.003	0.021	0.003	0.020	0.003
Member of a club	0.195	0.013	0.166	0.014	0.168	0.014	0.173	0.015
Mother's education								
< High	−0.068	0.009	−0.062	0.009	−0.058	0.009	−0.057	0.009
> High	0.135	0.008	0.134	0.008	0.125	0.008	0.128	0.008
Missing	0.015	0.013	0.015	0.013	0.013	0.013	0.014	0.013
Mother's job								
Professional	0.036	0.009	0.034	0.009	0.032	0.010	0.032	0.010
Other	−0.035	0.008	−0.035	0.008	−0.034	0.008	−0.034	0.008
Missing	−0.068	0.012	−0.067	0.012	−0.063	0.012	−0.063	0.012
Contextual effects								
Female	−0.126	0.012	−0.119	0.012	−0.126	0.014	−0.126	0.015
Age	−0.048	0.004	−0.008	0.004	0.031	0.006	0.032	0.006
Hispanic	0.064	0.018	0.078	0.018	0.082	0.021	0.083	0.021
Race								
Black	0.005	0.017	0.030	0.018	0.045	0.021	0.057	0.021
Asian	−0.071	0.023	−0.096	0.024	−0.118	0.028	−0.117	0.029
Other	−0.031	0.020	−0.021	0.020	−0.001	0.022	0.000	0.022
Lives with both parents	−0.039	0.016	−0.028	0.016	−0.017	0.018	−0.018	0.018
Years in school	0.019	0.005	0.005	0.005	−0.005	0.006	−0.005	0.006
Member of a club	−0.144	0.027	−0.115	0.027	−0.086	0.031	−0.102	0.032
Mother's education								
< High	−0.022	0.017	0.002	0.017	0.025	0.019	0.025	0.019
> High	−0.005	0.018	−0.021	0.018	−0.030	0.022	−0.035	0.023
Missing	−0.058	0.024	−0.044	0.024	−0.027	0.026	−0.027	0.026
Mother's job								
Professional	−0.055	0.018	−0.044	0.018	−0.036	0.019	−0.034	0.019
Other	−0.078	0.014	−0.049	0.014	−0.024	0.016	−0.022	0.016
Missing	−0.073	0.021	−0.031	0.022	0.010	0.024	0.011	0.024
σ_η^2					0.289		0.285	
σ_ϵ^2	0.498		0.504		0.058		0.059	
ρ					0.396		0.395	
Weak instrument F	122		108		98		94	
Endogeneity Wald prob.	0.000		0.000		0.000		0.000	
Sargan test prob.	0.000		0.337		0.718		0.820	

C   Online Appendix

Supplementary material related to this paper can be found online at https://ahoundetoungan.com/files/Papers/PEEffort_OA.pdf