Abstract: In this paper we analyze the causal effects of reallocating individuals across social groups in the presence of social interactions or spillovers. We consider the case where individuals are either 'high' or 'low' types. Own outcomes may depend on the fraction of high types in one’s social group. We characterize the average outcome effect and inter-type inequality effects of ‘local’ increases in segregation. We relate our estimands to the theory of sorting in the presence of social interactions. For each estimand we provide conditions for identification, propose nonparametric estimators, and characterize their large sample properties. Finally we consider the social planner’s problems, characterizing the structure of average outcome-maximizing and -minimizing allocations of individuals to groups.

JEL Classification: C14, C31, D62, I21

Key Words: Social Interactions, Peer Group Effects, Sorting, Segregation, Equity vs. Efficiency Trade-off, Allocation Problems.

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1 Introduction

Debates about the social costs and benefits of segregation by socioeconomic status, ability, race or gender figure prominently in discussions of education, housing and other areas of social policy. In the late-1960s Coleman et al. (1966) argued that racial isolation lowered the academic achievement of minority students. This claim immediately generated controversy, spawning a vast empirical literature in education, sociology and economics. Forty years later Rivkin and Welch (2006), surveying the resulting body of work, concluded that “the effect of integration on black students remains largely unsettled” (p. 1043). Schofield (1995), reviewing the education and sociology literature, comes to a similarly tentative conclusion, emphasizing the “methodological and other problems that typify work in this area” (p. 597). After four decades of research, school busing and other mandated desegregation policies remain controversial. Other unsettled debates touching on issues of ‘segregation’ include those on school vouchers, single-sex schooling, ability tracking and public housing policy.2

Each of these debates centers on a common question: would society be better off if social groups were configured differently? Are there welfare-increasing deviations from the status quo assignment of individuals to classrooms, schools or neighborhoods? How do average outcomes and inequality respond to ‘reallocations’ of individuals across groups? Durlauf (1996c) has termed such reallocating policies ‘associational redistribution’.

Despite the long-standing controversy surrounding reallocation-inducing policies, econometric methods for framing and analyzing their effects are not widely available. Researchers interested in, for example, segregation in schools typically focus their efforts on identifying and estimating an average relationship between school racial composition and student achievement (e.g., Angrist and Lang, 2004; Guryan, 2004; Card and Rothstein, 2007). The optimality of segregation relative to integration is inferred by reference to this estimated relationship.3 The target estimand of this literature, the average marginal effect of school racial composition on student achievement, does not correspond to an implementable policy. It would be impossible, for example, to engineer an increase

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2 Disagreements about the magnitude and relevance of ‘cream-skimming’ in response to widespread school choice figure prominently in the debate on educational vouchers (e.g., Manski, 1992; Hexby, 2003; Ladd, 2003; Urquiola, 2005).

The evidence on the achievement effects of single-sex instruction is mixed (e.g., Morse 1998, Mael 2005), although this interpretation is debated by advocates of gender-separation (e.g., Sax 2005). In 2006 the United States Department of Education, in a controversial decision, modified Title IX regulations to allow the formation of single-sex classrooms in public schools (Paulson and Teicher 2006).

The literature on school tracking is enormous with supporting evidence available for both its advocates and opponents. For recent discussions see Oakes (1992), Epple, Newlon and Romano (2002) and Figlio and Page (2002).


3 The original Coleman Report provides a particularly thoughtful example of this type of informal inference process:

“If a white pupil from a home that is strongly and effectively supportive of education is put in a school where most students do not come from such homes, his achievement will be little different than if he were in a school composed of others like himself. But if a minority pupil from a home without much educational strength is put with schoolmates with strong educational backgrounds, his achievement is likely to increase” (Coleman et al., 1966, p. 22).
in minority enrollment across all schools – the policy effect measured by this estimand – since an increase in such enrollment in one school necessarily requires a commensurate decrease in another. While knowledge of the (average) mapping between school racial composition and outcomes may be an ingredient to an evaluation of a particular race-based allocation of students to schools, it is not sufficient.\textsuperscript{4}

In this paper we provide a comprehensive discussion of the econometrics of reallocating individuals across groups in the presence of social spillovers. Our analysis emphasizes issues of measurement, that is, the definition of relevant target estimands. Additionally, we provide conditions for nonparametric identification, propose estimators and characterize their large sample properties.

Our setup generalizes that of a class of stylized locational sorting models developed by de Bartolome (1990), Benabou (1993), Becker and Murphy (2000) and others.\textsuperscript{5} As in those papers, we consider a setting where individuals are either ‘high’ or ‘low’ types, with outcomes depending on the type composition of their social group in a fully nonparametric way. We add statistical content to this framework by introducing individual heterogeneity, both observed and unobserved (beyond type). We also allow for location-specific heterogeneity, again both observed and unobserved. These extensions complicate our analysis but are, of course, essential for empirical relevance.

An example, which we develop empirically below, helps to clarify the various issues involved. Consider a setting where individuals are students, with high and lows types respectively denoting girls and boys. Students may differ in observed ways, for example in their age, as well as in unobserved ways, for example in their ability. A social group is a classroom of students. Classrooms may also be heterogeneous, for example in observed and/or unobserved dimensions of teacher quality. This set-up is complicated because there are three distinct levels of heterogeneity: individual-level, peer-level and location-level. Any analysis of peer effects must keep track of, and impose conditions on, these three types of heterogeneities. Our approach involves imposing restrictions on the group formation process; both the mechanism whereby specific individuals sort together into groups, and that whereby such groups place themselves in specific locations. While we are restrictive regarding the process which generates the status quo allocation of individuals to groups, we are very flexible elsewhere. An alternative approach would involve imposing more restrictions on, say, the ‘production technology’, in exchange for imposing fewer restrictions on the status quo assignment process.

Within this setting we develop three classes of estimands. The first class measures the average strength of any social spillovers. Here our contribution is modest; we provide a nonparametric generalization of prior work on the measurement of spillovers (e.g., Manski, 1993; Brock and Durlauf, 2001; Moffitt, 2001; Glaeser and Scheinkman, 2003). In particular our measure of spillover strength can be viewed as a (simple) nonparametric generalization of Ciccone and Peri’s (2006) ‘constant composition’ externality measure. We view our second set of estimands as more innovative. They

\textsuperscript{4}More generally the menu of program evaluation estimands surveyed by Imbens (2004, 2006), Heckman and Vytlacil (2007), and others is, at best, only indirectly helpful for assessing the effects of reallocations. We justify this claim further below.

\textsuperscript{5}Much of this theoretical literature is surveyed by Piketty (2000), Fernández (2003) and Durlauf (2004).
measure the effects of small increases in segregation (relative to the status quo) on average outcomes as well as the average outcome gap between high and low type individuals. They provide a basis for characterizing any equity versus efficiency trade-offs associated with segregation-inducing policies. Our final class of estimands allow us to assess the efficiency of the status quo allocation relative to an outcome maximizing allocation. In our setup the social planner’s problem is a functional optimization (i.e., infinite dimensional) one. Nevertheless we are able to characterize its solution quite generally. As we leave the (average) mapping from group composition to outcomes a priori unrestricted (and also allow for a large number of social groups) our result generalizes the social planner analyses of, for example, de Bartolome (1990), Benabou (1993, 1996) and Becker and Murphy (2000), in addition to providing them with statistical content.

Our framework offers several advantages over existing methods of characterizing social spillovers. First, our approach explicitly connects ‘the data’ with many of the ideas emphasized in theoretical work on sorting in the presence of social spillovers. In particular, our estimands provide measures of segregation-induced inefficiencies, a key theme of the neighborhood sorting literature. For example, our local segregation outcome effect (LSOE) estimand has a representation as a weighted average of own and peer type complementarity and curvature. Benabou (1996), in the context of a stylized deterministic model, shows how the efficiency of segregation vis-a-vis integration depends on these two objects. Prior empirical work on social externalities generally only loosely connects to the relevant applied public finance theory. Fernández (2003), in her survey article, notes that “there has been very little work done to assess the significance of the inefficiencies [induced by segregation],” despite the growing body of empirical work that points to the importance of peer effects in a general way (p. 14). Piketty (2000) makes a similar point.

Second our focus on reallocations is novel. While we leave the microstructure of any social interactions processes unmodelled, our set-up allows us to think about reallocation-inducing policies in a straightforward way. Many controversial policies, such as busing, ‘school choice’ regimes or the provision of rental vouchers to public housing recipients, are fundamentally allocation mechanisms. Our estimands provide a partial basis for the evaluation of such policies.

Finally, unlike most work in this area, Brock and Durlauf (2007) being an important recent exception, our approach to identification and estimation is fully nonparametric.6 We provide nonparametric estimators for our first two classes of estimands and also characterize their large sample properties.7

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6 Examples of formal identification analyses of parametric social interaction models include those of Manski (1993), Brock and Durlauf (2001), Moffitt (2001) and Graham (2008a).

7 A limitation of our framework is that it is not helpful for assessing the effects of non-reallocating interventions, such as providing subsidies to low types. Manski (1993), Brock and Durlauf (2001) and Durlauf (2004) discuss this class of policy interventions. The analysis of such interventions generally requires an explicit model of the social interaction process. Durlauf (2004) makes a compelling case for greater focus on the microeconomic foundations of social interaction processes. We are sympathetic to this perspective, but nevertheless have found it useful to leave such structure unspecified in the present setting. Lazear (2001) and Weinberg (2006) provide nice examples of how concrete microstructures of social interaction generate specific reduced form mappings from group structure into outcomes. Since we leave this mapping nonparametric, our approach is arguably consistent with a wide-variety of interaction microstructures. An important caveat to this claim, however, is that explicit microstructures of strategic interaction can generate a mapping from group composition into outcomes that exhibits discontinuities (cf., Brock and Durlauf...
In recent years economists and other social scientists have made substantial progress on the identification and estimation of statistical models with social spillovers (e.g., Manski, 1993; Solon, 1999; Brock and Durlauf, 2001, 2007; Moffit, 2001; Duncan and Raudenbush, 2001; Sampson, Moreno, and Gannon-Rowley, 2002; Glaeser and Scheinkman, 2003; Graham 2008a,b). Our work builds on this work inasmuch as the production technology is a component of each of our estimands. However our focus substantially differs from this prior work. Our goal is to develop estimands which directly characterize the effects of reallocations on the distribution of outcomes. Related work in this vein includes that of Graham, Imbens and Ridder (2006, 2007) and Bhattacharya (2008).

Our work is also related to the mathematical programming and economic literature on resource allocation problems (e.g., Ginsberg, 1974; Ibaraki and Katoh, 1988; Luenberger, 1969, 2005). As noted above, in our setting the planner’s problem is one of functional optimization. Our general characterization of the solution to this problem appears to be new.8

The statistical aspects of this paper are most closely connected to the literature of semiparametric M-estimation as in Newey (1994a,b) and Newey and McFadden (1994). In particular our estimands share import features with weighted average derivatives as in Powell, Stock and Stoker (1990), Härdle and Stoker(1989), Newey and Stoker (1993) and others. While straightforward to compute, our estimators combine multiple ‘first step’ nonparametrically estimated objects together in different ways. Most of our estimators, for example, require nonparametric estimation of two conditional expectation functions as well as their derivatives. Consequently characterizing their asymptotic properties, as we do below, is nontrivial.

Section 2, which follows next, describes our sampling structure and maintained identifying assumptions. The need to carefully keep track of all the sources of individual, peer and locational heterogeneity requires the development of a relatively elaborate set of notational conventions. For our purposes we have found a heavily modified potential outcomes notation to be the most convenient for representing our problem and stating our assumptions (Neyman 1923, Rubin 1974, Holland 1986a,b). To simplify the exposition we begin with the stylized case where all groups are (i) equally sized and (ii) there are no covariates beyond type.

Section 3 presents our estimands. We begin by proposing a simple summary measure of the strength of social spillovers. We then present measures of the outcome and inequality effects of local reallocations of individuals across groups. In Section 4 we extend our setup to allow for unequally sized groups. There we also show how observed individual- and group-level covariates may be used to achieve identification under weaker conditions. Section 5 discusses estimation.

In Section 6 we discuss the planner’s problem. By characterizing the solution to this problem we are able to show that the inefficiency of the status quo – the difference between the observed

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8The closest work of which we are is aware is that of Arnott and Rowse (1987) which uses parametric estimates of educational production functions and numerical programming methods to evaluate classroom assignment mechanisms based on student ability. Their methods are fundamentally parametric in nature and they do not discuss issues of identification, estimation or inference. Our analysis of the allocation problem is also related to the neighborhood sorting models of de Bartolome (1990), Benabou (1993, 1996), Durlauf (1996a,b), Epple and Romano (1998) and Becker and Murphy (2000).
average outcome and that which would occur under an outcome-maximizing allocation— is identified under certain assumptions. In Section 8 we apply our methods, and compare them with parametric alternatives, in a study of the effect of classroom gender composition on student achievement using data collected in conjunction with the Tennessee Project STAR experiment (cf., Whitmore, 2005). Section 9 summarizes and suggests areas for future research. All proofs and derivations are collected in a series of appendices.

2 Setup and assumptions

In this section we present our statistical model and discuss the identifying assumptions we maintain in subsequent sections. Throughout we use upper case letters to denote random variables. Lower-case and calligraphic letters respectively denote specific realizations and the support of the corresponding distributions.

2.1 Population framework

There is a population of individuals (e.g., elementary school students). Individuals are indexed by \(i \in \mathcal{I} = \{1, \ldots, I_P\}\) and are one of two observed types \(T_i \in \{0, 1\}\), for example, boy or girl. Additional individual level heterogeneity is indexed by the vector \(A_i \in \mathcal{A}\). For reasons of exposition we refer to \(A_i\) as an individual’s ‘ability’. We also refer, without intending to be pejorative, to those individuals with \(T_i = 1\) as ‘high’ types and those individuals with \(T_i = 0\) as ‘low’ types. The population fraction of high types is given by \(p_H\). We assume that \(T_i\) is non-manipulable, denoting a permanent characteristic such as race or sex. The outcome of interest, say, student achievement, is \(Y_i \in \mathcal{Y}\) and may be discretely- or continuously-valued. Until Section 4 we assume there are no observed individual characteristics beyond type. This simplifies what immediately follows.

Individuals reside in different locations or, alternatively, ‘attend’ different ‘schools’. Members of the population of available locations are indexed by \(c \in \mathcal{C} = \{1, \ldots, C_P\}\). Associated with each location is a vector of unobserved characteristics \(U_c \in \mathcal{U}\). If locations are, for example, schools, then \(U_c\) might capture heterogeneity in teacher quality and facilities (We introduce observed location characteristics into our analysis in Section 4).

At times it will be necessary to compute averages across the population of locations and, at others, ones across individuals. When we use a \(c\) subscript the relevant average is over locations, whereas an \(i\) subscript signals an average over individuals.

Each individual’s location of residence is given by the assignment indicator \(G_i \in \mathcal{C}\). If individual \(i\) resides in location \(c\), then \(G_i = c\). To avoid double subscripts we use the notation \(U_i = U_{G_i}\). An allocation is a feasible assignment of individuals to groups and is completely specified by a vector of group assignment indicators \(G = (G_1, \ldots, G_{I_P})'\).

Individuals assigned to a common location are neighbors. All neighborhoods have room for exactly \(N = I_P/C_P\) residents (We allow for unequally sized groups in Section 4).

Individual \(i\)'s peer group includes those individuals also assigned to her location, i.e. the index
These peers’ types and abilities are given by the vectors

\[ T_p(i) = (T_p(i), 1, \ldots, T_p(i), N-1)’, \quad A_p(i) = (A_p(i), 1, \ldots, A_p(i), N-1)’. \]

where the subscripts \( p(i), j \) with \( j = 1, \ldots, N-1 \) indicate the members of \( i \)’s peer group in arbitrary order. Let \( T_i = (T_i, T_p(i))’ \) and \( A_i = (A_i, A_p(i))’ \) denote the vectors of types and abilities in \( i \)’s social group inclusive of herself.

The \( i^{th} \) individual’s neighborhood quality, \( Q_i \), depends on the type and ability of her peers as well as the vector of unobserved location characteristics \( U_i \) :

\[ Q_i = (T_p(i), A_p(i), U_i)’. \]

### 2.2 Potential outcomes notation

Our focus is on characterizing different (summary) features of the mapping from allocations into outcomes. We assume that this mapping is individual-specific and given by

\[ Y_i(g), \quad g \in \mathcal{G}, \tag{1} \]

where \( \mathcal{G} \) denotes the set of all feasible allocations and the relation is individual specific due to its (implicit) dependence on \( T_i \) and \( A_i \). The function \( Y_i(g) \) gives the potential outcome for individual \( i \) associated with allocation \( g \in \mathcal{G} \).\(^9,10\)

Tractability of our problem requires imposing restrictions on \( Y_i(g) \). Our first restriction rules out cross location spillovers.

**Assumption 2.1 (No Cross Neighborhood Spillovers)** Let \( g \) and \( \tilde{g} \) denote two feasible allocations with associated neighborhood qualities for individual \( i \) of \( q_i \) and \( \tilde{q}_i \). If \( q_i = \tilde{q}_i \) then

\[ Y_i(g) = Y_i(\tilde{g}). \]

\(^9\) Associated with each assignment is a mechanism by which it came about. For example assignment may be by lottery, tournament, or determined by a social planner. Implicit in (1) is the assumption that, conditional on the induced assignment, the mechanism by which it was achieved does not affect outcomes. If a court-ordered mandatory school busing plan implemented without taking any variable except the type into account induces the same allocation of students across schools as a lottery, then the associated outcome distributions will also be identical. This may be a strong assumption in certain settings. Schofield (1995), in her review of educational research on the impact of desegregation on black achievement, presents evidence suggesting that the desegregation mechanism matters. Similar (implicit) assumptions underlie the program evaluation literature (cf., Holland, 1986a).

\(^{10}\) The potential outcomes notation is convenient for our purposes, however, we could also use the ‘production function’ notation

\[ Y_i = g(T_i, G, A_i), \]

with \( A_i \) playing the role of a (non-separable) disturbance.
Assumption 2.1 means that individual outcomes depend only upon own characteristics and neighborhood quality; the type-structure, ability distribution, and location characteristics of, for example, adjacent neighborhoods do not affect outcomes. In the case where locations are spatially separated schools Assumption 2.1 may be reasonable. If locations represent residential neighborhoods the assumption of no cross location spillovers is considerably stronger. Nevertheless some restriction on the structure of dependence across locations is required for statistical analysis.

Under Assumption 2.1 we may write

$$Y_i(G) = Y_i(T_{p(i)}, A_{p(i)}, U_i) = Y_i(Q_i).$$

Our next assumption restricts the structure of peer influences within a neighborhood. Let $N^H_i = \sum_{j=1}^{N-1} T_{p(i),j}$ and $N^L_i = \sum_{j=1}^{N-1} (1 - T_{p(i),j})$ denote the total number of high and low type peers for individual $i$. Assume, without loss of generality, that $T_{p(i)}$ is ordered such that high types appear first, followed by low types (i.e., $T_{p(i)} = (1, \ldots, 1, 0, \ldots, 0)$). The $N - 1$ vector of peer ‘abilities’ is arranged conformably such that $\bar{A}_{p(i)} = (\bar{A}^H_{p(i)}; \bar{A}^L_{p(i)})'$, where $\bar{A}^H_{p(i)}$ equals the $N^H_i \times 1$ vector of abilities for each high type peer in individual $i$’s social group and $\bar{A}^L_{p(i)}$ equals the corresponding $N^L_i \times 1$ vector of low type peer abilities.

**Assumption 2.2 (Within-Type Peer Exchangeability)** Let $\bar{A}_{p(i)} = (\bar{A}^H_{p(i)}; \bar{A}^L_{p(i)})'$ where $\bar{A}^H_{p(i)}$ and $\bar{A}^L_{p(i)}$ are permutations of $A^H_{p(i)}$ and $A^L_{p(i)}$, and let $\bar{T}_{p(i)}$ be a conformable re-ordering of $T_{p(i)}$ (note that $\bar{T}_{p(i)} = T_{p(i)}$ by construction), for all such within-type permutations

$$Y_i(\bar{T}_{p(i)}, \bar{A}_{p(i)}, U_i) = Y_i(T_{p(i)}, A_{p(i)}, U_i).$$

The function $Y_i(T_{p(i)}, A_{p(i)}, U_i)$ is a continuous function of $(A_{p(i)}, U_i)$ for all $T_{p(i)}$.

Assumption 2.2 implies that, among those of the same type, each of individual $i$’s peers are equally influential. This restriction follows from standard exchangeability arguments. As such it is a statement of researcher ignorance: *a priori* there is no reason to think that $i$’s ‘first’ high type neighbor affects her differently than her ‘ninth’ (Rubin, 1981). Manski (2000) and Durlauf (2001) have argued for improving data collection in order to avoid such restrictions. For example, if the researcher knew that $i$’s ‘ninth’ high type neighbor was across the street, while her ‘first’ was two blocks away, then Assumption 2.2 might be implausible. However, in most datasets, the structure of within-group social networks is unavailable and hence Assumption 2.2 is an appropriate, as well as unavoidable, representation of prior information.\(^{11}\)

By Assumption 2.2 and the Weierstrass Theorem we can approximate the function $Y_i(\bar{T}_{p(i)}, \bar{A}_{p(i)}, U_i)$ by

$$Y_i(\bar{T}_{p(i)}, \bar{A}_{p(i)}, U_i) \approx Y_i(S_{-i}, \tau_{K_H}(\bar{A}^H_{p(i)}), \tau_{K_L}(\bar{A}^L_{p(i)}), U_i)$$

\(^{11}\)Calvó-Armengol, Patacchini and Zenou (2008) provide a nice example of how richer network data can be used to study peer influences.
with \( \tau_{KH}(A^H_{p(i)}) \) denoting the vector of the first \( KH \) symmetric polynomials in \( A^H_{p(i)} \) and \( \tau_{KL}(A^L_{p(i)}) \) defined similarly (cf., Altonji and Matzkin, 2005, pp. 1062 - 1063).\(^{12}\)

We emphasize that Assumption 2.2 allows for individuals to be differentially affected by the ability structure of their high- and low-type peers. For example, outcomes may vary freely with the average ability of low type peers and/or the average ability of high type peers (rather than being restricted to vary with average ability taken across all peers). Some individuals, for example, may be particularly sensitive to variation in high-type peer ability, while others to variation in low-type peer ability.

Our final restriction on \( Y_i(g) \) follows from being precise about the meaning of an agent’s type.

**Assumption 2.3 (Inclusive Definition of Type) \( T_i \perp A_i \)**

Independence of \( A_i \) from \( T_i \) follows by definition of the phenomena we seek to characterize. We are interested in whether, for example, an individual learns more when surrounded by female classmates. Not whether he learns more when surrounded by female classmates once we condition on their ‘disruptiveness’. If, across the population under consideration, girls tend to be less disruptive than boys then these two questions have different answers. For the first question the appropriate definition of \( A_i \) is precisely all individual heterogeneity that is independent of \( T_i \). We want our notion of ‘gender’ to include, not exclude, systematic differences in behavior across boys and girls.\(^{13}\)

Assumption 2.3 can always be imposed by a normalization. Assume that unnormalized ability is \( A^*_i \), then normalized ability is given by \( A_i = F(A^*_i | T_i) \). That is our definition of an individual’s ‘ability’ is their rank amongst those of their own type.\(^{14}\) Let \( Y_i = g(T_i, A_i, s_i, \tau_{KH}(A^H_{p(i)}), \tau_{KL}(A^L_{p(i)}), u_i) \) denote the \( i^{th} \) individual’s potential outcome given assignment to a group with fraction \( S_i = s_i \) high type peers, peer abilities \( \tau_{KH}(A^H_{p(i)}) = \tau_{KH}(A^H_{p(i)}) \) and \( \tau_{KL}(A^L_{p(i)}) = \tau_{KL}(A^L_{p(i)}) \), and location attributes \( U_i = u_i \). Assuming the distribution of \( A_i \) does not

\(^{12}\)For the case where \( A^H_{p(i)} \) is scalar the elementary symmetric polynomials are of the form

\[
e_0(A^H_{p(i)}) = 1 \\
e_1(A^H_{p(i)}) = \sum_{1 \leq j \leq N^H_i} A^H_{p(i),j} \\
e_2(A^H_{p(i)}) = \sum_{1 \leq j < k \leq N^H_i} A^H_{p(i),j} A^H_{p(i),k} \\
e_3(A^H_{p(i)}) = \sum_{1 \leq j < k < l \leq N^H_i} A^H_{p(i),j} A^H_{p(i),k} A^H_{p(i),l} \\
\vdots \\
e_{N_e}(A^H_{p(i)}) = A^H_{p(i),1} A^H_{p(i),2} A^H_{p(i),3} \cdots A^H_{p(i),N^H_i},
\]

so that \( \tau_{KH}(A^H_{p(i)}) = (e_0(A^H_{p(i)}), e_1(A^H_{p(i)}), \ldots, e_{N_e}(A^H_{p(i)}))\)

\(^{13}\)If \( T_i \) indexes a manipulable ‘treatment’ then this assumption, of course, has more content. Our framework can be adapted to this case. This leads to a method of program evaluation that allows for treatment spillovers. This extension is a topic of ongoing research.

\(^{14}\)Many of our results extend straightforwardly to the case where unnormalized ability is a \( J \times 1 \) vector \( A^*_i =
depend on $T_i$ does not restrict the conditional distribution of $Y_i(s_{-i}, \tau_{KH}(A^H_{p(i)}), \tau_{KL}(A^L_{p(i)}), u_i)| T_i$ so that Assumption 2.3 can be made without loss of generality.

The allocation response function $Y_i(S_{-i}, \tau_{KH}(A^H_{p(i)}), \tau_{KL}(A^L_{p(i)}), U_i)$ defines an individual-specific mapping from peer types, ability, and neighborhood characteristics into outcomes. In our framework the ‘treatment’ induced by a given allocation is a specific configuration of peers, as summarized by their observed type composition, $S_{-i}$, and unobserved ability, $\tau_{KH}(A^H_{p(i)})$ and $\tau_{KL}(A^L_{p(i)})$. Residence in a specific location, where specificity is indexed by the vector of unobserved characteristics $U_i$, is also a feature of the ‘treatment’.

The non-observability of $A_{p(i)}$ and $U_i$ generates complications, relative to the standard potential outcomes model of causal inference (Neyman, 1923; Rubin, 1974; Holland, 1986a,b), because it implies that we do not observe the full ‘treatment’. The observed ‘treatment’ is an assignment to a set of peers with a given type composition. However, because peers and locations are heterogeneous, observationally equivalent assignments may be associated with distinct ‘treatments’ (and hence potential outcomes). Assumptions 2.1 and 2.2 are not strong enough to ensure that the observed treatment satisfies the homogenous treatment assumption that is part of Rubin’s Stable-Unit-Treatment-Value-Assumption (SUTVA) (cf., Holland, 1986a,b; Rubin, 1990).15

To deal with this issue we define an intermediate object: the expected allocation response function. Individual’s $i$’s expected allocation response function is given by

$$Y_i^e(s_{-i}) = \int \int \ldots \int Y_i(s_{-i}, \tau_{KH}(A^H_{p(i)}), \tau_{KL}(A^L_{p(i)}), u) \left\{ \prod_{j \in p(i)} f_A(a_{p(i),j}) da_{p(i),j} \right\} f_U(u) du. \quad (2)$$

Equation (2) gives an individual’s expected outcome when assigned to a group with peer composition $S_{-i} = s_{-i}$ when groups are formed in a certain way. The group formation process enters into the definition of $Y_i^e(s_{-i})$ because it is meant to measure the expected effect of exogenous changes in observed peer composition, $s_{-i}$. For this effect to have a causal interpretation it should be unconfounded by the effects of matching and/or sorting of peers.

Matching occurs if individuals choose (or are assigned to) a location on the basis of its unobserved attribute $U_c$ and the utility derived from that choice depends on own attributes ($T_i, A_i$). Matching implies that the vector $(T_i, A_i)$ of individual peer and own attributes at the location of $i$ is related to the unobserved location characteristic $U_i$. Hence there is no matching if

$$(T_i, A_i) \perp U_i,$$

$(A^1_i, \ldots, A^j_i)'$. In that case Assumption 2.3 is imposed by the one-to-one mapping

$$A_{1i} = F(A^1_i| T_i)$$
$$A_{2i} = F(A^2_i| A^1_i, T_i)$$
$$\vdots$$
$$A_{ji} = F(A^j_i| A^1_i, \ldots, A^{j-1}_i, T_i).$$

15In related work Sobel (2006a,b) conceptualizes ‘neighborhood effects’ as violations of SUTVA.
which implies the density factorization
\[ f_{A,U|T}(a,c,u|T_c) = f_{A|T}(a|T_c)f_U(u). \]

Sorting is related to the distribution of \( A_c \). Sorting occurs if, for example, an individual’s ability, \( A_i \), is related to those of her peers, \( A_p(i) \). Such a dependence would arise if an individual’s preference for a location (or the assignment rule used) depends on the attributes and types of its residents and this preference varies systematically with \( (T_i, A_i) \). The absence of sorting therefore implies that
\[ (T_p(i), A_p(i)) \perp A_i | T_i, \]
so that, conditional on own type, own ability does not vary with the type or ability composition of one’s peers. No sorting generates the density factorization
\[ f_{A|T}(a|T_c) = \prod_{j=1}^{N} f_{A}(a_{cj}), \]
where the final equality is due to Assumption 2.3. Note that sorting, as defined above, does not preclude high types seeking out peer groups composed of many other high types. Therefore the distribution of peer composition across groups is not restricted by the absence of sorting. There is neither matching nor sorting if, for a group of a given type composition, high type members are random draws from the subpopulation of high types, low type members are random draws from the subpopulation of low types, and the group, so formed, is randomly assigned to a specific location.

In the absence of both matching and sorting the joint density of \( A_c, U_c \) given \( T_c \) factors into
\[ f_{A,U|T}(a,c,u|T_c) = \left\{ \prod_{j=1}^{N} f_{A}(a_{cj}) \right\} f_U(u), \]
which is the product of marginals being integrated over in (2), which defines \( Y^e_i(s_{-i}) \).

Averaging \( Y^e_i(s_{-i}) \) over the subpopulations of low and high types gives the type-specific mean allocation response functions
\[ m^*_L(s_{-i}) = \mathbb{E} [Y^e_i(s_{-i}) | T = 0], \quad m^*_H(s_{-i}) = \mathbb{E} [Y^e_i(s_{-i}) | T = 1]. \]

In what follows it is convenient to instead work with the one-to-one mappings
\[ m_H(s) = m^*_H \left( \frac{SN}{N-1} \right), \quad m_H(s) = m^*_H \left( \frac{SN-1}{N-1} \right), \]
where \( s \) is the overall fraction of high types in a group (inclusive of oneself). That is, we let \( S_c = \sum_{i=1}^{l_P} \frac{1(G_i=c)T_i}{N} \) denote the fraction of high types in location \( c \). Henceforth we refer to \( S_c \) as a location \( c \)'s group composition.
The type-specific mean allocation response functions \( m_H(s) \) and \( m_L(s) \) feature in each of our estimands. They equal the expected outcome, given exogenous assignment to a group of composition \( S = s \), of a randomly selected member of, respectively, the subpopulation of high and low types if groups are formed without matching and sorting. Most of our identification results follow directly from identification of \( m_H(s) \) and \( m_L(s) \).

The overall mean allocation response function is given by the composition weighted average

\[
m(s) = sm_H(s) + (1 - s)m_L(s),
\]

which is the expected outcome of a randomly selected member of the population when assigned to a group of composition \( S = s \). This function is related to the average structural function of Blundell and Powell (2003). A direct application of their definition would replace the average in (2) with one over the joint distribution of \((A', U')\). Such an average would not be causal in our setting as it would be contaminated by sorting (correlation in ability across group members) and matching (correlation between ability and location quality) (cf., Graham, 2008a,b). This is a one example of how the presence of heterogeneity from multiple individuals (as well as locations) in the production function for each individual complicates analysis and requires extra care when defining estimands.

As we show below, it also complicates our identification analysis.

Equation (4) can be viewed as a statistical analog of the deterministic production technology that features prominently in the theoretical public finance literature on multi-community models (e.g., de Bartolome, 1990; Benabou, 1993, 1996; Durlauf, 1996a,b; Becker and Murphy, 2000). In order to provide a clean characterization of locational equilibrium as well as the solution to the social planner’s problem, the multi-community literature has generally placed strong \( a \) priori restrictions on \( m(s) \). A typical set of assumptions is that \( m_H(s) - m_L(s) > 0 \) for all \( s \in S \) and that \( \partial^2 m(s)/\partial s^2 \) is either positive or negative for all \( s \in S \). Fernández (2003) provides an extensive discussion of the role of these assumptions in this literature. In contrast, other than smoothness assumptions, we leave \( m(s) \) completely unrestricted.

Differentiating \( m(s) \) with respect to \( s \) gives the marginal effect of changes in group composition on group average outcomes:

\[
\nabla_s m(s) = p(s) + e(s),
\]

where

\[
p(s) = m_H(s) - m_L(s), \quad e(s) = s\nabla_s m_H(s) + (1 - s)\nabla_s m_L(s).
\]

The derivative of \( m(s) \) with respect to group composition consists of two parts. The first part, \( p(s) \), is the effect of changing group composition on expected outcomes holding spillover strength constant. It is the compositional effect of changing group composition on expected group average outcomes. Irrespective of the presence of social spillovers, average outcomes will rise because the composition of the group has shifted toward high types. This effect is private, in the sense that it reflects benefits that are entirely confined to the entering high type.

The second component, \( e(s) \), measures the spillover or external effect associated with increasing
s. The introduction of an additional high type individual into the group creates a spillover which raises outcomes for all individuals in the group. Benabou (1996) and others have emphasized that, since agents do not internalize the second effect when choosing locations, decentralized equilibria may be inefficient.

Our final three main assumptions ensure that \( m_H(s), m_L(s) \) and their derivatives, \( \nabla_s m_H(s) \) and \( \nabla_s m_L(s) \), are identified. First we make an assumption on the status quo assignment mechanism. In particular, we assume the absence of matching and sorting, as defined above.

**Assumption 2.4 (No Matching and Sorting)**

\[
(T_i, A_i) \perp U_i, \quad (T_{p(i)}, A_{p(i)}) \perp A_i \mid T_i.
\]

Assumption 2.4 will be satisfied if groups are formed, and locations selected at random, (i.e. under a double randomization scheme). To describe this scheme assume that the social planner first chooses a feasible distribution of group compositions

\[ F_{S}^{sq}(s), \]

where the ‘sq’ superscript denotes ‘status quo’ and the density is across groups (i.e., it describes composition for the population of locations/groups). Feasibility of the status quo (as well as that of any other allocation), requires that it satisfies a restriction. Because the fraction high types \( p_H \) is fixed, and all groups are equally-sized, feasibility requires that

\[
p_H = \int_0^1 s f_{S}^{sq}(s) ds, \quad (5)
\]

where we treat \( S_c \) as a continuously-valued random variable (as would be appropriate if the common group size, \( N \), is large).

After choosing a feasible joint distribution for group composition the planner fills high and low type spaces in each group by randomly sampling from the high and low type subpopulations. This ensures, along with Assumption 2.3, satisfaction of the second part of Assumption 2.4. The social groups, so formed, are then randomly assigned to a specific location. Random assignment at this stage ensures that the first part of Assumption 2.4 is satisfied.

As discussed above Assumption 2.4 rules out ‘matching’ and ‘sorting’ (cf., Graham, 2008a). However, we emphasize that it does not restrict the degree of status quo segregation or integration (\( F_{S}^{sq}(s) \) is unrestricted beyond the requirement of feasibility). Consider the example where locations are schools and \( T_i = 1 \) for white students and \( T_i = 0 \) for black students. In that case double randomization implies that the ability distribution of blacks is similar across schools regardless of the degree to which they are segregated. Furthermore it requires that unobserved teacher quality is independent of the degree to which a school is segregated. Clearly these are rather strong restrictions outside of explicitly experimental settings. Nevertheless, by initially maintaining Assumption 2.4 in what follows, we are able to develop some results on the effects reallocations in a reasonably
straightforward way. In Section 4 we show how the presence of observable individual- and location- 
level attributes may be used to weaken Assumption 2.4. We also briefly discuss the identifying value 
of panel data. We expect these more general results to be most useful in practice.

Our next assumption ensures that the gradients, \( \nabla_s m_H(s) \) and \( \nabla_s m_L(s) \), are identified.

**Assumption 2.5 (Continuous Variation)** If \( f_{S}^{eq}(s) > 0 \) then \( f_{S}^{eq}(s') > 0 \) for all \( s' \) in a neighborhood of \( s \subset S \).

Assumption 2.5 only makes sense if it is legitimate to treat group composition, \( S_c \), ‘as if’ it were a continuously distributed random variable. Such an approximation requires that the common group size, \( N \), be relatively large. Thus our estimands and estimators are not appropriate for situations where groups are small (e.g., college roommates).

Finally we assume the availability of a random sample of locations.

**Assumption 2.6 (Random Sampling)** \( \{Y_c, T_c \}_{c=1}^{C} \) is a random sample of \( C \) neighborhoods of \( I = CN \) individuals.

These last three assumptions, as well as the restrictions on each individual’s allocation response function implied by Assumptions 2.1 to 2.3, ensure that \( m_H(s) \), \( m_L(s) \) and their derivatives with respect to \( s \) are asymptotically revealed.

**Proposition 2.1** Under Assumptions 2.1 to 2.6 (i) \( m_L(s) \) and \( m_H(s) \) are identified for all \( s \) such that \( f_{S}^{eq}(s) > 0 \) by the conditional expectation functions (CEFs):

\[
E[Y_i|T_i = 0, S_i = s] = m_L(s), \quad E[Y_i|T_i = 1, S_i = s] = m_H(s),
\]

and (ii) \( \nabla_s m_L(s, n) \) and \( \nabla_s m_H(s, n) \) are identified by the derivative of these CEFs with respect to \( s \).

**Proof** See Appendix B.1.

### 3 Characterizing the effects of social spillovers

In this section we introduce new estimands which characterize different features of the outcome effects of social spillovers. Prior work on the empirics of social interactions has emphasized testing for their presence and/or measuring their average strength. We therefore begin by proposing a simple measure of average spillover strength. The primary goal of this section, however, is to present summary measures of the effect of local reallocations on the distribution of outcomes. In particular we consider the outcome and inequality effects of a class of reallocations which increase segregation marginally.
3.1 Measuring spillover strength

Manski (1993), Brock and Durlauf (2001), Glaeser and Scheinkman (2003) and Graham (2008a) emphasizes the notion of a social multiplier or the ratio of the full effect of marginal changes in group composition to the private effect:

\[
\frac{\nabla_s m (s)}{p(s)} = 1 + \frac{e(s)}{p(s)}, \quad \text{for } p(s) \neq 0.
\]

The social multiplier is an intuitive measure of spillover strength and has the virtue of being unitless. Nevertheless, for simplicity, as well as technical reasons, we instead suggest a direct measure of average spillover strength. Conditional on \( S_i = s \) the average external effect is given by \( e(s) \). Averaging over individuals gives an overall average spillover effect (ASE) of

\[
\beta_{ase} = \mathbb{E} [d_\kappa (S_i) e (S_i)] = \mathbb{E} [d_\kappa (S_i) \{ S_i \nabla_s m_H (S_i) + (1 - S_i) \nabla_s m_L (S_i) \}],
\]

where \( d_\kappa (s) \) is a fixed trimming function that gives zero weight to values of \( e(s) \) near the boundary of the support of \( S \), specifically,

\[
d_\kappa (s) = 1 \left( s > \underline{s} + \kappa \right) 1 \left( s < \overline{s} - \kappa \right), \quad \kappa \subset S = [\underline{s}, \overline{s}]
\]

The introduction of fixed trimming into the definition of \( \beta_{ase} \) is somewhat awkward, but is required to ensure that (i) the semiparametric efficiency bound for \( \beta_{ase} \) is non-zero and (ii) to avoid boundary bias problems associated with nonparametric estimation of \( m_H (s) \) and \( m_L (s) \) (cf., Newey and McFadden, 1994; Newey and Stoker, 1993).

Equation (6) equals the mean external effect, or spillover benefit, of an unit increase in the fraction of high type individuals in each group. Identification of \( \beta_{ase} \) follows directly from Proposition 2.1 and random sampling. Below we show that the outcome effects of reallocations can be nontrivial even if \( \beta_{ase} = 0 \) (and vice versa). Nevertheless \( \beta_{ase} \) is a simple summary measure of spillover strength; being a nonparametric generalization of the target estimand of a large empirical literature (e.g., Coleman et al., 1966; Mayer and Jencks, 1989; Solon, 1999; Angrist and Lang, 2004; Ciccone and Peri, 2006; Graham, 2008a). While \( \beta_{ase} \) is arguably of scientific interest it does not, since the peer structure of all individuals cannot be simultaneously improved, correspond to an implementable policy.

3.2 Measuring the effects of reallocations

The average spillover effect measures the outcome benefit of an infeasible increase in the population frequency of high types. In contrast reallocations of individuals across groups, since they leave the population type distribution unchanged, are, at least in principal, implementable policies. Before considering the effects of a reallocation of individuals across groups, we define the general class of reallocations under consideration. We assume that the social planner, or allocating agency, observes each individual’s type, \( T_i \) and initial assignment (i.e., the planner observes \( F_{s_i}^{\text{sq}} (s) \), the distribution
of $S_c$ under the status quo, and $p_{H}$). The planner also knows the high- and low-type mean allocation response functions $m_H(s)$ and $m_L(s)$. The planner does not observe $A_i$ or $U_c$ (or is institutionally constrained to not act on this knowledge).

We consider reallocations obeying the feasibility constraint

$$\int_0^1 sf_S^* (s) \, ds = p_H. \quad (7)$$

Equation (7) says that $F_S^* (s)$ cannot imply an augmentation of resources, in this case the population frequency of high types. The set of reallocations satisfying condition (7) is very large. In Section 6 we characterize average outcome-maximizing reallocations. Here we consider estimands which characterize the effects of a specific class of local reallocations.

Our local reallocation estimands measure the effects of a particular parameterization of a small, segregation increasing (relative to the status quo), reallocation. Specifically they give the sign of a small such increase in segregation on average outcomes and inter-type inequality.

The reallocation density we consider takes the form

$$f_S^* (s; \lambda, \kappa) = \frac{s}{1 + \lambda d_\kappa (s)} f_S^{sq} \left( \frac{s + \lambda d_\kappa (s) p_{H, \kappa}}{1 + \lambda d_\kappa (s)} \right), \quad (8)$$

where $p_{H, \kappa} = \mathbb{E} \left[ d_\kappa (S_i) T_i | d_\kappa (S_i) = 1 \right]$ is the trimmed population frequency of high types (i.e., the frequency of high types with status quo assignments to groups with group compositions in the interior of $S$). Appendix B.2 demonstrates that (8) is a feasible reallocation.

Implementing the allocation defined by (8) is equivalent to altering the composition of the $c^{th}$ group according to the rule

$$S_c^* = S_c + \lambda d_\kappa (S_c) (S_c - p_{H, \kappa}). \quad (9)$$

When $\lambda > 0$ reallocation (8) increases segregation across those groups with status quo compositions, $S_c$, within the interval from $\bar{s} + \kappa$ to $\bar{s} - \kappa$. It leaves group composition unchanged across those groups that are initially highly segregated such that $S_c \leq \bar{s} + \kappa$ or $S_c > \bar{s} - \kappa$. That is implementing (8) involves moving high type individuals from groups where the fraction of high types is below their trimmed population frequency ($S_c < p_{H, \kappa}$), to groups where it is above that frequency ($S_c > p_{H, \kappa}$). Such moves are accommodated by switching each high type with a corresponding low type individual. Highly segregated group compositions are left unchanged by (8) to (i) ensure feasibility (it is difficult to increase segregation in a group that is already very segregated) and (ii) for technical reasons. We assume that $\lambda$ is small enough, or equivalently, $\kappa$ large enough, to ensure that $S_c^* \in [0, 1]$ for all groups.

From (9) average outcomes after an exposure decreasing reallocation are given by

$$\mathbb{E} \left[ m (S_i^*) \right] = \mathbb{E} \left[ m (S_i + \lambda d_\kappa (S_i) (S_i - p_{H, \kappa})) \right].$$

We are interested in the direction of the effect of implementing (8) on average outcomes when
$\lambda \to 0$. This corresponds to a small increase in segregation. Differentiating the above expression with respect to $\lambda$ and evaluating at $\lambda = 0$ gives the desired local segregation outcome effect (LSOE):

$$
\beta_{\text{lsoe}} = \mathbb{E} [d_\kappa (S_i) \nabla_s m (S_i) (S_i - p_{H,\kappa})] = \pi_\kappa \mathbb{C} (\nabla_s m (S_i), S_i | d_\kappa (S_i) = 1),
$$

(10)

with $\pi_\kappa = \Pr (d_\kappa (S_i) = 1)$.

Equation (10) is an intuitive condition. If groups where the fraction of high type agents exceeds the trimmed population mean ($S_c > p_{H,\kappa}$) tend also to be relatively responsive to changes in $s$ (i.e., $\nabla_s m (S_c)$ is larger than average), then reallocations that reinforce any existing segregation across groups will tend to raise average outcomes. In contrast, if groups with a low fraction of high type agents are very responsive to changes in $s$, then reallocations that reinforce existing segregation will tend to lower average outcomes.

To highlight structure of $\beta_{\text{lsoe}}$, and connect it to theoretical work on neighborhood sorting, it is helpful to consider the decomposition

$$
\beta_{\text{lsoe}} = \alpha_{\text{lppe}} + \alpha_{\text{lepe}},
$$

where

$$
\alpha_{\text{lppe}} = \pi_\kappa \mathbb{C} (p (S_i), S_i | d_\kappa (S_i) = 1), \quad \alpha_{\text{lepe}} = \pi_\kappa \mathbb{C} (e (S_i), S_i | d_\kappa (S_i) = 1).
$$

Under the current setup, local reallocations may alter population average outcomes for two distinct reasons. First, peer quality changes for those individuals who change groups as part of the reallocation. This is an internalizeable or private peer effect. Second, peer quality changes for those individuals who do not switch groups as part of the reallocation, called ‘stayers’, we call this the external peer effect.

First, consider the private peer effect. If the benefits of improved peer quality for high type movers entering groups with an initially above average fraction of high types exceed the costs for low type movers leaving such groups, then implementing (8) will tend to raise the average achievement of movers. Observe that the private peer effect will be zero when outcomes are separable in own and peer types (as is often assumed in empirical work), positive when they are complementary (as is typically assumed in theoretical work on sorting) and negative when they are substitutable. The sign of the private effect on average outcomes is captured by $\alpha_{\text{lppe}}$. Positivity of $\alpha_{\text{lppe}}$ suggests the presence of private incentives for further, segregating-increasing, sorting.

Second consider the external peer effect. This term captures changes in average outcomes operating through the reallocation’s effect on average spillover strength. If the marginal benefit of an additional high type on stayers is greater in groups with a large fraction of high types (i.e., $\alpha_{\text{lepe}} > 0$), then increased segregation will raise average outcomes by raising average spillover strength. This term is only non-zero in the presence of some form of social spillover. The sign of $\alpha_{\text{lepe}}$ determines the direction of the external effect associated with implementing (8). This effect is not internalized by individuals as they negotiate switches in group membership.

The next theorem makes the above statements more precise and explicitly connects $\beta_{\text{lsoe}}$ to the
Theoretical work on segregation and efficiency done by de Bartolome (1990), Benabou (1993, 1996), Becker and Murphy (2000) and others.

**Theorem 3.1** Under Assumptions 2.1 to 2.6 \( \beta_{\text{loe}} = \alpha_{\text{lppe}} + \alpha_{\text{lepe}} \) with (i)

\[
\alpha_{\text{lppe}} = \pi_{\kappa} \mathbb{V}(S | d_{\kappa}(S) = 1) \mathbb{E}[\omega(S_i) \{ \nabla_s m_H(S_i) - \nabla_s m_L(S_i) \} | d_{\kappa}(S_i) = 1]
\]
\[
\alpha_{\text{lepe}} = \pi_{\kappa} \mathbb{V}(S | d_{\kappa}(S_i) = 1)
\times \mathbb{E}[\omega(S_i) \{ \nabla_s m_H(S_i) - \nabla_s m_L(S_i) + S_i \nabla_{ss} m_H(S_i) + (1 - S_i) \nabla_{ss} m_L(S_i) \} | d_{\kappa}(S_i) = 1],
\]
where \( \mathbb{E}[\omega(S_i)] = 1 \) with

\[
\omega(s) = \frac{1}{f_{S(d_{\kappa}(S))} (s | d_{\kappa}(S_i) = 1)} \times \frac{\mathbb{E}[S_i - p_{H,\kappa}| S_i > s, d_{\kappa}(S_i) = 1] (1 - F_{S(d_{\kappa}(S))} (s | d_{\kappa}(S) = 1))}{\int_{v=0}^{1} \mathbb{E}[S_i - p_{H,\kappa}| S_i > v, d_{\kappa}(S_i) = 1] (1 - F_{S(d_{\kappa}(S))} (v | d_{\kappa}(S) = 1)) dv},
\]
and (ii) the averages \( \alpha_{\text{lppe}} \) and \( \alpha_{\text{lepe}} \) give maximal weight to values at \( S = p_{H,\kappa} \) and minimal weight to those at \( S = \bar{s} + \kappa \) and \( S = \bar{s} - \kappa \).

**Proof** See Appendix B.3.

Theorem 3.1 provides a mathematical representation of the private and external effects discussed above. Theorem 3.1 implies that a small increase in segregation raises average outcomes if

\[
2 \mathbb{E}[\omega(S_i) \{ \nabla_s m_H(S_i) - \nabla_s m_L(S_i) \} | d_{\kappa}(S_i) = 1]
\]
\[
+ \mathbb{E}[\omega(S_i) \{ S_i \nabla_{ss} m_H(S_i) + (1 - S_i) \nabla_{ss} m_L(S_i) \} | d_{\kappa}(S_i) = 1]
\]
is greater than zero. The two terms in the above expression, to use the language of Benabou (1996), are respectively weighted averages of the degree of complementarity and curvature. They are local statistical analogs of identically named global deterministic objects discussed by Benabou (1996), Fernández (2003) and others.

Theoretical work has generally assumed that \( \nabla_s m_H(s) - \nabla_s m_L(s) > 0 \) for all \( s \in (0, 1) \) or that own and peers’ type are global complements. Global complementarity ensures that high type residents will always benefit more from improvements in peer quality than their low type neighbors. While the empirical evidence for such a strong form of complementarity is mixed, theoretical work nevertheless takes it as a primitive since it induces equilibrium stratification.\(^{16}\)

Theorem 3.1 indicates that a measure of local average complementarity,

\[
\mathbb{E}[\omega(S_i) \{ \nabla_s m_H(S_i) - \nabla_s m_L(S_i) \} | d_{\kappa}(S_i) = 1],
\]
is important for determining whether small increases in segregation raise the average outcome. If,\(^{16}\)
in the neighborhood of \( s = p_{H, \kappa} \), own and peers’ type tend to be complementary, then the first term in (11) will be positive. This is a ‘force’ in favor of a local increases in segregation being outcome-raising. It is also suggestive of the existence of incentives for further segregation relative to the status quo.

The theory literature also discusses the importance of curvature for determining whether segregation is outcome-maximizing. Curvature, equal to \( s\nabla_{ss}m_H(s) + (1-s)\nabla_{ss}m_L(s) \), determines whether there are diminishing returns to peer quality at the neighborhood level. Theoretical work emphasizes the case where curvature is such that \( 2\{\nabla_sm_H(s) - \nabla_sm_L(s)\} + s\nabla_{ss}m_H(s) + (1-s)\nabla_{ss}m_L(s) \) is negative for all \( s \in S \) (i.e., global concavity of \( m(s) \) in group composition). In that case complementarity of own and peer quality induces equilibrium segregation, but such segregation is inefficient in the sense that it does not maximize average outcomes (cf., Benabou, 1996, Proposition 7). In such a situation within a neighborhood high types always benefit more from improvements in peer quality than do low types, while across neighborhoods areas with few high types benefit more from increases in peer quality than do areas with many high types. This situation, where the private and social incentives for sorting are misaligned has been emphasized by Benabou (1993, 1996) and others.

Theorem 3.1 indicates that a measure of local average curvature,

\[
E \left[ \omega(S_i) \{S_i\nabla_{ss}m_H(S_i) + (1-S_i)\nabla_{ss}m_L(S_i)\} \mid d_\kappa(S_i) = 1 \right],
\]

is important for determining whether segregation is outcome raising in the current context as well. If, again in the neighborhood of \( s = p_{H, \kappa} \), the marginal benefit of an additional high type peer tends to decline more with \( s \) for high relative to low types, then the second term in (11) will be negative.

To summarize Theorem 3.1 indicates that the average outcome effects of small increases in segregation depend on the relative magnitudes of local average complementarity and local average curvature. These are statistical analogs of well-known deterministic objects from the multi-community models literature. The novelty here, besides the introduction of statistical content, is that the interpretation of \( \beta^{\text{lsoe}} \) does not depend on a priori restrictions on \( m(s) \). The cost of such flexibility is that \( \beta^{\text{lsoe}} \) provides only local information about the relative average outcome effects of segregation versus integration.

The LSOE provides an indication of the likely effects of small increases in segregation on average outcomes. An abiding concern of the literature on segregation, however, is the potential for an equity versus efficiency trade-off. Even if increases in segregation raise average outcomes, such efficiency gains may be unacceptable if they increase inequality across groups. On the other hand, reallocations which both reduce inter-type inequality and raise average outcomes are especially compelling.

Our next estimand measures the sign of the change in the high-low outcome gap associated with a segregation-increasing reallocation. This object, the local segregation inequality effect (LSIE), along with the LSOE defined above, allows one to test for the presence of a local equity-efficiency trade-off.

The average outcome of a high type individual under the status quo is given by, using iterated
expectations,

\[ \mathbb{E}[m_H(S_i)|T_i = 1] = \mathbb{E}\left[ \frac{T_i m_H(S_i)}{p_H} \right] = \mathbb{E}\left[ \frac{S_i m_H(S_i)}{p_H} \right], \]

with a similar expression holding for low types. Therefore, after reallocation the high-low outcome gap is given by

\[
\mathbb{E}\left[ \frac{S_i}{p_H} m_H(S_i) \right] - \mathbb{E}\left[ \frac{1 - S_i}{1 - p_H} m_L(S_i) \right] = \\
\mathbb{E}\left[ \frac{(S_i + \lambda d_\kappa(S_i)(S_i - p_{H,\kappa}))}{p_H} m_H(S_i + \lambda d_\kappa(S_i)(S_i - p_{H,\kappa})) \right] - \\
\mathbb{E}\left[ \frac{(1 - S_i - \lambda d_\kappa(S_i)(S_i - p_{H,\kappa}))}{1 - p_H} m_L(S_i + \lambda d_\kappa(S_i)(S_i - p_{H,\kappa})) \right].
\]

Differentiating with respect to \( \lambda \) and evaluating at \( \lambda = 0 \) gives a local segregation inequality effect of, or the sign of the reallocation’s effect on the high versus low type average outcome gap equal to,

\[
\beta^{\text{lsie}} = \mathbb{E}\left[ \frac{d_\kappa(S_i)}{p_H} \{m_H(S_i) + S_i \nabla_s m_H(S_i) \} (S_i - p_{H,\kappa}) \right] - \\
\mathbb{E}\left[ \frac{d_\kappa(S_i)}{1 - p_H} \{-m_L(S_i) + (1 - S_i) \nabla_s m_L(S_i) \} (S_c - p_{H,\kappa}) \right].
\]

4 Observables

5 Estimation

Our approach to estimation of \( \beta^{\text{ase}}, \beta^{\text{lsoe}} \) and \( \beta^{\text{lsie}} \) involves forming sample analogs of the right-hand-sides of, respectively, (6), (10) and (12) above. In order to do this we must replace \( m_H(s) \), \( m_L(s) \) and/or their derivatives with estimates (along with replacing \( p_{H,\kappa} \) and, for the case of \( \beta^{\text{lsie}}, p_H \) with estimates). We propose to use kernel smoothing methods to estimate each of these objects.

Let \( K(u) \) denote a kernel function that integrates to one and satisfies other conditions. Define \( K_b(s - S_i) = b^{-1} K((s - S_i)/b) \). Our estimates of \( m_H(s) \) and \( m_L(s) \) are given by

\[
\tilde{m}_H(s,n) = \frac{\hat{g}_{1H}(s,n)}{\hat{g}_{2H}(s,n)}, \quad \tilde{m}_L(s,n) = \frac{\hat{g}_{1L}(s,n)}{\hat{g}_{2L}(s,n)}
\]

(13)

where

\[
\hat{g}_{1H}(s) = \frac{1}{I_1} \sum_{i=1}^{I_1} K_b(s - S_i) Y_i, \quad \hat{g}_{1L}(s) = \frac{1}{I_0} \sum_{i=I_1+1}^{I} K_b(s - S_i) Y_i,
\]

\[
\hat{g}_{2H}(s) = \frac{1}{I_1} \sum_{i=1}^{I_1} K_b(s - S_i), \quad \hat{g}_{2L}(s) = \frac{1}{I_0} \sum_{i=I_1+1}^{I} K_b(s - S_i).
\]

We assume that the sample is ordered so that the \( I_1 \) high types appear first followed by the \( I_0 = I - I_1 \)
low types.

We estimate the derivatives of \(m_H(s)\) and \(m_L(s)\) by the derivatives of their estimates:

\[
\nabla_s \bar{m}_H(s, n) = \frac{1}{\bar{g}_{2H}(s)} [\nabla_s \bar{g}_{1H}(s) - \nabla_s \bar{g}_{2H}(s) \bar{m}_H(s)] \tag{14}
\]

\[
\nabla_s \bar{m}_L(s, n) = \frac{1}{\bar{g}_{2L}(s)} [\nabla_s \bar{g}_{1L}(s) - \nabla_s \bar{g}_{2L}(s) \bar{m}_L(s)].
\]

Finally we estimate \(p_{H, \kappa}\) and \(p_H\) by

\[
\hat{p}_{H, \kappa} = \frac{1}{T} \sum_{i=1}^{T} d_{\kappa}(S_i) T_i, \quad \hat{p}_H = \frac{1}{T} \sum_{i=1}^{T} T_i. \tag{15}
\]

We begin by describing our average spillover effect estimator, which is

\[
\beta^{\text{ase}} = \frac{1}{T} \sum_{i=1}^{T} d_{\kappa}(S_i) \{S_i \nabla_s \bar{m}_H(S_i) + (1 - S_i) \nabla_s \bar{m}_L(S_i)\}.
\]

The next proposition characterizes the large sample properties of \(\beta^{\text{ase}}\).

**Proposition 5.1** Under regularity conditions \(\beta^{\text{ase}}\) is \(\sqrt{C}\) consistent with an asymptotic sampling distribution of

\[
\sqrt{C} \left( \beta^{\text{ase}} - \beta^{\text{ase}} \right) \xrightarrow{D} N \left( 0, \mathbb{E} \left[ \phi_c \phi_c^t \right] \right),
\]

where, \(\phi_c = \sum_{i; G_i = c} \phi(Z_i)\), and \(\phi(Z_i)\), the efficient influence function, is given by

\[
\phi(Z_i) = \frac{d_{\kappa}(S_i)}{N} \left\{ e(S_i) - \beta^{\text{ase}} - \frac{\nabla_s f_S(S_i)}{f_S(S_i)} (Y_i - m(S_i)) \right. \\
- \left. \left[ T_i Y_i - (1 - T_i) Y_i \right] - [ m_H(S_i) - m_L(S_i) ] \right\}.
\]

**Proof** See Appendix C for a sketch.

Observe that the asymptotic variance formula \(\beta^{\text{ase}}\) is of the ‘clustered’ variety. Independence of outcomes holds across groups but not within them due to the presence of unobserved locational heterogeneity, \(U_c\).\(^{17}\) The form of the influence function is also instructive. The first term would be the influence function if \(e(s)\) we known. The second two terms therefore capture the effects of first-step nonparametric estimation of \(e(s)\). Of these two terms the first is identical to the correction term associated with semiparametric average derivative estimation (cf., Härdle and Stoker, 1989; Powell, Stock and Stoker, 1989; Newey and McFadden, 1994). This follows from re-expressing the

\(^{17}\)Newey (1994a, p. 1367) notes that dependence of this type does not affect the form of the efficient influence function.
estimand as the difference
\[ \beta^{ase} = \mathbb{E} \left[ d_\kappa (S_i) \nabla_s m(S_i) \right] - \mathbb{E} \left[ d_\kappa (S_i) \{m_H(S_i) - m_L(S_i)\} \right]. \]

Thus the first of the two correction terms captures the sampling uncertainty from having to estimate \( \nabla_s m(S_i) \), while the second is due to sampling error in the estimate of the difference \( m_H(S_i) - m_L(S_i) \).

Appendix C derives the form of \( \phi(Z_i) \) using the methods described by Newey (1994a). It does not provide primitive conditions for \( \sqrt{C} \) consistency and asymptotic normality. This can be done along the lines of Newey and McFadden (1994, Section 8). Here we make only a few comments that are particular to our problem. First, the weight function \( d_\kappa (s) \) serves two distinct purposes. First, it ensures that the product \( d_\kappa(s) f_S(s) \) is zero on the boundary of the support of \( S \). The pathwise derivative calculations in the appendix make clear that such a condition is required for the semiparametric variance bound to be finite. Analogous weight functions play a similar role in average derivative estimation as elegantly explained in Newey and Stoker (1993, p. 1206). A second concern is boundary bias in our first step estimates \( \hat{r}_S m_H(S_i) \) and \( \hat{r}_S m_L(S_i) \). Eliminating such bias is required for the remainder term from linearization (of our second step moment) to be small. The \( d_\kappa(s) \) weight effectively eliminates this problem by requiring us to only estimate \( \hat{r}_S m_H(S_i) \) and \( \hat{r}_S m_L(S_i) \) on the interior of the support of \( S \). As is usual in semiparametric estimation, higher order kernels are required for bias reduction, although the use of such kernels in practice may be ill-advised.

Estimation of \( \beta^{lsoe} \) parallels that of \( \beta^{ase} \). Using the first step estimates defined in (13), (14) and (15) above we form the sample analog of (10):

\[ \tilde{\beta}^{lsoe} = \frac{1}{I} \sum_{i=1}^{I} d_\kappa (S_i) \left[ \hat{m}_H(S_i) - \hat{m}_L(S_i) + S_i \nabla_s \hat{m}_H(S_i) + (1 - S_i) \nabla_s \hat{m}_L(S_i) \right] (S_i - \tilde{p}_{H,\kappa}). \]

**Proposition 5.2** Under regularity conditions \( \tilde{\beta}^{lsoe} \) is \( \sqrt{C} \) consistent with an asymptotic sampling distribution of

\[ \sqrt{C} \left( \tilde{\beta}^{lsoe} - \beta^{lsoe} \right) \xrightarrow{D} \mathcal{N} \left( 0, \mathbb{E} \left[ \tilde{\phi}_c \tilde{\phi}_c \right] \right), \]

where, \( \tilde{\phi}_c = \sum_{i \in \{i:G_i=c\}} \phi(Z_i) \), and \( \phi(Z_i) \), the efficient influence function, is given by

\[ \phi(Z_i) = \frac{d_\kappa (S_i)}{N} \left\{ \nabla_s m(S_i) (S_i - p_{H,\kappa}) - \beta^{lsoe} \right\} - \frac{\nabla_s f_S(S_i)}{f_S(S_i)} (Y_i - m(S_i)) (S_i - p_{H,\kappa}) - d_\kappa (S_i) [Y_i - m(S_i)] \]

\[-\mathbb{E} \left[ \nabla_s m(S_i) | d_\kappa (S_i) = 1 \right] (T_i - p_{H,\kappa}) \].

**Proof** See Appendix C for a sketch.
As discussed in Section 3 above is interesting to decompose $\beta_{\text{loe}}$ into is private, $\alpha_{\text{lppe}}$, and spillover components, $\alpha_{\text{lepe}}$. These components may be estimated by

\begin{align*}
\tilde{\alpha}_{\text{lppe}} &= \frac{1}{I} \sum_{i=1}^{I} d_{\kappa}(S_i) \left[ \tilde{m}_H(S_i) - \tilde{m}_L(S_i) \right] (S_i - \tilde{p}_{H,k}) \\
\tilde{\alpha}_{\text{lepe}} &= \frac{1}{I} \sum_{i=1}^{I} d_{\kappa}(S_i) \left[ S_i \nabla_s \tilde{m}_H(S_i) + (1 - S_i) \nabla_s \tilde{m}_L(S_i) \right] (S_i - \tilde{p}_{H,k}).
\end{align*}

The next two propositions characterizes the large sample properties of these estimators.

**Proposition 5.3** Under regularity conditions $\tilde{\alpha}_{\text{lppe}}$ is $\sqrt{C}$ consistent with an asymptotic sampling distribution of

$$\sqrt{C} \left( \tilde{\alpha}_{\text{lppe}} - \alpha_{\text{lppe}} \right) \xrightarrow{D} \mathcal{N} \left( 0, \mathbb{E} \left[ \phi_c \tilde{\phi}_c \right] \right),$$

where, $\tilde{\phi}_c = \sum_{i \in \{i | G_i = c\}} \phi(Z_i)$, and $\phi(Z_i)$, the efficient influence function, is given by

\begin{align*}
\phi(Z_i) &= \frac{d_{\kappa}(S_i)}{N} \left\{ p(S_i) (S_i - p_{H,k}) - \alpha_{\text{lppe}} - \left\{ \left( \frac{T_i}{S_i} \right) Y_i - m_H(S_i) \right\} (S_i - p_{H,k}) - \left\{ \left( \frac{1 - T_i}{1 - S_i} \right) Y_i - m_L(S_i) \right\} (S_i - p_{H,k}) - \mathbb{E} \left[ p(S_i) \right] \right\} \\
&\quad - \mathbb{E} \left[ p(S_i) \right] \left\{ d_{\kappa}(S_i) = 1 \right\} \left( T_i - p_{H,k} \right).
\end{align*}

**Proof** See Appendix C for a sketch.

**Proposition 5.4** Under regularity conditions $\tilde{\alpha}_{\text{lepe}}$ is $\sqrt{C}$ consistent with an asymptotic sampling distribution of

$$\sqrt{C} \left( \tilde{\alpha}_{\text{lepe}} - \alpha_{\text{lepe}} \right) \xrightarrow{D} \mathcal{N} \left( 0, \mathbb{E} \left[ \phi_c \tilde{\phi}_c \right] \right),$$

where, $\tilde{\phi}_c = \sum_{i \in \{i | G_i = c\}} \phi(Z_i)$, and $\phi(Z_i)$, the efficient influence function, is given by

\begin{align*}
\phi(Z_i) &= \frac{d_{\kappa}(S_i)}{N} \left\{ e(S_i) (S_i - p_H) - \alpha_{\text{lepe}} - \left\{ \frac{\nabla s f_S(S_i)}{f_S(S_i)} (Y_i - m(S_i)) (S_i - p_{H,k}) - [Y_i - m(S_i)] \right\} \right. \\
&\quad - \left\{ \left( \frac{T_i}{S_i} \right) Y_i - m_H(S_i) \right\} (S_i - p_{H,k}) + \left\{ \left( \frac{1 - T_i}{1 - S_i} \right) Y_i - m_L(S_i) \right\} (S_i - p_{H,k}) - \mathbb{E} \left[ e(S_i) \right] \right\} \\
&\quad - \mathbb{E} \left[ e(S_i) \right] \left\{ d_{\kappa}(S_i) = 1 \right\} \left( T_i - p_{H,k} \right).
\end{align*}

**Proof** See Appendix C for a sketch.

Note that the sum of the influence functions for $\tilde{\alpha}_{\text{lppe}}$ and $\tilde{\alpha}_{\text{lepe}}$ equal that of $\tilde{\beta}_{\text{loe}}$. 

22
6 The social planner’s problem

In this section we characterize the structure of average outcome maximizing assignments of individuals to groups. As before we consider reallocations which leave the joint distribution of group-size fixed. This class of reallocations is completely characterized by \( l = 1, \ldots, L \) conditional group-composition cumulative distribution functions: \( F_{S|N} (s|n_l) \). The social planner’s problem is thus a functional (i.e., infinite-dimensional) optimization one. Such problems are typically quite difficult to solve, standard mathematical programming results being inapplicable.

In our case we show, by exploiting the special structure of the planner’s problem and the feasibility constraint, that a direct solution is available, easily characterized and computationally feasible. This result allows us to identify the maximum average outcome level available via reallocation. A comparison of the maximum average outcome with that observed under the status quo provides a measure of efficiency of the status quo (cf., Bhattacharya, 2008). Consider a school board pondering open enrollment. If current achievement levels are near the maximum attainable via reallocation, then costly reassignment policies are unattractive.

Analysis of the planner’s problem also provides insight into the interaction of the production technology and resource constraint (i.e., the fraction of high types in the population) in determining the optimal allocation. Below we provide examples where, holding technology fixed, the optimal allocation is either integrating or segregating depending on the type structure of the population. This highlights the danger of informally inferring the optimality of segregation versus integration by inspection of the production technology alone.

We continue to maintain the assumptions that the planner knows the mean allocation response function, \( m (s, n) \), as well as the status quo joint distribution, \( F_{S,N}^{sq} (s, n) \) and population fraction of high types, \( p_H \). Her problem is to choose an allocation which maximizes expected average outcomes:

\[
\max \sum_{l=1}^{L} \left[ \frac{n_l}{\mu_N} \int m (s, n_l) f_{S|N} (s|n_l) \, ds \right] \tau_l^{sq}
\]

subject to restriction (5). Weighting by \( n_l/\mu_N \) ensures that the planner maximizes average individual outcomes (and not the average of mean group outcomes).

Our characterization of the solution to (16) involves two steps. First, we solve a simplified problem. In the simplified problem all groups are of the same size. In this case the only observable dimension distinguishing groups is their composition. We show that the optimizing planner chooses the allocation, \( F_S^* (s) \), in a way that implicitly ‘concavifies’ the mean allocation response function, \( m (s) \) (we suppress the \( n \) argument when discussing the simplified problem). One intuition for our result follows from the observation that an optimizing planner behaves similarly to that of a cost minimizing producer facing (possibly) nonconvex isoquants (McFadden 1978).

Second, using our first step result we show that the original problem can be broken into two simple steps. Let \( \sigma_l \) denote the fraction of high types in the subpopulation of individuals assigned to groups of size \( n_l \) (as part of a candidate reallocation). Conditional on choosing such an allocation,
the optimal conditional allocations \( F_{S|N}(s|n_1), \ldots, F_{S|N}(s|n_L) \) are determined by our first result. Since \( \sigma_l = \int s f_{S|N}(s|n_1) \, ds \) we can re-write the feasibility constraint (5) as

\[
\sum_{i=1}^{L} \frac{n_i}{\mu_N} \sigma_i^{(s_0)} = p_H,
\]

and hence show that the original problem is equivalent to a finite-dimensional optimization problem where the planner chooses the vector \( \sigma = (\sigma_1, \ldots, \sigma_L)' \). Furthermore we show that the equivalent problem is a concave one and hence that the Kuhn-Tucker conditions are both necessary and sufficient. This allows us to provide a fairly complete characterization of the planner’s problem. Numerical computation of an outcome maximizing allocation is straightforward. We can therefore estimate the maximum attainable average outcome. A similar argument can be used to characterize the problem of minimizing expected average outcomes.

The concave envelope of \( m(s, n) \) plays an important role in our argument. The following definition, adapted from Horst, Pardalos and Thoai (2000), defines this object.

**Definition 6.1** Let \( m : S \rightarrow \mathbb{R}^1 \) be a continuous function with \( S = [s, \bar{s}] \) (a convex set in \( \mathbb{R}^1 \)), then the concave envelope of \( m(s) \) taken over \( S \) is a function \( M(s) \) such that (i) \( M(s) \) is concave on \( S \), (ii) \( M(s) \geq m(s) \) for all \( s \in S \), (iii) if \( h(s) \) is any concave function defined on \( S \) such that \( h(s) \geq m(s) \) for all \( s \in S \), then \( h(s) \geq M(s) \) for all \( s \in S \).

Formally \( M(s) \) is the function whose truncated lower epigraph coincides with the convex hull of the truncated lower epigraph of \( m(s) \) (cf., Rockafellar, 1970). Intuitively it is the uniformly best concave overestimator of \( m(s) \).

We begin by considering the planner’s problem when all groups are equally-sized. Outcome maximizing allocations in that setting are characterized by the following theorem.

**Theorem 6.1** Consider the problem

\[
\max_{f_S(\cdot) \in \Gamma_S} \int m(s) f_S(s) \, ds, \quad \text{s.t.} \quad \int s f_S(s) \, ds = p_H, \tag{17}
\]

where \( s \in S = [s, \bar{s}] \) with \( s \geq 0, \bar{s} \leq 1 \), \( \Gamma_S \) is the space of all probability measures on \( S \), and \( p_H = \mathbb{E}[T_i] \), then, with \( F^*_S(\cdot) \) denoting a solution to (17),

\[
\int m(s) f^*_S(s) \, ds = M(p_H) \tag{18}
\]

and

\[
F^*_S(s) = (1 - \pi) \mathbf{1}(s \geq s_L) + \pi \mathbf{1}(s \geq s_U), \quad \pi = \begin{cases} \frac{p_H - s_L}{s_U - s_L} & s_L < s_U \\ 1/2 & s_L = s_U \end{cases} \tag{19}
\]

where

\[
s_L = \max \{ s : s \geq \underline{s}, \, s \leq p_H, \, M(s) = m(s) \}, \quad s_U = \min \{ s : s \leq \bar{s}, \, s \geq p_H, \, M(s) = m(s) \}.
\]
Proof See Appendix B.4.

Theorem 6.1 shows that an outcome maximizing allocation may be constructed by a group composition density with just two mass points. The location of these mass points coincide with the $s$-axis values of the first extreme points to the ‘right’ and left’ of $(p_H, M(p_H))$. To see why this is the case it is helpful to examine some examples in detail.\footnote{We thank Emmanuel Saez for providing some of these examples. His intuitive insight was key in being able to show Theorem 6.1.} Figure 1 plots\footnote{Each panel plots a different expected allocation response function, $m(s)$ (solid dark line). The concave envelopes of these expected allocation response functions, $M(s)$, are the given by the dashed lines at or above $m(s)$. The vertical dashed lines indicate the population frequency of high types, $p_H$. For figures with two such lines the second line (i.e., the right-most line) gives the location of a second population frequency, $p_H'$. The point labeled $A$ marks the location of $(p_H, M(p_H))$. The points labeled $B$ and $C$ mark the locations of, respectively, $(s_L, m(s_L))$ and $(s_U, m(s_U))$ (when $s_L \neq s_U$). The point labeled $A'$, if present, marks the location of $(p_H', M(p_H'))$.} four different forms for $m(s)$. Consider Panel A of the figure. In that panel $m(s)$ is globally convex (on the support of $s$). The concave envelope of $m(s)$ is equal to the straight line passing through the points B, A and C. The vertical dashed line in this figure depicts the population frequency of high types, $p_H$. If ‘production’ on $M(s)$, the concave envelope of $m(s)$, were feasible, then, by Jensen’s inequality, an optimal allocating would clearly be integrating: all groups would have a fraction of high types equal to $p_H$. While this is not possible, this same average outcome is achievable by a segregating allocation with groups of all low or high types. In Panel B of the figure, $m(s)$ is globally concave. In that case $m(s)$ and its concave envelope $M(s)$ coincide such that the integrated allocation maximizes average outcomes. These two cases correspond to those emphasized in the multi-community models literature.

Panels C and D depict more complicated examples. In Panel C $m(s)$ has both concave and convex regions. If $p_H = 0.2$, shown by the left-most vertical dashed line in the figure, then the social planner will form some groups with no high types (point B in the figure) and some partially integrated groups (point C in the figure). The proportion of each type of groups is determined by the feasibility constraint. This example illustrates the key idea of the theorem: because groups can be formed with different proportions of high types, the output level $M(p_H)$ is attainable. Since $M(s) \geq m(s)$ for all $s \in [0, 1]$ and is concave it follows that $M(p_H)$ equals the maximal attainable average outcome level. Mathematically the result follows from that fact that any point on the convex hull of a set of points can be represented as a linear combination of extreme points on the hull.

Panel C highlights a second feature of our problem. As discussed above, when $p_H = 0.2$ (left-most vertical dashed line), $M(p_H) \geq m(p_H)$ so that the social planner will choose a segregating allocation. In contrast when $p_H = 0.8$ (right-most vertical dashed line) $M(p_H) = m(p_H)$ so that the social planner will choose a perfectly integrated allocation. This provides a simple, albeit stylized, example of how knowledge of the production technology alone is not sufficient for solving the planners problem. Panel D gives a further example of an average outcome response function with both convex and concave portions.

The solution to the original social planner’s problem is characterized by the following corollary to Theorem 6.1.
Figure 1: Optimal allocations for different $m(s)$ and $p_H$

NOTES: Each panel plots a different expected allocation response function, $m(s)$ (solid dark line). The concave envelopes of these expected allocation response functions, $M(s)$, are given by the dashed lines at or above $m(s)$. The vertical dashed lines indicate the population frequency of high types, $p_H$. For figures with two such lines the second line (i.e., the right-most line) gives the location of a second population frequency, $p'_H$. The point labeled A marks the location of $(p_H, M(p_H))$. The points labeled B and C mark the locations of, respectively, $(s_L, m(s_L))$ and $(s_U, m(s_U))$ (when $s_L \neq s_U$). The point labeled $A'$, if present, marks the location of $(p'_H, M(p'_H))$.

**Corollary 6.1** A solution to the social planner’s problem defined by (16) and (5) is given by

$$F^*_{s|N}(s|n_l) = [1 - \pi (\sigma_l)] 1(s \geq s_L(\sigma_l)) + \pi (\sigma_l) 1(s \geq s_U(\sigma_l))$$

where

$$\pi (\sigma_l) = \left\{ \begin{array}{ll}
\frac{\sigma_l - s_L(\sigma_l)}{s_U(\sigma_l) - s_L(\sigma_l)} & s_L(\sigma_l) < s_U(\sigma_l) \\
1/2 & s_L(\sigma_l) = s_U(\sigma_l)
\end{array} \right.$$  

for $l = 1, \ldots, L$ and

$$s_L(\sigma_l) = \max \{s : s \geq \bar{s}, s \leq \sigma_l, M(s, n_l) = m(s, n_l)\}$$

$$s_U(\sigma_l) = \min \{s : s \leq \bar{s}, s \geq \sigma_l, M(s, n_l) = m(s, n_l)\},$$

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with $M(s, n_l)$ the concave envelope of $m(s, n_l)$ on $s \in S$ and $\sigma_1, \ldots, \sigma_L$ the solution to the concave programming problem

$$
\max_{\sigma_1 \in \mathcal{S}, \ldots, \sigma_L \in \mathcal{S}} \sum_{l=1}^{L} \frac{n_l}{\mu_N} M(\sigma_l, n_l) \tau_l^{sq}, \quad \text{s.t.} \quad \sum_{l=1}^{L} \frac{n_l}{\mu_N} \sigma_l \tau_l^{sq} = p_H. \quad (20)
$$

**Proof** See Appendix B.5.

Corollary 6.1 provides a simple algorithm for calculating the maximum attainable average outcome available via reallocation. First, compute $M(s, n_l)$ for each of the $L$ group sizes. Second, solve the concave program (20). Third, compute the value of $\sum_{l=1}^{L} \frac{n_l}{\mu_N} M(\sigma_l, n_l) \tau_l^{sq}$ at the solution.

Our final identification result is:

**Proposition 6.1** If (i) Assumptions 2.1 to 2.6 hold and (ii) $f_{sq}^{*}(s|n_l) > 0$ for all $s \in S$ and $l = 1, \ldots, L$, then (a) $F_{S|N}^{*}(s|n_l)$ is identified and (b) so is the efficiency measure

$$
\beta^{esq} = \sum_{l=1}^{L} \left[ \frac{n_l}{\mu_N} \int m(s, n_l) f_{S|N}^{*}(s|n_l) \, ds \right] \tau_l^{sq} - \mathbb{E}[Y].
$$

**Proof** See Appendix B.6.

The efficiency of the status quo measure (ESQ), $\beta^{esq}$, equals the maximum average outcome gain, relative to the status quo, available via reallocation.

7

8  Empirical illustration

9  Summary
Table 1: Nonparametric and parametric estimates of spillover strength and reallocation effects (math achievement, Project STAR Kindergarten Students)

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</tbody>
</table>

Notes: The estimates reported in Panel A of the Table were calculated using the kernel procedure outlined in the main text. Estimated standard errors are in parentheses. A multivariate standard normal kernel was used with a bandwidth matrix proportional to the covariance matrix of the regressors (fraction female in the classroom, total school enrollment, fraction female in the entire school and class size). In the first column of Panel A the degrees of proportionality used for estimating \( m_H(s, r) \) and \( m_L(s, r) \) were chosen by leave-own-school-out cross validation. The bandwidths for \( \nabla_s m_H(s, r) \) and \( \nabla_s m_L(s, r) \) were then taken to be rescaled versions of the corresponding cross-validated ones. The chosen rescaling reflects the differential MSE-optimal bandwidth for pointwise conditional mean and derivative estimation. The estimated standard errors are calculated using nonparametric estimates of the relevant influence functions. The bandwidth used for the joint density of \( f_{S,R}(s, r) \), which appears in the influence functions, is a multivariate version of Silverman’s ‘rule-of-thumb’ bandwidth (cf., Wand and Jones, 1995, p. 111). The bandwidth used for \( \nabla_s f_{S,R}(s, r) \) is a rescaling of this rule-of-thumb bandwidth. Columns 2 through 4 report undersmoothed estimates based on bandwidth values equal to, respectively, 5/6, 2/3 and 1/2 of the column one bandwidth values. Panel B of the table reports estimates based on parametric models for \( m_H(s, r) \) and \( m_L(s, r) \). Standard errors were calculated taking into account the sequential nature of the estimation procedure. In both the nonparametric and parametric cases standard errors appropriately account for arbitrary within-school dependence in outcomes across individuals. See the notes to Figure 2 for additional details on the data estimation sample.
Figure 2: Average math achievement and classroom gender composition, Project STAR Kindergarten Students

Notes: The left-hand-side of the figure plots kernel partial mean estimates of $\mathbb{E}[m(s; R_i)]$ where $R_i = (\tau(W_i), X_i', N_i)'$ with $W_i$ is empty and $X_i$ including total school enrollment and fraction female in the school. A multivariate standard normal kernel was used with a bandwidth matrix proportional to the covariance matrix of the regressors. The degree of proportionality was chosen by leave-own-school-out cross-validation. The dashed lines are pointwise 90 percent confidence intervals calculated using the approach of Newey (1994b) (modified to allow for within-school dependence across observations). Units attending schools with enrollments below 50 or above 150 and/or those in schools with fraction female below 0.35 or above 0.65 were trimmed when forming the partial mean (about 9 percent of the students). Valid test scores, standardized to be mean zero with unit variance, were available for $I = 5,871$ students in $C = 325$ classrooms located across 79 different schools. The right-hand-side of the figure plots a histogram of peer composition at the individual level.
Figure 3: Average math achievement by gender and classroom gender composition, Project STAR Kindergarten Students

Notes: The figure plots kernel partial mean estimates of $\bar{m}_H(s) = \mathbb{E}[m_H(s, R_i)]$ and $\bar{m}_L(s) = \mathbb{E}[m_L(s, R_i)]$. Bandwidths, regressors, trimming and confidence intervals are as described in the notes to Figure 2. A total of 2,857 students are used to compute the girls’ figure and 3014 students for the boys’ figure.
Appendices

A  Some preliminary results

Lemma A.1  For $X$, a continuous random variable, with (i) compact support $X = [a, b]$, (ii) cumulative distribution function $F_X(X)$, and (iii) $g(\cdot)$ a continuously differentiable function on the support of $X$:

1. The slope coefficient of the (mean squared error minimizing) linear predictor (LP) of $g(X)$ given $X$ has a weighted average derivative representation of

$$B = \frac{\mathbb{C}(g(X), X)}{\mathbb{V}(X)} = \mathbb{E}\left[\omega(X) \frac{\partial g(X)}{\partial x}\right],$$

where

$$\omega(x) = \frac{1}{f_X(x)} \frac{\mathbb{E}[X - \mu_X | X \geq x] (1 - F_X(x))}{\int_{u=a}^{b} \mathbb{E}[X - \mu_X | X \geq u] (1 - F_X(u)) \, du}, \quad \mathbb{E}[\omega(X)] = 1,$$

and

2. $B$ gives maximum weight to values of $\frac{\partial g(X)}{\partial x}$ for $X$ close to its mean, $\mu_X = \mathbb{E}[X]$, and minimum weight when $X$ is near the boundaries of its support.

The proof for the first result of the Lemma is similar to that of Lemma 5 of Angrist, Graddy and Imbens (2000). The second result of the Lemma, i.e., the precise characterization of the weighting process follows from a simple integration by parts argument. Observe that $g(X) - g(a) = \int_{u=a}^{X} \frac{\partial g(u)}{\partial x} \, du$ and that $\mathbb{E}[g(a) (X - \mu_X)] = 0$. Under weak conditions we therefore have

$$\mathbb{C}(g(X), X) = \mathbb{E}[g(X) (X - \mu_X)]$$

$$= \mathbb{E}\left[\int_{u=a}^{X} \frac{\partial g(u)}{\partial x} (X - \mu_X) \, du\right]$$

$$= \mathbb{E}\left[\int_{u=a}^{b} \frac{\partial g(u)}{\partial x} (X \geq u) (X - \mu_X) \, du\right]$$

$$= \int_{u=a}^{b} \frac{\partial g(u)}{\partial x} \mathbb{E}[X - \mu_X | X \geq u] (1 - F_X(u)) \, du.$$

The variance of $X$ can be written as

$$\mathbb{V}(X) = \mathbb{E}\left[X (X - \mu_X)\right]$$

$$= \mathbb{E}\left[\int_{v=a}^{X} 1 (X - \mu_X) \, dv\right]$$

$$= \int_{v=a}^{b} \mathbb{E}[X - \mu_X | X \geq v] (1 - F_X(v)) \, dv.$$

The first result follows for $\omega(x)$ as given in the Lemma. To show the second result, that the weighted average derivative representation of $B$ gives the most emphasis to values of $\frac{\partial g(X)}{\partial x}$ for $X$ close to its mean, begin by noting that

$$\mathbb{E}\left[\omega(X) \frac{\partial g(X)}{\partial x}\right] = \frac{\int_{u=a}^{b} \frac{\partial g(u)}{\partial x} \mathbb{E}[X - \mu_X | X \geq u] (1 - F_X(u)) \, du}{\int_{u=a}^{b} \mathbb{E}[X - \mu_X | X \geq u] (1 - F_X(u)) \, du}.$$

Therefore the size of the weight on $\frac{\partial g(u)}{\partial x}$ is proportional to

$$\mathbb{E}[X - \mu_X | X \geq x] (1 - F_X(x)).$$
Integration by parts (with \( u = 1 - F_X(t) \) and \( v = t \)) gives
\[
\int_x^b [1 - F_X(t)] \, dt = [1 - F_X(t)] t_x^b + \int_x^b t f_X(t) \, dt
\]
\[= -[1 - F_X(x)] x + \int_x^b t f_X(t) \, dt. \tag{21} \]
We then write
\[
\frac{\partial}{\partial x} \{ \mathbb{E}[X - \mu_X | X \geq x] (1 - F_X(x)) \} = \frac{\partial}{\partial x} \int_x^b x f_X(t) \, dt - \frac{\partial}{\partial x} [1 - F_X(x)] \mu_X \\
= \frac{\partial}{\partial x} \int_x^b x f_X(t) \, dt + \mu_X f_X(x)
\]
Using (21) to substitute for \( \frac{\partial}{\partial x} \int_x^b x f_X(t) \, dt \) gives
\[
\frac{\partial}{\partial x} \{ \mathbb{E}[X - \mu_X | X \geq x] (1 - F_X(x)) \} = \frac{\partial}{\partial x} \left\{ [1 - F_X(x)] x + \int_x^b [1 - F_X(t)] \, dt \right\} \\
+ \mu_X f_X(x) \\
= [1 - F_X(x)] + \frac{\partial}{\partial x} \int_x^b [1 - F_X(t)] \, dt \\
- (x - \mu_X) f_X(x) \\
= [1 - F_X(x)] - [1 - F_X(x)] - (x - \mu_X) f_X(x) \\
= -(x - \mu_X) f_X(x).
\]
This gives \( \frac{\partial}{\partial x} \{ \mathbb{E}[X - \mu_X | X \geq x] (1 - F_X(x)) \} = 0 \) at \( x = \mu_X \). This derivative is negative for \( x > \mu_X \) and positive for \( x < \mu_X \), hence it attains a maximum at \( x = \mu_X \) and its minimum at the boundaries of the support of \( X \).

## B Identification proofs

### B.1 Proof of Proposition 2.1

Under Assumptions 2.1 and 2.2 we have \( Y_1 = Y_i(S_{-i}, \tau_{K^H}(A^H_{\pi(i)}), \tau_{K^L}(A^L_{\pi(i)}), U_i) \). Writing
\[
Y_i(S_{-i}, \tau_{K^H}(A^H_{\pi(i)}), \tau_{K^L}(A^L_{\pi(i)}), U_i) = g(T_i, A_i, S_{-i}, \tau_{K^H}(A^H_{\pi(i)}), \tau_{K^L}(A^L_{\pi(i)}), U_i)
\]
we therefore have
\[
\mathbb{E}[Y_i] \mid T_i = 1, S_i = s = \mathbb{E} g(T_i, A_i, S_{-i}, \tau_{K^H}(A^H_{\pi(i)}), \tau_{K^L}(A^L_{\pi(i)}), U_i) \mid T_i = 1, S_i = s \\
= \int \left\{ \prod_{j \in \pi(1)} f_{A_j}(a_{\pi(j)}) \, da_{\pi(j)} \right\} f_U(u) \, du \right\} \right\}
\times \left\{ \int g(1, a, s_{-i}, \tau_{K^H}(A^H_{\pi(i)}), \tau_{K^L}(A^L_{\pi(i)}), U) \right\}
\]
where the second equality follows from Assumptions 2.3 to 2.3. Let the integral in outermost set of \( \{ \cdot \} \) equal \( g^\circ(1, a, s_{-i}) \). Observe that \( g^\circ(T_i, A_i, S_{-i}) = Y_i^\circ(s_{-i}) \), therefore by Assumption 2.3 we have
\[
\int g^\circ(1, a, s_{-i}) \, da = \mathbb{E}[Y_i^\circ(s_{-i})] \mid T = 1 = m_H(s),
\]
as claimed. The result for \( m_L(s) \) follows analogously. Identification of the two gradient function then follows directly from Assumption 2.5.
B.2 Feasibility of local reallocation density

Feasibility of (8) follows from the fact that, making the change of variables \( v = (s + \lambda p_{H,\kappa}) / (1 + \lambda) \), and decomposing the integral,

\[
\int_0^1 s f_{S_0}(s; \lambda, \kappa) ds = \int_0^{s_{\mu}} \frac{s}{1 + \lambda d_p} f_{S_0}^{eq} \left( \frac{s + \lambda d_p (s) p_{H,\kappa}}{1 + \lambda d_p (s)} \right) ds
\]

\[
= \int_{s_{\mu}}^{s_{\mu} + \kappa} s f_{S_0}^{eq} (s) ds + \int_{s_{\mu} + \kappa}^{s_{\max}} \frac{s}{1 + \lambda} f_{S_0}^{eq} \left( \frac{s + \lambda p_{H,\kappa}}{1 + \lambda} \right) ds + \int_{s_{\max}}^1 s f_{S_0}^{eq} (s) ds
\]

\[
= \Pr(S_i \leq s + \kappa) \mathbb{E}[T_i | S_i \leq s + \kappa]
\]

\[
+ \int_{s + \kappa}^{s_{\max}} \{(1 + \lambda) v - \lambda p_{H,\kappa}\} f_{S_0}^{eq}(v) dv
\]

\[
+ \Pr(S_i \geq s - \kappa) \mathbb{E}[T_i | S_i \geq s - \kappa]
\]

\[
= \mathbb{E}[d_p(S_i) \{|(1 + \lambda) S_i - \lambda p_{H,\kappa}\}]
\]

\[
+ \Pr(S_i \geq s - \kappa) \mathbb{E}[T_i | S_i \geq s - \kappa]
\]

\[
= p_H.
\]

B.3 Proof of Theorem 3.1

The result follows directly from Lemma A.1 above.

B.4 Proof of Theorem 6.1

Consider the problem

\[
\max_{F_S(\cdot) \in \mathcal{F}_S} \int M(s) f_S(s) ds, \quad \text{s.t.} \quad \int s f_S(s) ds = p_H,
\]

where \( M(s) \) is the concave envelope of \( m(s) \) on \( S \). By concavity of \( M(s) \) and Jensen’s inequality we have

\[
\int M(s) f_S(s) ds \leq M(\mathbb{E}_F[S]).
\]

Feasibility requires that \( \mathbb{E}_F[S] = p_H \), therefore

\[
\max_{F_S(\cdot) \in \mathcal{F}_S} \int M(s) f_S(s) ds \leq M(p_H).
\]

Observe that this upper bound is attained by the degenerate distribution concentrated at \( p_H \) (i.e., \( M^* = M(p_H) \)).

Since \( M(s) \geq m(s) \) for all \( s \in S \) we have the inequalities

\[
M(p_H) \geq \int M(s) f_S(s) ds \geq \int m(s) f_S(s) ds,
\]

for all feasible \( F_S(\cdot) \). Therefore any feasible \( F_S^*(s) \) such that \( M(p_H) = \int m(s) f_S^*(s) ds \) must be a solution to the planner’s problem.

By the definition of \( M(s) \), \( s_L \) and \( s_U \) we have that \( M(s) \) is linear on the interval \( s \in [s_L, s_U] \), i.e.,

\[
M(s) = a + bs, \quad s \in [s_L, s_U]
\]

with

\[
a = m(s_L) - \left( \frac{m(s_U) - m(s_L)}{s_U - s_L} \right) s_L, \quad b = \frac{m(s_U) - m(s_L)}{s_U - s_L}.
\]
This gives

\[
M(p_H) = m(s_L) - \left(\frac{m(s_U) - m(s_L)}{s_U - s_L}\right) s_L + \left(\frac{m(s_U) - m(s_L)}{s_U - s_L}\right) p_H
\]

= \left(1 - \pi\right) m(s_L) + \pi m(s_L)

= \int m(s) f^*_s(s) \, ds.

Since \( \int s f^*_s(s) \, ds = p_H \), and therefore \( F^*_s(s) \) feasible, we have that \( F^*_s(s) \) is a solution to the planner’s problem as claimed.

### B.5 Proof of Corollary 6.1

Conditional on setting the fraction of high types assigned to groups of size \( n_i \) equal to \( \sigma_i \) we know, by Theorem 6.1, that \( F^*_{\Sigma|N}(s|n_i) \) is an outcome-maximizing allocation. Since, again conditional on \( \sigma_i \), \( \int m(s, n_i) f^*_{\Sigma|N}(s|n_i) \, ds = M(\sigma_i) \), we may therefore choose \( \sigma_1, \ldots, \sigma_L \) by solving (20) which is concave by inspection.

### B.6 Proof of Proposition 6.1

[TO BE COMPLETED]

### C Influence function derivations

This appendix details the derivation of the influence functions associated with the estimators described in Section 5. In this appendix all expectations are with respect to the population of individuals unless noted otherwise. The \( i \) subscripts on random variables are omitted to simplify the notation.

We begin by noting that \( \beta^{asc}, \beta^{base} \) and \( \beta^{bisc} \) are unrestricted parameters in the sense that their definitions do not place substantive restrictions on the joint distribution of \( Z = (Y, T, S)' \). Newey (1990, pp. 106 - 107) notes that the pathwise derivative of such unrestricted parameters will be unique. This implies that any regular estimator will have an influence function equal to the unique pathwise derivative. Furthermore, as described in Newey (1994a), the semiparametric efficiency bound for such parameters can be calculated as the variance of the pathwise derivative of the parameter with respect to the distribution of the data. The large sample characterization of the two-step M-estimators described in the main text follows from these observations. While we do not provide regularity conditions ensuring \( \sqrt{n} \) consistency and asymptotic normality of our proposed estimators, our calculations do provide a formula for their large sample variance. In this sense our approach is similar in spirit and implementation to that of Newey and Stoker (1993) in their analysis of weighted average derivatives.

To describe our calculations further we let \( f(z) \) denote the true density of \( Z = z \). A parametric submodel or path is a parametric family of densities \( f(z; \eta) \) containing the ‘truth’ (i.e., \( f(z; \eta_0) = f(z) \) for some \( \eta_0 \)). Let \( \beta(\eta) \) denote the population value of the parameter in question when \( Z \) is distributed according to \( f(z; \eta) \). The pathwise derivative is the function \( \phi(Z) \) such that

\[
\nabla_{\eta} \beta(\eta)|_{\eta=\eta_0} = E\left[\phi(Z) S_{\eta}(Z)\right]
\]

(24)

where \( S_{\eta}(z) = \nabla_\eta f(z; \eta_0) / f(z; \eta_0) \) denotes the score of \( f(z; \eta) \) at \( \eta = \eta_0 \). By the delta method the Cramer-Rao

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20 In such models the allowable set of scores can approximate any mean zero function of \( Z \) (with finite variance).

21 The form of (24) and a simple argument due to Newey (1990, pp. 106 - 107) shows why \( \phi(Z) \) is unique when \( \beta \) is an unrestricted parameter. Let \( \phi(Z) \) and \( \tilde{\phi}(Z) \) denote two pathwise derivatives (centered to be mean zero), by (24) we have

\[
E \left[ \left\{ \phi(Z) - \tilde{\phi}(Z) \right\} S_{\eta}(Z) \right] = 0.
\]

When \( \beta \) is an unrestricted parameter the set of valid scores, or the tangent set, for the model is given by \( T = \{S_{\eta}(Z) : E[S_{\eta}(Z)] = 0\} \). Since \( \phi(Z) - \tilde{\phi}(Z) \) belongs to this set orthogonality requires that

\[
E \left[ \left\{ \phi(Z) - \tilde{\phi}(Z) \right\}' \left\{ \phi(Z) - \tilde{\phi}(Z) \right\} \right] = 0
\]

In this case the influence function is the delta method variance estimate
variance bound for $\beta(\eta)$ in the parametric submodel is

$$\nabla_\eta \beta(\eta) \mathbb{E} \left[ S_\eta(Z) S_\eta(Z)' \right]^{-1} \nabla_\eta \beta(\eta)' = \mathbb{E} \left[ \phi(Z) S_\eta(Z) \right] \mathbb{E} \left[ S_\eta(Z) S_\eta(Z)' \right]^{-1} \mathbb{E} \left[ S_\eta(Z) \phi(Z)' \right].$$

Since $S_\eta(z)$ is unrestricted the supremum of all such Cramer-Rao bounds, or the semiparametric variance bound, is obviously

$$\mathbb{E} \left[ \phi(Z) \phi(Z)' \right].$$

By the arguments of Newey (1994a) the asymptotic variance of any regular estimator of $\beta$ is given by this bound.

The specific structure of each of our estimators can be used to simplify the calculation of $\phi(Z)$. In particular each of our estimators can be formulated as a two-step M-estimator with a nonparametric first step (cf., Newey and McFadden, 1994). As shown by Newey (1994a) such problems have certain features which can be exploited in order to calculate the pathwise derivative. Let $h$ be a function of $Z$, the arguments of which are suppressed in order to simplify notation; each our estimators can be defined as the solution to

$$\frac{1}{I} \sum_{i=1}^{I} \psi(Z_i, \hat{\beta}, \hat{h}) = 0,$$

where $\psi(Z, \beta, h)$ is some known function, $\hat{h}$ is a preliminary ‘first step’ nonparametric estimate of $h$.

Let $\psi(Z, h) = \psi(Z, \beta_0, h)$. Application of the chain rule yields

$$\nabla_\eta \mathbb{E}_{\eta_0} \left[ \psi(Z, h(\eta)) \right] = \int \nabla_\eta \psi(z, h(\eta)) f(z) \, dz + \int \psi(z, h_0) S_\eta(z)' f(z) \, dz = \nabla_\eta \mathbb{E}_{\eta_0} \left[ \psi(Z, h(\eta)) \right] + \mathbb{E}_{\eta_0} \left[ \psi(Z, h_0) S_\eta(Z)' \right],$$

where $\mathbb{E}_\eta[\cdot]$ denotes expectations taken with respect to the density $f(z; \eta)$ (throughout $\mathbb{E}[\cdot] = \mathbb{E}_{\eta_0}[\cdot]$). Noting that $\mathbb{E}_{\eta_0} \left[ \psi(Z, \beta(\eta), h(\eta)) \right]_{\eta = \eta_0} = 0$ a direct application of the implicit function theorem and the previous result then gives

$$\nabla_\eta \beta(\eta)_{\eta = \eta_0} = -\nabla_\beta \mathbb{E}_{\eta_0} \left[ \psi(Z, \beta_0, h(\eta_0)) \right]^{-1} \times \nabla_\eta \mathbb{E}_{\eta_0} \left[ \psi(Z, \beta_0, h(\eta_0)) \right]$$

with $\Gamma = \nabla_\beta \mathbb{E}[\psi(Z, \beta, h_0)]_{|\beta = \beta_0}$ (assumed nonsingular). If we can find at function $\delta(z)$ such that

$$\nabla_\eta \mathbb{E}[\psi(Z, h(\eta))] = \mathbb{E}_\eta \left[ \delta(Z) S_\eta(Z)' \right],$$

then the influence function for any regular estimator of $\beta$, by the results of Newey (1990, 1994a) and equation (24) above, will be

$$\phi(Z) = -\Gamma^{-1} \{ \psi(Z, h_0) + \delta(Z) \}.$$

As explained by Newey (1994a) and also Newey and McFadden (1994), the function $\delta(Z)$ may be viewed a correction term which accounts for first step estimation of $h$. Below we use the structure of (25) to calculate the appropriate correction term for each of our estimators. In particular we begin by linearizing $\psi(z, h(\eta))$ around the truth $h_0$. With $\psi(z, h) - \psi(z, h_0) \simeq \Psi(z, h - h_0)$, $\Psi(z, h)$ linear in $h$, and (25) we then have

$$\nabla_\eta \mathbb{E}[\psi(Z, h(\eta) - h_0)] = \nabla_\eta \mathbb{E}[\Psi(Z, h(\eta))] = \mathbb{E}_\eta \left[ \delta(Z) S_\eta(Z)' \right].$$

Finding the form of $\delta(z)$ thus involves finding an ‘integral representation’ for $\mathbb{E}[\Psi(Z, h(\eta))]$. The bulk of our derivations detailed below are devoted to this step.

Once the form of $\delta(Z)$ has been calculated, the asymptotic variance formulae given in Section 5 follow directly. A minor complication involves appropriately accounting for within-group dependence in the data induced by the presence of unobserved location-specific attributes. As noted by Newey (1994a, p. 1367), such dependence does not affect the form of $\delta(Z)$ and so can be accounted for relatively easily. Note that $\hat{\beta}$ can be equivalently expressed as the solution to

$$\frac{1}{C} \sum_{c=1}^{C} \sum_{i \in c} \psi(Z_i, \hat{\beta}, \hat{h}) = 0,$$

or, equivalently, the equality $\phi(Z) = \phi(Z)$. A simple intuition for this result, also due to Newey (1990), is that when the model places no restrictions on the distribution of the data $\beta$ is just identified.
with independence across groups so that the second step moment function is the within-group summation \( g(Z_i, \beta, h) = \sum_{i \in \{i; G_i = c\}} \psi(Z_i, \beta, h) \). Let
\[
G = \nabla_{\beta} \mathbb{E} \left[ \sum_{i \in \{i; G_i = c\}} \psi(Z_i, \beta, h_0) \right] \bigg|_{\beta = \beta_0},
\]
and
\[
\bar{\phi}_c = -G^{-1} \left\{ \sum_{i \in \{i; G_i = c\}} \psi(Z_i, h_0) + \delta(Z_i) \right\},
\]
so that the appropriate asymptotic sampling distribution is
\[
\sqrt{C(\hat{\beta} - \beta_0)} \xrightarrow{D} N \left( 0, \mathbb{E} \left[ \bar{\phi}_c \bar{\phi}_c^T \right] \right).
\]
In all of the estimators considered here \( G = -\mathbb{E} [N_i] = -\mu_N \), so that \( \bar{\phi}_c = \mu_N^{-1} \left\{ \sum_{i \in \{i; G_i = c\}} \psi(Z_i, h_0) + \delta(Z_i) \right\} \).

## C.1 Influence function derivation for \( \hat{\beta}^{\text{lsoe}} \)

We begin with the local segregation outcome effect (LSE) defined in Section 3:
\[
\hat{\beta}^{\text{lsoe}}_0 = \mathbb{E} \left[ d_n (S) \nabla_s m (S) (S - p_{H,s}) \right] = \mathbb{E} \left[ d_n (S) \nabla_s \left\{ \frac{h_{10} (R) + h_{20} (R)}{h_{30} (R)} \right\} \left( S - \frac{h_{40} (R)}{h_{50} (R)} \right) \right],
\]
where \( R = (T, S)' \) (such that \( Z = (Y, R)' \)) and
\[
\begin{align*}
h_{10} (r) &= f_S (s) \mathbb{E} [TY | S = s] = f_S (s) s m_H (s) \quad (27) \\
h_{20} (r) &= f_S (s) \mathbb{E} [(1 - T) Y | S = s] = f_S (s) (1 - s) m_L (s) \\
h_{30} (r) &= f_S (s) \\
h_{40} (r) &= \mathbb{E} [d_n (S) T] \\
h_{50} (r) &= \mathbb{E} [d_n (S)]
\end{align*}
\]
Let \( h (r) = (h_1 (r), h_2 (r), h_3 (r), h_4 (r), h_5 (r))' \). For what follows it is helpful to note that \( f_{T|S} (t | s) = s^t (1 - s)^{1-t} \).

The second step moment restriction defining \( \beta^{\text{lsoe}}_0 \) is
\[
\mathbb{E} \left[ \psi \left( R, \hat{\beta}^{\text{lsoe}}_0, h_0 \right) \right] = 0,
\]
with
\[
\psi \left( r, \hat{\beta}^{\text{lsoe}}_0, h \right) = d_n (s) \nabla_s \left\{ \frac{h_1 (r) + h_2 (r)}{h_3 (r)} \right\} \times \left( s - \frac{h_{40} (R)}{h_{50} (R)} \right) - \hat{\beta}^{\text{lsoe}}_0.
\]

Let \( \psi \left( r, \beta^{\text{lsoe}}_0, h \right) = \psi (r, h) \), linearizing \( \psi (r, h) \) about \( h_0 \) gives
\[
\psi (r, h) - \psi (r, h_0) \simeq \Psi (r, h - h_0),
\]
where \( \Psi (r, h - h_0) \) is linear in \( h - h_0 \). The precise form of \( \Psi (r, h - h_0) \) is obtained by expanding the two ratios entering \( \psi (R, h) \) pointwise. Since \( a/b - a_0/b_0 = b_0^{-1} \left[ 1 - b^{-1} (b - b_0) \right] [(a - a_0) - (a_0/b_0) (b - b_0)] \), the linearization of \( a/b \) around \( a_0/b_0 \) is given by \( b_0^{-1} [(a - a_0) - (a_0/b_0) (b - b_0)] \). This fact and the product rule allow us to write
\[
\Psi (r, h - h_0) = d_n (s) \nabla_s \left\{ \frac{1}{h_{30} (r)} \left[ 1, 1, -\frac{h_{10} (r) + h_{20} (r)}{h_{30} (r)} \right] \left( \frac{h_{10} (r) - h_{10} (r)}{h_{30} (r)} \right) \right\}
\times \left( s - \frac{h_{40} (r)}{h_{50} (r)} \right)
- d_n (s) \nabla_s \left\{ \frac{h_{10} (r) + h_{20} (r)}{h_{30} (r)} \right\} \times \frac{1}{h_{50} (r)} \left\{ 1, -\frac{h_{40} (r)}{h_{50} (r)} \right\} \left( \frac{h_4 (r) - h_{40} (r)}{h_5 (r) - h_{50} (r)} \right).
\]
Differentiating the first term in \( \{ \cdot \} \) with respect to \( s \), collecting terms, and rearranging yields

\[
\Psi (r, h (r)) = a_0 (r)' h (r) + \nabla_s h (r)' b_0 (r) + c_0 (r)' h (r),
\]  

(28)

where

\[
a_0 (r) = d_n (s) \frac{s - p_{H,n}}{f_S (s)} (-k (r), -k (r), -\nabla_s m (s) + m (s) k (r), 0, 0)'
\]

\[
b_0 (r) = d_n (s) \frac{s - p_{H,n}}{f_S (s)} (1, 1, -m (s), 0, 0)'
\]

\[
c_0 (r) = -\frac{d_n (s)}{\mathbb{E} [d_n (S)]} \nabla_s m (s) (0, 0, 0, 1, -\mathbb{E} [T | d_n (S) = 1])'
\]

with

\[
k (r) = \frac{\nabla_s f_S (s)}{f_S (s)}, \quad m (s) = \frac{h_{10} (r) + h_{20} (r)}{h_{30} (r)}.
\]

As noted above the influence function for \( \beta_{\text{base}} \) will take the form \( \psi (R, \gamma_0, h_0) + \delta (Z) \), where \( \delta (Z) \) is the term which ‘corrects’ for first stage nonparametric estimation. From (28) and (26) this term solves

\[
\nabla \psi \left[ a_0 (R)' h (R; \eta) \right] + \nabla \psi \left[ \nabla_s h (R; \eta)' b_0 (R) \right] + \nabla \psi \left[ c_0 (R)' h (R; \eta) \right] = \mathbb{E}_\eta \left[ \delta (Z) S_\eta (Z)' \right]
\]

To apply this result we begin by evaluating the expectations of on the left-hand-side of the above equation term-by-term. By iterated expectations we have, for the first term in (28),

\[
\mathbb{E} \left[ a_0 (R)' h (R; \eta) \right] = \int d_n (s) \frac{s - p_{H,n}}{f_S (s)} (-k (r), -k (r), -\nabla_s m (s) + m (s) k (r))
\]

\[
\times \left( \begin{array}{c}
\mathbb{E}_{\eta} \left[ Y | T = 1, S = s \right] \\
\mathbb{E}_{\eta} \left[ Y | T = 0, S = s \right]
\end{array} \right)
\times f_S (s; \eta) \int f_0 (r) \, dr
\]

\[
= \int d_n (s) \frac{s - p_{H,n}}{f_S (s)} (-k (r), -k (r), -\nabla_s m (s) + m (s) k (r))
\]

\[
\times \left( \begin{array}{c}
\mathbb{E}_\eta \left[ (1 - T) Y | S = s \right] \\
1
\end{array} \right)
\times f_S (s; \eta) \mathbb{E}_\eta \left[ v_1 (R) d_n (S) \{1, T, TY, (1 - T) Y\}' \right]
\]

where the second equality follows from the fact that \( f_{T|S} (t | s; \eta) = s^t (1 - s)^{1-t} \) does not depend on \( \eta \) and

\[
v_1 (r) = (s - p_{H,n}) \left\{ -\nabla_s m (s) + m (s) k (r), 0, -k (r), -k (r) \right\}'.
\]

To evaluate the second term of (28) we use integration by parts as in Powell, Stock and Stoker (1989) (with \( u (r) = f_0 (r) b_0 (r)' \) and \( v (r) = h (r; \eta) \)) to obtain a representation directly in terms of \( h (r; \eta) \). Using the fact that \( b_0 (r) \) and \( h (r; \eta) \) vary in \( s \) alone, as well as the density factorization \( f_0 (s) = s^t (1 - s)^{1-t} f_0 (s) \), we have

\[
\mathbb{E} \left[ \nabla_s h (R; \eta)' b_0 (R) \right] = \int f_0 (r) b_0 (r)' \left[ \nabla_s h (r; \eta) \right] \, dr
\]

\[
= \int \sum_{s=0}^{t=1} \int \sum_{t=0,1} s^t (1 - s)^{1-t} f_0 (s) b_0 (r)' \left[ \nabla_s h (r; \eta) \right] \, ds
\]

\[
= \int f_0 (s) b_0 (r)' \left[ \nabla_s h (r; \eta) \right] \, ds
\]

\[
= \left[ f_0 (s) b_0 (r)' h (r; \eta) \right]_0^1 - \int \nabla_s \left[ f_0 (s) b_0 (r)' \right] h (r; \eta) \, ds
\]

\[
= 0 - \int \nabla_s \left[ f_0 (s) b_0 (r)' \right] h (r; \eta) \, dr
\]

\[
= \mathbb{E}_\eta \left[ v_2 (R) d_n (S) \{1, T, TY, (1 - T) Y\}' \right],
\]
with

\[ v_2 (r) = (s - p_{R, \alpha}) \{ \nabla_x m (s), 0, 0, 0 \} + \{ m (s), 0, -1, -1 \}'. \]

This follows from the fact that \( f_0 (s) b_0 (r) = 0 \) at \( s = 0, 1 \) since \( d_\alpha (0) = d_\alpha (1) = 0 \) and also that

\[ \nabla_x \left[ f_0 (s) b_0 (r) \right]' = \nabla_x \left[ d_\alpha (s) (s - p_{R, \alpha}) \{ 1, 1, -m (s), 0, 0 \} \right] \\
= d_\alpha (s) (s - p_{R, \alpha}) \{ 0, 0, -\nabla_x m (s), 0, 0 \}' \\
+ d_\alpha (s) \{ 1, 1, -m (s), 0, 0 \}'. \]

Finally we take the expectation of the final term in (28):

\[ \mathbb{E} \left[ c_0 (R) h (R; \eta) \right] = - \int \frac{d_\alpha (s)}{\mathbb{E} [d_\alpha (s)]} \nabla_x m (s) (0, 0, 0, 1, -\mathbb{E} [T] d_\alpha (s) = 1) h (r; \eta) f_0 (r) \, dr \\
= - \int \frac{d_\alpha (s)}{\mathbb{E} [d_\alpha (s)]} \nabla_x m (s) \left( \mathbb{E}_\eta [d_\alpha (s) T] - \mathbb{E}_\eta [d_\alpha (s)] \mathbb{E} [T] d_\alpha (s) = 1 \right) f_0 (r) \, dr \\
= - \left\{ \int \frac{d_\alpha (s)}{\mathbb{E} [d_\alpha (s)]} \nabla_x m (s) f_0 (r) \, dr \right\} \mathbb{E}_\eta [d_\alpha (s) (T - p_{R, \alpha})] \\
= - \mathbb{E} [\nabla_x m (s) d_\alpha (s) = 1] \mathbb{E}_\eta [d_\alpha (s) (T - p_{R, \alpha})] \\
= \mathbb{E}_\eta \left[ v_3 (R) d_\alpha (S) \{ 1, T, TY, (1 - T) Y \} \right], \]

where

\[ v_3 (R) = \mathbb{E} [\nabla_x m (s) | d_\alpha (S) = 1] \{ p_{R, \alpha}, -1, 0, 0 \}'. \]

Combining terms gives

\[ \mathbb{E} [\Psi (R, h_0)] = \mathbb{E}_\eta \left[ v (R) d_\alpha (S) \{ 1, T, TY, (1 - T) Y \} \right], \]

with \( v (r) = v_1 (r) + v_2 (r) + v_3 (r) \) or, equivalently,

\[
\begin{align*}
 v (r) &= \{ m (s) + (s - p_{R, \alpha}) m (r) k (r) + \mathbb{E} [\nabla_x m (s)] d_\alpha (S) = 1 \} p_{R, \alpha} \\
&\quad - \mathbb{E} [\nabla_x m (s)] d_\alpha (S) = 1 \}, \quad (s - p_{R, \alpha}) k (r) - 1, \quad (s - p_{R, \alpha}) k (r) - 1. \end{align*}
\]

Differentiating with respect to \( \eta \) gives

\[ \nabla_\eta \mathbb{E}_\eta \left[ v (R) d_\alpha (S) \{ 1, T, TY, (1 - T) Y \} \right] = \mathbb{E}_\eta \left[ v (R) d_\alpha (S) \{ 1, T, TY, (1 - T) Y \} \right] \beta_s, \]

and hence a correction term of \( \delta (Z) = v (R) d_\alpha (S) \{ 1, T, TY, (1 - T) Y \} \) or

\[ \delta \text{loc} (z) = -d_\alpha (s) \nabla_x f s (s) (y - m (s)) (s - p_{R, \alpha}) \]
\[ - d_\alpha (s) (y - m (s)) - \mathbb{E} [\nabla_x m (s)] d_\alpha (S) = 1] d_\alpha (s) (t - p_{R, \alpha}), \]

as claimed.

### C.2 Influence function derivation for \( \hat{\alpha} \text{lppe} \)

The local private peer effect (LPPE) of Section 3 is given by

\[ \alpha_0 \text{lppe} = \mathbb{E} \left[ d_\alpha (S) \left( \frac{h_{R, 30} (R)}{h_{30} (R)} - \frac{h_{R, 30} (R)}{(1 - s) h_{30} (R)} \right) \left( S - \frac{h_{R, 30} (R)}{h_{50} (R)} \right) \right] \]

with \( h (r) = (h_1 (r), h_2 (r), h_3 (r), h_4 (r), h_5 (r))' \) as defined in (27) above. Linearizing the implied moment function gives

\[ \Psi (r, h (r)) = a_0 (r)' h (r) + b_0 (r)' h (r), \]

(30)
where

\[ a_0 (r) = \frac{d_\kappa (s)}{f_S (s)} \left\{ \frac{s - \text{PH}_s}{s}, - \frac{s - \text{PH}_s}{1 - s}, \frac{m_H (s) - m_L (s)}{s} \right\} \cdot \]

\[ b_0 (r) = -d_\kappa (s) \frac{m_H (s) - m_L (s)}{\mathbb{E} [d_\kappa (S)]} \{ 0, 0, 1, -\text{PH}_s \} \cdot \]

Taking expectations of \( a_0 (R)' h (R;\eta) \) yields

\[ \mathbb{E} [a_0 (R)' h (R;\eta)] = \int d_\kappa (s) \left\{ \frac{s - \text{PH}_s}{s}, - \frac{s - \text{PH}_s}{1 - s}, \frac{m_H (s) - m_L (s)}{s} \right\} f_S (s;\eta) \mathbb{E} [TY | S = s] f_S (s;\eta) ds \]

\[ = \int d_\kappa (s) \left\{ \frac{s - \text{PH}_s}{s}, - \frac{s - \text{PH}_s}{1 - s}, \frac{m_H (s) - m_L (s)}{s} \right\} \frac{\mathbb{E} [TY | S = s]}{f_S (s;\eta)} f_S (s;\eta) ds \]

\[ = \mathbb{E} \left[ v_1 (R) d_\kappa (S) \{ 1, T, TY, (1 - T) Y \} \right], \]

where

\[ v_1 (r) = \left\{ - \frac{m_H (s) - m_L (s)}{s} \frac{s - \text{PH}_s}{1 - s}, - \frac{s - \text{PH}_s}{s} \right\}. \]

Now taking expectations of \( b_0 (R)' h (R;\eta) \) we get

\[ \mathbb{E} [b_0 (R)' h (R;\eta)] = - \int d_\kappa (s) \frac{m_H (s) - m_L (s)}{\mathbb{E} [d_\kappa (S)]} \left\{ 1, -\text{PH}_s \right\} \left( \frac{\mathbb{E} [d_\kappa (S) T]}{\mathbb{E} [d_\kappa (S)]} \right) f_S (s;\eta) ds \]

\[ = - \int d_\kappa (s) \left( \frac{m_H (s) - m_L (s)}{\mathbb{E} [d_\kappa (S)]} f_S (s;\eta) ds \right) \left( \frac{\mathbb{E} [d_\kappa (S) T]}{\mathbb{E} [d_\kappa (S)]} \right) \]

\[ = - \mathbb{E} \left[ \frac{d_\kappa (S)}{\mathbb{E} [d_\kappa (S)]} (m_H (S) - m_L (S)) \right] \left\{ 1, -\text{PH}_s \right\} \]

\[ = - \mathbb{E} [m_H (S) - m_L (S)] d_\kappa (S) (1) \times \mathbb{E} [d_\kappa (S) (T - \text{PH}_s)] \]

\[ = - \mathbb{E} \left[ v_2 (R) d_\kappa (S) \{ 1, T, TY, (1 - T) Y \} \right], \]

with

\[ v_2 (r) = \mathbb{E} [m_H (S) - m_L (S)] d_\kappa (S) = 1 \left\{ -\text{PH}_s, 1 \right\}. \]

Using (30) and (26), these calculations suggest a correction term of the form

\[ \varrho^{\text{lepe}} (z) = d_\kappa (s) \left\{ \left( \frac{t}{s} \right) y - m_H (s) \right\} (s - \text{PH}_s) - d_\kappa (s) \left\{ \left( \frac{1 - t}{1 - s} \right) y - m_L (s) \right\} (s - \text{PH}_s) \]

\[ - \mathbb{E} [m_H (S) - m_L (S)] d_\kappa (S) = 1 \left\{ -\text{PH}_s \right\} \left( 1 - \text{PH}_s \right), \]

as claimed.

**C.3 Influence function derivation for \( \hat{\alpha}^{\text{lepe}} \)**

The local external peer effect (LEPE) of Section 3 is given by

\[ a^{\text{lepe}}_0 = \mathbb{E} \left[ d_\kappa (S) \left\{ \frac{h_{10} (R)}{h_{30} (R)} \right\} + (1 - S) \nabla \left\{ \frac{h_{20} (R)}{(1 - S) h_{30} (R)} \right\} \left( S - \frac{h_{40} (R)}{h_{50} (R)} \right) \right]. \]
with \( h(r) = (h_1(r), h_2(r), h_3(r), h_4(r), h_5(r))' \) as defined in (27) above. Linearizing the implied moment function gives

\[
\Psi(r, h(r)) = d_\kappa(s) \nabla_s \left\{ \frac{1}{f_S(s)} \left( \frac{1}{s} - m_H(s) \right) \begin{pmatrix} h_1(r) - h_{10}(r) \\ h_3(r) - h_{30}(r) \end{pmatrix} \right\} (s - p_{H,\kappa}) + d_\kappa(s) (1 - s) \nabla_s \left\{ \frac{1}{f_S(s)} \left( \frac{1}{1 - s} - m_L(s) \right) \begin{pmatrix} h_2(r) - h_{20}(r) \\ h_3(r) - h_{30}(r) \end{pmatrix} \right\} (s - p_{H,\kappa}) - d_\kappa(s) (s\nabla_s m_H(s) + (1 - s) \nabla_s m_L(s)) \frac{1}{h_{50}(r)} \begin{pmatrix} 1, -h_{10}(r) \\ h_5(r) - h_{50}(r) \end{pmatrix}.
\]

By the chain rule we have

\[
d_\kappa(s) \nabla_s \left\{ \frac{1}{f_S(s)} \left( \frac{1}{s} - m_H(s) \right) \begin{pmatrix} h_1(r) - h_{10}(r) \\ h_3(r) - h_{30}(r) \end{pmatrix} \right\} (s - p_{H,\kappa}) \]

\[
= d_\kappa(s) \nabla_s \left( \begin{pmatrix} h_1(r) - h_{10}(r) \\ h_3(r) - h_{30}(r) \end{pmatrix} \right)' \left\{ \frac{s - p_{H,\kappa}}{f_S(s)} [1, -s m_H(s)] \right\}' + d_\kappa(s) \frac{s - p_{H,\kappa}}{f_S(s)} \left\{ \begin{pmatrix} 1 \\ -k(r) \end{pmatrix}, k(r) (s m_H(s) - s \nabla_s m_H(s)) \right\} \begin{pmatrix} h_1(r) - h_{10}(r) \\ h_3(r) - h_{30}(r) \end{pmatrix}.
\]

where \( k(r) = \nabla_s f_S(s) / f_S(s) \) as above. Similarly we have

\[
d_\kappa(s) (1 - s) \nabla_s \left\{ \frac{1}{f_S(s)} \left( \frac{1}{1 - s} - m_L(s) \right) \begin{pmatrix} h_2(r) - h_{20}(r) \\ h_3(r) - h_{30}(r) \end{pmatrix} \right\} (s - p_{H,\kappa}) \]

\[
= d_\kappa(s) \nabla_s \left( \begin{pmatrix} h_2(r) - h_{20}(r) \\ h_3(r) - h_{30}(r) \end{pmatrix} \right)' \left\{ \frac{s - p_{H,\kappa}}{f_S(s)} [1, -(1 - s) m_L(s)] \right\}' + d_\kappa(s) \frac{s - p_{H,\kappa}}{f_S(s)} \left\{ \begin{pmatrix} 1 \\ 1 - s \end{pmatrix} - k(r), k(r) (1 - s) m_L(s) - (1 - s) \nabla_s m_L(s) \right\} \begin{pmatrix} h_2(r) - h_{20}(r) \\ h_3(r) - h_{30}(r) \end{pmatrix}.
\]

Collecting terms and reorganizing yields the linearization

\[
\Psi(r, h(r)) = a_0(r)' h(r) + \nabla_s h(r)' b_0(r) + c_0(r)' h(r),
\]

where

\[
a_0(r) = d_\kappa(s) \frac{s - p_{H,\kappa}}{f_S(s)} \left\{ -\frac{1}{s} - k(r), \frac{1}{1 - s} - k(r), k(r) m(s) - e(s), 0, 0 \right\},
\]

\[
b_0(r) = d_\kappa(s) \frac{s - p_{H,\kappa}}{f_S(s)} \{ 1, 1, -m(s), 0, 0 \},
\]

\[
c_0(r) = -\frac{d_\kappa(s)}{\mathbb{E} [d_\kappa(s)]'} e(s) \{ 0, 0, 0, 1, -p_{H,\kappa} \},
\]

recalling that \( e(s) = s \nabla_s m_H(s) + (1 - s) \nabla_s m_L(s) \).

Evaluating the expectation of \( \mathbb{E} [a_0(R)' h(R; \eta)] \) yields

\[
\mathbb{E} [a_0(R)' h(R; \eta)] = \int d_\kappa(s) \frac{s - p_{H,\kappa}}{f_S(s)} \left[ \begin{pmatrix} 1 \\ 1 - s \end{pmatrix} - k(r), \frac{1}{1 - s} - k(r), k(r) m(s) - e(s) \right] f_S(s) \ ds
\]

\[
\times \left( \frac{f_S(s; \eta \mathbb{E}_\eta[TY|S = s]}{f_S(s; \eta \mathbb{E}_\eta[(1 - T)Y|S = s]} \right) f_S(s) \ ds
\]

\[
= \int d_\kappa(s) \left( \frac{s - p_{H,\kappa}}{f_S(s)} \right) \left[ \begin{pmatrix} 1 \\ 1 - s \end{pmatrix} - k(r), \frac{1}{1 - s} - k(r), k(r) m(s) - e(s) \right] \times \left( \frac{\mathbb{E}_\eta[TY|S = s]}{\mathbb{E}_\eta[(1 - T)Y|S = s]} \right) f_S(s; \eta) \ ds
\]

\[
= \mathbb{E}_\eta \left[ u_1(R) d_\kappa(S) \{ 1, T, TY, (1 - T) Y \} \right],
\]

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where
\[ v_1 (r) = \left\{ (s - ph) \left[ \frac{\nabla r f_s (s)}{f_s (s)} m (s) - e (s) \right], 0, \right. \]
\[ (s - ph) \left( -1 - \frac{\nabla r f_s (s)}{f_s (s)} \right), (s - ph) \left( 1 - s - \frac{\nabla r f_s (s)}{f_s (s)} \right) \} . \]

From the analysis of \( \hat{\beta}_{\text{base}} \) above we have
\[ E \left[ \nabla r h (R; \eta)^{'b_U (R)} \right] = E_{\eta} [ v_2 (R) d_A (S) \{ 1, T, TY, (1 - T) Y \} ] , \]
with
\[ v_2 (r) = (s - ph, s) \{ \nabla r m (s), 0, 0, 0 \} ' + \{ m (s), 0, -1, -1 \} '. \]

Finally we evaluate the expectation of \( c_0 (R)' h (R; \eta) \):
\[ E \left[ c_0 (R)' h (R; \eta) \right] = - \int \frac{d_A (s)}{E [d_A (s)']} e (s) \left( 0, 0, 0, 1, -E [T] d_A (s) = 1 \right)' h (r; \eta) f_0 (r) dr \]
\[ = - \int \frac{d_A (s)}{E [d_A (s)']} e (s) \left( E_0 [d_A (s) T] - E_0 [d_A (s)] E [T] d_A (s) = 1 \right) f_0 (r) dr \]
\[ = - \int \frac{d_A (s)}{E [d_A (s)']} e (s) f_0 (r) dr \left( E_0 [d_A (s) (T - ph, s)] \right) \]
\[ = E_0 [ e (s) | d_A (S) = 1] E_0 [d_A (s) (T - ph, s)] \]
\[ = E_0 [ v_3 (R) d_A (S) \{ 1, T, TY, (1 - T) Y \} ] , \]
where
\[ v_3 (R) = E [ e (S) | d_A (S) = 1] \{ ph, a, -1, 0, 0 \} ' . \]

The form of \( v_1 (r) \), \( v_2 (r) \) and \( v_3 (r) \) together imply a correction term of
\[ \delta_{\text{base}} (z) = -d_A (s) \frac{\nabla r f_s (s)}{f_s (s)} (y - m (s)) (s - ph, s) \]
\[ - d_A (s) (y - m (s)) \]
\[ - d_A (s) \left\{ \frac{t}{s} y - m_H (s) \right\} (s - ph, s) + d_A (s) \left\{ \frac{1 - t}{1 - s} y - m_L (s) \right\} (s - ph, s) \]
\[ - E \left[ e (S) | d_A (S) = 1] d_A (s) (t - ph, s) , \right. \]
as claimed. Note that \( \delta_{\text{base}} (z) + \delta_{\text{base}} (z) = \delta_{\text{base}} (z) \) as would be expected.

### C.4 Influence function derivation for \( \hat{\beta}_{\text{base}} \)

The average spillover effect is given by
\[ \hat{\beta}_{\text{base}} = E [d_A (S) e (S)] \]
\[ = E \left[ d_A (S) \nabla_s \left\{ \frac{h_{10} (R) + h_{20} (R)}{h_{30} (R)} \right\} - d_A (S) \left\{ \frac{h_{10} (R) - h_{20} (R)}{S - 1} \right\} \right] , \]
where \( h_{10} (r) \), \( h_{20} (r) \) and \( h_{30} (r) \) are as defined in (27) above. Linearizing the implied moment function gives
\[ \Psi (r, h (r) - h_0 (r)) = d_A (s) \nabla_s \left\{ \frac{h_{10} (r) + h_{20} (r)}{h_{30} (r)} \right\} \left( \frac{h_1 (r) - h_0 (r)}{h_1 (r) - h_0 (r)} \right) \]
\[ - d_A (s) \left\{ \frac{1}{S - 1} \right\} \left( \frac{h_{10} (r) - h_{20} (r)}{h_{30} (r)} \right) \left\{ \frac{h_1 (r) - h_0 (r)}{h_1 (r) - h_0 (r)} \right\} \]
\[ - \frac{d_A (s)}{h_{30} (r)} \left\{ \frac{1}{S - 1} \right\} \left( \frac{h_{10} (r) - h_{20} (r)}{h_{30} (r)} \right) \left\{ \frac{h_1 (r) - h_0 (r)}{h_1 (r) - h_0 (r)} \right\} . \]
Differentiating the first term in $\{ \cdot \}$ with respect to $s$ and collecting terms yields

$$
\Psi (r, h (r)) = a_0 (r) h (r) + \nabla_s h (r) b_0 (r) + c_0 (r) \frac{d}{dr} (h (r))
$$

with

$$
h (r) = (h_1 (r), h_2 (r), h_3 (r))
$$

and

$$
a_0 (r) = \frac{d}{ds} \left( -k (r), -k (r), -\nabla_s m (r) + m (r) k (r) \right),
$$

$$
b_0 (r) = \frac{d}{ds} \left( 1, 1, -m (r) \right),
$$

$$
c_0 (r) = -\frac{d}{ds} \left( \frac{1}{s}, \frac{1}{1-s}, -[m_H (s) - m_L (s)] \right),
$$

where

$$
k (r) = \frac{\nabla_s f_s (s)}{f_s (s)}, \quad m (s) = \frac{h_{10} (r) + h_{20} (r)}{h_{30} (r)}, \quad m_H (s) = \frac{h_{10} (r)}{sh_{30} (r)}, \quad m_L (s) = \frac{h_{20} (r)}{(1-s)h_{30} (r)}.
$$

Taking expectations of the first term in $\Psi (r, h (r))$ we have

$$
\mathbb{E} \left[ a_0 (R) h (R; \eta) \right] = \int \frac{d}{ds} \left( -k (r), -k (r), -\nabla_s m (r) + m (r) k (r) \right)
$$

$$
\times \left( \frac{f_s (s; \eta) s \mathbb{E}_\eta [Y \mid T = 1, S = s]}{f_s (s; \eta) (1-s) \mathbb{E}_\eta [Y \mid T = 0, S = s]} \right) f_0 (r) \, dr
$$

$$
= \int d_s (s; \eta) \left( -k (r), -k (r), -\nabla_s m (r) + m (r) k (r) \right)
$$

$$
\times \left( \frac{\mathbb{E}_\eta [TY \mid S = s]}{\mathbb{E}_\eta [(1-T)Y \mid S = s]} \right) f_s (s; \eta) \, ds
$$

$$
= \mathbb{E}_\eta \left[ v_1 (R) d_s (S) \{ 1, T, TY, -(1-T) Y \} \right],
$$

where the second equality follows from the fact that $f_T \mid S (t; s; \eta) = s^t (1-s)^{1-t}$ does not depend on $\eta$ and

$$
v_1 (r) = \{-\nabla_s m (r) + m (r) k (r), 0, -k (r), -k (r) \}.
$$

To evaluate the second term of (33) we use integration by parts (with $u (r) = f_0 (r) b_0 (r)'$ and $v (r) = h (r; \eta)$) to obtain a representation directly in terms of $h (r; \eta)$. As in our analysis of $\beta^{\text{lasso}}$ above we use the fact that $b_0 (r)$ and $h (r; \eta)$ vary in $s$ alone, as well as the density factorization $f_0 (r) = s^{\nu_1 (1-s)^{1-\nu_1}} f_0 (s)$, to get

$$
\mathbb{E} \left[ \nabla_s h (R; \eta) b_0 (R) \right] = 0 - \int \nabla_s \left[ f_0 (s) b_0 (r) \right] h (r; \eta) \, ds
$$

$$
= \mathbb{E}_\eta \left[ v_2 (R) d_s (S) \{ 1, T, TY, -(1-T) Y \} \right],
$$

with

$$
v_2 (r) = \{ \nabla_s m (r), 0, 0, 0 \}.
$$

This follows from the fact that

$$
\nabla_s \left[ f_0 (s) b_0 (r) \right]' = \nabla_s \left[ d_s (s) (1, 1, -m (s))' \right]
$$

$$
= d_s (0, 0, -\nabla_s m (s)''.
$$
Evaluating the expectation of the third term in (33) gives

$$E \left[ c_0 \left( R \right)^T h \left( R, \eta \right) \right] = - \int \frac{d_n \left( s \right)}{f_S \left( s \right)} \left( \frac{1}{s^2} - \frac{1}{1 - s} - \left[ m_H \left( s \right) - m_L \left( s \right) \right] \right)$$

$$\times \left( \frac{f_S \left( s; \eta \right) s m_H \left( s; \eta \right)}{f_S \left( s; \eta \right)} \left( 1 - s \right) m_L \left( s; \eta \right) \right) f_S \left( s; \eta \right) ds$$

$$= - \int \frac{d_n \left( s \right)}{f_S \left( s \right)} \left( \frac{1}{s^2} - \frac{1}{1 - s} - \left[ m_H \left( s \right) - m_L \left( s \right) \right] \right)$$

$$\times \left( \frac{E_0 \left[ \left( 1 - T \right) Y \right] S = s}{1} \right) f_S \left( s; \eta \right) ds$$

$$= E_0 \left[ v_3 \left( R \right) d_n \left( S \right) \left( 1, T, TY, \left( 1 - T \right) Y \right)^T \right],$$

with

$$v_3 \left( r \right) = \left\{ m_H \left( s \right) - m_L \left( s \right), 0, -\frac{1}{s}, -\frac{1}{1 - s} \right\}. $$

Together these calculations suggest a correction term of the form

$$\delta^{\text{ase}} \left( z \right) = - d_n \left( s \right) \nabla_s f_S \left( s \right) \left( y - m \left( s \right) \right)$$

$$- d_n \left( s \right) \left[ \left\{ \left( \frac{1}{s} \right) y - m_H \left( s \right) \right\} - \left\{ \left( \frac{1}{1 - s} \right) y - m_L \left( s \right) \right\} \right]$$

(34)

as claimed.

C.5 Influence function derivation for $\beta^{\text{lsie}}$ [THIS DERIVATION NEEDS TO BE CORRECTED]

The local segregation inequality effect (LSIE) is given by

$$\beta^{\text{lsie}}_0 = \beta^{\text{lsie}}_H - \beta^{\text{lsie}}_L$$

where

$$\beta^{\text{lsie}}_H = E \left[ \frac{1}{P_H} \left\{ m_H \left( S, N \right) + S \nabla_s m_H \left( S, N \right) \right\} \left( S - p_H \right) \right]$$

$$= E \left[ \frac{1}{h_{40} \left( R \right)} \left( \frac{h_{10} \left( R \right)}{Sh_{30} \left( R \right)} + S \nabla_s \left\{ \frac{h_{10} \left( R \right)}{Sh_{30} \left( R \right)} \right\} \right) \left( S - h_{40} \left( R \right) \right) \right]$$

and

$$\beta^{\text{lsie}}_L = E \left[ \frac{1}{1 - p_H} \left\{ -m_L \left( S, N \right) + \left( 1 - S \right) \nabla_s m_L \left( S, N \right) \right\} \left( S - p_H \right) \right]$$

$$= E \left[ \frac{1}{1 - h_{40} \left( R \right)} \left( - \frac{h_{20} \left( R \right)}{1 - h_{30} \left( R \right)} + \left( 1 - S \right) \nabla_s \left\{ \frac{h_{20} \left( R \right)}{1 - h_{30} \left( R \right)} \right\} \right) \left( S - h_{40} \left( R \right) \right) \right],$$

with $h \left( r \right) = \left( h_1 \left( r \right), h_2 \left( r \right), h_3 \left( r \right), h_4 \left( r \right) \right)'$ as defined in (27) above.
We begin by analyzing the first component of the estimand, \( \beta^{\text{true}}_H \). Linearizing the moment defining \( \beta^{\text{true}}_H \) we get

\[
\Psi (r, h (r) - h_0 (r)) = \left\{ \frac{1}{f_{S,N}(s,n)} s - \frac{p_H}{p_H} h_1 (r) - \frac{1}{f_{S,N}(s,n)} s - \frac{p_H}{p_H} m_H (s, n), \frac{1}{f_{S,N}(s,n)} s - \frac{p_H}{p_H} m_H (s, n) - \frac{s^2}{p_H^2} \nabla_s m_H (s, n) \right\}
\]

Taking the expectation of the first component of \( \Psi (R, h (R; \eta)) \) yields

\[
\frac{s}{p_H} \nabla_s \left\{ \frac{1}{f_{S,N}(s,n)} s - \frac{p_H}{p_H} \left( h_1 (r) - h_0 (r) \right) \right\} (s - p_H) = \nabla_s \left( \frac{h_1 (r)}{h_3 (r)} \right) \left[ \frac{s}{p_H} \left( \frac{1}{f_{S,N}(s,n)} s - \frac{1}{s} m_H (s, n) \right) \right] + \left( \frac{s}{p_H} \frac{f_{S,N}(s,n)}{s} \right) \left( 1 - \frac{1}{s - k(r)}, k(r) s m_H (s, n) - s \nabla_s m_H (s, n) \right) \right,
\]

where

\[
k(r) = \frac{\nabla_s f_{S,N}(s,n)}{f_{S,N}(s,n)}.
\]

Collecting terms allows us to write

\[
\Psi (r, h (r)) = a_0 (r) h (r) + \nabla_s h (r) b_0 (r),
\]

with

\[
a_0 (r) = \left\{ \frac{1}{f_{S,N}(s,n)} s - \frac{p_H}{p_H} k(r), 0, \frac{1}{f_{S,N}(s,n)} s - \frac{p_H}{p_H} [-m_H (s, n) + sk(r) m_H (s, n) - s \nabla_s m_H (s, n)], \frac{s - \frac{p_H}{p_H} m_H (s, n) - \frac{s^2}{p_H^2} \nabla_s m_H (s, n)}{f_{S,N}(s,n)} \right\},
\]

\[
b_0 (r) = \frac{1}{f_{S,N}(s,n)} s - \frac{p_H}{p_H} \left\{ 1, 0, -sm_H (s, n), 0 \right\}.
\]

Taking the expectation of the first component of \( \Psi (R, h (R; \eta)) \) yields

\[
\mathbb{E} [a_0 (R) h (R; \eta)]
\]

\[
= \int \sum_{t=0,1} \left\{ \frac{1}{f_{S,N}(s,n)} s - \frac{p_H}{p_H} k(r), \frac{1}{f_{S,N}(s,n)} s - \frac{p_H}{p_H} [-m_H (s, n) + sk(r) m_H (s, n) - s \nabla_s m_H (s, n)], \frac{s - \frac{p_H}{p_H} m_H (s, n) - \frac{s^2}{p_H^2} \nabla_s m_H (s, n)}{f_{S,N}(s,n)} \right\}
\]

\[
\times f_{S,N}(s,n; \eta) \mathbb{E}_0 [TY | S = s, N = n] f_{S,N}(s,n; \eta) \mathbb{E}_0 [TY | S = s, N = n] s^t (1 - s)^{1-t} f_{S,N}(s,n; \eta) dsdn,
\]

\[
= \int \left\{ \frac{s - \frac{p_H}{p_H} m_H (s, n) - \frac{s^2}{p_H^2} \nabla_s m_H (s, n)}{f_{S,N}(s,n; \eta)} \right\}
\]

\[
\times \left( \mathbb{E}_0 [TY | S = s, N = n] f_{S,N}(s,n; \eta) \right) \mathbb{E}_0 [v_1 (R) \{ 1, T, TY, (1 - T) Y \}],
\]

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where

\[ v_1 (r) = \begin{cases} \frac{s - ph}{pH} \left[ -m_H (s, n) + sk (r) m_H (s, n) - s \nabla_s m_H (s, n) \right], \\
- \mathbb{E} \left[ \frac{S - ph}{pH} m_H (S, N) + \frac{S^2}{pH} \nabla_s m_H (S, N) \right], \frac{s - ph}{pH} k (r), 0 \end{cases}. \]

To take the expectation of the second component of \( \Psi (r, h (r)) \) we use integration by parts:

\[ \mathbb{E} \left[ \nabla_s h (R; \eta) \right] b_0 (R) = \int f_0 (r) b_0 (r) \left[ \nabla_s h (r; \eta) \right] dr = f_0 (r) b_0 (r) h (r; \eta) - \int \nabla_s \left[ f_0 (r) b_0 (r) \right] h (r; \eta) dr = 0 - \int \nabla_s \left[ f_0 (r) b_0 (r) \right] h (r; \eta) dr = \mathbb{E}_\eta \left[ v_2 (R) \right] (1, T, TY, (1 - T) Y) \]

with

\[ v_2 (r) = \frac{s - ph}{pH} \left[ m_H (s, n) + s \nabla_s m_H (s, n), 0, 0, 0 \right] + \frac{1}{pH} \{ s m_H (s, n), 0, -1, 0 \}. \]

This follows from the fact that

\[ \nabla_s \left[ f_0 (r) b_0 (r) \right] = \nabla_s \left[ s^t (1 - s)^{1-t} f_{S,N} (s, n) \frac{1}{f_{S,N} (s, n)} \frac{s - ph}{pH} \{ 1, 0, -s m_H (s, n), 0 \} \right] = \nabla_s \left[ s^t (1 - s)^{1-t} \frac{s - ph}{pH} \{ 1, 0, -s m_H (s, n), 0 \} \right] = s^t (1 - s)^{1-t} \frac{s - ph}{pH} \{ 0, 0, -m_H (s, n) - s \nabla_s m_H (s, n), 0 \} \]

and also that

\[ \frac{1}{pH} \sum_{t=0}^1 (s - ph) \frac{t - s}{s (1 - s)} s^t (1 - s)^{1-t} + s^t (1 - s)^{1-t} = \frac{1}{pH}. \]

The correction term portion of the efficient influence function will take the form \( \delta_{L}^{\text{bias}} (z) = \delta_{H}^{\text{bias}} (z) - \delta_{L}^{\text{bias}} (z) \). The forms for \( v_1 (r) \) and \( v_2 (r) \) given above suggest that

\[ \delta_{H}^{\text{bias}} (z) = -\frac{1}{pH} \frac{\nabla_s f_{S,N} (s, n)}{f_{S,N} (s, n)} (ty - sm_H (s, n)) (s - ph) \]

\[ - \frac{1}{pH} (ty - sm_H (s, n)) \]

\[ - \mathbb{E} \left[ \frac{S - ph}{pH} m_H (S, N) + \frac{S^2}{pH} \nabla_s m_H (S, N) \right] (t - ph). \]

The second part of the correction term, \( \delta_{L}^{\text{bias}} (z) \), can be derived similarly to the first. This derivation, which is omitted, yields

\[ \delta_{L}^{\text{bias}} (z) = -\frac{1}{pH} \frac{\nabla_s f_{S,N} (s, n)}{f_{S,N} (s, n)} ((1 - t) y - (1 - s) m_L (s, n)) (s - ph) \]

\[ - \frac{1}{pH} ((1 - t) y - (1 - s) m_L (s, n)) \]

\[ - \mathbb{E} \left[ \frac{S - ph}{(1 - ph)^2} m_L (S, N) + \left( \frac{1 - S}{1 - ph} \right)^2 \nabla_s m_L (S, N) \right] (t - ph). \]
and hence $\delta(z) = \delta_H(z) - \delta_L(z)$ equal to

$$
\delta^{\text{hie}}(z) = \delta_H^{\text{hie}}(z) - \delta_L^{\text{hie}}(z)
\quad = - \frac{1}{p_H} \frac{\nabla_s f_{S,N}(s,n)}{f_{S,N}(s,n)} (ty - sm_H(s,n)) (s - p_H) \\
+ \frac{1}{1 - p_H} \frac{\nabla_s f_{S,N}(s,n)}{f_{S,N}(s,n)} ((1 - t)y - (1 - s)m_L(s,n)) (s - p_H) \\
- \frac{1}{p_H} (ty - sm_H(s,n)) + \frac{1}{1 - p_H} ((1 - t)y - (1 - s)m_L(s,n)) \\
- E \left[ \frac{s - p_H}{p_H} m_H(S,N) + \left( \frac{S}{p_H} \right)^2 \nabla_s m_H(S,N) \right] (t - p_H) \\
+ E \left[ \frac{s - p_H}{1 - p_H} m_L(S,N) + \left( \frac{1 - S}{1 - p_H} \right)^2 \nabla_s m_L(S,N) \right] (t - p_H),
$$

as claimed.

References


