# Determining Individual or Time Effects in Panel Data Models* 

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#### Abstract

In this paper we propose a jackknife method to determine individual and time effects in linear panel data models. We first show that when both the serial and cross-sectional correlation among the idiosyncratic error terms are weak, our jackknife method can pick up the correct model with probability approaching one (w.p.a.1). In the presence of moderate or strong degree of serial correlation, we modify our jackknife criterion function and show that the modified jackknife method can also select the correct model w.p.a.1. We conduct Monte Carlo simulations to show that our new methods perform remarkably well in finite samples. We apply our methods to study ( $i$ ) the crime rates in North Carolina, (ii) the determinants of saving rates across countries, and (iii) the relationship between guns and crime rates in the U.S.


Key words: Consistency, Cross-validation, Dynamic panel, Information Criterion, Jackknife, Individual effect, Time effect.

JEL Classification: C23, C33, C51, C52.

[^0]
## 1 Introduction

Individual effects and time effects are often used in panel data models to model unobserved individual or time heterogeneity (see, e.g., Arellano (2003), Baltagi (2013), Hsiao (2014), and Wooldridge (2010) for a review on panel data models). The goal of this paper is to provide practical methods to determine whether to include individual effects, time effects, both, or neither in linear panel data models. Specifically, we consider the following four models:

$$
\begin{array}{ll}
\text { Model 1: } & y_{i t}=\beta^{\prime} x_{i t}+u_{i t}, \\
\text { Model 2: } & y_{i t}=\beta^{\prime} x_{i t}+\alpha_{i}+u_{i t}, \\
\text { Model 3: } & y_{i t}=\beta^{\prime} x_{i t}+\lambda_{t}+u_{i t}, \\
\text { Model 4: } & y_{i t}=\beta^{\prime} x_{i t}+\alpha_{i}+\lambda_{t}+u_{i t},
\end{array}
$$

where $i=1, \ldots, N, t=1, \ldots, T, x_{i t}$ is a $k \times 1$ vector of regressors that may include lagged dependent variables, $\alpha_{i}$ is an individual effect, $\lambda_{t}$ is a time effect, and $u_{i t}$ is an idiosyncratic error term. We will treat $\alpha_{i}$ 's and $\lambda_{t}$ 's as fixed parameters to be estimated despite the fact they can be either fixed effects or random effects for our purpose. For clarity, we assume that $x_{i t}$ contains the constant term in all models and impose restrictions on $\alpha_{i}$ or/and $\lambda_{t}$ in Models 2-4 to achieve identification for the individual or time effects. Specifically, we assume that

$$
\begin{align*}
& \sum_{i=1}^{N} \alpha_{i}=0 \text { in Model } 2,  \tag{1.1}\\
& \sum_{t=1}^{T} \lambda_{t}=0 \text { in Model 3, and }  \tag{1.2}\\
& \sum_{i=1}^{N} \alpha_{i}=0 \text { and } \sum_{t=1}^{T} \lambda_{t}=0 \text { in Model } 4 . \tag{1.3}
\end{align*}
$$

The above identification restrictions greatly facilitate the asymptotic analysis in this paper and make it straightforward to extend the methodology developed here to multi-dimensional panel data models. ${ }^{1}$

There are two main motivations for model selection in the above panel setup. First, we usually can achieve a small mean squared error (MSE) for the estimators of parameters of interest based on the true model, as shown in our simulation results in Section 3 (see Tables 4A and 4C). Therefore it is desirable to use the true model for point estimation and inference. In our simulations, we also show that the MSEs based on the selected model are usually smaller than those based on a single fixed model by ignoring the true underlying data generating process (DGP). Second, sometimes we may

[^1]be interested in knowing whether the individual/time effects are present, as these effects represent the unobservable heterogeneity and may have economic meaning. For example, in the wage equation where $y_{i t}$ is the hourly wage and $x_{i t}$ contains variables such as education and working experience, among others, the individual effects may be thought of as individual's unobservable ability. We may be interested in knowing whether the "ability" variable enters the wage equation.

We propose a jackknife or leave-one-out cross-validation (CV) method to select the correct model. ${ }^{2}$ There are several advantages of our jackknife method in the context of determining fixed effects. First, the new method is general and easy to implement. It does not require the choice of any tuning parameter. In all information-criterion-based methods, there is an implicit tuning parameter (e.g., a Bayesian information criterion (BIC) specifies the penalty term to be proportional to $\ln (N T) /(N T)$, which works as a tuning parameter). There, to show the consistency of model selection, we often have the flexibility of choosing alternative tuning parameters. For the procedure based on hypothesis testing as discussed below, we need to choose the sequence of testing and the nominal level, which are difficulty to choose in practice. Second, we assume that the cross-section dimension $(N)$ and time dimension ( $T$ ) pass to infinity simultaneously but allow the relative rate between $N$ and $T$ to be arbitrary. For example, $T$ can be much slower than $N$ such as $T \asymp \ln (N)$. Although our method requires a relatively large $T$ for the asymptotic analysis, it can be applied to the case in micro-econometrics where $T$ is much smaller than $N$. Third, our CV method can be applied to both static and dynamic panel models. We show that when serial correlation and cross-sectional dependence in the error term are absent or weak, our CV method can choose the correct model with probability approaching one (w.p.a.1). ${ }^{3}$ Fourth, we propose a modified CV method that is robust to strong serial correlation in the static panel models. We show that the modified CV can select the correct model w.p.a.1. in the presence of strong serial correlation. Fifth, our jackknife method can be easily extended to nonlinear panels and to multi-level panels where the determination of different fixed effects is also imperative. Sixth, in our simulations, we show that our jackknife outperforms other competing methods, such as AIC and BIC in the absence of serial correlation in the error terms. In the presence of strong serial correlation, only our modified jackknife works well and other methods, such as jackknife, AIC and BIC, all break down.

In the literature, there exist several tests for testing for the presence of fixed effects in two

[^2]dimensional panel data models. Most of the tests focus on short static panel models. Let $\sigma_{\alpha}^{2}$ and $\sigma_{\lambda}^{2}$ be the variances of $\alpha_{i}$ and $\lambda_{t}$, respectively. Under the normality assumption, Breusch and Pagan (1980, BP hereafter) propose a Lagrange multiplier (LM) test for testing the null hypothesis: $H_{01}: \sigma_{\alpha}^{2}=0$ and $\sigma_{\lambda}^{2}=0$. The BP test can also be applied to test the null hypotheses that $H_{02}: \sigma_{\alpha}^{2}=0$ (assuming $\sigma_{\lambda}^{2}=0$ ) and that $H_{03}: \sigma_{\lambda}^{2}=0$ (assuming $\sigma_{\alpha}^{2}=0$ ) (see, e.g., Baltagi, 2013 for a discussion). Honda (1985) shows that BP test is actually robust to the non-normality and also modifies the test to a one-sided test. Baltagi, Chang and Li (1992, BCL hereafter) modify the one-side test based on the results of Gourieroux, Holly and Monfort (1982). BCL also propose conditional LM tests for testing $H_{04}: \sigma_{\alpha}^{2}=0$ (allowing $\sigma_{\lambda}^{2}>0$ ) and $H_{05}: \sigma_{\lambda}^{2}=0$ (allowing $\sigma_{\alpha}^{2}>0$ ). Moulton and Randolph (1989) consider the ANOVA F-test. All the tests discussed above assume that the error terms $\left\{u_{i t}, t=1, \ldots, T\right\}$ are not serially correlated. Bera, Sosa-Escudero, and Yoon (2001) propose an LM test that allows serial correlation in the error term. Recently, Wu and Li (2014) propose Hausman-type tests for testing $H_{01}, H_{04}$ and $H_{05}$ by comparing the variances of the error terms at different robust levels. Wu and Zhu (2012) extend the Hausman-type tests to short dynamic panel models.

Potentially, these tests can be used to determine the correct model. For example, we can test $H_{01}, H_{04}$, and $H_{05}$ sequentially. However, there are several limitations of the approach based on the hypothesis testing. First, to determine the correct model, three separate tests need to be implemented sequentially. This involves the multiple testing issue and it is unclear how to choose an appropriate nominal level. ${ }^{4}$ In addition, in finite samples, it could occur that $H_{01}$ is rejected, while neither $H_{04}$ nor $H_{05}$ is rejected, in which case it is difficult to decide the correct model. Second, the existing tests are designed for short panels (i.e., $T$ is fixed), and it is unclear how the tests behave when $T$ also goes to infinity. We consider large panels where $N$ and $T$ go to infinity simultaneously and we allow the relative rates of $N$ and $T$ to be arbitrary. Third, except Wu and Zhu (2012), most existing tests do not apply to dynamic panel models, i.e., the regressors cannot contain any lagged dependent variables.

Alternatively, we can consider certain information criteria (IC) such as AIC and BIC. However, to the best of our knowledge, there is no theoretical analysis of AIC or BIC in the context of determining fixed effects in panel data. When all four models are allowed, a careful analysis indicates that AIC is always inconsistent and BIC is consistent in the special case where $N$ and $T$ pass to infinity at the same rate. In Monte Carlo simulations we compare our jackknife method with AIC and BIC, and find that our jackknife method generally outperforms this IC-based approach.

In this paper, we only focus on the consistency of model selection and do not address the issue

[^3]of post-selection inference. As is well known in the literature, usually post-selection inference is not uniformly valid (see, e.g., Leeb and Pötscher (2005)). This is a general and challenging question in the model selection literature. Despite its importance, it is beyond the scope of this paper to provide a thorough theory on uniform inference.

The rest of the paper is structured as follows. In Section 2, we propose the jackknife and the modified jackknife method and study their asymptotic properties. Section 3 reports Monte Carlo simulation results and compares our new methods with IC-based methods for both static and dynamic panel data generating processes. In Section 4, we provide three empirical applications. In the first application, we study the crime rates in North Carolina and find that Model 4 is the correct model. The second application is about the determinants of saving rates across countries and our methods select Model 2. In the third application, we investigate the relationship between guns and crime rates in the U.S. and we determine that Model 4 is the correct model. Section 5 concludes. The proofs of the main results and some additional results are relegated to the online supplement.

Notation. For an $m \times n$ real matrix $A$, we denote its transpose as $A^{\prime}$ and its Frobenius norm as $\|A\|$ $\left(\equiv\left[\operatorname{tr}\left(A A^{\prime}\right)\right]^{1 / 2}\right)$ where $\equiv$ means "is defined as". Let $P_{A} \equiv A\left(A^{\prime} A\right)^{-1} A^{\prime}$ and $M_{A} \equiv I_{m}-P_{A}$, where $I_{m}$ denotes an $m \times m$ identity matrix. When $A=\left\{a_{i j}\right\}$ is symmetric, we use $\lambda_{\max }(A)$ and $\lambda_{\min }(A)$ to denote its maximum and minimum eigenvalues, respectively. The operator $\xrightarrow{P}$ denotes convergence in probability. We use $(N, T) \rightarrow \infty$ to denote that $N$ and $T$ pass to infinity simultaneously.

## 2 Methodology and Asymptotic Theory

In this section, we first introduce the jackknife method to determine individual or time effects in panel data models and then study the consistency of our jackknife estimator. To allow for strong degree of serial correlation we also propose a modified jackknife criterion function and justify its asymptotic validity.

### 2.1 Methodology

Let $x_{i}=\left(x_{i 1}, \ldots, x_{i T}\right)^{\prime}$ and $X=\left(x_{1}^{\prime}, \ldots, x_{N}^{\prime}\right)^{\prime}$. Define $y_{i}, u_{i}, Y$, and $U$ analogously. To facilitate the presentation, we define the following dummy matrices:

$$
D_{\alpha}=\binom{I_{N-1}}{-\iota_{N-1}^{\prime}} \otimes \iota_{T}, D_{\lambda}=\iota_{N} \otimes\binom{I_{T-1}}{-\iota_{T-1}^{\prime}}, \text { and } D_{\alpha \lambda}=\left(D_{\alpha}, D_{\lambda}\right),
$$

where $\iota_{a}$ is an $a \times 1$ vector of ones for any integer $a \geq 1$. To unify the notation, we write

$$
X^{(1)}=X, X^{(2)}=\left(X, D_{\alpha}\right), X^{(3)}=\left(X, D_{\lambda}\right), \text { and } X^{(4)}=\left(X, D_{\alpha}, D_{\lambda}\right) .
$$

We use $x_{i t}^{(m) \prime}$ to denote a typical row of $X^{(m)}$ such that $X^{(m)}=\left(x_{11}^{(m)}, \ldots, x_{1 T}^{(m)}, \ldots, x_{N 1}^{(m)}, \ldots, x_{N T}^{(m)}\right)^{\prime}$ for $m=1,2,3,4$. Similarly, we use $d_{\alpha, i t}^{\prime}, d_{\lambda, i t}^{\prime}$, and $d_{\alpha \lambda, i t}^{\prime}$ to denote a typical row of $D_{\alpha}, D_{\lambda}$, and $D_{\alpha \lambda}$, respectively. Then we can rewrite Models 1-4 as follows:

$$
\begin{array}{ll}
\text { Model 1: } & y_{i t}=\beta^{\prime} x_{i t}+u_{i t} \equiv \beta^{(1) \prime} x_{i t}^{(1)}+u_{i t}, \\
\text { Model 2: } & y_{i t}=\beta^{\prime} x_{i t}+\underline{\alpha}^{\prime} d_{\alpha, i t}+u_{i t} \equiv \beta^{(2)} x_{i t}^{(2)}+u_{i t}, \\
\text { Model 3: } & y_{i t}=\beta^{\prime} x_{i t}+\underline{\lambda}^{\prime} d_{\lambda, i t}+u_{i t} \equiv \beta^{(3) \prime} x_{i t}^{(3)}+u_{i t}, \\
\text { Model 4: } & y_{i t}=\beta^{\prime} x_{i t}+\underline{\alpha}^{\prime} d_{\alpha, i t}+\underline{\lambda}^{\prime} d_{\lambda, i t}+u_{i t} \equiv \beta^{(4)} x_{i t}^{(4)}+u_{i t},
\end{array}
$$

where $\underline{\alpha}=\left(\alpha_{1}, \ldots, \alpha_{N-1}\right)^{\prime}, \underline{\lambda}=\left(\lambda_{1}, \ldots, \lambda_{T-1}\right)^{\prime}, \beta^{(1)}=\beta, \beta^{(2)}=\left(\beta^{\prime}, \underline{\alpha}^{\prime}\right)^{\prime}, \beta^{(3)}=\left(\beta^{\prime}, \underline{\lambda}^{\prime}\right)^{\prime}$, and $\beta^{(4)}=\left(\beta^{\prime}, \underline{\alpha}^{\prime}, \underline{\lambda}^{\prime}\right)^{\prime}$. Note that we have imposed the identification conditions in (1.1)-(1.3) for Models $2-4$ in the above representation. In matrix notation, we can write these models simply as

$$
\begin{array}{ll}
\text { Model 1: } & Y=X \beta+U=X^{(1)} \beta^{(1)}+U, \\
\text { Model 2: } & Y=X \beta+D_{\alpha} \underline{\alpha}+U=X^{(2)} \beta^{(2)}+U, \\
\text { Model 3: } & Y=X \beta+D_{\lambda} \underline{\lambda}+U=X^{(3)} \beta^{(3)}+U, \\
\text { Model 4: } & Y=X \beta+D_{\alpha} \underline{\alpha}+D_{\lambda} \underline{\lambda}+U=X^{(4)} \beta^{(4)}+U .
\end{array}
$$

Note that Model 1 is nested in Models 2-4, both Models 2 and 3 are nested in Model 4, and $D_{\alpha}^{\prime} D_{\lambda}=0$. These observations greatly simplify the asymptotic analysis in this paper.

### 2.1.1 Jackknife without bias correction

The OLS estimator of $\beta^{(m)}$ based on all observations $\left\{\left(y_{i t}, x_{i t}^{(m)}\right): 1 \leq i \leq N, 1 \leq t \leq T\right\}$ is given by

$$
\begin{equation*}
\hat{\beta}^{(m)}=\left(X^{(m)^{\prime}} X^{(m)}\right)^{-1} X^{(m) \prime} Y \text { for } m=1,2,3,4 . \tag{2.1}
\end{equation*}
$$

We also consider the leave-one-out estimator of $\beta^{(m)}$ with the $(i, t)$ th observation deleted:

$$
\begin{equation*}
\hat{\beta}_{i t}^{(m)}=\left(X^{(m)^{\prime}} X^{(m)}-x_{i t}^{(m)} x_{i t}^{(m)^{\prime}}\right)^{-1}\left(X^{(m) \prime} Y-x_{i t}^{(m)} y_{i t}\right) \text { for } m=1,2,3,4, \tag{2.2}
\end{equation*}
$$

where $i=1, \ldots, N, t=1, \ldots, T$. Define the out-of-sample predicted value of $y_{i t}$ as $\hat{y}_{i t}^{(m)}=\hat{\beta}_{i t}^{(m) \prime} x_{i t}^{(m)}$. Our jackknife method is based on the following leave-one-out CV function

$$
\begin{equation*}
C V(m)=\frac{1}{N T} \sum_{t=1}^{T} \sum_{i=1}^{N}\left(y_{i t}-\hat{y}_{i t}^{(m)}\right)^{2} \text { for } m=1,2,3,4 . \tag{2.3}
\end{equation*}
$$

Let

$$
\begin{equation*}
\hat{m}=\underset{1 \leq m \leq 4}{\operatorname{argmin}} C V(m) . \tag{2.4}
\end{equation*}
$$

Under some regularity conditions, we will show that w.p.a.1, $\hat{m}$ is given by $m$ when Model $m$ is the true model.

### 2.1.2 Jackknife with bias correction

It is well known that when $x_{i t}$ is only sequentially exogenous, $\hat{\beta}^{(2)}$ and $\hat{\beta}^{(4)}$ and their jackknife versions are asymptotically biased because of the presence of the individual fixed effects in Models 2 and 4. It is worthwhile to examine the jackknife method when we construct the out-of-sample predicted value based on the bias-corrected versions of the parameter estimators in Models 2 and 4.

Let $\frac{1}{T} b_{1}^{(m)}$ denote the leading asymptotic bias of the least squares dummy variable (LSDV) estimator of $\beta$ in Model $m$. It is well known that $b_{1}^{(m)}=0$ for Models 1 and 3 and $b_{1}^{(m)}$ is $O(1)$ for Models 2 and 4. Therefore, there is no need for bias correction in Models 1 and 3 and we focus on the bias correction in Models 2 and 4. Let $\hat{b}_{1}^{(m)}$ denote an estimator of $b_{1}^{(m)}$ in Model $m$ for $m=2,4$. For example, $\hat{b}_{1}^{(m)}$ can be obtained by the half-panel jackknife method of Dhaene and Jochmans (2015). See Arellano and Hahn (2007) and Fernandez-Val and Weidner (2018) for a review. In the following study, we consider two scenarios for the bias estimator: (1) $\hat{b}_{1}^{(m)}=O_{P}(1)$ for $m=2,4$, and (2) $\hat{b}_{1}^{(m)}=O_{P}(1)$ and $\sqrt{N T} \frac{1}{T}\left(\hat{b}_{1}^{(m)}-b_{1}^{(m)}\right)=o_{P}(1)$ for $m=2,4$. Note that Scenario (2) requires that the full correction of the bias so that it does not contribute to the asymptotic distribution. This typically puts some restrictions on the relative rates at which $N$ and $T$ pass to infinity.

To proceed, we first define the bias-corrected (BC) jackknife estimators in Models 2 and 4.
Model 2. By leaving out the $(i, t)$ th observation, the leave-one-out estimator of $\beta^{(2)}=\left(\beta^{\prime}, \underline{\alpha}^{\prime}\right)^{\prime}$ is

$$
\hat{\beta}_{i t}^{(2)} \equiv\left(\hat{\beta}_{i t, 1}^{(2) \prime}, \underline{\hat{\alpha}}_{i t}^{(2) \prime}\right)^{\prime}=\left(X^{(2) \prime} X^{(2)}-x_{i t}^{(2)} x_{i t}^{(2) \prime}\right)^{-1}\left(X^{(2) \prime} Y-x_{i t}^{(2)} y_{i t}\right)
$$

where we can also write $\underline{\hat{\alpha}}_{i t}^{(2)}$ as follows:

$$
\hat{\underline{\alpha}}_{i t}^{(2)}=\left(D_{\alpha}^{\prime} D_{\alpha}-d_{\alpha, i t} d_{\alpha, i t}^{\prime}\right)^{-1}\left[D_{\alpha}^{\prime}\left(Y-X \hat{\beta}_{i t, 1}^{(2)}\right)-d_{\alpha, i t}\left(y_{i t}-x_{i t}^{\prime} \hat{\beta}_{i t, 1}^{(2)}\right)\right]
$$

The BC version of $\hat{\beta}_{i t}^{(2)} \equiv\left(\hat{\beta}_{i t, 1}^{(2) \prime}, \underline{\hat{\alpha}}_{i t}^{(2) \prime}\right)^{\prime}$ is given by $\breve{\beta}_{i t}^{(2)} \equiv\left(\breve{\beta}_{i t, 1}^{(2) \prime}, \underline{\breve{\alpha}}_{i t}^{(2) \prime}\right)^{\prime}$, where

$$
\begin{aligned}
\breve{\beta}_{i t, 1}^{(2)} & =\hat{\beta}_{i t, 1}^{(2)}-\frac{1}{T} \hat{b}_{1}^{(2)} \\
\breve{\underline{\alpha}}_{i t}^{(2)} & =\left(D_{\alpha}^{\prime} D_{\alpha}-d_{\alpha, i t} d_{\alpha, i t}^{\prime}\right)^{-1}\left[D_{\alpha}^{\prime}\left(Y-X \breve{\beta}_{i t, 1}^{(2)}\right)-d_{\alpha, i t}\left(y_{i t}-x_{i t}^{\prime} \breve{\beta}_{i t, 1}^{(2)}\right)\right]=\hat{\alpha}_{i t}^{(2)}-\zeta_{\alpha, i t} \frac{1}{T} \hat{b}_{1}^{(2)}
\end{aligned}
$$

where $\zeta_{\alpha, i t}=\left(D_{\alpha}^{\prime} D_{\alpha}-d_{\alpha, i t} d_{\alpha, i t}^{\prime}\right)^{-1}\left[D_{\alpha}^{\prime} X-d_{\alpha, i t} x_{i t}^{\prime}\right]$. That is,

$$
\begin{equation*}
\breve{\beta}_{i t}^{(2)}=\binom{\breve{\beta}_{i t, 1}^{(2)}}{\breve{\underline{\alpha}}_{i t}^{(2)}}=\hat{\beta}_{i t}^{(2)}-\binom{I_{k}}{\zeta_{\alpha, i t}} \frac{1}{T} \hat{b}_{1}^{(2)} \equiv \hat{\beta}_{i t}^{(2)}-\vec{\beta}_{i t}^{(2)} \tag{2.5}
\end{equation*}
$$

Then the out-of-sample predictive value of $y_{i t}$ based on Model 2 is given by $\breve{y}_{i t}^{(2)}=x_{i t}^{(2) \prime} \breve{\beta}_{i t}^{(2)}$.

Model 4. Let $\underline{\gamma}=\left(\underline{\alpha}^{\prime}, \underline{\lambda}^{\prime}\right)^{\prime}$. By leaving out the $(i, t)$ th observation, the leave-1-out estimator of $\beta^{(4)}=\left(\beta^{\prime}, \underline{\gamma}^{\prime}\right)^{\prime}$ is

$$
\hat{\beta}_{i t}^{(4)} \equiv\left(\hat{\beta}_{i t, 1}^{(4) \prime}, \hat{\gamma}_{i t}^{(4) \prime}\right)^{\prime}=\left(X^{(4) \prime} X^{(4)}-x_{i t}^{(4)} x_{i t}^{(4) \prime}\right)^{-1}\left(X^{(4) \prime} Y-x_{i t}^{(4)} y_{i t}\right),
$$

where we can also write $\hat{\hat{\gamma}}_{i t}^{(4)}=\left(\underline{\hat{\alpha}}_{i t}^{(4) \prime}, \underline{\hat{\lambda}}_{i t}^{(4) \prime}\right)^{\prime}$ as follows:

$$
\hat{\underline{\gamma}}_{i t}^{(4)}=\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}-d_{\alpha \lambda, i t} d_{\alpha \lambda, i t}^{\prime}\right)^{-1}\left[D_{\alpha \lambda}^{\prime}\left(Y-X \hat{\beta}_{i t, 1}^{(4)}\right)-d_{\alpha \lambda, i t}\left(y_{i t}-x_{i t}^{\prime} \hat{\beta}_{i t, 1}^{(4)}\right)\right] .
$$

The BC version of $\hat{\beta}_{i t}^{(4)} \equiv\left(\hat{\beta}_{i t, 1}^{(4) \prime}, \hat{\gamma}_{i t}^{(4) \prime}\right)^{\prime}$ is given by $\breve{\beta}_{i t}^{(4)} \equiv\left(\breve{\beta}_{i t, 1}^{(4) \prime}, \breve{\gamma}_{i t}^{(4) \prime}\right)^{\prime}$, where
$\breve{\beta}_{i t, 1}^{(4)}=\hat{\beta}_{i t, 1}^{(4)}-\frac{1}{T} \hat{b}_{1}^{(4)}$,
$\breve{\underline{\gamma}}_{i t}^{(4)}=\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}-d_{\alpha \lambda, i t} d_{\alpha \lambda, i t}^{\prime}\right)^{-1}\left[D_{\alpha \lambda}^{\prime}\left(Y-X \breve{\beta}_{i t, 1}^{(4)}\right)-d_{\alpha \lambda, i t}\left(y_{i t}-x_{i t}^{\prime} \breve{\beta}_{i t, 1}^{(4)}\right)\right]=\hat{\hat{\gamma}}_{i t}^{(4)}-\zeta_{\alpha \lambda, i t} \frac{1}{T} \hat{b}_{1}^{(4)}$,
where $\zeta_{\alpha \lambda, i t}=\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}-d_{\alpha \lambda, i t} d_{\alpha \lambda, i t}^{\prime}\right)^{-1}\left[D_{\alpha \lambda}^{\prime} X-d_{\alpha \lambda, i t} x_{i t]}^{\prime}\right]$. That is,

$$
\begin{equation*}
\breve{\beta}_{i t}^{(4)}=\binom{\breve{\beta}_{i t, 1}^{(4)}}{\breve{\underline{q}}_{i t}^{(4)}}=\hat{\beta}_{i t}^{(4)}-\binom{I_{k}}{\zeta_{\alpha \lambda, i t}} \frac{1}{T} \hat{b}_{1}^{(4)} \equiv \hat{\beta}_{i t}^{(4)}-\vec{\beta}_{i t}^{(4)} . \tag{2.6}
\end{equation*}
$$

Then the out-of-sample predictive value of $y_{i t}$ based on Model 4 is given by $\breve{y}_{i t}^{(4)}=x_{i t}^{(4)} \breve{\beta}_{i t}^{(4)}$.
In the above procedure, we correct $\hat{\beta}_{i t}^{(m)}$ for the same bias estimator $\frac{1}{T} \hat{b}_{1}^{(m)}$ for simplicity as all of these $N T$ jackknife estimates differ only in one observation. Based on the BC version $\breve{\beta}_{i t, 1}^{(m)}$ of $\hat{\beta}_{i t, 1}^{(m)}$, we obtain the updated estimators of the fixed effects in Model $m=2,4$.

For Models 1 and 3 with $m=1,3$, we can define $\breve{\beta}_{i t}^{(m)}=\hat{\beta}_{i t}^{(m)}$ and the corresponding out-of-sample prediction of $y_{i t}$ is given by $\breve{y}_{i t}^{(m)}=x_{i t}^{(m)} \breve{\beta}_{i t}^{(m)}$. The "bias-corrected" jackknife (or CV) objective function for Model $m$ is then given by

$$
\begin{equation*}
C V^{b c}(m)=\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(y_{i t}-\breve{y}_{i t}^{(m)}\right)^{2} . \tag{2.7}
\end{equation*}
$$

Let

$$
\begin{equation*}
\breve{m}=\underset{1 \leq m \leq 4}{\operatorname{argmin}} C V^{b c}(m) . \tag{2.8}
\end{equation*}
$$

Under some regularity conditions, we will show that w.p.a.1, $\breve{m}$ is given by $m$ when Model $m$ is the true model.

Remark 1. In panel data models, when the regressors are not strictly exogenous, bias-correction is typically needed for the estimation and inference of parameters in Models 2 and 4 unless $N / T \rightarrow 0$ as $(N, T) \rightarrow \infty$. One paramount example is the dynamic panel models, although this can happen
with static panel models too. There is a large literature on the bias-correction for estimation and inference in panel data models; see Arellano and Hahn (2007) and Fernandez-Val and Weidner (2018) for a review. Here our purpose is to select the correct model consistently but not to conduct the inference. We will show that the consistency of our jackknife method does not depend on whether the parameter estimators are bias corrected (BC) or not. In fact, as it shall be clear momentarily, the asymptotic validity of the non-BC version jackknife only requires both $N$ and $T$ pass to infinity but does not restrict the relative rates at which they pass to infinity. In contrast, the BC version of jackknife shall put some rate restrictions on $N$ and $T$.

Remark 2. Here we focus on the determination of whether the individual effects, time effects, both, or neither should enter the model from the out-of-sample predictive power of these effects. Even though we treat either effects as fixed parameters to be estimated and allow them to be correlated with the regressors in $x_{i t}$, they can be either fixed effects or random effects for subsequent estimation and inference. So far, our jackknife method can only tell whether either the individual effects or time effects are present or not, but cannot tell whether they are random or fixed effects. ${ }^{5}$ Note that even in a random effects model, we have the issue of which effects should be included in the model. For example, in an experimental setting where the key regressor is randomized and random effect models are adopted, we still need to consider whether we should include individual or time effects (or both) for the efficiency consideration. Our method provides a practical solution. In a setting where it is unclear whether we should use random or fixed effects, we may implement a two-step procedure. In the first step, we apply our method to determine whether the individual or time effects should be included in the model. In the second step, we apply the Hausman-Wu type test (see, e.g., Hausman (1978) and Hausman and Taylor (1981)) to determine whether the effects are "random" or "fixed".

### 2.2 Asymptotic theory under weak serial and cross-sectional correlations

In this section we first state some basic assumptions that underline our asymptotic analysis and then study the asymptotic properties of $\hat{m}$ and $\breve{m}$.

### 2.2.1 Basic Assumptions

Let $\bar{u}_{i .}=T^{-1} \sum_{t=1}^{T} u_{i t}, \bar{u}_{\cdot t}=N^{-1} \sum_{i=1}^{N} u_{i t}$, and $\bar{u} . .=(N T)^{-1} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t}$. Let $\bar{x}_{i} ., \bar{x}_{\cdot t}$, and $\bar{x} .$. be defined analogously. Define

$$
\hat{Q}=\frac{1}{N T} X^{\prime} X \text { and } \hat{Q}_{D_{\xi}}=\frac{1}{N T} X^{\prime} M_{D_{\xi}} X \text { for } D_{\xi}=D_{\alpha}, D_{\lambda}, \text { and } D_{\alpha \lambda}
$$

[^4]Let $C$ denote a generic large positive constant whose value may vary across lines. To proceed, we make the following set of assumptions.

Assumption A.1. (i) $E\left(u_{i t}\right)=0, \max _{1 \leq i \leq N, 1 \leq t \leq T} E\left(u_{i t}^{4}\right) \leq C$, and $\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t}^{2} \xrightarrow{P} \bar{\sigma}_{u}^{2}>0$.
(ii) $\max _{1 \leq i \leq N, 1 \leq t \leq T} E\left\|x_{i t}\right\|^{4} \leq C$.
(iii) $\bar{u}$.. $=O_{P}\left((N T)^{-1 / 2}\right)$ and $\frac{1}{N T} X^{\prime} U=O_{P}\left((N T)^{-1 / 2}\right)$.
(iv) There exist positive constants $\underline{c}_{Q}$ and $\bar{c}_{Q}$ such that $P\left(\underline{c}_{Q} \leq \lambda_{\min }\left(\hat{Q}_{D_{\xi}}\right) \leq \lambda_{\max }(\hat{Q}) \leq \bar{c}_{Q}\right)$ $\rightarrow 1$ for $D_{\xi}=D_{\alpha}, D_{\lambda}$, and $D_{\alpha \lambda}$.
(v) $\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t} \alpha_{i}=o_{P}(1)$ and $\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t} \lambda_{t}=o_{P}(1)$ when Model 2, 3, or 4 is true and applicable.

Assumption A.2. (i) $\frac{T}{N} \sum_{i=1}^{N}\left(\bar{u}_{i} .\right)^{2} \xrightarrow{P} \bar{\sigma}_{u 1}^{2}>0$.
(ii) $\frac{N}{T} \sum_{t=1}^{T}\left(\bar{u}_{. t}\right)^{2} \xrightarrow{P} \bar{\sigma}_{u 2}^{2}>0$.
(iii) $\frac{1}{N} \sum_{i=1}^{N} \bar{x}_{i} \cdot \bar{u}_{i}=O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right)$.
(iv) $\frac{1}{T} \sum_{t=1}^{T} \bar{x}_{. t} \bar{u}_{. t}=O_{P}\left(N^{-1}+(N T)^{-1 / 2}\right)$.

Assumption A.3. (i) If Model 2 is the true model, there exist positive constants $c_{\alpha, X}$ and $c_{\alpha, X_{\lambda}}$ such that

$$
\begin{align*}
\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[\alpha_{i}-x_{i t}^{\prime}\left(X^{\prime} X\right)^{-1} X^{\prime} D_{\alpha} \underline{\alpha}\right]^{2} \xrightarrow{P} c_{\alpha, X} & >0, \text { and }  \tag{2.9}\\
\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[\alpha_{i}-x_{i t}^{(3) \prime}\left(X^{(3) \prime} X^{(3)}\right)^{-1} X^{(3) \prime} D_{\alpha} \underline{\alpha}\right]^{2} \xrightarrow{P} c_{\alpha, X_{\lambda}} & >0 . \tag{2.10}
\end{align*}
$$

(ii) If Model 3 is the true model, there exist positive constants $c_{\lambda, X}$ and $c_{\lambda, X_{\alpha}}$ such that

$$
\begin{align*}
\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[\lambda_{t}-x_{i t}^{\prime}\left(X^{\prime} X\right)^{-1} X^{\prime} D_{\lambda} \underline{\lambda}\right]^{2} \xrightarrow{P} c_{\lambda, X} & >0, \text { and }  \tag{2.11}\\
\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[\lambda_{t}-x_{i t}^{(2) \prime}\left(X^{(2) \prime} X^{(2)}\right)^{-1} X^{(2) \prime} D_{\lambda} \underline{\lambda}\right]^{2} \xrightarrow{P} c_{\lambda, X_{\alpha}} & >0 . \tag{2.12}
\end{align*}
$$

(iii) If Model 4 is the true model, there exist positive constants $c_{\alpha \lambda, X}, c_{\alpha, X_{\lambda}}$, and $c_{\lambda, X_{\alpha}}$ such that

$$
\begin{equation*}
\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[\alpha_{i}+\lambda_{t}-x_{i t}^{\prime}\left(X^{\prime} X\right)^{-1} X^{\prime}\left(D_{\alpha} \underline{\alpha}+D_{\lambda} \underline{\lambda}\right)\right]^{2} \xrightarrow{P} c_{\alpha \lambda, X}>0 \tag{2.13}
\end{equation*}
$$

and both (2.10) and (2.12) hold.
Assumptions A.1(i)-(ii) impose weak moment conditions on $\left\{u_{i t}\right\}$ and $\left\{x_{i t}\right\}$, which are frequently assumed in the literature. The fourth-order moment conditions on $\left\{u_{i t}\right\}$ and $\left\{x_{i t}\right\}$ imply that $\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left\|x_{i t} u_{i t}\right\|^{2}=O_{P}(1)$ and $\max _{1 \leq i \leq N, 1 \leq t \leq T}\left\|x_{i t}\right\|=O_{P}\left((N T)^{1 / 4}\right)$ by Markov and Jensen
inequalities and the union bound. Assumption A.1(iii) is also weak and commonly imposed in panel data models in the absence of endogeneity. In particular, we permit $x_{i t}$ to contain lagged dependent variables so that dynamic panel data models are allowed. Assumption A.1(iv) specifies the usual identification conditions for the OLS or fixed effects (FE) estimation of Models 1-4. For example, the condition that $\lambda_{\min }\left(\hat{Q}_{D_{\alpha}}\right)$ is bounded below from 0 requires that $x_{i t}$ should not contain any time-invariant regressor beyond a constant term; it is allowed to contain a constant term because we have imposed the identification constraint that $\sum_{i=1}^{N} \alpha_{i}=0$. Similarly, the condition that $\lambda_{\min }\left(\hat{Q}_{D_{\lambda}}\right)$ is bounded below from 0 requires that $x_{i t}$ should not contain any individual-invariant regressor beyond a constant term; it is allowed to contain a constant term because we have imposed the identification constraint that $\sum_{t=1}^{T} \lambda_{t}=0$. On the surface, this condition rules out the inclusion of any time-invariant regressor in Model 2, individual-invariant regressor in Model 3, and both types of regressors in Model 4. If $x_{i t}$ contains such regressors, they should be removed from Models 2-4 correspondingly and then we can redefine $x_{i t}^{(m)}$ for $m=2,3,4$ with such regressors removed. For example, if $x_{i t}$ contains a time-invariant regressor other than the constant term, say, $z_{i}$, then $z_{i}$ will be omitted from Models 2 and 4 in the estimation procedure, but still kept in Models 1 and 3. The omission of $z_{i}$ in Models 2 and 4 will not cause the endogenous problem, as its effect will be captured by the individual effects in Models 2 and 4, which are allowed to be correlated with the other regressors in $x_{i t}$. So the asymptotic analysis below will continue to hold. Assumption A.1(v) essentially imposes conditions on the interactions between the idiosyncratic error terms and the individual and time effects, whenever applicable, in Models 2-4. A sufficient condition for it to hold is that both $\left\{u_{i t} \alpha_{i}\right\}$ and $\left\{u_{i t} \lambda_{t}\right\}$ have zero mean and follow a version of weak law of large numbers. The zero mean condition is commonly assumed in the panel data literature. Note that we allow the individual effects $\alpha_{i}$ and time effects $\lambda_{t}$ to be random in the true model (if present) even if we treat them as fixed parameters in the estimation procedure.

Assumption A.2(i) requires that $\left\{u_{i t}, t \geq 1\right\}$ be weakly serially dependent such that $\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}$ $\sum_{s=1}^{T} E\left(u_{i t} u_{i s}\right)$ has a finite limit. For example, the latter condition is satisfied by the Davydov inequality if $\left\{u_{i t}, t \geq 1\right\}$ is strong mixing with finite $(2+\delta)$-th moment and mixing coefficients $\alpha_{i}(\cdot)$ such that $\alpha_{i}(\tau)=\tau^{-\gamma_{i}}$ with $\min _{1 \leq i \leq N} \gamma_{i}>(2+\delta) / \delta$; see, e.g., Bosq (1998, pp.19-20) or the online supplement of Su, Shi, and Phillips (2016). Similarly, Assumption A.2(ii) requires that $\left\{u_{i t}, i \geq 1\right\}$ be weakly cross-sectionally dependent such that $\frac{1}{N T} \sum_{i=1}^{N} \sum_{j=1}^{N} \sum_{t=1}^{T} E\left(u_{i t} u_{j t}\right)$ has a finite limit. Assumption A.2(iii)-(iv) can be verified under both weak serial and cross-sectional correlations by the Chebyshev inequality and it is easily met in the absence of both serial and cross-sectional correlations. In the online supplement, we demonstrate that the primitive conditions to ensure Assumption A.2(iii)(iv) are: (i) $\max _{1 \leq i \leq N} E\left\|\frac{1}{T} \sum_{t=1}^{T} \sum_{s=1}^{T} x_{i t}^{*} u_{i s}\right\|^{2} \leq C$, (ii) $\max _{1 \leq t \leq T} E\left\|\frac{1}{N} \sum_{i=1}^{N} \sum_{j=1}^{N} x_{i t}^{*} u_{j t}\right\|^{2} \leq C$, and (iii) $\frac{1}{N T} \sum_{i=1}^{N} \sum_{j=1}^{N} \sum_{t=1}^{T} \sum_{s=1}^{T}\left|E\left(u_{i t} u_{j s}\right)\right| \leq C$, where $x_{i t}^{*}=x_{i t}-E\left(x_{i t}\right)$. Analogous condi-
tions are frequently assumed in the panel data literature to control weak serial and cross-section dependence; see, e.g., Bai and Ng (2002). It is worth mentioning that $\bar{\sigma}_{u 1}^{2}=\bar{\sigma}_{u}^{2}$ if there is no serial correlation among $\left\{u_{i t}, t \geq 1\right\}$, and $\bar{\sigma}_{u 2}^{2}=\bar{\sigma}_{u}^{2}$ if there is no cross-sectional correlation among $\left\{u_{i t}, i \geq 1\right\}$. When serial correlation is present, $\bar{\sigma}_{u 1}^{2}$ is generally different from $\bar{\sigma}_{u}^{2}$; when cross-sectional correlation is present, $\bar{\sigma}_{u 2}^{2}$ is generally different from $\bar{\sigma}_{u}^{2}$.

Assumption A. 3 specifies conditions to ensure that the underfitted or misspecified models will never be chosen asymptotically. The interpretations of the conditions in (2.9)-(2.13) are easy. For example, when Model 2 is the true model, Models 1 and 3 are underfitted and misspecified, respectively. In this case, (2.9) and (2.10) require that the individual effects $\alpha_{i}$, when stacked into an $N T \times 1$ vector, should not lie in the column space spanned by the regressor matrix $X$ in Model 1 and $X^{(3)}$ in Model 3, respectively. Similarly, when Model 4 is the true model, Models 1,2 , and 3 are all underfitted. In this case, (2.13) requires that $\alpha_{i}+\lambda_{t}$, when stacked into an $N T \times 1$ vector, should not lie in the column space spanned by the regressor matrix $X$ in Model 1, (2.12) requires that the time effects $\lambda_{t}$ should not lie in the column space spanned by $X^{(2)}$ in Model 2, and (2.10) requires that the individual effects $\alpha_{i}$ should not lie in the column space spanned by $X^{(3)}$ in Model 3 . In short, Assumption A. 3 rules out asymptotic multicollinearity between the individual/time effects and the regressors.

It is worth mentioning that we allow for both cross-sectional and serial dependence of unknown form in $\left\{\left(x_{i t}, u_{i t}\right)\right\}$ despite the fact that some of the results derived below need further constraints. We do not need identical distributions or homoskedasticity along either the cross-section dimension or the time dimension, neither do we need to assume mean or covariance stationarity along either dimension. In this sense, we say our results below are applicable to a variety of linear panel data models in practice.

### 2.2.2 Asymptotic consistency of the jackknife without bias correction

Theorem 2.1 below studies the asymptotic property of $\hat{m}$ based on the non-BC jackknife objective function.

Theorem 2.1 Suppose that Assumptions A.1-A.3 hold. Suppose that $\max \left(\bar{\sigma}_{u 1}^{2}, \bar{\sigma}_{u 2}^{2}\right)<2 \bar{\sigma}_{u}^{2}$, where $\bar{\sigma}_{u 1}^{2}, \bar{\sigma}_{u 2}^{2}$, and $\bar{\sigma}_{u}^{2}$ are defined in Assumptions 2(i), 2(ii), and 1(i), respectively. Then

$$
P(\hat{m}=m \mid \text { Model } m \text { is the true model }) \rightarrow 1 \text { as }(N, T) \rightarrow \infty \text { for } m=1, \ldots, 4
$$

Remark 3. The proof of Theorem 2.1 is given in Appendix A of the online supplement. To appreciate the above result, we outline the main idea that underlines our proof. When Model 1 is true, all the other models are overfitted, and we can show that $P(C V(1)<C V(m)) \rightarrow 1$ for
$m=2,3,4$ by showing that

$$
\begin{aligned}
T[C V(2)-C V(1)] \xrightarrow{P} 2 \bar{\sigma}_{u}^{2}-\bar{\sigma}_{u 1}^{2} & >0, \\
N[C V(3)-C V(1)] \xrightarrow{P} 2 \bar{\sigma}_{u}^{2}-\bar{\sigma}_{u 2}^{2} & >0, \\
(N \wedge T)[C V(4)-C V(1)] \xrightarrow{P} c_{\sigma} & >0,
\end{aligned}
$$

where $c_{\sigma}=2(1+c) \bar{\sigma}_{u}^{2}-\left(\bar{\sigma}_{u 1}^{2}+c \bar{\sigma}_{u 2}^{2}\right) 1\left\{c_{1} \geq 1\right\}-\left(c \bar{\sigma}_{u 1}^{2}+\bar{\sigma}_{u 2}^{2}\right) 1\left\{c_{1}<1\right\}, c=\lim _{(N, T) \rightarrow \infty}\left(\frac{N}{T} \wedge \frac{T}{N}\right)$, $c_{1}=\lim _{(N, T) \rightarrow \infty} \frac{N}{T}$, and $a \wedge b=\min (a, b)$. When Model 2 is true, Models 1,3 and 4 are underfitted, misspecified and overfitted, respectively, and we can show that $P(C V(2)<C V(m)) \rightarrow 1$ for $m=$ $1,3,4$ by showing that

$$
\begin{aligned}
C V(1)-C V(2) \xrightarrow{P} c_{\alpha, X} & >0, \\
C V(3)-C V(2) \xrightarrow{P} c_{\alpha, X_{\lambda}} & >0, \\
N[C V(4)-C V(2)] \xrightarrow{P} 2 \bar{\sigma}_{u}^{2}-\bar{\sigma}_{u 2}^{2} & >0 .
\end{aligned}
$$

When Model 3 is true, Models 1, 2 and 4 are underfitted, misspecified and overfitted, respectively, and we can show that $P(C V(3)<C V(m)) \rightarrow 1$ for $m=1,2,4$ by showing that

$$
\begin{aligned}
C V(1)-C V(3) \xrightarrow{P} c_{\lambda, X} & >0, \\
C V(2)-C V(3) \xrightarrow{P} c_{\lambda, X_{\alpha}} & >0, \\
T[C V(4)-C V(3)] \xrightarrow{P} 2 \bar{\sigma}_{u}^{2}-\bar{\sigma}_{u 1}^{2} & >0 .
\end{aligned}
$$

When Model 4 is true, all other models are underfitted, and we can show that $P(C V(4)<C V(m)) \rightarrow$ 1 for $m=1,2,3$ by showing that

$$
\begin{aligned}
& C V(1)-C V(4) \xrightarrow{P} c_{\alpha \lambda, X}>0, \\
& C V(2)-C V(4) \xrightarrow{P} c_{\lambda, X_{\alpha}}>0, \\
& C V(3)-C V(4) \xrightarrow{P} c_{\alpha, X_{\lambda}}>0 .
\end{aligned}
$$

As a result, $C V(m)$ has the minimal value among $\{C V(l), l=1, \ldots, 4\}$ asymptotically only when Model $m$ is the true model. Note that here $C V(m)$ is a measure of out-of sample predictive power and its dominant and first order terms are not related to the mean squared error (MSE) or bias of the estimator of $\beta$ at all. The MSE and bias (if exists) only make a second order contribution (namely, $O_{P}\left((N T)^{-1}\right), O_{P}\left(T^{-2}+(N T)^{-1}\right), O_{P}\left(N^{-2}+(N T)^{-1}\right)$ or $O_{P}\left(N^{-2}+T^{-2}\right)$ in Models 1-4, respectively) to $C V(m)$. For example, suppose that the true model is the panel $\operatorname{AR}(1)$ without individual or time effects: $y_{i t}=\beta_{0}+\beta_{1} y_{i, t-1}+u_{i t}$ where $u_{i t}$ 's are uncorrelated along both the individual and time dimensions with $\operatorname{Var}\left(u_{i t}\right)=\sigma_{u}^{2}$, then the estimators of $\beta_{1}$ have leading bias $0,-\frac{1+\beta_{1}}{T}, 0$ and $-\frac{1+\beta_{1}}{T}$
in Models 1-4, respectively, and they share the same asymptotic variance $\frac{1-\beta_{1}^{2}}{N T}$. In addition, we can show that

$$
\begin{aligned}
& C V(1)=\sigma_{u}^{2}+O_{P}\left((N T)^{-1}\right), \\
& C V(2)=\sigma_{u}^{2}+\frac{1}{T} \sigma_{u}^{2}+O_{P}\left((N T)^{-1}+T^{-2}\right), \\
& C V(3)=\sigma_{u}^{2}+\frac{1}{N} \sigma_{u}^{2}+O_{P}\left((N T)^{-1}+N^{-2}\right), \\
& C V(4)=\sigma_{u}^{2}+\frac{1}{\min (N, T)}(1+c) \sigma_{u}^{2}+O_{P}\left(N^{-2}+T^{-2}\right),
\end{aligned}
$$

where terms like $O_{P}\left((N T)^{-1}\right), O_{P}\left(T^{-2}+(N T)^{-1}\right), O_{P}\left(N^{-2}+(N T)^{-1}\right)$ and $O_{P}\left(N^{-2}+T^{-2}\right)$ reflect the effect of variance and bias (if exists) of the parameter estimators on $C V(m)$ for $m=1,2,3,4$, respectively.

Remark 4. Theorem 2.1 indicates that we can choose the correct model w.p.a. 1 as $(N, T) \rightarrow \infty$. In other words, our jackknife method can choose the correct model consistently as long as the serial or cross-sectional correlation among the error terms is not strong enough to overtake the average noise level as represented by $\bar{\sigma}_{u}^{2}$. As remarked above, the additional condition max $\left(\bar{\sigma}_{u 1}^{2}, \bar{\sigma}_{u 2}^{2}\right)<$ $2 \bar{\sigma}_{u}^{2}$ would be automatically satisfied in the absence of both serial and cross-sectional correlation among the idiosyncratic error terms. For simplicity, we can consider the special case where there is no cross-sectional correlation among the error terms. In this case, $\bar{\sigma}_{u 2}^{2}=\bar{\sigma}_{u}^{2}$ and the condition $\max \left(\bar{\sigma}_{u 1}^{2}, \bar{\sigma}_{u 2}^{2}\right)<2 \bar{\sigma}_{u}^{2}$ becomes $\bar{\sigma}_{u 1}^{2}<2 \bar{\sigma}_{u}^{2}$. Note that the above result does not have any restriction on the degree of serial or cross-sectional correlation among $\left\{x_{i t}\right\}$ as long as Assumptions A.1(ii)-(v) are satisfied. More importantly, we do not need any relative rate condition on how $N$ and $T$ pass to infinity. In fact, our theory allows $T=O(\ln N)$ such that our method may be applied to micro panels when $T$ is typically small in comparison with $N$.

Remark 5. To see when the above additional condition can be met in Theorem 2.1, consider the case where $\left\{u_{i t}, t \geq 1\right\}$ follows a covariance-stationary $\operatorname{AR}(1)$ process with mean zero and variance $\sigma_{u}^{2}$ for each $i$ and is independently and identically distributed (i.i.d.) along the cross-section dimension. Let $\rho \in(-1,1)$ denote the $\operatorname{AR}(1)$ coefficient. Then by straightforward calculations,

$$
\begin{aligned}
\frac{T}{N} \sum_{i=1}^{N} E\left(\bar{u}_{i .}\right)^{2} & =\frac{1}{T} \sum_{t=1}^{T} E\left(u_{i t}^{2}\right)+\frac{2}{T} \sum_{t=1}^{T-1} \sum_{s=t+1}^{T} E\left(u_{i t} u_{i s}\right)=\sigma_{u}^{2}+\frac{2 \sigma_{u}^{2}}{T} \sum_{t=1}^{T-1} \sum_{s=t+1}^{T} \rho^{s-t} \\
& =\sigma_{u}^{2}\left(1+\frac{2 \sigma_{u}^{2}}{T} \sum_{t=1}^{T-1} \frac{\rho\left(1-\rho^{T-t+1}\right)}{1-\rho}\right) \rightarrow \sigma_{u}^{2}\left(1+\frac{2 \rho}{1-\rho}\right)=\bar{\sigma}_{u 1}^{2} .
\end{aligned}
$$

In this case, $\bar{\sigma}_{u}^{2}=\sigma_{u}^{2}$ and $\bar{\sigma}_{u 1}^{2}<2 \bar{\sigma}_{u}^{2}$ provided $\rho<\frac{1}{3}$. Similarly, if $\left\{u_{i t}, i \geq 1\right\}$ has mean zero and variance $\sigma_{u}^{2}$ for each $i, t$ such that $\operatorname{Corr}\left(u_{i t}, u_{j t}\right)=\rho^{d_{i j}}$ for all $i, j, t$ for some $\rho \in(-1,1)$ and for some
economic or geographic distance measure $d_{i j}$ between units $i$ and $j$, then

$$
\frac{N}{T} \sum_{t=1}^{T} E\left(\bar{u}_{. t}\right)^{2}=\sigma_{u}^{2}\left(1+\frac{2}{N} \sum_{1 \leq i<j \leq N} \rho^{d_{i j}}\right)
$$

and $\bar{\sigma}_{u 2}^{2}<2 \bar{\sigma}_{u}^{2}$ provided $\lim _{N \rightarrow \infty} \frac{2}{N} \sum_{1 \leq i<j \leq N} \rho^{d_{i j}}<\frac{1}{3} .{ }^{6}$ We can also consider a stationary $m$ dependent process for $\left\{u_{i t}, t \geq 1\right\}$ with mean zero and variance $\sigma_{u}^{2}$ for each $i$ (assuming i.i.d. in the cross-section dimension). In this case, we can show that

$$
\bar{\sigma}_{u 1}^{2}=\lim _{T \rightarrow \infty}\left(\sigma_{u}^{2}+\frac{2(T-1)}{T} \sum_{j=1}^{m} \operatorname{Cov}\left(u_{i 1}, u_{i, j+1}\right)\right)=\left[1+2 \sum_{j=1}^{m} \operatorname{Corr}\left(u_{i 1}, u_{i, j+1}\right)\right] \sigma_{u}^{2} .
$$

So the condition $\bar{\sigma}_{u 1}^{2}<2 \bar{\sigma}_{u}^{2}$ is satisfied if $\sum_{j=1}^{m} \operatorname{Corr}\left(u_{i 1}, u_{i, j+1}\right)<\frac{1}{2}$. Again, this means that we cannot have too large time-series correlation. Note that this condition is always satisfied for an invertible MA(1) process: $u_{i t}=e_{i t}+\theta e_{i, t-1}$ where $|\theta|<1$ and $\left\{e_{i t}, t \geq 1\right\}$ is a white noise with mean 0 and variance $\sigma_{e}^{2}$, as in this case,

$$
\bar{\sigma}_{u 1}^{2}=\lim _{T \rightarrow \infty}\left(1+\frac{T-1}{T} \frac{2 \theta}{1+\theta^{2}}\right) \sigma_{u}^{2}<2 \sigma_{u}^{2},
$$

where $\sigma_{u}^{2}=\left(1+\theta^{2}\right) \sigma_{e}^{2}$.
The above calculations indicate that the serial or cross-sectional correlation among the error terms cannot be moderately large in order for our jackknife method to work. In the next subsection, we consider the relaxation of such conditions. Since there is typically no natural ordering among the individual units, we focus on the relaxation on the serial dependence along the time dimension and propose a modified jackknife criterion function to handle strong or moderately large degree of serial correlation.

### 2.2.3 Asymptotic consistency of the jackknife with bias correction

Theorem 2.2 below studies the asymptotic property of $\breve{m}$ based on the BC jackknife objective function.
Theorem 2.2 Suppose the conditions in Theorem 2.1 hold. Suppose that one of the following set of conditions holds: (1) $\hat{b}_{1}^{(m)}=O_{P}(1)$ for $m=2,4$ and $N / T^{2}=o(1)$, or (2) $\hat{b}_{1}^{(m)}=O_{P}(1)$, $\sqrt{N T} \frac{1}{T}\left(\hat{b}_{1}^{(m)}-b_{1}^{(m)}\right)=o_{P}(1)$ for $m=2,4$, and $N / T^{3}=O(1)$. Then

$$
P(\breve{m}=m \mid \text { Model } m \text { is the true model }) \rightarrow 1 \text { as }(N, T) \rightarrow \infty \text { for } m=1, \ldots, 4 .
$$

[^5]Remark 6. The proof of Theorem 2.2 is given in the online Appendix. Remark 3 after Theorem 2.1 continues to hold with $C V(m)$ replaced by $C V^{b c}(m)$ under the additional conditions stated in the above theorem. Because of the presence of the BC terms in the definitions of $\breve{\beta}_{i t}^{(2)}$ and $\breve{\beta}_{i t}^{(4)}$, special attention must be paid to assess the influence of these terms. Theorem 2.2 suggests that if we only require the estimated bias $\frac{1}{T} \hat{b}_{1}^{(m)}$ be of the same order as the leading bias term $\frac{1}{T} b_{1}^{(m)}$ in Model $m=2,4$, the consistency of the BC jackknife or CV method would require $N / T^{2}=o(1)$, as is typically assumed in the literature on bias correction in panel data models. On the other hand, if we also require that after bias correction, the bias term does not contribute to the first order asymptotic distribution of the bias-corrected LSDV estimators in Models 2 and 4, Theorem 2.2 suggests that we can relax the above relative rate condition on $(N, T)$ to $N / T^{3}=O(1)$ and continue to ensure the consistency of the BC jackknife method. In our simulations (Sections 3.3 and 3.4) and an empirical application (Section 4.2), we implement both CV methods for dynamic models. Our simulations suggest that bias correction may or may not help with the model selection, which depends on the true model. Given that no method dominates the other, in practice, to determine the correct model, we can try both CV methods (with and without bias-correction) as a simple way to conduct robustness checks. Of course, if the regressors are not strictly exogenous, we generally need to implement the bias-correction for estimation and inference after the model selection.

Remark 7. A close examination of the proof of Theorem 2.2 suggests some meaningful findings. First, the bias correction always plays a second order role in the model selection procedure. When a model is underfitted, the model specification bias that is of exact order $O(1)$ would dominate the bias correction that is of exact order $O\left(T^{-1}\right)$ in Models 2 or 4. When a model is overfitted, the contributions of the bias correction are reflected through the terms $R_{1}$ through $R_{8}$ in the proof. Let $C V_{l, m}$ and $C V_{l, m}^{b c}$ denote $C V(m)$ and $C V^{b c}(m)$, respectively, when Model $l$ is the true model. Specifically, we have demonstrated the following results:

1. When Model 1 is true so that Models 2-4 are all overfitted: The contribution of the bias correction to $T\left[C V_{1,2}^{b c}-C V_{1,1}^{b c}\right]$ is given by $T\left[R_{1}+2 R_{2}\right]=O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right.$ ) (see equation (A.19) in Appendix A), which is asymptotically negligible in comparison with plim $N, T \rightarrow \infty T\left[C V_{1,2}-\right.$ $\left.C V_{1,1}\right]=2 \bar{\sigma}_{u}^{2}-\bar{\sigma}_{u 1}^{2}>0$. Similarly, the contribution of the bias correction to $(N \wedge T)\left[C V_{1,4}^{b c}-\right.$ $\left.C V_{1,1}^{b c}\right]$ is given by $(N \wedge T)\left[R_{3}+2 R_{4}\right]=O_{P}\left(T^{-1}\right)$ (see equation (A.24) in Appendix A), which is asymptotically negligible in comparison with $\operatorname{plim}_{N, T \rightarrow \infty}(N \wedge T)\left[C V_{1,4}-C V_{1,1}\right]=c_{\sigma}>0$. Recall that no bias correction is needed for Model 3.
2. When Model 2 is true so that only Model 4 is overfitted: The contribution of the bias correction to $N\left[C V_{2,4}^{b c}-C V_{2,2}^{b c}\right]$ is given by

$$
N\left[R_{5}+2 R_{6}\right]=N O_{P}\left(T^{-1}\left(N^{-1}+T^{-1}\right)\right)=o_{P}(1)
$$

if $\hat{b}_{1}^{(m)}=O_{P}(1)$ for $m=2,4$ and $N / T^{2}=o(1)$, and given by

$$
N\left[R_{5}+2 R_{6}\right]=N o_{P}\left((N T)^{-1}+N^{-1 / 2} T^{-3 / 2}\right)=o_{P}(1)
$$

if $\hat{b}_{1}^{(m)}=O_{P}(1), \sqrt{N T} \frac{1}{T}\left(\hat{b}_{1}^{(m)}-b_{1}^{(m)}\right)=o_{P}(1)$ for $m=2,4$, and $N / T^{3}=O(1) \cdot$ [See equations (A.31) and (A.32) in Appendix A.] In either case, the contribution is asymptotically negligible in comparison with $\operatorname{plim}_{N, T \rightarrow \infty} N\left[C V_{2,4}-C V_{2,2}\right]=2 \bar{\sigma}_{u}^{2}-\bar{\sigma}_{u 2}^{2}>0$.
3. When Model 3 is true so that only Model 4 is overfitted: The contribution of the bias correction to $T\left[C V_{3,4}^{b c}-C V_{3,3}^{b c}\right]$ is given by $T\left[R_{7}+2 R_{8}\right]=O_{P}\left(N^{-1}+T^{-1}\right)$, which is asymptotically negligible in comparison with $\operatorname{plim}_{N, T \rightarrow \infty} T\left[C V_{3,4}-C V_{3,3}\right]=2 \bar{\sigma}_{u}^{2}-\bar{\sigma}_{u 1}^{2}>0$.

Second, the above discussions also indicate that the additional conditions stated in Theorem 2.2 are only required to show that Model 2 can be correctly chosen w.p.a. 1 when it is the true model. In other words, these additional conditions will ensure that the overfitted model (Model 4) will not be selected in large samples when Model 2 is true.

### 2.3 A modified jackknife criterion function

In this subsection, we consider the panel data model with serially correlated errors and propose a modified version of the jackknife criterion function. Note that if a generic ARMA process is invertible, it can be written as an $\operatorname{AR}(\infty)$ process and well approximated by an $\operatorname{AR}(p)$ process for sufficiently large $p$. For this reason, we assume that the error process $\left\{u_{i t}, t \geq 1\right\}$ can be approximated by an $\mathrm{AR}(p)$ process:

$$
\begin{align*}
u_{i t} & =\sum_{j=1}^{\infty} \rho_{j} u_{i, t-j}+e_{i t}=\left(\sum_{j=1}^{p} \rho_{j} u_{i, t-j}\right)+\left(\sum_{j=p+1}^{\infty} \rho_{j} u_{i, t-j}+e_{i t}\right) \\
& =\boldsymbol{\rho}^{\prime} \underline{u}_{i, t-1}+v_{i t} \tag{2.14}
\end{align*}
$$

where $i=1, \ldots, N, t=p+1, \ldots, T, \boldsymbol{\rho}=\left(\rho_{1}, \ldots, \rho_{p}\right)^{\prime}$ is a vector of unknown parameters, $\underline{u}_{i, t-1}=$ $\left(u_{i, t-1}, \ldots, u_{i, t-p}\right)^{\prime}, v_{i t}=v_{i t, p}+e_{i t}, e_{i t}$ is an innovation term, and $v_{i t, p}=\sum_{j=p+1}^{\infty} \rho_{j} u_{i, t-j}$ signifies the approximation error. If $\left\{u_{i t}, t \geq 1\right\}$ is an autoregressive process of order $p$ or less, then $v_{i t, p}=0$ and $v_{i t}=e_{i t}$.

Let $\hat{u}_{i t}^{(m)}=y_{i t}-\hat{\beta}^{(m) \prime} x_{i t}^{(m)}$ for $m=1,2,3,4$. We propose to estimate the $\operatorname{AR}(p)$ coefficients based on the residuals from Model 4 (the largest model), i.e., we run the following regression

$$
\begin{equation*}
\hat{u}_{i t}^{(4)}=\rho_{1} \hat{u}_{i, t-1}^{(4)}+\rho_{2} \hat{u}_{i, t-2}^{(4)}+\ldots+\rho_{p} \hat{u}_{i, t-p}^{(4)}+\tilde{v}_{i t}=\rho^{\prime} \underline{\hat{u}}_{i, t-1}^{(4)}+\tilde{v}_{i t} \tag{2.15}
\end{equation*}
$$

where $i=1, \ldots, N, t=p+1, \ldots, T, \underline{\hat{u}}_{i, t-1}^{(4)}=\left(\hat{u}_{i, t-1}^{(4)}, \ldots, \hat{u}_{i, t-p}^{(4)}\right)^{\prime}$, and $\tilde{v}_{i t}=\left(\hat{u}_{i t}^{(4)}-u_{i t}\right)+\rho^{\prime}\left(\underline{u}_{i, t-1}-\right.$ $\left.\underline{\hat{u}}_{i, t-1}^{(4)}\right)+v_{i t}$. Let $\hat{\boldsymbol{\rho}}=\left(\hat{\rho}_{1}, \hat{\rho}_{2}, \ldots \hat{\rho}_{p}\right)^{\prime}$ denote the OLS estimator of $\boldsymbol{\rho}$ in the above regression. Let
$\underline{y}_{i, t-1}=\left(y_{i, t-1}, \ldots, y_{i, t-p}\right)^{\prime}$ and $\underline{\hat{y}}_{i, t-1}^{(m)}=\left(\hat{y}_{i, t-1}^{(m)}, \ldots, \hat{y}_{i, t-p}^{(m)}\right)^{\prime}$. We modify the CV criterion function as

$$
\begin{equation*}
C V^{*}(m)=\frac{1}{N(T-p)} \sum_{t=p+1}^{T} \sum_{i=1}^{N}\left[\left(y_{i t}-\hat{\boldsymbol{\rho}}^{\prime} \underline{y}_{i, t-1}\right)-\left(\hat{y}_{i t}^{(m)}-\hat{\boldsymbol{\rho}}^{\prime} \hat{\underline{y}}_{i, t-1}^{(m)}\right)\right]^{2} . \tag{2.16}
\end{equation*}
$$

Let

$$
\begin{equation*}
\tilde{m}=\underset{1 \leq m \leq 4}{\operatorname{argmin}} C V^{*}(m) . \tag{2.17}
\end{equation*}
$$

Ideally, when Model $m$ is correctly specified, $\left(y_{i t}-\hat{\boldsymbol{\rho}}^{\prime} \underline{y}_{i, t-1}\right)-\left(\hat{y}_{i t}^{(m)}-\hat{\boldsymbol{\rho}}^{\prime} \underline{\hat{y}}_{i, t-1}^{(m)}\right)$ will approximate the true innovation term $v_{i t}$. As long as there is no serial correlation among $\left\{v_{i t}\right\}$ or the serial correlation is weak, $\tilde{m}$ is given by $m$ w.p.a.1. when Model $m$ is the true model.

Let

$$
\Phi(L)=1-\rho_{1} L-\rho_{2} L^{2}-\cdots-\rho_{p} L^{p},
$$

where $L$ is the lag operator. Similarly, $\Phi(1)=1-\rho_{1}-\rho_{2}-\cdots-\rho_{p}$. Let $\breve{x}_{i t}^{(m)}=\Phi(L) x_{i t}^{(m)}$ for $t=p+1, \ldots, T$ and $m=1,2,3,4$. Note that $\breve{x}_{i t}^{(1)}=\Phi(L) x_{i t} \equiv \breve{x}_{i t}$. Let $\bar{v}_{i} .=T_{p}^{-1} \sum_{t=p+1}^{T} v_{i t}$ for $i=1, \ldots N$, and $\bar{v}_{. t}=N^{-1} \sum_{i=1}^{N} v_{i t}$ for $t=p+1, \ldots, N$, where $T_{p}=T-p$. Let $\underline{u}_{i, t-1}=\left(u_{i, t-1}, \ldots, u_{i, t-p}\right)^{\prime}$ and $\Gamma_{p}=\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \underline{u}_{i, t-1} \underline{u}_{i, t-1}^{\prime}$.

To state the next result, we add the following set of assumptions.
Assumption A.4. (i) $\sum_{j=1}^{\infty} \rho_{j} z^{j} \neq 0$ for any complex number $z$ with $|z| \leq 1, \sum_{j=1}^{\infty}\left|\rho_{j}\right|<\infty$, $p^{3 / 2}\left(N^{-1}+T^{-1}\right)=o(1)$, and $\lambda_{\min }\left(\Gamma_{p}\right)$ is bounded away from zero in probability as $(N, T) \rightarrow \infty$.
(ii) $E\left(v_{i t}\right)=0, \max _{1 \leq i \leq N, p+1 \leq t \leq T} E\left(v_{i t}^{4}\right) \leq C$, and $\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t}^{2} \xrightarrow{P} \bar{\sigma}_{v}^{2}>0$.
(iii) $\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \zeta_{i t} v_{i t}=O_{P}\left((N T)^{-1 / 2}\right)$ for $\zeta_{i t}=1$ and $\breve{x}_{i t}$, and $\left\|\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \underline{u}_{i, t-1} v_{i t}\right\|=$ $O_{P}\left((N T / p)^{-1 / 2}\right)$.
(iv) $\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t} \alpha_{i}=o_{P}(1)$ and $\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t}\left[\Phi(L) \lambda_{t}\right]=o_{P}(1)$ when Model 2, 3 , or 4 is true and applicable.

Assumption A.5. (i) $\frac{T_{p}}{N} \sum_{i=1}^{N}\left(\bar{v}_{i} .\right)^{2} \xrightarrow{P} \bar{\sigma}_{v 1}^{2}>0$.
(ii) $\frac{N}{T_{p}} \sum_{t=p+1}^{T}\left(\bar{v}_{\cdot}\right)^{2} \xrightarrow{P} \bar{\sigma}_{v 2}^{2}>0$.
(iii) $\frac{1}{N} \sum_{i=1}^{N} \bar{x}_{i} \cdot \bar{v}_{i}=O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right)$.
(iv) $\frac{1}{T_{p}} \sum_{t=p+1}^{T} \bar{x}_{. t} \bar{v}_{t}=O_{P}\left(N^{-1}+(N T)^{-1 / 2}\right)$.

Assumption A.6. (i) If Model 2 is the true model, there exist positive constants $c_{\alpha, X}^{*}$ and $c_{\alpha, X_{\lambda}}^{*}$ such that

$$
\begin{align*}
\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}\left[\Phi(1) \alpha_{i}-\breve{x}_{i t}^{\prime}\left(X^{\prime} X\right)^{-1} X^{\prime} D_{\alpha} \underline{\alpha}\right]^{2} \xrightarrow{P} c_{\alpha, X}^{*} & >0, \text { and }  \tag{2.18}\\
\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}\left[\Phi(1) \alpha_{i}-\breve{x}_{i t}^{(3) \prime}\left(X^{(3) \prime} X^{(3)}\right)^{-1} X^{(3) \prime} D_{\alpha} \underline{\alpha}\right]^{2} \xrightarrow{P} c_{\alpha, X_{\lambda}}^{*} & >0 . \tag{2.19}
\end{align*}
$$

(ii) If Model 3 is the true model, there exist positive constants $c_{\lambda, X}^{*}$ and $c_{\lambda, X_{\alpha}}^{*}$ such that

$$
\begin{align*}
\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}\left[\Phi(L) \lambda_{t}-\breve{x}_{i t}^{\prime}\left(X^{\prime} X\right)^{-1} X^{\prime} D_{\lambda} \underline{\lambda}\right]^{2} \xrightarrow{P} c_{\lambda, X}^{*} & >0, \text { and }  \tag{2.20}\\
\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}\left[\Phi(L) \lambda_{t}-\breve{x}_{i t}^{(2) \prime}\left(X^{(2) \prime} X^{(2)}\right)^{-1} X^{(2) \prime} D_{\lambda} \underline{\lambda}\right]^{2} \xrightarrow{P} c_{\lambda, X_{\alpha}}^{*} & >0 . \tag{2.21}
\end{align*}
$$

(iii) If Model 4 is the true model, there exist positive constants $c_{\alpha \lambda, X}^{*}, c_{\alpha, X_{\lambda}}^{*}$, and $c_{\lambda, X_{\alpha}}^{*}$ such that

$$
\begin{equation*}
\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}\left[\left(\Phi(1) \alpha_{i}+\Phi(L) \lambda_{t}\right)-\breve{x}_{i t}^{\prime}\left(X^{\prime} X\right)^{-1} X^{\prime}\left(D_{\alpha} \underline{\alpha}+D_{\lambda} \underline{\lambda}\right)\right]^{2} \xrightarrow{P} c_{\alpha \lambda, X}^{*}>0 \tag{2.22}
\end{equation*}
$$

and both (2.19) and (2.21) hold.
Assumption A.4(i) rules out unit root or explosive processes for $\left\{u_{i t}, t \geq 1\right\}$. Assumption A.4(ii)(iv) parallels Assumption A.1(i), (iii) and (v). Assumption A.5(i)-(iv) parallels Assumption A.2(i)(iv). Assumption A.6(i)-(iii) is analogous to Assumption A.3(i)-(iii). In the online supplement (Section C.2), we verify Assumptions A. 4 and A. 5 under a set of sufficient primitive conditions on $\left\{\left(x_{i t}, e_{i t}, \alpha_{i}, \lambda_{t}\right)\right\}$.

Theorem 2.3 Suppose that Assumptions A.1-A.2 and A.4-A.6 hold. Suppose that $\max \left(\bar{\sigma}_{v 1}^{2}, \bar{\sigma}_{v 2}^{2}\right)<$ $2 \bar{\sigma}_{v}^{2}$. Then

$$
P(\tilde{m}=m \mid \text { Model } m \text { is the true model }) \rightarrow 1 \text { as }(N, T) \rightarrow \infty \text { for } m=1, \ldots, 4 .
$$

Remark 8. Theorem 2.3 indicates that the modified jackknife criterion function helps us to select the correct model w.p.a. 1 as $(N, T) \rightarrow \infty$ under the weak side condition $\max \left(\bar{\sigma}_{v 1}^{2}, \bar{\sigma}_{v 2}^{2}\right)<2 \bar{\sigma}_{v}^{2}$. Where there is no serial correlation among $\left\{u_{i t}, t \geq 1\right\}$ such that $\Phi(1)=\Phi(L)=1$ and $u_{i t}=v_{i t}$, then $\bar{\sigma}_{v 1}^{2}=\bar{\sigma}_{u 1}^{2}=\bar{\sigma}_{u}^{2}=\bar{\sigma}_{v}^{2}$ and $\bar{\sigma}_{v 2}^{2}=\bar{\sigma}_{u 2}^{2}$. This implies that the result in Theorem 2.3 coincides with that in Theorem 2.1 in this case. If there is no serial or cross-sectional correlation among $\left\{v_{i t}\right\}$, then $\bar{\sigma}_{v 1}^{2}=\bar{\sigma}_{v 2}^{2}=\bar{\sigma}_{v}^{2}$ and $\max \left(\bar{\sigma}_{v 1}^{2}, \bar{\sigma}_{v 2}^{2}\right)<2 \bar{\sigma}_{v}^{2}$ is automatically satisfied. More generally, if $\left\{u_{i t}, t \geq 1\right\}$ is an $\operatorname{AR}(\infty)$ process, in the online supplement, we show that when $p \rightarrow \infty$ under certain rate condition, the approximation error $v_{i t, p}\left(=\sum_{j=p+1}^{\infty} \rho_{j} u_{i, t-j}\right)$ is asymptotically negligible so that $\bar{\sigma}_{v 1}^{2}=\bar{\sigma}_{v 2}^{2}=\bar{\sigma}_{v}^{2}$ is always satisfied.

Remark 9. In the above analysis, we run the pooled $\operatorname{AR}(p)$ regression for $\hat{u}_{i t}^{(4)}$. A close examination of the proof of Theorem 2.3 indicates that only the consistency of the pooled OLS estimator $\hat{\boldsymbol{\rho}}$ is used. Alternatively, one can allow heterogeneity in both the order of autoregression and its coefficients. In this case, we use $p_{i}$ and $\boldsymbol{\rho}_{i}, i=1, \ldots, N$, to denote the order and individual coefficients
in the autoregressive models and run the $\operatorname{AR}\left(p_{i}\right)$ regression for $\left\{\hat{u}_{i t}^{(4)}, t \geq 1\right\}$ to estimate $\boldsymbol{\rho}_{i}$ by $\hat{\boldsymbol{\rho}}_{i}$ for $i=1, \ldots, N$. Then we can modify the jackknife criterion function to be

$$
C V^{*}(m)=\frac{1}{N} \sum_{i=1}^{N} \frac{1}{T-p_{i}} \sum_{t=p_{i}+1}^{T}\left[\left(y_{i t}-\hat{\boldsymbol{\rho}}_{i}^{\prime} \underline{y}_{i, t-1}\right)-\left(\hat{y}_{(i t)}^{(m)}-\hat{\boldsymbol{\rho}}_{i}^{\prime} \underline{\hat{y}}_{i, t-1}^{(m)}\right)\right]^{2} .
$$

Accordingly, we can modify Assumptions A.4-A. 6 and establish a result similar to that in Theorem 2.3.

Remark 10. Alternatively, we can rewrite the original model by including $p$ lagged $y_{i t}$ and $p$ lagged $x_{i t}$ (excluding the constant) as additional $(p k)$ regressors via the standard Cochrane-Orcutt procedure. Take Model 4 as an example. Let $\stackrel{\circ}{x}_{i t}$ be the $x_{i t}$ excluding the constant term, i.e., $x_{i t}=\left(1, x_{i t}^{\prime}\right)^{\prime}$. Correspondingly, let $\beta=\left(\beta_{1}, \beta^{\prime}\right)^{\prime}$. Then, Model 4

$$
y_{i t}=\beta^{\prime} x_{i t}+\alpha_{i}+\lambda_{t}+u_{i t}=\left(\beta_{1}, \circ^{\prime}\right)\left(1, \check{x}_{i t}^{\prime}\right)^{\prime}+\alpha_{i}+\lambda_{t}+u_{i t}
$$

can be rewritten as

$$
\begin{aligned}
y_{i t}= & \left(1-\rho_{1}-\ldots-\rho_{p}\right) \beta_{1}+\stackrel{\circ}{\beta}^{\prime} \stackrel{\circ}{x}_{i t}+\rho_{1} y_{i, t-1}+\ldots+\rho_{p} y_{i, t-p}-\left(\rho_{1} \stackrel{\circ}{\beta}^{\prime} \stackrel{\circ}{x}_{i, t-1}+\ldots+\rho_{p} \stackrel{\circ}{ }^{\prime} \dot{x}_{i, t-p}\right) \\
& +\left(1-\rho_{1}-\ldots-\rho_{p}\right) \alpha_{i}+\left(\lambda_{t}-\rho_{1} \lambda_{t-1}-\ldots-\rho_{p} \lambda_{t-p}\right)+v_{i t} \\
= & \tilde{\beta}^{\prime} \tilde{x}_{i t}+\tilde{\alpha}_{i}+\tilde{\lambda}_{t}+v_{i t},
\end{aligned}
$$

where $\tilde{x}_{i t}=\left(1, \grave{x}_{i t}^{\prime}, y_{i, t-1}, \ldots, y_{i, t-p}, \check{x}_{i, t-1}^{\prime}, \ldots, \check{x}_{i t-p}^{\prime}\right)^{\prime}, \tilde{\beta}$ is the new vector of regression coefficients, $\tilde{\alpha}_{i}=\left(1-\rho_{1}-\ldots-\rho_{p}\right) \alpha_{i}$ and $\tilde{\lambda}_{t}=\left(\lambda_{t}-\rho_{1} \lambda_{t-1}-\ldots-\rho_{p} \lambda_{t-p}\right)$. With the new regressor $\tilde{x}_{i t}$ replacing $x_{i t}$, we can continue to apply the jackknife criterion function $C V(m)$ as in Section 2.1.

Remark 11. As mentioned above, we regard our $\operatorname{AR}(p)$ model as an approximation for the error process $\left\{u_{i t}, t \geq 1\right\}$ that does not need to follow the $\operatorname{AR}(p)$ process exactly. Note that our original jackknife method in Section 2.1 works in the presence of weak serial correlation. Hence, here it is sufficient to reduce and control the serial correlation among $\left\{u_{i t}, t \geq 1\right\}$. Despite this fact, we need to choose the value of $p$. In practice there are several approaches. First, we may use a "rule of thumb" and let $p$ increase with $T$, e.g., $p=\left\lfloor T^{1 / 4}\right\rfloor$, where $\left\lfloor T^{1 / 4}\right\rfloor$ is the nearest integer less than or equal to $T^{1 / 4}$. Alternatively, we can follow Lee, Okui, and Shintani (2018) by setting $p_{\max }=\left\lfloor T^{1 / 4}\right\rfloor$ and consider a general-to-specific testing procedure based on $t$-statistic until we reject the null. Third, we may apply the information criteria, such as AIC and BIC, to the residuals obtained from Model $4\left(\hat{u}_{i t}^{(4)}\right)$ to determine $p$. For the implementation, see, e.g., Stock and Watson (2012, Section 14.5). In general, BIC gives a consistent estimator of $p$, and AIC tends to choose a relatively large $p$. See Section D in the online supplement for more details.

Remark 12. As a referee points out, the standard jackknife (cross-validation) method is originally designed for i.i.d. observations. For dependent time series data, various modifications have
been proposed in the literature. For example, Burman, Chow and Nolan (1994) consider a $h$-block cross-validation function by removing the $t$ th observation and the $h$ observations on its either side to estimate the regression parameter, which simplifies to the usual leave-one-out cross-validation function when $h=0$. Racine (2000) finds that the $h$-block cross-validation is not consistent in general and proposes to combine Shao's (1993) solution of $v$-blocking on independent data with Burman, Chow and Nolan's (1994) $h$-blocking on dependent data to yield a $h v$-block cross-validation for improved model-selection. Note that the $h$-block cross-validation requires the selection of one tuning parameter $(h)$ while the $h v$-block cross-validation requires the choices of two tuning parameters ( $h$ and $v$ ). The minimum sample size ( $T$ in our notation) in Racine's (2000) simulations is 100 in order for his method to work reasonably well. But we usually do not have so many time series observations in the panel setup. If $T$ is only 5,10 , or at most 50 as in our simulations, we do not know how these alternative methods work and whether it is possible to justify their consistency in determining whether to include the individual or time effects into a panel data model. At the minimum, our modified jackknife method offers an easy-to-implement alternative solution to handle serial correlation in the error terms that only demands the choice of a single tuning parameter $(p)$ in practice.

## 3 Monte Carlo Simulations

In this section, we conduct Monte Carlo simulations to examine the finite sample performance of our jackknife method and compare it with various information criteria (IC). We consider the following three different cases: ( $i$ ) static panel models with possibly serially correlated errors, (ii) dynamic panel models without exogenous regressors and (iii) dynamic panel models with exogenous regressors.

### 3.1 Implementation

As a comparison, we consider the commonly used information criterion (IC): AIC and BIC, though to the best of our knowledge, there is no theoretical analysis of AIC and BIC in the context of determining fixed effects. Here the number of parameters involved depends on $N$ and $T$ and goes to infinity, thus the standard theory of AIC and BIC is not directly applicable.

For Model $m, m=1,2,3,4$, define the in-sample residual as $\hat{u}_{i t}^{(m)}=y_{i t}-\hat{\beta}^{(m) \prime} x_{i t}^{(m)}$. Then AIC and BIC for Model $m$ are defined respectively as

$$
\begin{aligned}
& A I C(m)=\ln \left(\left(\hat{\sigma}^{(m)}\right)^{2}\right)+\frac{2 k^{(m)}}{N T} \\
& B I C(m)=\ln \left(\left(\hat{\sigma}^{(m)}\right)^{2}\right)+\frac{\log (N T) k^{(m)}}{N T}
\end{aligned}
$$

where $\left(\hat{\sigma}^{(m)}\right)^{2}=\frac{1}{N T} \sum_{t=1}^{T} \sum_{i=1}^{N}\left(\hat{u}_{i t}^{(m)}\right)^{2}$ and $k^{(m)}$ is the dimension of $x_{i t}^{(m)}$ in the $m$ th model.

Specifically, $k^{(1)}=k, k^{(2)}=k+N-1, k^{(3)}=k+T-1$ and $k^{(4)}=k+N+T-2$. We also consider the modified BIC as

$$
B I C_{2}(m)=\ln \left(\left(\hat{\sigma}^{(m)}\right)^{2}\right)+\frac{\log (\log (N T)) k^{(m)}}{N T}
$$

We choose the model by minimizing the above three ICs. ${ }^{7}$
For static panel models, we consider CV (defined in (2.3)) and CV* (defined in (2.16)). To take into account the possible serial correlation, we also apply CV to the augmented regression with additional $p$ lagged $y_{i t}$ and $p$ lagged $x_{i t}$ (excluding the constant), as discussed in Remark 10 above. We denote it as $\mathrm{CV}^{* *}$. For $\mathrm{CV}^{*}$ and $\mathrm{CV}^{* *}$, we need to choose the number of lags $p$. As discussed in Remark 11, there are several data-driven methods. Here we adopt the testing procedure to determine $p$ with the maximum value of $p$ being $\left\lfloor T^{1 / 4}\right\rfloor$, where $\left\lfloor T^{1 / 4}\right\rfloor$ is the nearest integer less than or equal to $T^{1 / 4}$. Other methods, such as "rule of thumb", AIC and BIC, give similar results. For dynamic panel models, we do not consider $\mathrm{CV}^{*}$ and $\mathrm{CV}^{* *}$, as serial correlation can cause the endogenous problem and in general is not allowed in dynamic panel models. As discussed in Section 2.2 above, we also implement CV with bias-correction for dynamic models, which we denote as CV-BC. We use the half panel jackknife method (Dhaene and Jochmans (2015)) to conduct bias-correction.

For all the simulations, we consider different combinations of $N$ and $T:(N, T)=(10,5),(50,5)$, $(10,10),(50,10),(10,50)$ and $(50,50)$. The number of replications is 1000 .

### 3.2 Static panel models

We consider the following static fixed-effect data generating processes (DGPs):

$$
\begin{array}{ll}
\text { DGP 1.1: } y_{i t}=1+x_{i t}+u_{i t} & \text { DGP 1.2: } y_{i t}=1+x_{i t}+\alpha_{i}+u_{i t} \\
\text { DGP 1.3: } y_{i t}=1+x_{i t}+\lambda_{t}+u_{i t} & \text { DGP 1.4: } y_{i t}=1+x_{i t}+\alpha_{i}+\lambda_{t}+u_{i t}
\end{array}
$$

where $x_{i t}=1+\alpha_{i}+\lambda_{t}+\xi_{i t}$ and $\alpha_{i}, \lambda_{t}$ and $\xi_{i t}$ are mutually independent $N(0,1)$ random variables. The error term $u_{i t}$ is generated as

$$
u_{i t}=\rho u_{i, t-1}+v_{i t}
$$

where $v_{i t}$ is a $N(0,1)$ random variable, and $\rho$ takes different values: $0, \frac{1}{3}$, and $\frac{3}{4} .{ }^{8}$ The additional simulation results for $\rho=\frac{1}{4}$ and $\frac{1}{2}$ are reported in Tables E1 and E2 in Section E of the online supplement, respectively. Here the true models corresponding to DGPs 1.1-1.4 are Models 1-4, respectively.

[^6]Tables 1A, 1B, and 1C present the simulation results for $\rho=0, \frac{1}{3}$, and $\frac{3}{4}$, respectively. When $\rho=0$, i.e., there is no serial correlation in the error term, our CV performs best. For example, when $N=10$ and $T=10$, our CV can choose the correct model with a probability close to $95 \%$. When $T$ is small $(T=5)$ and $N$ is large $(N=50)$, the correct rate of our CV is above $90 \%$. Even when both $T$ and $N$ are small ( $T=5, N=10$ ), our CV can achieve a reasonable correct rate above $70 \%$. The performance of AIC is also good and comparable to that of CV. CV* and CV**, which are robust to possible serial correlation, perform slightly worse than CV when $T$ is relatively large ( $T=10$ or $T=50$ ). The performance of BIC is poor. For example, when the true model is Model 4 and $(N, T)=(10,50)$, BIC can only choose the correct model with a probability of $4 \%$. $\mathrm{BIC}_{2}$ outperforms BIC, but still underperforms CV and AIC.
$\rho=\frac{1}{3}$ is an interesting case, as $\rho=\frac{1}{3}$ is the cut-off point for CV to work. In the discussion following Theorem 2.1, we show that when $\rho=\frac{1}{3}, \bar{\sigma}_{u 1}^{2}=2 \bar{\sigma}_{u}^{2}$, thus the key condition $\max \left(\bar{\sigma}_{u 1}^{2}, \bar{\sigma}_{u 2}^{2}\right)<2 \bar{\sigma}_{u}^{2}$ is violated. In our proof, we show that in this case, when the true model is Model 1, $T[C V(2)-C V(1)] \xrightarrow{P} 0$ and when the true model is Model $3, T[C V(4)-C V(3)] \xrightarrow{P} 0$. This suggests that CV cannot distinguish Model 1 and Model 2 when the true model is Model 1 and cannot distinguish Model 3 and Model 4 when the true model is Model 3. Our simulations confirm the theoretical analysis. For example, when the true model is Model 1 and $(N, T)=(50,50)$, CV selects Model 1 and Model 2 with probabilities of $56 \%$ and $44 \%$, respectively. In this case, CV, AIC, BIC and $\mathrm{BIC}_{2}$ all break down. However, both $\mathrm{CV}^{*}$ and $\mathrm{CV}^{* *}$, which explicitly take serial correlation into account, perform well in large samples, as suggested by our theory. For example, when $(N, T)=(50,50)$, both $\mathrm{CV}^{*}$ and $\mathrm{CV}^{* *}$ can select the correct model with a probability close to $100 \%$. For this DGP, CV* slightly outperforms CV** as a whole. However, in general, for CV* and CV** to work well, a relatively large $T$ is required.

When the serial correlation is high, such as $\rho=\frac{3}{4}$, the performances of CV, AIC, BIC and $\mathrm{BIC}_{2}$ are all poor. In general, $\mathrm{CV}^{*}$ and $\mathrm{CV}^{* *}$ perform well when the sample is large. For this DGP, CV* outperforms $\mathrm{CV}^{* *}$ in general. For example, when $(N, T)=(50,50), \mathrm{CV}^{*}$ can choose the correct model with a probability close to $100 \%$. However, when the true model is Model 4 and $(N, T)=(50,50), \mathrm{CV}^{* *}$ can only choose the correct model with a probability of $45 \%$. Also, when $T$ or $N$ is small, $\mathrm{CV}^{*}$ and $\mathrm{CV}^{* *}$ can perform poorly. This suggests that when serial correlation is high, a large sample is required.

To examine the effect of model misspecification, in Table 4A, we compare the mean squared errors (MSEs) of the estimators of the slope coefficient $(\beta=1)$ using the four different models and the model selected by our CV when $\rho=0 .{ }^{9}$ It is clear that for this DGP, the correct model achieves the smallest MSE. For example, when the true model is Model 1 and $(N, T)=(10,10)$, the MSE based on Model

[^7]4 is about 3.5 times as large as that based on Model 1 . When $T$ is relatively large, the MSEs based on our selected models are almost the same as those based on the true models. When $T$ is small, our model selection can also achieve MSE reduction, compared with say, the largest model, Model 4. Table 4 B reports the performance of post-selection inference by presenting the empirical coverage and length of the $95 \%$ confidence intervals (CI). We find that for this DGP, the empirical coverage and length based on our selected model are similar to those based on the true models, especially when $T$ is relatively large.

In sum, for static panel models, when there is no serial correlation or serial correlation is low, CV, $\mathrm{CV}^{*}, \mathrm{CV}^{* *}$ and AIC all work well. In the absence of serial correlation, CV is the best performer. When serial correlation is high, only $\mathrm{CV}^{*}$ and $\mathrm{CV}^{* *}$ work in large samples and $\mathrm{CV}^{*}$ generally outperforms $\mathrm{CV}^{* *}$. Also it is noted that a relatively large $T$ is required for $\mathrm{CV}^{*}$ and $\mathrm{CV}^{* *}$ to work well in the presence of high correlation.

### 3.3 Dynamic panel models without exogenous regressors

We consider the following dynamic panel DGPs:

$$
\begin{array}{ll}
\text { DGP 2.1: } y_{i t}=1+\beta y_{i, t-1}+u_{i t} & \text { DGP 2.2: } y_{i t}=1+\beta y_{i, t-1}+\alpha_{i}+u_{i t} \\
\text { DGP 2.3: } y_{i t}=1+\beta y_{i, t-1}+\lambda_{t}+u_{i t} & \text { DGP 2.4: } y_{i t}=1+\beta y_{i, t-1}+\alpha_{i}+\lambda_{t}+u_{i t}
\end{array}
$$

where $\alpha_{i}, \lambda_{t}$ and $u_{i t}$ are mutually independent $N(0,1)$ random variables and $\beta=\frac{3}{4}$. The additional simulation results for $\beta=\frac{1}{4}$ and $\frac{1}{2}$ are reported in Tables E3 and E4 in Section E of the online supplement, respectively.

Tables 2 reports the simulations results for $\beta=\frac{3}{4}$. For most cases, our CV and CV-BC can select the correct method with a high probability and dominate other methods. Despite its inconsistency, AIC performs slightly worse than CV and CV-BC. For example, when the true model is Model 1, $(N, T)=(10,10)$, CV, CV-BC and AIC choose the correct model with probabilities of $71 \%, 85 \%$ and $63 \%$, respectively. Between CV and CV-BC, it is unclear which one is dominant. In general, when the true model is Model 1 or Model 3, CV-BC outperforms CV. Nevertheless, when the true model is Model 2 or Model 4, CV outperforms CV-BC. The performance of BIC is poor in many cases. For example, when the true model is Model 2 and $(N, T)=(50,10)$, BIC selects the correct model with zero probability. The performance of $\mathrm{BIC}_{2}$ is better than that of BIC, but still worse than those of CV and AIC in general.

Table 4C shows the MSEs of estimators of $\beta$ based on the four models and the selected model by CV when $\beta=\frac{3}{4}$. We consider both the non-bias corrected estimator and bias corrected estimator. For the bias correction, we adopt the half panel jackknife method as proposed in Dhaene and Jochmans (2015). For both types of estimators, the estimator based on the true model has the smallest MSE.

For example, when true model is Model 1 and $(N, T)=(10,10)$, the MSEs of the non-bias corrected estimator based on Model 4 is about 10 times as large as that based on Model 1, and the MSE of the bias corrected estimator based on Model 4 is about 5 times as large as that based on Model 1. The MSEs based on our selected models are close to those based on the true models when $T$ is large. When $T$ is small, in general, our model selection can also achieve a smaller MSE than a single fixed model. Table 4D shows that the empirical coverage and length of the $95 \%$ CI based on our selected model are comparable to those based on the true models, especially when $T$ is large.

### 3.4 Dynamic panel models with exogenous regressors

We consider the following dynamic panel DGPs with 5 exogenous regressors:

$$
\begin{aligned}
& \text { DGP 3.1: } y_{i t}=1+\beta y_{i, t-1}+\sum_{j=1}^{5} 0.2 x_{i t, j}+u_{i t} \\
& \text { DGP 3.2: } y_{i t}=1+\beta y_{i, t-1}+\sum_{j=1}^{5} 0.2 x_{i t, j}+\alpha_{i}+u_{i t} \\
& \text { DGP 3.3: } y_{i t}=1+\beta y_{i, t-1}+\sum_{j=1}^{5} 0.2 x_{i t, j}+\lambda_{t}+u_{i t} \\
& \text { DGP 3.4: } y_{i t}=1+\beta y_{i, t-1}+\sum_{j=1}^{5} 0.2 x_{i t, j}+\alpha_{i}+\lambda_{t}+u_{i t}
\end{aligned}
$$

where $x_{i t, 1}=1+\alpha_{i}+\lambda_{t}+\xi_{i t}$, and $x_{i t, 2}, x_{i t, 3}, x_{i t, 4}, x_{i t, 5}, \alpha_{i}, \lambda_{t}, u_{i t}$ and $\xi_{i t}$ are mutually independent $N(0,1)$ random variables, and $\beta=\frac{3}{4}$. The additional simulation results for $\beta=\frac{1}{4}$ and $\frac{1}{2}$ are reported in Tables E5 and E6 in Section E of the online supplement, respectively.

Table 3 represents the frequency of the model selected for $\beta=\frac{3}{4}$. The simulation results are similar to those in the dynamic models without exogenous regressors. In general, our CV and CVBC perform best, followed by AIC. CV, CV-BC and AIC all can select the correct model with a high probability, especially when the sample size is large. For example, when $(N, T)=(50,50)$, the correct probabilities are all close to $100 \%$. Again, between CV and CV-BC, there is no clearly dominant one. BIC performs poorly when the true model is Model 2 or Model 4. $\mathrm{BIC}_{2}$ outperforms BIC, but still underperforms CV, CV-BC and AIC.

## 4 Empirical Applications

In this section we consider three empirical applications that illustrate the usefulness of our method in selecting individual or time effects in panel data models.

### 4.1 Application I: Crime rates in North Carolina

Cornwell and Trumbull (1994) study the crime rates using the panel data on 90 counties in North Carolina over the period 1981 - 1987. The vector of explanatory variables $x_{i t}$ includes: (1) the probability of arrest, measured by the ratio of arrests to offences, (2) the probability of conviction given arrest, measured by the ratio of convictions to arrests, (3) the probability of a prison sentence given a conviction, measured by the proportion of total convictions resulting in prison sentences, (4) the average prison sentence in days, (5) the number of police per capita, (6) the population density, measured by the county population divided by the county land area, (7) the percentage of young male, measured by the proportion of the county's population that is male and between the ages of 15 and 24 , and $(8-16)$ the average weekly wage in the county in the following nine industries: $(i)$ construction, (ii) transportation, utilities and communication, (iii) wholesale and retail trade, (iv) finance, insurance and real estate, $(v)$ services, (vi) manufacturing, (vii) federal government, (viii) state government and (ix) local government. All the variables are in logarithm. Hence we have a static panel with $N=90, T=7$ and $k=17$ (including the constant). The same dataset is also used in Baltagi (2006) and Wu and Li (2014).

Table 5A presents the values of AIC, BIC, $\mathrm{BIC}_{2}, \mathrm{CV}, \mathrm{CV}^{*}$, and $\mathrm{CV}^{* *}$, where the number of lags $p$ used in $\mathrm{CV}^{*}$ and $\mathrm{CV}^{* *}$ is 1 . All these methods determine that Model 4 (i.e., including both individual and time fixed effects) is the correct model. For the value of $p$, both AIC and BIC choose $p=0$, while the testing procedure determines $p=1$.

Table 5B reports the estimates and $95 \%$ CIs for the coefficient on the probability of arrest. ${ }^{10}$ For the estimator without bias-correction, we consider both the non-clustered and clustered standard errors (SEs) where the clustered SEs are robust to the serial correlation in the error terms. Based on the selected Model 4, the point estimate is around -0.355 and the coefficient is significant at the $5 \%$ level. With bias-correction, the estimate is similar, -0.330 .

### 4.2 Application II: Cross-country saving rates

Su, Shi, and Phillips (2016) use a dynamic panel data model to study the determinants of savings rates. Following Edwards (1996), they let $y_{i t}$ be the ratio of savings to GDP for country $i$ in year $t$, and let $x_{i t}$ include ( $i$ ) its CPI-based inflation rate, (ii) its real interest rate, (iii) its per capita GDP growth rate and (iv) its lagged saving rate, i.e., $y_{i, t-1}$. Their dataset includes 56 countries over the period of 1995 - 2010. Hence, we have a dynamic panel data model with $N=56, T=15$, and $k=5$ (including the constant).

Table 6A shows the values of $\mathrm{AIC}, \mathrm{BIC}, \mathrm{BIC}_{2}, \mathrm{CV}$ and $\mathrm{CV}-\mathrm{BC}$. $\mathrm{AIC}, \mathrm{BIC}_{2}$, and CV all select Model 2, while BIC and CV-BC selects Model 1. We conclude that Model 2 (i.e., including individual

[^8]fixed effects only) is likely to be the correct model for the following reasons. First, Model 1 is rarely used in empirical research. Second, the performance of BIC is poor in the simulations. Third, the values of CV are less than or equal to the values of CV-BC. If we combine all values of CV and CV-BC, Model 2 will be chosen.

Table 6B presents the estimation and inference results for the coefficient on the per capita GDP growth rate. ${ }^{11}$ Given the dynamic specification, we report both the non-bias corrected and biascorrected results. The bias-correction is based on the half panel jackknife method as proposed in Dhaene and Jochmans (2015). Based on the selected Model 2, the bias-corrected estimate is 0.178 with the $95 \%$ CI of $[0.074,0.281]$.

### 4.3 Application III: Guns and crime in the U.S.

In the paper "Shooting down the 'More Guns less Crime' hypothesis", Ayres and Donohue (2003) consider how the "shall-issue" law affects the crime rates in the U.S., where the "shall-issue" law refers to whether local authorities can issue a concealed weapon permit if the applicants meet certain determinate criteria. So, here $y_{i t}$ is the logarithms of the violent crime rate for state $i$ in year $t$, which are measured by incidents per 100,000 members of the population. The key regressor in $x_{i t}$ is the "shall-issue" variable, which is 1 if the state has a shall-carry law in effect in that year and 0 otherwise. Other controls in $x_{i t}$ include ( $i$ ) the incarceration rate in the state in the previous year, which is measured by sentenced prisoners per 100,000 residents, ( $i i$ ) the population density per square mile of land area, divided by 1000 , (iii) the real per capita personal income in the state, in thousands of dollars, $(i v)$ the state population, in millions of people, $(v)$ the percentage of state population that is male with an age between 10 and $29,(v i)$ the percentage of state population that is white with an age between 10 to 64 and (vii) the percentage of state population that is black with an age between 10 and 64. The dataset contains 50 US states and the District of Columbia $(N=51)$ over the period of $1977-1999(T=23)$. The dataset is also discussed in the textbook by Stock and Watson (2012).

We consider a static panel model, where the dimension of $x_{i t}$ is $k=9$ (including constant). Table 7A shows the results for the model selection. All the information criteria and CV methods select Model 4 (i.e., including both individual and time fixed effects). For the value of $p$, both AIC and BIC determine $p=1$, while the testing procedure determines $p=2$. Considering this, we report the values of $\mathrm{CV}^{*}$ and $\mathrm{CV}^{* *}$ with $p=1$ and $p=2$.

In this application, the coefficient on the "shall issue" is often the parameter of interest. Table 7B reports the estimation and inference results. We find that the effect of the "shall issue" is not significant at the $5 \%$ level based on the selected Model 4. When we do not implement bias-correction,

[^9]the estimate is -0.028 with the $95 \%$ CI of $[-0.106,0.050]$ using the clustered SEs. When we implement bias-correction, the estimate is 0.015 with the $95 \%$ CI of [-0.027, 0.056]. In this application, whether to include individual fixed effects makes a difference. If we do not include individual effects, the effects of the "shall issue" are in general negative and significant at the $5 \%$ level. However, after including individual fixed effects, the significance is gone.

## 5 Conclusion

In this paper, we propose a jackknife method to determine fixed effects in panel data models based on the leave-one-out cross validation (CV) criterion function. We show that when the serial correlation and cross-sectional dependence in the error terms are weak, our new method can consistently select the correct model. We also modify the CV criterion function to take into account the strong serial correlation in the error term. Our simulations suggest that our new method outperforms the methods based on the information criteria such as AIC and BIC. We provide three empirical applications on (i) the crime rates in North Carolina, (ii) the determinants of saving rates across countries, and (iii) the relationship between guns and crime rates in the U.S.

Several extensions are possible. First, our method can be extended to multidimensional panel data models where there are many ways of incorporating fixed effects (see, e.g., Balazsi, Matyas, and Wansbeek (2017) for a review and Lu et al. (2019) for some ongoing work). Therefore, it is even more imperative to select an appropriate specification of fixed effects in multidimensional panels. Second, given the fact that there is no natural ordering along the cross-section dimension in general, it is not easy to extend our jackknife method as in Section 2.3 to allow for strong or moderate degree of cross-section dependence in the standard two-way or one-way panel. If cross-section dependence is a concern, one can follow Bai (2009) and consider the determination of individual effects, time effects, and interactive fixed effects (IFEs) in the following model

$$
y_{i t}=x_{i t}^{\prime} \beta+\alpha_{i}+\lambda_{t}+\gamma_{i}^{\prime} f_{t}+u_{i t}
$$

where $f_{t}$ is an $R \times 1$ vector of factors and $\gamma_{i}$ is an $R \times 1$ vector of factor loadings. The above equation models the cross-section dependence explicitly. Conceptually, we can apply the jackknife idea to the above models to select the number of factors and to determine the presence of $\alpha_{i}$ and/or $\lambda_{t}$ simultaneously. The major difficulty lies in the fact that after deleting one observation, the panel data becomes unbalanced, which is not easy to deal with due to the presence of unobservable factors (see, e.g., Bai, Liao and Yang (2015)). When the regressors also share the factor structure as in Pesaran (2006), we conjecture that we can augment Models 1-4 by the cross-sectional means of the dependent and independent variables and then apply our jackknife method. Alternatively, we could
model cross-sectional dependence using certain metric of economic distance, as in Conley (1999). We shall explore these topics in our future research.

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Table 1A: Frequency of the model selected: static panels, $\rho=0$

| True M |  | Model 1 |  |  |  | Model 2 |  |  |  | Model 3 |  |  |  | Model 4 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Selected M |  | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 |
| ( $\mathrm{N}, \mathrm{T}$ ) |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| AIC | $(10,5)$ | . 80 | . 06 | . 11 | . 03 | . 04 | . 74 | . 02 | . 20 | . 05 | . 01 | . 82 | . 13 | . 06 | . 05 | . 04 | . 86 |
|  | $(50,5)$ | . 90 | 0 | . 10 | 0 | 0 | . 84 | 0 | . 16 | . 01 | 0 | . 99 | 0 | 0 | 0 | 0 | 1 |
|  | $(10,10)$ | . 90 | . 06 | . 04 | . 01 | . 01 | . 91 | 0 | . 08 | . 01 | 0 | . 90 | . 09 | 0 | . 01 | . 01 | . 98 |
|  | $(50,10)$ | . 96 | 0 | . 04 | 0 | 0 | . 93 | 0 | . 07 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 97 | . 03 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 95 | . 05 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| BIC | $(10,5)$ | . 99 | 0 | . 01 | 0 | . 49 | . 46 | . 04 | . 01 | . 23 | 0 | . 77 | 0 | . 74 | . 02 | . 06 | . 18 |
|  | $(50,5)$ | 1 | 0 | 0 | 0 | . 51 | 0 | . 49 | 0 | . 03 | 0 | . 97 | 0 | . 52 | 0 | . 48 | 0 |
|  | $(10,10)$ | 1 | 0 | 0 | 0 | . 14 | . 86 | 0 | 0 | . 20 | 0 | . 80 | 0 | . 74 | . 03 | . 01 | . 22 |
|  | $(50,10)$ | 1 | 0 | 0 | 0 | . 41 | . 39 | . 20 | 0 | 0 | 0 | 1 | 0 | . 54 | 0 | . 41 | . 05 |
|  | $(10,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | . 35 | . 28 | . 37 | 0 | . 40 | . 56 | 0 | . 04 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| $\mathrm{BIC}_{2}$ | $(10,5)$ | . 44 | . 20 | . 17 | . 20 | 0 | . 59 | . 01 | . 41 | . 02 | . 02 | . 56 | . 40 | 0 | . 04 | . 01 | . 95 |
|  | $(50,5)$ | . 85 | . 01 | . 14 | . 01 | 0 | . 76 | 0 | . 24 | 0 | 0 | . 98 | . 02 | 0 | 0 | 0 | 1 |
|  | $(10,10)$ | . 65 | . 13 | . 16 | . 06 | 0 | . 74 | 0 | . 26 | 0 | 0 | . 76 | . 24 | 0 | 0 | 0 | 1 |
|  | $(50,10)$ | . 93 | 0 | . 07 | 0 | 0 | . 90 | 0 | . 11 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 94 | . 06 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 90 | . 10 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| CV | $(10,5)$ | . 87 | . 03 | . 10 | 0 | . 08 | . 80 | . 03 | . 08 | . 07 | . 01 | . 90 | . 03 | . 15 | . 07 | . 08 | . 70 |
|  | $(50,5)$ | . 90 | 0 | . 10 | 0 | 0 | . 90 | . 01 | . 09 | . 01 | 0 | 1 | 0 | 0 | 0 | . 02 | . 98 |
|  | $(10,10)$ | . 93 | . 04 | . 03 | 0 | . 01 | . 96 | 0 | . 03 | . 01 | 0 | . 95 | . 04 | . 01 | . 02 | . 01 | . 96 |
|  | $(50,10)$ | . 96 | 0 | . 04 | 0 | 0 | . 97 | 0 | . 04 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 97 | . 03 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 98 | . 02 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| CV* | $(10,5)$ | . 68 | . 20 | . 09 | . 03 | . 04 | . 83 | . 03 | . 11 | . 07 | . 03 | . 72 | . 19 | . 10 | . 10 | . 05 | . 76 |
|  | $(50,5)$ | . 79 | . 12 | . 08 | . 01 | 0 | . 89 | 0 | . 11 | 0 | 0 | . 87 | . 12 | 0 | . 01 | 0 | 1 |
|  | $(10,10)$ | . 85 | . 11 | . 04 | . 01 | . 01 | . 95 | 0 | . 04 | . 01 | 0 | . 88 | . 10 | . 01 | . 02 | . 01 | . 96 |
|  | $(50,10)$ | . 94 | . 01 | . 05 | 0 | 0 | . 95 | 0 | . 05 | 0 | 0 | . 99 | . 01 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 96 | . 04 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 96 | . 04 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| CV** | $(10,5)$ | . 81 | . 08 | . 10 | . 02 | . 16 | . 69 | . 07 | . 08 | . 11 | . 02 | . 80 | . 08 | . 15 | . 09 | . 19 | . 58 |
|  | $(50,5)$ | . 89 | 0 | . 11 | 0 | . 15 | . 51 | . 28 | . 06 | . 01 | 0 | . 99 | 0 | . 02 | . 01 | . 49 | . 49 |
|  | $(10,10)$ | . 89 | . 07 | . 03 | 0 | . 01 | . 95 | 0 | . 04 | . 01 | 0 | . 91 | . 08 | . 01 | . 02 | . 02 | . 94 |
|  | $(50,10)$ | . 96 | 0 | . 04 | 0 | 0 | . 95 | 0 | . 05 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 97 | . 03 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 96 | . 04 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |

Table 1B: Frequency of the model selected: static panels, $\rho=1 / 3$

| True M |  | Model 1 |  |  |  | Model 2 |  |  |  | Model 3 |  |  |  | Model 4 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Selected M |  | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 |
| (N,T) |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| AIC | $(10,5)$ | . 41 | . 42 | . 05 | . 13 | . 01 | . 78 | . 01 | . 20 | . 03 | . 03 | . 38 | . 56 | . 02 | . 05 | . 01 | . 92 |
|  | $(50,5)$ | . 41 | . 46 | . 03 | . 10 | 0 | . 83 | 0 | . 17 | 0 | 0 | . 41 | . 59 | 0 | 0 | 0 | 1 |
|  | $(10,10)$ | . 47 | . 44 | . 03 | . 06 | . 01 | . 89 | 0 | . 11 | . 01 | 0 | . 44 | . 55 | 0 | . 01 | . 01 | . 98 |
|  | $(50,10)$ | . 45 | . 49 | . 02 | . 04 | 0 | . 91 | 0 | . 09 | 0 | 0 | . 44 | . 56 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 57 | . 43 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 48 | . 52 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | . 53 | . 47 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 49 | . 51 | 0 | 0 | 0 | 1 |
| BIC | $(10,5)$ | . 95 | . 04 | . 01 | 0 | . 31 | . 66 | . 02 | . 01 | . 27 | . 01 | . 67 | . 05 | . 55 | . 05 | . 04 | . 36 |
|  | $(50,5)$ | 1 | 0 | 0 | 0 | . 55 | . 02 | . 43 | 0 | . 04 | 0 | . 97 | 0 | . 57 | 0 | . 43 | 0 |
|  | $(10,10)$ | . 99 | . 01 | 0 | 0 | . 10 | . 90 | 0 | 0 | . 27 | . 01 | . 70 | . 01 | . 61 | . 06 | . 01 | . 32 |
|  | $(50,10)$ | 1 | 0 | 0 | 0 | . 28 | . 65 | . 07 | 0 | 0 | 0 | 1 | 0 | . 49 | 0 | . 29 | . 22 |
|  | $(10,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | . 38 | . 45 | . 17 | 0 | . 37 | . 61 | 0 | . 02 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| $\mathrm{BIC}_{2}$ | $(10,5)$ | . 14 | . 45 | . 05 | . 36 | 0 | . 58 | 0 | . 42 | . 01 | . 02 | . 16 | . 81 | 0 | . 03 | 0 | . 97 |
|  | $(50,5)$ | . 15 | . 63 | . 02 | . 20 | 0 | . 76 | 0 | . 24 | 0 | 0 | . 15 | . 85 | 0 | 0 | 0 | 1 |
|  | $(10,10)$ | . 24 | . 52 | . 05 | . 20 | 0 | . 74 | 0 | . 25 | 0 | 0 | . 25 | . 75 | 0 | 0 | 0 | 1 |
|  | $(50,10)$ | . 28 | . 62 | . 02 | . 09 | 0 | . 89 | 0 | . 12 | 0 | 0 | . 28 | . 72 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 47 | . 52 | . 01 | 0 | 0 | . 99 | 0 | . 01 | 0 | 0 | . 41 | . 59 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | . 60 | . 40 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 56 | . 44 | 0 | 0 | 0 | 1 |
| CV | $(10,5)$ | . 55 | . 36 | . 05 | . 04 | . 03 | . 87 | . 01 | . 09 | . 05 | . 03 | . 57 | . 35 | . 07 | . 08 | . 04 | . 82 |
|  | $(50,5)$ | . 64 | . 29 | . 05 | . 03 | 0 | . 90 | 0 | . 11 | . 01 | 0 | . 68 | . 31 | 0 | 0 | 0 | 1 |
|  | $(10,10)$ | . 54 | . 42 | . 02 | . 02 | . 01 | . 94 | 0 | . 05 | . 01 | . 01 | . 57 | . 41 | 0 | . 02 | . 01 | . 97 |
|  | $(50,10)$ | . 55 | . 41 | . 02 | . 02 | 0 | . 95 | 0 | . 05 | 0 | 0 | . 58 | . 42 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 58 | . 42 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 58 | . 43 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | . 56 | . 44 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 56 | . 44 | 0 | 0 | 0 | 1 |
| CV* | $(10,5)$ | . 50 | . 40 | . 05 | . 05 | . 03 | . 86 | . 01 | . 10 | . 04 | . 04 | . 52 | . 40 | . 06 | . 07 | . 03 | . 83 |
|  | $(50,5)$ | . 58 | . 34 | . 04 | . 04 | 0 | . 89 | 0 | . 11 | . 01 | 0 | . 62 | . 37 | 0 | 0 | 0 | 1 |
|  | $(10,10)$ | . 64 | . 31 | . 04 | . 02 | . 02 | . 93 | 0 | . 06 | . 01 | . 01 | . 67 | . 31 | . 01 | . 02 | . 02 | . 95 |
|  | $(50,10)$ | . 85 | . 10 | . 04 | . 01 | 0 | . 95 | 0 | . 05 | 0 | 0 | . 90 | . 10 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 93 | . 07 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 93 | . 07 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| CV** | $(10,5)$ | . 57 | . 34 | . 05 | . 04 | . 08 | . 80 | . 02 | . 09 | . 05 | . 04 | . 58 | . 33 | . 07 | . 08 | . 09 | . 76 |
|  | $(50,5)$ | . 67 | . 26 | . 05 | . 03 | . 02 | . 85 | . 03 | . 10 | . 01 | 0 | . 72 | . 28 | 0 | . 01 | . 06 | . 93 |
|  | $(10,10)$ | . 67 | . 28 | . 04 | . 02 | . 18 | . 74 | . 03 | . 04 | . 01 | . 01 | . 71 | . 28 | . 01 | . 02 | . 30 | . 67 |
|  | $(50,10)$ | . 92 | . 03 | . 05 | 0 | . 09 | . 75 | . 13 | . 03 | 0 | 0 | . 97 | . 03 | 0 | 0 | . 34 | . 66 |
|  | $(10,50)$ | . 95 | . 05 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 95 | . 05 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |

Table 1C: Frequency of the model selected: static panels, $\rho=3 / 4$

| True M |  | Model 1 |  |  |  | Model 2 |  |  |  | Model 3 |  |  |  | Model 4 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Selected M |  | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 |
| (N,T) |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| AIC | $(10,5)$ | . 02 | . 77 | 0 | . 21 | . 01 | . 78 | 0 | . 21 | 0 | . 05 | . 02 | . 93 | 0 | . 05 | 0 | . 94 |
|  | $(50,5)$ | 0 | . 80 | 0 | . 20 | 0 | . 80 | 0 | . 20 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 1 |
|  | $(10,10)$ | . 01 | . 84 | 0 | . 14 | 0 | . 85 | 0 | . 15 | 0 | . 03 | . 01 | . 96 | 0 | . 03 | 0 | . 97 |
|  | $(50,10)$ | 0 | . 87 | 0 | . 13 | 0 | . 87 | 0 | . 13 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 02 | . 95 | 0 | . 03 | 0 | . 97 | 0 | . 03 | 0 | . 01 | . 01 | . 98 | 0 | . 01 | 0 | . 99 |
|  | $(50,50)$ | 0 | . 98 | 0 | . 02 | 0 | . 98 | 0 | . 02 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 1 |
| BIC | $(10,5)$ | . 20 | . 77 | 0 | . 03 | . 05 | . 91 | 0 | . 04 | . 11 | . 16 | . 10 | . 63 | . 13 | . 18 | . 01 | . 68 |
|  | $(50,5)$ | . 52 | . 48 | 0 | . 01 | . 06 | . 93 | . 01 | . 01 | . 06 | . 01 | . 44 | . 50 | . 10 | . 02 | . 03 | . 86 |
|  | $(10,10)$ | . 24 | . 75 | 0 | . 01 | . 04 | . 95 | 0 | . 01 | . 19 | . 36 | . 08 | . 38 | . 19 | . 38 | . 01 | . 42 |
|  | $(50,10)$ | . 47 | . 53 | 0 | 0 | . 01 | . 99 | 0 | 0 | . 02 | 0 | . 42 | . 56 | . 06 | . 01 | 0 | . 94 |
|  | $(10,50)$ | . 47 | . 53 | 0 | 0 | 0 | 1 | 0 | 0 | . 25 | . 76 | 0 | 0 | . 23 | . 77 | 0 | 0 |
|  | $(50,50)$ | . 77 | . 23 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 74 | . 26 | 0 | 0 | 0 | 1 |
| $\mathrm{BIC}_{2}$ | $(10,5)$ | . 01 | . 61 | 0 | . 38 | 0 | . 62 | 0 | . 38 | 0 | . 02 | . 01 | . 97 | 0 | . 02 | 0 | . 98 |
|  | $(50,5)$ | 0 | . 75 | 0 | . 25 | 0 | . 75 | 0 | . 25 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 1 |
|  | $(10,10)$ | 0 | . 74 | 0 | . 26 | 0 | . 74 | 0 | . 26 | 0 | . 01 | . 01 | . 98 | 0 | . 01 | 0 | . 99 |
|  | $(50,10)$ | 0 | . 84 | 0 | . 16 | 0 | . 84 | 0 | . 16 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 01 | . 94 | 0 | . 05 | 0 | . 95 | 0 | . 05 | 0 | . 01 | . 01 | . 99 | 0 | . 01 | 0 | 1 |
|  | $(50,50)$ | 0 | . 98 | 0 | . 02 | 0 | . 98 | 0 | . 02 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 1 |
| CV | $(10,5)$ | . 04 | . 85 | 0 | . 11 | . 01 | . 88 | 0 | . 11 | . 01 | . 08 | . 04 | . 87 | . 01 | . 08 | . 01 | . 91 |
|  | $(50,5)$ | 0 | . 87 | 0 | . 13 | 0 | . 87 | 0 | . 13 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 1 |
|  | $(10,10)$ | . 02 | . 90 | . 01 | . 08 | 0 | . 92 | 0 | . 08 | . 01 | . 06 | . 03 | . 91 | 0 | . 06 | 0 | . 94 |
|  | $(50,10)$ | 0 | . 91 | 0 | . 09 | 0 | . 91 | 0 | . 09 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 02 | . 96 | 0 | . 02 | 0 | . 98 | 0 | . 02 | 0 | . 02 | . 03 | . 95 | 0 | . 02 | 0 | . 98 |
|  | $(50,50)$ | 0 | . 98 | 0 | . 02 | 0 | . 98 | 0 | . 02 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 1 |
| CV* | $(10,5)$ | . 08 | . 79 | . 01 | . 12 | . 02 | . 85 | . 01 | . 12 | . 01 | . 07 | . 09 | . 83 | . 01 | . 07 | . 03 | . 89 |
|  | $(50,5)$ | 0 | . 87 | 0 | . 12 | 0 | . 88 | 0 | . 12 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 1 |
|  | $(10,10)$ | . 30 | . 63 | . 02 | . 05 | . 04 | . 90 | 0 | . 07 | . 01 | 0 | . 32 | . 68 | 0 | . 01 | . 05 | . 94 |
|  | $(50,10)$ | . 15 | . 79 | . 01 | . 05 | 0 | . 94 | 0 | . 06 | 0 | 0 | . 17 | . 83 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 70 | . 30 | 0 | 0 | . 01 | . 99 | 0 | 0 | 0 | 0 | . 68 | . 32 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | . 95 | . 05 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 95 | . 05 | 0 | 0 | 0 | 1 |
| CV** | $(10,5)$ | . 25 | . 62 | . 04 | . 10 | . 21 | . 65 | . 04 | . 11 | . 03 | . 06 | . 26 | . 65 | . 03 | . 06 | . 24 | . 67 |
|  | $(50,5)$ | . 54 | . 34 | . 07 | . 05 | . 43 | . 39 | . 12 | . 06 | 0 | 0 | . 62 | . 38 | 0 | 0 | . 57 | . 42 |
|  | $(10,10)$ | . 66 | . 29 | . 03 | . 02 | . 53 | . 41 | . 04 | . 02 | . 01 | 0 | . 73 | . 26 | . 01 | 0 | . 64 | . 36 |
|  | $(50,10)$ | . 87 | . 09 | . 04 | 0 | . 65 | . 23 | . 11 | . 01 | 0 | 0 | . 91 | . 09 | 0 | 0 | . 82 | . 19 |
|  | $(10,50)$ | . 91 | . 09 | 0 | 0 | . 33 | . 67 | 0 | 0 | 0 | 0 | . 92 | . 08 | 0 | 0 | . 54 | . 46 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | . 18 | . 82 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | . 55 | . 45 |

Table 2: Frequency of the model selected: dynamic panels without exogenous regressors, $\beta=3 / 4$

| True M |  | Model 1 |  |  |  | Model 2 |  |  |  | Model 3 |  |  |  | Model 4 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Selected M |  | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 |
| (N,T) |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| AIC | $(10,5)$ | . 37 | . 45 | . 04 | . 15 | . 09 | . 70 | . 01 | . 20 | . 03 | . 03 | . 34 | . 60 | . 01 | . 05 | . 08 | . 87 |
|  | $(50,5)$ | . 44 | . 44 | . 05 | . 07 | . 01 | . 84 | 0 | . 15 | 0 | 0 | . 45 | . 54 | 0 | 0 | . 01 | . 99 |
|  | $(10,10)$ | . 63 | . 30 | . 03 | . 03 | . 05 | . 87 | 0 | . 08 | . 01 | 0 | . 61 | . 39 | 0 | 0 | . 05 | . 95 |
|  | $(50,10)$ | . 83 | . 12 | . 03 | . 02 | 0 | . 93 | 0 | . 08 | 0 | 0 | . 85 | . 16 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 92 | . 08 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 89 | . 12 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| BIC | $(10,5)$ | . 97 | . 03 | 0 | 0 | . 87 | . 12 | 0 | 0 | . 20 | . 01 | . 76 | . 04 | . 15 | . 02 | . 71 | . 12 |
|  | $(50,5)$ | 1 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | . 03 | 0 | . 98 | 0 | . 02 | 0 | . 98 | 0 |
|  | $(10,10)$ | 1 | 0 | 0 | 0 | . 95 | . 05 | 0 | 0 | . 12 | 0 | . 87 | . 01 | . 09 | . 01 | . 85 | . 05 |
|  | $(50,10)$ | 1 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 1 | 0 |
|  | $(10,50)$ | 1 | 0 | 0 | 0 | . 08 | . 92 | 0 | 0 | . 09 | 0 | . 91 | 0 | . 03 | . 05 | . 08 | . 84 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | . 91 | . 10 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | . 90 | . 10 |
| $\mathrm{BIC}_{2}$ | $(10,5)$ | . 09 | . 52 | . 03 | . 36 | 0 | . 60 | 0 | . 40 | 0 | . 02 | . 10 | . 88 | 0 | . 03 | 0 | . 97 |
|  | $(50,5)$ | . 13 | . 65 | . 02 | . 20 | 0 | . 77 | 0 | . 23 | 0 | 0 | . 14 | . 86 | 0 | 0 | 0 | 1 |
|  | $(10,10)$ | . 33 | . 45 | . 05 | . 17 | . 01 | . 75 | 0 | . 24 | 0 | 0 | . 35 | . 65 | 0 | 0 | . 01 | . 99 |
|  | $(50,10)$ | . 66 | . 26 | . 04 | . 04 | 0 | . 90 | 0 | . 10 | 0 | 0 | . 68 | . 33 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 89 | . 11 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 84 | . 17 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| CV | $(10,5)$ | . 54 | . 36 | . 05 | . 05 | . 20 | . 69 | . 03 | . 08 | . 05 | . 03 | . 58 | . 34 | . 02 | . 07 | . 29 | . 63 |
|  | $(50,5)$ | . 70 | . 21 | . 07 | . 02 | . 09 | . 83 | . 01 | . 07 | 0 | 0 | . 78 | . 21 | 0 | 0 | . 12 | . 88 |
|  | $(10,10)$ | . 71 | . 26 | . 02 | . 01 | . 08 | . 88 | 0 | . 04 | . 01 | 0 | . 76 | 23 | 0 | . 01 | . 14 | . 85 |
|  | $(50,10)$ | . 89 | . 07 | . 03 | . 01 | . 01 | . 95 | 0 | . 04 | 0 | 0 | . 92 | . 08 | 0 | 0 | . 01 | . 99 |
|  | $(10,50)$ | . 93 | . 07 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 93 | . 07 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| CV-BC | $(10,5)$ | . 74 | . 16 | . 07 | . 02 | . 51 | . 38 | . 06 | . 05 | . 06 | . 01 | . 77 | . 16 | . 04 | . 04 | . 58 | . 35 |
|  | $(50,5)$ | . 90 | . 02 | . 08 | 0 | . 66 | . 24 | . 08 | . 02 | 0 | 0 | . 98 | . 02 | 0 | 0 | . 76 | . 24 |
|  | $(10,10)$ | . 85 | . 12 | . 03 | . 01 | . 39 | . 58 | . 01 | . 02 | . 01 | 0 | . 89 | . 10 | . 01 | 0 | . 46 | . 53 |
|  | $(50,10)$ | . 95 | . 01 | . 04 | 0 | . 34 | . 60 | . 02 | . 04 | 0 | 0 | . 99 | . 01 | 0 | 0 | . 39 | . 61 |
|  | $(10,50)$ | . 95 | . 05 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 96 | . 04 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |

Table 3: Frequency of the model selected: dynamic panels with exogenous regressors, $\beta=3 / 4$

| True M |  | Model 1 |  |  |  | Model 2 |  |  |  | Model 3 |  |  |  | Model 4 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Selected M |  | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 |
| ( $\mathrm{N}, \mathrm{T}$ ) |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| AIC | $(10,5)$ | . 37 | . 38 | . 06 | . 20 | . 14 | . 56 | . 04 | . 26 | . 04 | . 04 | . 35 | . 57 | . 02 | . 06 | . 14 | . 78 |
|  | $(50,5)$ | . 59 | . 25 | . 06 | . 10 | . 10 | . 64 | . 02 | . 24 | 0 | 0 | . 61 | . 39 | 0 | 0 | . 11 | . 89 |
|  | $(10,10)$ | . 64 | . 27 | . 03 | . 06 | . 13 | . 76 | . 01 | . 10 | 0 | 0 | . 61 | . 38 | . 01 | . 01 | . 14 | . 84 |
|  | $(50,10)$ | . 88 | . 07 | . 03 | . 02 | . 04 | . 85 | 0 | . 11 | 0 | 0 | . 89 | . 11 | 0 | 0 | . 05 | . 95 |
|  | $(10,50)$ | . 93 | . 08 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 88 | . 12 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| BIC | $(10,5)$ | . 95 | . 04 | . 01 | 0 | . 86 | . 11 | . 01 | . 01 | . 27 | . 01 | . 66 | . 06 | . 35 | . 02 | . 53 | . 11 |
|  | $(50,5)$ | 1 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | . 03 | 0 | . 97 | 0 | . 04 | 0 | . 96 | 0 |
|  | $(10,10)$ | 1 | 0 | 0 | 0 | . 96 | . 04 | 0 | 0 | . 26 | 0 | . 74 | 0 | . 48 | . 01 | . 49 | . 03 |
|  | $(50,10)$ | 1 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 0 | 1 | 0 | . 01 | 0 | . 99 | 0 |
|  | $(10,50)$ | 1 | 0 | 0 | 0 | . 38 | . 62 | 0 | 0 | . 44 | . 24 | . 32 | 0 | . 98 | . 01 | 0 | . 01 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 1 | 0 |
| $\mathrm{BIC}_{2}$ | $(10,5)$ | . 11 | . 41 | . 05 | . 45 | . 02 | . 48 | . 01 | . 49 | . 01 | . 03 | . 13 | . 83 | 0 | . 04 | . 03 | . 93 |
|  | $(50,5)$ | . 23 | . 47 | . 04 | . 27 | . 01 | . 64 | 0 | . 35 | 0 | 0 | . 24 | . 76 | 0 | 0 | . 01 | . 99 |
|  | $(10,10)$ | . 36 | . 39 | . 07 | . 18 | . 02 | . 69 | . 02 | . 27 | 0 | 0 | . 37 | . 63 | 0 | 0 | . 04 | . 96 |
|  | $(50,10)$ | . 75 | . 16 | . 05 | . 04 | . 01 | . 83 | 0 | . 16 | 0 | 0 | . 78 | . 22 | 0 | 0 | . 01 | . 99 |
|  | $(10,50)$ | . 89 | . 11 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 84 | . 17 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| CV | $(10,5)$ | . 65 | . 23 | . 07 | . 05 | . 41 | . 45 | . 06 | . 07 | . 09 | . 04 | . 66 | . 21 | . 10 | . 07 | . 44 | . 39 |
|  | $(50,5)$ | . 82 | . 08 | . 08 | . 02 | . 36 | . 48 | . 07 | . 09 | 0 | 0 | . 89 | . 10 | 0 | 0 | . 47 | . 53 |
|  | $(10,10)$ | . 78 | . 19 | . 02 | . 01 | . 24 | . 71 | . 01 | . 03 | . 01 | . 01 | . 81 | . 17 | . 03 | . 01 | . 37 | . 59 |
|  | $(50,10)$ | . 93 | . 03 | . 03 | 0 | . 08 | . 85 | . 01 | . 06 | 0 | 0 | . 96 | . 04 | 0 | 0 | . 13 | . 87 |
|  | $(10,50)$ | . 93 | . 07 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 93 | . 07 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| CV-BC | $(10,5)$ | . 84 | . 05 | . 10 | . 02 | . 74 | . 13 | . 11 | . 03 | . 12 | . 01 | . 82 | . 05 | . 15 | . 02 | . 73 | . 09 |
|  | $(50,5)$ | . 91 | 0 | . 08 | 0 | . 78 | . 05 | . 14 | . 02 | . 01 | 0 | . 99 | . 01 | 0 | 0 | . 92 | . 07 |
|  | $(10,10)$ | . 89 | . 07 | . 03 | 0 | . 57 | . 39 | . 03 | . 02 | . 01 | 0 | . 92 | . 07 | . 04 | . 01 | . 61 | . 34 |
|  | $(50,10)$ | . 96 | 0 | . 03 | 0 | . 56 | . 33 | . 08 | . 04 | 0 | 0 | 1 | 0 | 0 | 0 | . 68 | . 33 |
|  | $(10,50)$ | . 96 | . 04 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 96 | . 04 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |

Table 4A: MSEs $\times 1000$ : static panels, $\rho=0$

|  | Adopted Model | M1 | M2 | M3 | M4 | Selected by CV |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| True Model |  |  |  |  |  |  |
| M1 | $\mathrm{N}=10 \mathrm{~T}=5$ | 8.03 | 14.56 | 11.41 | 29.77 | 9.83 |
|  | $\mathrm{N}=50 \mathrm{~T}=5$ | 1.45 | 2.82 | 2.05 | 5.23 | 1.61 |
|  | $\mathrm{N}=10 \mathrm{~T}=10$ | 3.79 | 6.32 | 5.83 | 13.16 | 4.16 |
|  | $\mathrm{N}=50 \mathrm{~T}=10$ | 0.71 | 1.23 | 1.02 | 2.31 | 0.73 |
|  | $\mathrm{N}=10 \mathrm{~T}=50$ | 0.68 | 1.03 | 0.99 | 2.16 | 0.69 |
|  | $\mathrm{N}=50 \mathrm{~T}=50$ | 0.14 | 0.21 | 0.21 | 0.41 | 0.14 |
| M2 | $\mathrm{N}=10 \mathrm{~T}=5$ | 165.85 | 14.56 | 300.24 | 29.77 | 36.35 |
|  | $\mathrm{N}=50 \mathrm{~T}=5$ | 148.68 | 2.82 | 262.69 | 5.23 | 5.11 |
|  | $\mathrm{N}=10 \mathrm{~T}=10$ | 145.62 | 6.32 | 295.26 | 13.16 | 6.99 |
|  | $\mathrm{N}=50 \mathrm{~T}=10$ | 130.7 | 1.23 | 259.24 | 2.31 | 1.31 |
|  | $\mathrm{N}=10 \mathrm{~T}=50$ | 128.66 | 1.03 | 287.75 | 2.16 | 1.03 |
|  | $\mathrm{N}=50 \mathrm{~T}=50$ | 117.76 | 0.21 | 258.94 | 0.41 | 0.21 |
| M3 | $\mathrm{N}=10 \mathrm{~T}=5$ | 94.25 | 250.15 | 11.41 | 29.77 | 14.62 |
|  | $\mathrm{N}=50 \mathrm{~T}=5$ | 82.01 | 223.07 | 2.05 | 5.23 | 2.05 |
|  | $\mathrm{N}=10 \mathrm{~T}=10$ | 102.06 | 245.89 | 5.83 | 13.16 | 6.66 |
|  | $\mathrm{N}=50 \mathrm{~T}=10$ | 94.97 | 235.31 | 1.02 | 2.31 | 1.02 |
|  | $\mathrm{N}=10 \mathrm{~T}=50$ | 109.93 | 249.80 | 0.99 | 2.16 | 1.01 |
|  | $\mathrm{N}=50 \mathrm{~T}=50$ | 107.42 | 246.93 | 0.21 | 0.41 | 0.21 |
| M4 | $\mathrm{N}=10 \mathrm{~T}=5$ | 427.81 | 250.15 | 300.24 | 29.77 | 103.77 |
|  | $\mathrm{N}=50 \mathrm{~T}=5$ | 404.04 | 223.07 | 262.69 | 5.23 | 9.38 |
|  | $\mathrm{N}=10 \mathrm{~T}=10$ | 440.18 | 245.89 | 295.26 | 13.16 | 17.93 |
|  | $\mathrm{N}=50 \mathrm{~T}=10$ | 422.87 | 235.31 | 259.24 | 2.31 | 2.31 |
|  | $\mathrm{N}=10 \mathrm{~T}=50$ | 448.25 | 249.80 | 287.75 | 2.16 | 2.16 |
|  | $\mathrm{N}=50 \mathrm{~T}=50$ | 441.74 | 246.93 | 258.94 | 0.41 | 0.41 |

Table 4B: Coverages and length of $95 \%$ CIs: static panels, $\rho=0$

| True Model | Adopted Model | Coverages |  |  |  |  | Length |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | M1 | M2 | M3 | M4 | CV | M1 | M2 | M3 | M4 | CV |
|  |  |  |  |  |  |  |  |  |  |  |  |
| M1 | $\mathrm{N}=10 \mathrm{~T}=5$ | 0.93 | 0.90 | 0.92 | 0.88 | 0.91 | 0.32 | 0.39 | 0.37 | 0.54 | 0.32 |
|  | $\mathrm{N}=50 \mathrm{~T}=5$ | 0.96 | 0.91 | 0.94 | 0.91 | 0.94 | 0.15 | 0.18 | 0.17 | 0.25 | 0.15 |
|  | $\mathrm{N}=10 \mathrm{~T}=10$ | 0.93 | 0.92 | 0.92 | 0.90 | 0.92 | 0.23 | 0.28 | 0.26 | 0.38 | 0.23 |
|  | $\mathrm{N}=50 \mathrm{~T}=10$ | 0.96 | 0.93 | 0.95 | 0.94 | 0.96 | 0.10 | 0.13 | 0.12 | 0.17 | 0.10 |
|  | $\mathrm{N}=10 \mathrm{~T}=50$ | 0.94 | 0.95 | 0.94 | 0.94 | 0.94 | 0.10 | 0.12 | 0.12 | 0.17 | 0.10 |
|  | $\mathrm{N}=50 \mathrm{~T}=50$ | 0.95 | 0.95 | 0.95 | 0.95 | 0.95 | 0.05 | 0.06 | 0.05 | 0.08 | 0.05 |
| M2 | $\mathrm{N}=10 \mathrm{~T}=5$ | 0.13 | 0.90 | 0.07 | 0.88 | 0.81 | 0.40 | 0.39 | 0.45 | 0.54 | 0.40 |
|  | $\mathrm{N}=50 \mathrm{~T}=5$ | 0.00 | 0.91 | 0.00 | 0.91 | 0.89 | 0.19 | 0.18 | 0.21 | 0.25 | 0.19 |
|  | $\mathrm{N}=10 \mathrm{~T}=10$ | 0.05 | 0.92 | 0.02 | 0.90 | 0.91 | 0.29 | 0.28 | 0.32 | 0.38 | 0.28 |
|  | $\mathrm{N}=50 \mathrm{~T}=10$ | 0.00 | 0.93 | 0.00 | 0.94 | 0.93 | 0.13 | 0.13 | 0.15 | 0.17 | 0.13 |
|  | $\mathrm{N}=10 \mathrm{~T}=50$ | 0.00 | 0.95 | 0.00 | 0.94 | 0.95 | 0.13 | 0.12 | 0.14 | 0.17 | 0.12 |
|  | $\mathrm{N}=50 \mathrm{~T}=50$ | 0.00 | 0.95 | 0.00 | 0.95 | 0.95 | 0.06 | 0.06 | 0.07 | 0.08 | 0.06 |
| M3 | $\mathrm{N}=10 \mathrm{~T}=5$ | 0.34 | 0.17 | 0.92 | 0.88 | 0.89 | 0.38 | 0.46 | 0.37 | 0.54 | 0.37 |
|  | $\mathrm{N}=50 \mathrm{~T}=5$ | 0.11 | 0.04 | 0.94 | 0.91 | 0.94 | 0.18 | 0.21 | 0.17 | 0.25 | 0.17 |
|  | $\mathrm{N}=10 \mathrm{~T}=10$ | 0.09 | 0.03 | 0.92 | 0.90 | 0.91 | 0.28 | 0.33 | 0.26 | 0.38 | 0.27 |
|  | $\mathrm{N}=50 \mathrm{~T}=10$ | 0.01 | 0.00 | 0.95 | 0.94 | 0.95 | 0.13 | 0.15 | 0.12 | 0.17 | 0.12 |
|  | $\mathrm{N}=10 \mathrm{~T}=50$ | 0.00 | 0.00 | 0.94 | 0.94 | 0.94 | 0.13 | 0.15 | 0.12 | 0.17 | 0.12 |
|  | $\mathrm{N}=50 \mathrm{~T}=50$ | 0.00 | 0.00 | 0.95 | 0.95 | 0.95 | 0.06 | 0.07 | 0.05 | 0.08 | 0.05 |
| M4 | $\mathrm{N}=10 \mathrm{~T}=5$ | 0.01 | 0.17 | 0.07 | 0.88 | 0.66 | 0.41 | 0.46 | 0.45 | 0.54 | 0.49 |
|  | $\mathrm{N}=50 \mathrm{~T}=5$ | 0.00 | 0.04 | 0.00 | 0.91 | 0.89 | 0.19 | 0.21 | 0.21 | 0.25 | 0.24 |
|  | $\mathrm{N}=10 \mathrm{~T}=10$ | 0.00 | 0.03 | 0.02 | 0.90 | 0.88 | 0.29 | 0.33 | 0.32 | 0.38 | 0.38 |
|  | $\mathrm{N}=50 \mathrm{~T}=10$ | 0.00 | 0.00 | 0.00 | 0.94 | 0.94 | 0.13 | 0.15 | 0.15 | 0.17 | 0.17 |
|  | $\mathrm{N}=10 \mathrm{~T}=50$ | 0.00 | 0.00 | 0.00 | 0.94 | 0.94 | 0.13 | 0.15 | 0.14 | 0.17 | 0.17 |
|  | $\mathrm{N}=50 \mathrm{~T}=50$ | 0.00 | 0.00 | 0.00 | 0.95 | 0.95 | 0.06 | 0.07 | 0.07 | 0.08 | 0.08 |

Table 4C: MSEs $\times 1000$ : dynamic panels without exogenous regressors, $\beta=3 / 4$

|  | Adopted M | Non-bias correction |  |  |  |  | Bias correction |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | M1 | M2 | M3 | M4 | CV | M1 | M2 | M3 | M4 | CV |
| True M |  |  |  |  |  |  |  |  |  |  |  |
| M1 | $\mathrm{N}=10 \mathrm{~T}=5$ | 11.78 | 208.92 | 11.13 | 214.24 | 124.20 | 12.47 | 88.12 | 11.64 | 98.40 | 55.41 |
|  | $\mathrm{N}=50 \mathrm{~T}=5$ | 1.90 | 174.56 | 1.87 | 174.77 | 51.53 | 1.96 | 19.85 | 1.93 | 19.96 | 8.95 |
|  | $\mathrm{N}=10 \mathrm{~T}=10$ | 5.55 | 57.34 | 5.40 | 58.74 | 30.10 | 5.41 | 25.20 | 5.52 | 28.49 | 13.30 |
|  | $\mathrm{N}=50 \mathrm{~T}=10$ | 0.95 | 45.78 | 0.94 | 45.91 | 6.53 | 0.94 | 4.69 | 0.95 | 4.80 | 1.71 |
|  | $\mathrm{N}=10 \mathrm{~T}=50$ | 0.84 | 2.48 | 0.92 | 2.64 | 1.25 | 0.85 | 1.51 | 0.94 | 1.69 | 0.95 |
|  | $\mathrm{N}=50 \mathrm{~T}=50$ | 0.17 | 1.61 | 0.17 | 1.62 | 0.17 | 0.17 | 0.32 | 0.17 | 0.32 | 0.17 |
| M2 | $\mathrm{N}=10 \mathrm{~T}=5$ | 47.88 | 208.92 | 49.05 | 214.24 | 200.23 | 47.28 | 88.12 | 48.72 | 98.40 | 84.22 |
|  | $\mathrm{N}=50 \mathrm{~T}=5$ | 47.65 | 174.56 | 47.88 | 174.77 | 167.70 | 47.51 | 19.85 | 47.80 | 19.96 | 23.21 |
|  | $\mathrm{N}=10 \mathrm{~T}=10$ | 46.82 | 57.34 | 48.10 | 58.74 | 60.86 | 46.54 | 25.20 | 47.92 | 28.49 | 24.83 |
|  | $\mathrm{N}=50 \mathrm{~T}=10$ | 47.76 | 45.78 | 48.00 | 45.91 | 46.19 | 47.71 | 4.69 | 47.98 | 4.80 | 4.97 |
|  | $\mathrm{N}=10 \mathrm{~T}=50$ | 46.77 | 2.48 | 48.04 | 2.64 | 2.48 | 46.86 | 1.51 | 48.11 | 1.69 | 1.51 |
|  | $\mathrm{N}=50 \mathrm{~T}=50$ | 47.74 | 1.61 | 47.98 | 1.62 | 1.61 | 47.75 | 0.32 | 47.99 | 0.32 | 0.32 |
| M3 | $\mathrm{N}=10 \mathrm{~T}=5$ | 38.70 | 261.27 | 11.13 | 214.24 | 116.90 | 62.42 | 201.05 | 11.64 | 98.40 | 55.80 |
|  | $\mathrm{N}=50 \mathrm{~T}=5$ | 23.14 | 235.57 | 1.87 | 174.77 | 49.00 | 40.55 | 142.49 | 1.93 | 19.96 | 8.60 |
|  | $\mathrm{N}=10 \mathrm{~T}=10$ | 20.31 | 79.86 | 5.40 | 58.74 | 28.02 | 24.37 | 56.13 | 5.52 | 28.49 | 13.06 |
|  | $\mathrm{N}=50 \mathrm{~T}=10$ | 13.41 | 72.01 | 0.94 | 45.91 | 6.38 | 17.73 | 39.64 | 0.95 | 4.80 | 1.72 |
|  | $\mathrm{N}=10 \mathrm{~T}=50$ | 3.16 | 5.09 | 0.92 | 2.64 | 1.34 | 3.85 | 4.59 | 0.94 | 1.69 | 1.05 |
|  | $\mathrm{N}=50 \mathrm{~T}=50$ | 2.41 | 4.35 | 0.17 | 1.62 | 0.17 | 3.02 | 3.56 | 0.17 | 0.32 | 0.17 |
| M4 | $\mathrm{N}=10 \mathrm{~T}=5$ | 37.69 | 261.27 | 49.05 | 214.24 | 192.47 | 35.79 | 201.05 | 48.72 | 98.40 | 89.18 |
|  | $\mathrm{N}=50 \mathrm{~T}=5$ | 38.03 | 235.57 | 47.88 | 174.77 | 165.80 | 36.60 | 142.49 | 47.80 | 19.96 | 23.82 |
|  | $\mathrm{N}=10 \mathrm{~T}=10$ | 36.30 | 79.86 | 48.10 | 58.74 | 63.45 | 36.09 | 56.13 | 47.92 | 28.49 | 28.45 |
|  | $\mathrm{N}=50 \mathrm{~T}=10$ | 37.51 | 72.01 | 48.00 | 45.91 | 46.21 | 37.25 | 39.64 | 47.98 | 4.80 | 5.10 |
|  | $\mathrm{N}=10 \mathrm{~T}=50$ | 36.75 | 5.09 | 48.04 | 2.64 | 2.64 | 37.13 | 4.59 | 48.11 | 1.69 | 1.69 |
|  | $\mathrm{N}=50 \mathrm{~T}=50$ | 37.62 | 4.35 | 47.98 | 1.62 | 1.62 | 37.87 | 3.56 | 47.99 | 0.32 | 0.32 |

Table 4D: Coverages and length of $95 \%$ CIs (bias-corrected): dynamic panels without exogenous regressors, $\beta=3 / 4$

|  | Adopted Model | Coverages |  |  |  |  | Length |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | M1 | M2 | M3 | M4 | CV | M1 | M2 | M 3 | M4 | CV |
| True Model |  |  |  |  |  |  |  |  |  |  |  |
| M1 | $\mathrm{N}=10 \mathrm{~T}=5$ | 0.91 | 0.70 | 0.91 | 0.66 | 0.75 | 0.37 | 0.62 | 0.36 | 0.62 | 0.45 |
|  | $\mathrm{N}=50 \mathrm{~T}=5$ | 0.94 | 0.67 | 0.93 | 0.66 | 0.83 | 0.16 | 0.28 | 0.16 | 0.28 | 0.19 |
|  | $\mathrm{N}=10 \mathrm{~T}=10$ | 0.93 | 0.72 | 0.91 | 0.70 | 0.84 | 0.26 | 0.36 | 0.26 | 0.36 | 0.29 |
|  | $\mathrm{N}=50 \mathrm{~T}=10$ | 0.94 | 0.77 | 0.94 | 0.76 | 0.91 | 0.12 | 0.16 | 0.12 | 0.16 | 0.12 |
|  | $\mathrm{N}=10 \mathrm{~T}=50$ | 0.95 | 0.88 | 0.94 | 0.88 | 0.94 | 0.12 | 0.12 | 0.12 | 0.12 | 0.12 |
|  | $\mathrm{N}=50 \mathrm{~T}=50$ | 0.96 | 0.88 | 0.96 | 0.89 | 0.96 | 0.05 | 0.06 | 0.05 | 0.06 | 0.05 |
| M2 | $\mathrm{N}=10 \mathrm{~T}=5$ | 0.01 | 0.70 | 0.01 | 0.66 | 0.50 | 0.14 | 0.62 | 0.13 | 0.62 | 0.49 |
|  | $\mathrm{N}=50 \mathrm{~T}=5$ | 0.00 | 0.67 | 0.00 | 0.66 | 0.59 | 0.06 | 0.28 | 0.06 | 0.28 | 0.26 |
|  | $\mathrm{N}=10 \mathrm{~T}=10$ | 0.00 | 0.72 | 0.00 | 0.70 | 0.68 | 0.10 | 0.36 | 0.09 | 0.36 | 0.34 |
|  | $\mathrm{N}=50 \mathrm{~T}=10$ | 0.00 | 0.77 | 0.00 | 0.76 | 0.76 | 0.04 | 0.16 | 0.04 | 0.16 | 0.16 |
|  | $\mathrm{N}=10 \mathrm{~T}=50$ | 0.00 | 0.88 | 0.00 | 0.88 | 0.88 | 0.04 | 0.12 | 0.04 | 0.12 | 0.12 |
|  | $\mathrm{N}=50 \mathrm{~T}=50$ | 0.00 | 0.88 | 0.00 | 0.89 | 0.88 | 0.02 | 0.06 | 0.02 | 0.06 | 0.06 |
| M3 | $\mathrm{N}=10 \mathrm{~T}=5$ | 0.57 | 0.50 | 0.91 | 0.66 | 0.77 | 0.42 | 0.62 | 0.36 | 0.63 | 0.44 |
|  | $\mathrm{N}=50 \mathrm{~T}=5$ | 0.36 | 0.29 | 0.93 | 0.67 | 0.83 | 0.19 | 0.28 | 0.16 | 0.28 | 0.19 |
|  | $\mathrm{N}=10 \mathrm{~T}=10$ | 0.64 | 0.49 | 0.91 | 0.70 | 0.84 | 0.29 | 0.36 | 0.26 | 0.36 | 0.28 |
|  | $\mathrm{N}=50 \mathrm{~T}=10$ | 0.30 | 0.27 | 0.94 | 0.76 | 0.91 | 0.13 | 0.16 | 0.12 | 0.16 | 0.12 |
|  | $\mathrm{N}=10 \mathrm{~T}=50$ | 0.68 | 0.66 | 0.94 | 0.88 | 0.93 | 0.12 | 0.12 | 0.12 | 0.12 | 0.12 |
|  | $\mathrm{N}=50 \mathrm{~T}=50$ | 0.36 | 0.36 | 0.96 | 0.89 | 0.96 | 0.05 | 0.06 | 0.05 | 0.06 | 0.05 |
| M4 | $\mathrm{N}=10 \mathrm{~T}=5$ | 0.12 | 0.50 | 0.01 | 0.66 | 0.42 | 0.18 | 0.62 | 0.13 | 0.63 | 0.45 |
|  | $\mathrm{N}=50 \mathrm{~T}=5$ | 0.01 | 0.29 | 0.00 | 0.67 | 0.57 | 0.08 | 0.28 | 0.06 | 0.28 | 0.25 |
|  | $\mathrm{N}=10 \mathrm{~T}=10$ | 0.03 | 0.49 | 0.00 | 0.70 | 0.63 | 0.13 | 0.36 | 0.09 | 0.36 | 0.32 |
|  | $\mathrm{N}=50 \mathrm{~T}=10$ | 0.00 | 0.27 | 0.00 | 0.76 | 0.76 | 0.06 | 0.16 | 0.04 | 0.16 | 0.16 |
|  | $\mathrm{N}=10 \mathrm{~T}=50$ | 0.00 | 0.66 | 0.00 | 0.88 | 0.88 | 0.06 | 0.12 | 0.04 | 0.12 | 0.12 |
|  | $\mathrm{N}=50 \mathrm{~T}=50$ | 0.00 | 0.36 | 0.00 | 0.89 | 0.89 | 0.03 | 0.06 | 0.02 | 0.06 | 0.06 |

Table 5A: Application I: Crime rates in North Carolina ( $\mathrm{N}=90, \mathrm{~T}=7, \mathrm{k}=17$ )

|  | A: Model selection |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Model | AIC | BIC | $\mathrm{BIC}_{2}$ | CV | $(p=1)$ | $(p=1)$ |
| Model 1 | -2.121 | -2.001 | -2.125 | 0.124 | 0.094 | 0.028 |
| Model 2 | -3.773 | -3.025 | -3.796 | 0.025 | 0.023 | 0.026 |
| Model 3 | -2.124 | -1.962 | -2.129 | 0.124 | 0.094 | 0.027 |
| Model 4 | -3.823 | -3.032 | -3.847 | 0.024 | 0.022 | 0.025 |
| Selected | M 4 | M 4 | M 4 | M 4 | M 4 | M 4 |

Table 5B: Application I: Crime rates in North Carolina ( $\mathrm{N}=90, \mathrm{~T}=7, \mathrm{k}=17$ )

| Model | B: Inference for the coefficient on the "probability of arrest" |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | Non-bias correction |  |  | Bias correction |  |
|  | Estimates | $95 \% \mathrm{CI}^{1}$ | $95 \% \mathrm{CI}^{2}$ | Estimates | $95 \% \mathrm{CI}^{1}$ |
| Model 1 | -0.530 | [-0.655, -0.406] | [-0.785, -0.276] | -0.525 | [-0.653, -0.398] |
| Model 2 | -0.385 | [-0.473, -0.297] | [-0.500, -0.270] | -0.393 | [-0.487, -0.300] |
| Model 3 | -0.521 | [-0.646, -0.396] | [-0.778, -0.264] | -0.512 | [-0.638, -0.387] |
| Model 4 | -0.355 | [-0.441, -0.269] | [-0.470, -0.240] | -0.330 | [-0.423, -0.237] |
| Selected | -0.355 | [-0.441, -0.269] | [-0.470, -0.240] | -0.330 | [-0.423, -0.237] |

Notes: $\mathrm{CI}^{1}$ and $\mathrm{CI}^{2}$ stand for the CIs based on the non-clustered and clustered standard errors, respectively.

Table 6A: Application II: Cross-country saving rates ( $\mathrm{N}=56, \mathrm{~T}=15, \mathrm{k}=5$ )

|  | A: Model selection |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Model | AIC | BIC | BIC $_{2}$ | CV | CV-BC |
| Model 1 | 2.547 | 2.576 | 2.547 | 12.844 | 12.844 |
| Model 2 | 2.505 | 2.843 | 2.498 | 12.459 | 13.201 |
| Model 3 | 2.555 | 2.663 | 2.553 | 12.953 | 12.953 |
| Model 4 | 2.512 | 2.929 | 2.504 | 12.584 | 13.340 |
| Selected | M2 | M1 | M2 | M2 | M1 |

Table 6B: Application II: Cross-country saving rates ( $\mathrm{N}=56, \mathrm{~T}=15, \mathrm{k}=5$ )

|  | B: Inference for the coefficient on the "GDP growth" |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | Non-bias correction |  |  | Bias correction |  |
| Model | Estimates | $95 \% \mathrm{CI}^{1}$ |  | Estimates | $95 \% \mathrm{CI}^{1}$ |
| Model 1 | 0.190 | $[0.108,0.273]$ |  | 0.192 | $[0.107,0.277]$ |
| Model 2 | 0.188 | $[0.088,0.288]$ |  | 0.178 | $[0.074,0.281]$ |
| Model 3 | 0.160 | $[0.072,0.248]$ |  | 0.163 | $[0.073,0.253]$ |
| Model 4 | 0.149 | $[0.039,0.258]$ |  | 0.146 | $[0.031,0.262]$ |
| Selected | 0.188 | $[0.088,0.288]$ |  | 0.178 | $[0.074,0.281]$ |

Notes: $\mathrm{CI}^{1}$ stands for the CIs based on the non-clustered standard errors.

Table 7A: Application III: Guns and crime in the U.S. ( $\mathrm{N}=51, \mathrm{~T}=23, \mathrm{k}=9$ )

|  | A: Model selection |  |  |  |  |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Model | AIC | BIC | $\mathrm{BIC}_{2}$ | CV | $(p=1)$ | $(p=1)$ | $(p=2)$ | $(p=2)$ |  |
| Model 1 | -1.6911 | -1.6522 | -1.6914 | 0.1860 | 0.0165 | 0.0073 | 0.0177 | 0.0071 |  |
| Model 2 | -3.6072 | -3.3523 | -3.6094 | 0.0274 | 0.0080 | 0.0072 | 0.0077 | 0.0069 |  |
| Model 3 | -1.7198 | -1.5859 | -1.7210 | 0.1816 | 0.0140 | 0.0061 | 0.0155 | 0.0062 |  |
| Model 4 | -3.8653 | -3.5154 | -3.8684 | 0.0211 | 0.0063 | 0.0059 | 0.0062 | 0.0058 |  |
| Selected | M4 | M4 | M4 | M4 | M4 | M4 | M4 | M4 |  |

Table 7B: Application III: Guns and crime in the U.S. $(\mathrm{N}=51, \mathrm{~T}=23, \mathrm{k}=9)$

| Model | B: Inference for the coefficient of the "shall issue" |  |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
|  | Non-bias correction |  |  | Bias correction |  |
|  | Estimates | 95\% CI ${ }^{1}$ | 95\% CI ${ }^{2}$ | Estimates | $95 \% \mathrm{CI}^{1}$ |
| Model 1 | -0.368 | [-0.436, -0.301] | [-0.589, -0.148] | -0.364 | [-0.442, -0.287] |
| Model 2 | -0.046 | [-0.084, -0.008] | $[-0.127,0.035]$ | -0.022 | [-0.066, 0.022] |
| Model 3 | -0.288 | [-0.359, -0.217] | [-0.526, -0.050] | -0.282 | [-0.359, -0.204] |
| Model 4 | -0.028 | $[-0.065,0.009]$ | [-0.106, 0.050] | 0.015 | [-0.027, 0.056] |
| Selected | -0.028 | [-0.065, 0.009] | [-0.106, 0.050] | 0.015 | [-0.027, 0.056] |

Notes: $\mathrm{CI}^{1}$ and $\mathrm{CI}^{2}$ stand for the CIs based on the non-clustered and clustered standard errors, respectively.

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This supplement is composed of five parts. Appendix A contains the proofs of the main results in the paper. Appendix B contains the proofs of the technical lemmas used in Appendix A. Section C provides some primitive conditions to verify Assumptions A.2(iii)-(iv) and A.4-A. 5 in the paper. Appendix D discusses how to choose $p$ in our modified jackknife and contains some additional simulation results. Appendix E contains additional simulation results for the DGPs in the main text.

## A Proofs of the main results

Let $\delta_{N T}=N^{-1}+T^{-1}$. To prove Theorem 2.1, we need the following six lemmas whose proofs can be found in Appendix B below.

Lemma A. 1 Let $X_{D}=(X, D)$ and $M_{D}=I_{N T}-D\left(D^{\prime} D\right)^{-1} D^{\prime}$. If both $D^{\prime} D$ and $X^{\prime} M_{D} X$ are nonsingular, then

$$
\left(X_{D}^{\prime} X_{D}\right)^{-1}=\left(\begin{array}{cc}
X_{D}^{*} & -X_{D}^{*} X^{\prime} D\left(D^{\prime} D\right)^{-1} \\
-\left(D^{\prime} D\right)^{-1} D^{\prime} X X_{D}^{*} & \left(D^{\prime} D\right)^{-1}+\left(D^{\prime} D\right)^{-1} D^{\prime} X X_{D}^{*} X^{\prime} D\left(D^{\prime} D\right)^{-1}
\end{array}\right)
$$

where $X_{D}^{*}=\left(X^{\prime} M_{D} X\right)^{-1}$.
Lemma A. 2 Let $X_{D}=(X, D)$ and $D=\left(D_{1}, D_{2}\right)$ where $D_{1}^{\prime} D_{2}=0$. If $D_{1}^{\prime} D_{1}, D_{2}^{\prime} D_{2}$, and $X^{\prime} M_{D} X$ are all nonsingular, then

$$
\left(X_{D}^{\prime} X_{D}\right)^{-1}=\left(\begin{array}{ccc}
X_{D}^{*} & -X_{D}^{*} B_{1} & -X_{D}^{*} B_{2} \\
-B_{1}^{\prime} X_{D}^{*} & \left(D_{1}^{\prime} D_{1}\right)^{-1}+B_{1}^{\prime} X_{D}^{*} B_{1} & B_{1}^{\prime} X_{D}^{*} B_{2} \\
-B_{2}^{\prime} X_{D}^{*} & B_{2}^{\prime} X_{D}^{*} B_{1} & \left(D_{2}^{\prime} D_{2}\right)^{-1}+B_{2}^{\prime} X_{D}^{*} B_{2}
\end{array}\right)
$$

where $X_{D}^{*}=\left(X^{\prime} M_{D} X\right)^{-1}$ and $B_{\ell}=X^{\prime} D_{\ell}\left(D_{\ell}^{\prime} D_{\ell}\right)^{-1}$ for $\ell=1,2$.
Lemma A. 3 Suppose that Assumption A.1(iii) holds. Then
(i) $\frac{1}{N T} U^{\prime} D_{\alpha}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} U=\frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i}^{2}-\bar{u}_{.2}^{2}=\frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i .}^{2}-O_{P}\left((N T)^{-1}\right)$,
(ii) $\frac{1}{N T} U^{\prime} D_{\lambda}\left(D_{\lambda}^{\prime} D_{\lambda}\right)^{-1} D_{\lambda}^{\prime} U=\frac{1}{T} \sum_{t=1}^{T} \bar{u}_{. t}^{2}-\bar{u}_{. .}^{2}=\frac{1}{T} \sum_{t=1}^{T} \bar{u}_{. t}^{2}-O_{P}\left((N T)^{-1}\right)$,
(iii) $\frac{1}{N T} U^{\prime} D_{\alpha \lambda}\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}\right)^{-1} D_{\alpha \lambda}^{\prime} U=\frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i}^{2}+\frac{1}{T} \sum_{t=1}^{T} \bar{u}_{\cdot t}^{2}-2 \bar{u}_{.}^{2}=\frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i}^{2}+\frac{1}{T} \sum_{t=1}^{T} \bar{u}_{. t}^{2}-$ $O_{P}\left((N T)^{-1}\right)$.

Lemma A. 4 Suppose that Assumptions A.1(iii) and A.2(iii)-(iv) holds. Then
(i) $\frac{1}{N T} X^{\prime} D_{\alpha}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} U=\frac{1}{N} \sum_{i=1}^{N} \bar{x}_{i} \cdot \bar{u}_{i} .-\bar{x} . . \bar{u} . .=O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right)$,
(ii) $\frac{1}{N T} X^{\prime} D_{\lambda}\left(D_{\lambda}^{\prime} D_{\lambda}\right)^{-1} D_{\lambda}^{\prime} U=\frac{1}{T} \sum_{t=1}^{T} \bar{x}_{t} . \bar{u}_{t} .-\bar{x} . . \bar{u} . .=O_{P}\left(N^{-1}+(N T)^{-1 / 2}\right)$,
(iii) $\frac{1}{N T} X^{\prime} D_{\alpha \lambda}\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}\right)^{-1} D_{\alpha \lambda}^{\prime} U=\frac{1}{N} \sum_{i=1}^{N} \bar{x}_{i} . \bar{u}_{i} .+\frac{1}{T} \sum_{t=1}^{T} \bar{x}_{t} . \bar{u}_{t} .-2 \bar{x} . \bar{u}_{. .}=O_{P}\left(\delta_{N T}\right)$.

Lemma A. 5 Let $\eta_{i t}^{(m)}=x_{i t}^{(m) \prime}\left(X^{(m)^{\prime}} X^{(m)}\right)^{-1} X^{(m)^{\prime}} U$ and $J_{m N T}=\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(\eta_{i t}^{(m)}\right)^{2}=\frac{1}{N T} U^{\prime} X^{(m)}$ $\times\left(X^{(m) \prime} X^{(m)}\right)^{-1} X^{(m) \prime} U$ for $m=1,2,3,4$. Suppose that Assumptions A.1(iii)-(iv) and A.2(iii)-(iv) hold. Then
(i) $J_{1 N T}=O_{P}\left((N T)^{-1}\right)$,
(ii) $J_{2 N T}=\frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i}^{2}+O_{P}\left((N T)^{-1}+T^{-2}\right)$,
(iii) $J_{3 N T}=\frac{1}{T} \sum_{t=1}^{T} \bar{u}_{. t}^{2}+O_{P}\left((N T)^{-1}+N^{-2}\right)$,
(iv) $J_{4 N T}=\frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i \cdot}^{2}+\frac{1}{T} \sum_{t=1}^{T} \bar{u}_{\cdot t}^{2}+O_{P}\left(\delta_{N T}^{2}\right), J_{4 N T}-J_{2 N T}=\frac{1}{T} \sum_{t=1}^{T} \bar{u}_{. t}^{2}+O_{P}\left(N^{-2}+(N T)^{-1}\right)$, and $J_{4 N T}-J_{3 N T}=\frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i}^{2} .+O_{P}\left(T^{-2}+(N T)^{-1}\right)$.
Lemma A. 6 Let $h_{i t}^{(m)}=x_{i t}^{(m) \prime}\left(X^{(m) \prime} X^{(m)}\right)^{-1} x_{i t}^{(m)}$ for $m=1,2,3,4$ and $B_{\ell}=X^{\prime} D_{\ell}\left(D_{\ell}^{\prime} D_{\ell}\right)^{-1}$ for $\ell=\alpha, \lambda$, and $\alpha \lambda$. Let $\max _{i, t}=\max _{1 \leq i \leq N, 1 \leq t \leq T}$. Suppose that Assumption A.1(i), (ii) and (iv) holds. Then
(i) $\max _{i, t} h_{i t}^{(1)}=O_{P}\left((N T)^{-1 / 2}\right)$,
(ii) $h_{i t}^{(2)}=T^{-1} \frac{N-1}{N}+\left(x_{i t}-B_{\alpha} d_{\alpha, i t}\right)^{\prime} X_{D_{\alpha}}^{*}\left(x_{i t}-B_{\alpha} d_{\alpha, i t}\right)$ and $\max _{i, t} h_{i t}^{(2)}=O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right)$,
(iii) $h_{i t}^{(3)}=N^{-1} \frac{T-1}{T}+\left(x_{i t}-B_{\lambda} d_{\lambda, i t}\right)^{\prime} X_{D_{\lambda}}^{*}\left(x_{i t}-B_{\lambda} d_{\lambda, i t}\right)$ and $\max _{i, t} h_{i t}^{(3)}=O_{P}\left(N^{-1}+(N T)^{-1 / 2}\right)$,
(iv) $h_{i t}^{(4)}=T^{-1} \frac{N-1}{N}+N^{-1} \frac{T-1}{T}+\left(x_{i t}-B_{\alpha \lambda} d_{\alpha \lambda, i t}\right)^{\prime} X_{D_{\alpha \lambda}}^{*}\left(x_{i t}-B_{\alpha \lambda} d_{\alpha \lambda, i t}\right)$ and $\max _{i, t} h_{i t}^{(4)}=O_{P}\left(\delta_{N T}\right)$,
(v) $\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(x_{i t}-B_{\alpha} d_{\alpha, i t}\right)^{\prime} X_{D_{\alpha}}^{*}\left(x_{i t}-B_{\alpha} d_{\alpha, i t}\right) u_{i t}^{2}=O_{P}\left((N T)^{-1}\right)$,
(vi) $\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(x_{i t}-B_{\lambda} d_{\lambda, i t}\right)^{\prime} X_{D_{\lambda}}^{*}\left(x_{i t}-B_{\lambda} d_{\lambda, i t}\right) u_{i t}^{2}=O_{P}\left((N T)^{-1}\right)$,
(vii) $\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(x_{i t}-B_{\alpha \lambda} d_{\alpha \lambda, i t}\right)^{\prime} X_{D_{\alpha \lambda}}^{*}\left(x_{i t}-B_{\alpha \lambda} d_{\alpha \lambda, i t}\right) u_{i t}^{2}=O_{P}\left((N T)^{-1}\right)$.

Proof of Theorem 2.1. Recall that $\hat{\beta}^{(m)}=\left(X^{(m)^{\prime}} X^{(m)}\right)^{-1} X^{(m) \prime} Y$ and $\hat{\beta}_{i t}^{(m)}=\left(X^{(m)^{\prime}} X^{(m)}-\right.$ $\left.x_{i t}^{(m)} x_{i t}^{(m) \prime}\right)^{-1}\left(X^{(m) \prime} Y-x_{i t}^{(m)} y_{i t}\right)$. By the updated formula for OLS estimation (e.g., Greene (2008, p.964), we have for $m=1,2,3,4$,

$$
\begin{align*}
& \hat{\beta}_{i t}^{(m)}-\hat{\beta}^{(m)} \\
& =\left(X^{(m) \prime} X^{(m)}-x_{i t}^{(m)} x_{i t}^{(m) \prime}\right)^{-1}\left(X^{(m)} Y-x_{i t}^{(m)} y_{i t}\right)-\hat{\beta}^{(m)} \\
& =\left[\left(X^{(m)^{\prime}} X^{(m)}\right)^{-1}+\frac{1}{1-h_{i t}^{(m)}}\left(X^{(m)^{\prime}} X^{(m)}\right)^{-1} x_{i t}^{(m)} x_{i t}^{(m)^{\prime}}\left(X^{(m)^{\prime}} X^{(m)}\right)^{-1}\right]\left(X^{(m) \prime} Y-x_{i t}^{(m)} y_{i t}\right)-\hat{\beta}^{(m)} \\
& =\frac{-1}{1-h_{i t}^{(m)}}\left(X^{(m)^{\prime}} X^{(m)}\right)^{-1} x_{i t}^{(m)} y_{i t}+\frac{1}{1-h_{i t}^{(m)}}\left(X^{(m)^{\prime}} X^{(m)}\right)^{-1} x_{i t}^{(m)} x_{i t}^{(m)^{\prime}}\left(X^{(m)^{\prime}} X^{(m)}\right)^{-1} X^{(m) \prime} Y, \tag{A.1}
\end{align*}
$$

 true model is given by Model $l$ where $l, m=1,2,3,4$. Let $c_{i t, m}=\left(1-h_{i t}^{(m)}\right)^{-1}$ and $c_{i t, l m}=c_{i t, l} c_{i t, m}$. By Lemma A.6, for $l, m=1,2,3,4$ we have

$$
\begin{equation*}
\max _{i, t} h_{i t}^{(m)}=O_{P}\left(\delta_{m N T}\right), \max _{i, t}\left|c_{i t, m}-1\right|=O_{P}\left(\delta_{m N T}\right) \text { and } \max _{i, t}\left|c_{i t, l m}-1\right|=O_{P}\left(\delta_{l N T}+\delta_{m N T}\right), \tag{A.2}
\end{equation*}
$$

where $\delta_{1 N T}=(N T)^{-1 / 2}, \delta_{2 N T}=T^{-1}+(N T)^{-1 / 2}, \delta_{3 N T}=N^{-1}+(N T)^{-1 / 2}$, and $\delta_{4 N T}=\delta_{N T}$.
Case 1: Model 1 is the true model. In this case, Models 2-4 are all overfitted and we will show that $P\left(C V_{1,1}<C V_{1, m}\right) \rightarrow 1$ for $m=2,3,4$. When Model 1 is true, we have

$$
y_{i t}=\beta^{\prime} x_{i t}+u_{i t}=\beta^{(m)^{\prime}} x_{i t}^{(m)}+u_{i t} \text { and } \hat{\beta}^{(m)}-\beta^{(m)}=\left(X^{(m)^{\prime}} X^{(m)}\right)^{-1} X^{(m) \prime} U \equiv B_{U}^{(m)},
$$

where the true values correspond to the coefficients of the dummies $d_{\alpha, i t}$ and $d_{\lambda, i t}$ for $\alpha_{i}$ and $\lambda_{t}$ in $\beta^{(m)}, m=2,3,4$, are all zero. This, in conjunction with (A.1), implies that for $m=1,2,3,4$,

$$
\begin{align*}
& x_{i t}^{(m) \prime}\left(\hat{\beta}_{i t}^{(m)}-\beta^{(m)}\right) \\
= & x_{i t}^{(m) \prime}\left(\hat{\beta}^{(m)}-\beta^{(m)}\right) \\
& +x_{i t}^{(m) \prime}\left[-\frac{1}{1-h_{i t}^{(m)}}\left(X^{(m)^{\prime}} X^{(m)}\right)^{-1} x_{i t}^{(m)} u_{i t}+\frac{1}{1-h_{i t}^{(m)}}\left(X^{(m)^{\prime}} X^{(m)}\right)^{-1} x_{i t}^{(m)} x_{i t}^{(m) \prime} B_{U}^{(m)}\right] \\
= & -\frac{h_{i t}^{(m)}}{1-h_{i t}^{(m)}} u_{i t}+\frac{1}{1-h_{i t}^{(m)}} x_{i t}^{(m) \prime} B_{U}^{(m)}, \tag{A.3}
\end{align*}
$$

and

$$
\begin{equation*}
y_{i t}-\hat{y}_{i t}^{(m)}=u_{i t}-x_{i t}^{(m) \prime}\left(\hat{\beta}_{i t}^{(m)}-\beta^{(m)}\right)=c_{i t, m}\left(u_{i t}-x_{i t}^{(m) \prime} B_{U}^{(m)}\right) . \tag{A.4}
\end{equation*}
$$

It follows that $C V_{1, m}=\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(y_{i t}-\hat{y}_{i t}^{(m)}\right)^{2}=\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, m}^{2}\left(u_{i t}-x_{i t}^{(m) \prime} B_{U}^{(m)}\right)^{2}$. We first study $C V_{1,2}-C V_{1,1}$. We make the following decomposition:

$$
\begin{aligned}
C V_{1,2}-C V_{1,1}= & \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[c_{i t, 2}^{2}\left(u_{i t}-x_{i t}^{(2) \prime} B_{U}^{(2)}\right)^{2}-c_{i t, 1}^{2}\left(u_{i t}-x_{i t}^{(1) \prime} B_{U}^{(1)}\right)^{2}\right] \\
= & \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(c_{i t, 2}^{2}-c_{i t, 1}^{2}\right) u_{i t}^{2}+\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[c_{i t, 2}^{2}\left(x_{i t}^{(2) \prime} B_{U}^{(2)}\right)^{2}-c_{i t, 1}^{2}\left(x_{i t}^{(1) \prime} B_{U}^{(1)}\right)^{2}\right] \\
& -\frac{2}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[c_{i t, 2}^{2} u_{i t} x_{i t}^{(2) \prime} B_{U}^{(2)}-c_{i t, 1}^{2} u_{i t} x_{i t}^{(1) \prime} B_{U}^{(1)}\right] \\
\equiv & A_{1}+A_{2}-2 A_{3}, \text { say. }
\end{aligned}
$$

For $A_{1}$, we have $A_{1}=\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 12}^{2}\left(2-h_{i t}^{(1)}-h_{i t}^{(2)}\right) h_{i t}^{(2)} u_{i t}^{2}-\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 12}^{2}\left(2-h_{i t}^{(1)}-\right.$ $\left.h_{i t}^{(2)}\right) h_{i t}^{(1)} u_{i t}^{2} \equiv A_{1,1}-A_{1,2}$. For $A_{1,1}$, we make the following decomposition:

$$
\begin{aligned}
A_{1,1} & =\frac{2}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} h_{i t}^{(2)} u_{i t}^{2}+\frac{2}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(c_{i t, 12}^{2}-1\right) h_{i t}^{(2)} u_{i t}^{2}-\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 12}^{2}\left(h_{i t}^{(1)}+h_{i t}^{(2)}\right) h_{i t}^{(2)} u_{i t}^{2} \\
& \equiv A_{1,11}+A_{1,12}-A_{1,3} .
\end{aligned}
$$

By Lemma A.6(ii) and (v) we can readily show that

$$
\begin{aligned}
A_{1,11} & =\frac{2}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[d_{\alpha, i t}^{\prime}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} d_{\alpha, i t}+\left(x_{i t}-B_{\alpha} d_{\alpha, i t}\right)^{\prime} X_{D_{\alpha}}^{*}\left(x_{i t}-B_{\alpha} d_{\alpha, i t}\right)\right] u_{i t}^{2} \\
& =T^{-1} \frac{N-1}{N} \frac{2}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t}^{2}+\frac{2}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(x_{i t}-B_{\alpha} d_{\alpha, i t}\right)^{\prime} X_{D_{\alpha}}^{*}\left(x_{i t}-B_{\alpha} d_{\alpha, i t}\right) u_{i t}^{2} \\
& =T^{-1} \frac{2}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t}^{2}+O_{P}\left((N T)^{-1}\right) .
\end{aligned}
$$

This result, in conjunction with (A.2) and the dominated convergence theorem (DCT), implies that $A_{1,12}=o_{P}\left(T^{-1}\right)$ and $A_{1,13}=o_{P}\left(T^{-1}\right)$. For $A_{1,2}$, we have by (A.2)

$$
\begin{aligned}
A_{1,2} & \leq \max _{i, t} c_{i t, 12}^{2}\left|2-h_{i t}^{(1)}-h_{i t}^{(2)}\right| \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} x_{i t}^{\prime}\left(X^{\prime} X\right)^{-1} x_{i t} u_{i t}^{2} \\
& \leq \frac{1}{N T} \max _{i, t} c_{i t, 12}^{2}\left|2-h_{i t}^{(1)}-h_{i t}^{(2)}\right|\left[\lambda_{\min }\left(\frac{1}{N T} X^{\prime} X\right)\right]^{-1} \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left\|x_{i t}\right\|^{2} u_{i t}^{2}=O_{P}\left((N T)^{-1}\right)
\end{aligned}
$$

It follows that $A_{1}=2 T^{-1} \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t}^{2}+o_{P}\left(T^{-1}\right)$. For $A_{2}$, we write

$$
\begin{aligned}
A_{2} & =\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(x_{i t}^{(2) \prime} B_{U}^{(2)}\right)^{2}+\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(c_{i t, 2}^{2}-1\right)\left(x_{i t}^{(2) \prime} B_{U}^{(2)}\right)^{2}-\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 1}^{2}\left(x_{i t}^{(1) \prime} B_{U}^{(1)}\right)^{2} \\
& \equiv A_{2,1}+A_{2,2}-A_{23}, \text { say. }
\end{aligned}
$$

By Lemma A.5(ii), $A_{2,1}=\frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i}^{2}+O_{P}\left((N T)^{-1}+T^{-2}\right)$, where the first term is $O_{P}\left(T^{-1}\right)$. This result, in conjunction with (A.2) and the DCT, implies that $A_{2,2}=o_{P}\left(T^{-1}\right)$. By Lemmas A.5(i) and A.6(i), $A_{2,3}=O_{P}\left((N T)^{-1}\right)$. It follows that $A_{2}=\frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i}^{2} .+o_{P}\left(T^{-1}\right)$. For $A_{3}$, we have

$$
\begin{aligned}
A_{3}= & \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t} x_{i t}^{(2) \prime} B_{U}^{(2)}+\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(c_{i t, 2}^{2}-1\right) u_{i t} x_{i t}^{(2) \prime} B_{U}^{(2)} \\
& -\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t} x_{i t}^{(1) \prime} B_{U}^{(1)}+\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(1-c_{i t, 1}^{2}\right) u_{i t} x_{i t}^{(1) \prime} B_{U}^{(1)} \\
\equiv & A_{3,1}+A_{3,2}-A_{33}+A_{34}, \text { say. }
\end{aligned}
$$

By Lemma A.5(i) and (ii), $A_{3,1}=\frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i}^{2}+O_{P}\left((N T)^{-1}+T^{-2}\right)$ and $A_{3,3}=O_{P}\left((N T)^{-1}\right)$. In addition,

$$
\begin{aligned}
\left|A_{3,2}\right| & \leq \max _{i, t}\left|c_{i t, 2}^{2}-1\right|\left\|\left(\frac{1}{N T} X^{(2) \prime} X^{(2)}\right)^{-1}\right\|\left\|\frac{1}{N T} X^{(2)} U\right\| \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left\|x_{i t}^{(2)} u_{i t}\right\| \\
& =O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right) O_{P}(1) O_{P}\left((N T)^{-1 / 2}\right) O_{P}(1)=o_{P}\left(T^{-1}\right), \text { and } \\
\left|A_{3,4}\right| & \leq \max _{i, t}\left|c_{i t, 1}^{2}-1\right|\left\|\left(\frac{1}{N T} X^{(1) \prime} X^{(1)}\right)^{-1}\right\|\left\|\frac{1}{N T} X^{(1)} U\right\| \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left\|x_{i t}^{(1)} u_{i t}\right\| \\
& =O_{P}\left((N T)^{-1 / 2}\right) O_{P}(1) O_{P}\left((N T)^{-1 / 2}\right) O_{P}(1)=o_{P}\left(T^{-1}\right) .
\end{aligned}
$$

So $A_{3}=\frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i}^{2}+o_{P}\left(T^{-1}\right)$. Combining the above results, we have

$$
\begin{equation*}
T\left[C V_{1,2}-C V_{1,1}\right]=\frac{2}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t}^{2}-\frac{T}{N} \sum_{i=1}^{N} \bar{u}_{i .}^{2}+o_{P}(1) \xrightarrow{P} 2 \bar{\sigma}_{u}^{2}-\bar{\sigma}_{u 1}^{2}, \tag{A.5}
\end{equation*}
$$

where the convergence holds by Assumptions A.1(i) and A.2(i). Similarly, by using Lemma A.5(iii) and Lemma A.6(i) and (iii), we can show that

$$
\begin{equation*}
N\left[C V_{1,3}-C V_{1,1}\right]=2 \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t}^{2}-\frac{N}{T} \sum_{t=1}^{T} \bar{u}_{\cdot t}^{2}+o_{P}(1) \xrightarrow{P} 2 \bar{\sigma}_{u}^{2}-\bar{\sigma}_{u 2}^{2}, \tag{A.6}
\end{equation*}
$$

where the convergence holds by Assumptions A.1(i) and A.2(ii).
Note that

$$
\begin{aligned}
C V_{1,4}-C V_{1,1}= & \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[c_{i t, 4}^{2}\left(u_{i t}-x_{i t}^{(4) \prime} B_{U}^{(4)}\right)^{2}-c_{i t, 1}^{2}\left(u_{i t}-x_{i t}^{(1) \prime} B_{U}^{(1)}\right)^{2}\right] \\
= & \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(c_{i t, 4}^{2}-c_{i t, 1}^{2}\right) u_{i t}^{2}+\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[c_{i t, 4}^{2}\left(x_{i t}^{(4) \prime} B_{U}^{(4)}\right)^{2}-c_{i t, 1}^{2}\left(x_{i t}^{(1) \prime} B_{U}^{(1)}\right)^{2}\right] \\
& -\frac{2}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[c_{i t, 4}^{2} u_{i t} x_{i t}^{(4) \prime} B_{U}^{(4)}-c_{i t, 1}^{2} u_{i t} x_{i t}^{(1) \prime} B_{U}^{(1)}\right] \\
\equiv & A_{4}+A_{5}-2 A_{6}, \text { say. }
\end{aligned}
$$

As in the analysis of $A_{1}$, we can apply Lemma A.5(iv) and Lemma A.6(i), (iv) and (vii) to show that

$$
\begin{aligned}
A_{4} & =\frac{2}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(h_{i t}^{(4)}-h_{i t}^{(1)}\right) u_{i t}^{2}+o_{P}\left(N^{-1}+T^{-1}\right) \\
& =\frac{2}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[\frac{N-1}{N T}+\frac{T-1}{N T}+\left(x_{i t}-B_{\alpha \lambda} d_{\alpha \lambda, i t}\right)^{\prime} X_{D_{\alpha \lambda}}^{*}\left(x_{i t}-B_{\alpha \lambda} d_{\alpha \lambda, i t}\right)\right] u_{i t}^{2}+o_{P}\left(N^{-1}+T^{-1}\right) \\
& =\left(T^{-1}+N^{-1}\right) \frac{2}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t}^{2}+o_{P}\left(N^{-1}+T^{-1}\right) \\
A_{5} & =\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(x_{i t}^{(4) \prime} B_{U}^{(4)}\right)^{2}+o_{P}\left(N^{-1}+T^{-1}\right)=\frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i .}^{2}+\frac{1}{T} \sum_{t=1}^{T} \bar{u}_{. t}^{2}+o_{P}\left(N^{-1}+T^{-1}\right),
\end{aligned}
$$

and $A_{6}=\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t} x_{i t}^{(2) \prime} B_{U}^{(2)}+o_{P}\left(N^{-1}+T^{-1}\right)=\frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i .}^{2}+\frac{1}{T} \sum_{t=1}^{T} \bar{u}_{. t}^{2}+o_{P}\left(N^{-1}+T^{-1}\right)$. It follows that

$$
\begin{align*}
& (N \wedge T)\left[C V_{1,4}-C V_{1,1}\right] \\
= & (N \wedge T)\left[\left(T^{-1}+N^{-1}\right) \frac{2}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t}^{2}-\frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i \cdot}^{2}-\frac{1}{T} \sum_{t=1}^{T} \bar{u}_{\cdot t}^{2}\right]+o_{P}(1) \xrightarrow{P} c_{\sigma}, \tag{A.7}
\end{align*}
$$

where $c_{\sigma}=2(1+c) \bar{\sigma}_{u}^{2}-\left(\bar{\sigma}_{u 1}^{2}+c \bar{\sigma}_{u 2}^{2}\right) 1\left\{c_{1} \geq 1\right\}-\left(c \bar{\sigma}_{u 1}^{2}+\bar{\sigma}_{u 2}^{2}\right) 1\left\{c_{1}<1\right\}, c=\lim _{(N, T) \rightarrow \infty}\left(\frac{N}{T} \wedge \frac{T}{N}\right)$, $c_{1}=\lim _{(N, T) \rightarrow \infty} \frac{N}{T}$, and the convergence holds by Assumptions A.1(i) and A.2(i)-(ii). Combining (A.5)-(A.7) yields $P\left(C V_{1,1}<C V_{1, m}\right) \rightarrow 1$ for $m=2,3,4$ provided max $\left(\bar{\sigma}_{u 1}^{2}, \bar{\sigma}_{u 2}^{2}\right)<2 \bar{\sigma}_{u}^{2}$.

Case 2: Model 2 is the true model. In this case, Models 1, 3 and 4 are underfitted, misspecified and overfitted, respectively, and we will show that $P\left(C V_{2,2}<C V_{2, m}\right) \rightarrow 1$ for $m=1,3,4$. Let $u_{\alpha, i t}=\alpha_{i}+u_{i t}$ and $U_{\alpha}=\left(u_{\alpha, 11}, \ldots, u_{\alpha, 1 T}, \ldots, u_{\alpha, N 1}, \ldots, u_{\alpha, N T}\right)^{\prime}$. Note that $U_{\alpha}=D_{\alpha} \underline{\alpha}+U$ where $\underline{\alpha}=\left(\alpha_{1}, \ldots, \alpha_{N-1}\right)^{\prime}$. Following the steps to obtain (A.4), we can show that

$$
\begin{equation*}
y_{i t}-\hat{y}_{i t}^{(1)}=u_{\alpha, i t}-x_{i t}^{\prime}\left(\hat{\beta}_{i t}^{(1)}-\beta^{(1)}\right)=c_{i t, 1}\left(u_{\alpha, i t}-x_{i t}^{\prime} B_{U_{\alpha}}^{(1)}\right) \tag{A.8}
\end{equation*}
$$

where $B_{U_{\alpha}}^{(m)}=\left(X^{(m)^{\prime}} X^{(m)}\right)^{-1} X^{(m)^{\prime}} U_{\alpha}$ for $m=1,2,3,4$. Then $C V_{2,1}=\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(u_{\alpha, i t}-\right.$ $\left.x_{i t}^{\prime} B_{U_{\alpha}}^{(1)}\right)^{2}+\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(c_{i t, 1}^{2}-1\right)\left(u_{\alpha, i t}-x_{i t}^{\prime} B_{U_{\alpha}}^{(1)}\right)^{2} \equiv A_{7}+A_{8}$. It is easy to show that by Assumptions A. 1 and A.3(i)

$$
\begin{aligned}
A_{7} & =\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(\alpha_{i}-x_{i t}^{\prime}\left(X^{\prime} X\right)^{-1} X^{\prime} D_{\alpha} \underline{\alpha}+u_{i t}-x_{i t}^{\prime}\left(X^{\prime} X\right)^{-1} X^{\prime} U\right)^{2} \\
& =\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(\alpha_{i}-x_{i t}^{\prime}\left(X^{\prime} X\right)^{-1} X^{\prime} D_{\alpha} \underline{\alpha}\right)^{2}+\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t}^{2}+o_{P}(1) \xrightarrow{P} c_{\alpha, X}+\bar{\sigma}_{u}^{2}
\end{aligned}
$$

This result, in conjunction with (A.2) and the DCT, implies that $A_{8}=o_{P}(1)$. In addition, we can follow the analysis in Case 1 and readily show that $C V_{2,2}=\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t}^{2}+o_{P}(1) \xrightarrow{P} \bar{\sigma}_{u}^{2}$. It follows that

$$
\begin{equation*}
C V_{2,1}-C V_{2,2} \xrightarrow{P} c_{\alpha, X}>0 \tag{A.9}
\end{equation*}
$$

To study $C V_{2,3}$, we observe that

$$
\begin{equation*}
y_{i t}-\hat{y}_{i t}^{(3)}=u_{\alpha, i t}-x_{i t}^{(3) \prime}\left(\hat{\beta}_{i t}^{(3)}-\beta^{(3)}\right)=c_{i t, 3}\left(u_{\alpha, i t}-x_{i t}^{(3) \prime} B_{U_{\alpha}}^{(3)}\right) \tag{A.10}
\end{equation*}
$$

and $C V_{2,3}=\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(u_{\alpha, i t}-x_{i t}^{(3) \prime} B_{U_{\alpha}}^{(3)}\right)^{2}+\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(c_{i t, 3}^{2}-1\right)\left(u_{\alpha, i t}-x_{i t}^{(3) \prime} B_{U_{\alpha}}^{(3)}\right)^{2} \equiv$ $A_{9}+A_{10}$. By Assumptions A.1(i), A.1(iii) and A.3(i), Lemmas A.4-A.5, and (A.2), we can readily show that

$$
\begin{aligned}
A_{9} & =\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(\alpha_{i}-x_{i t}^{(3) \prime}\left(X^{(3) \prime} X^{(3)}\right)^{-1} X^{(3) \prime} D_{\alpha} \underline{\alpha}+u_{i t}-x_{i t}^{(3) \prime} B_{U}^{(3)}\right)^{2} \\
& =\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(\alpha_{i}-x_{i t}^{(3) \prime}\left(X^{(3) \prime} X^{(3)}\right)^{-1} X^{(3) \prime} D_{\alpha} \underline{\alpha}\right)^{2}+\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t}^{2}+o_{P}(1) \xrightarrow{P} c_{\alpha, X_{\lambda}}+\bar{\sigma}_{u}^{2}
\end{aligned}
$$

and $A_{10}=o_{P}(1)$. It follows that

$$
\begin{equation*}
C V_{2,3}-C V_{2,2} \xrightarrow{P} c_{\alpha, X_{\lambda}}>0 \tag{A.11}
\end{equation*}
$$

To study $C V_{2,4}$, noting that

$$
\begin{equation*}
y_{i t}-\hat{y}_{i t}^{(4)}=u_{i t}-x_{i t}^{(4) \prime}\left(\hat{\beta}_{i t}^{(4)}-\beta^{(4)}\right)=c_{i t, 4}\left(u_{i t}-x_{i t}^{(4) \prime} B_{U}^{(4)}\right) \tag{A.12}
\end{equation*}
$$

we have

$$
\begin{aligned}
C V_{2,4}-C V_{2,2}= & \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[c_{i t, 4}^{2}\left(u_{i t}-x_{i t}^{(4) \prime} B_{U}^{(4)}\right)^{2}-c_{i t, 2}^{2}\left(u_{i t}-x_{i t}^{(2) \prime} B_{U}^{(2)}\right)^{2}\right] \\
= & \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(c_{i t, 4}^{2}-c_{i t, 2}^{2}\right) u_{i t}^{2}+\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[c_{i t, 4}^{2}\left(x_{i t}^{(4) \prime} B_{U}^{(4)}\right)^{2}-c_{i t, 2}^{2}\left(x_{i t}^{(2) \prime} B_{U}^{(2)}\right)^{2}\right] \\
& -\frac{2}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[c_{i t, 4}^{2} u_{i t} x_{i t}^{(4) \prime} B_{U}^{(4)}-c_{i t, 2}^{2} u_{i t} x_{i t}^{(2) \prime} B_{U}^{(2)}\right] \\
\equiv & A_{11}+A_{12}-2 A_{13}, \text { say. }
\end{aligned}
$$

Following the analysis of $C V_{1,4}-C V_{1,1}$ in Case 1 and applying Lemma A.5(ii) and (iv), Lemma A. 6 and (A.2), we can readily show that

$$
\begin{aligned}
A_{11}= & \frac{2}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(h_{i t}^{(4)}-h_{i t}^{(2)}\right) u_{i t}^{2}+o_{P}\left(N^{-1}\right) \\
= & \frac{2}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[\frac{T-1}{N T}+\left(x_{i t}-B_{\alpha \lambda} d_{\alpha \lambda, i t}\right)^{\prime} X_{D_{\alpha \lambda}}^{*}\left(x_{i t}-B_{\alpha \lambda} d_{\alpha \lambda, i t}\right)\right. \\
& \left.-\left(x_{i t}-B_{\alpha} d_{\alpha, i t}\right)^{\prime} X_{D_{\alpha}}^{*}\left(x_{i t}-B_{\alpha} d_{\alpha, i t}\right)\right] u_{i t}^{2}+o_{P}\left(N^{-1}\right) \\
= & N^{-1} \frac{2}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t}^{2}+o_{P}\left(N^{-1}\right), \\
A_{12}= & \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[\left(x_{i t}^{(4) \prime} B_{U}^{(4)}\right)^{2}-\left(x_{i t}^{(2) \prime} B_{U}^{(2)}\right)^{2}\right]+o_{P}\left(N^{-1}\right)=\frac{1}{T} \sum_{t=1}^{T} \bar{u}_{\cdot t}^{2}+o_{P}\left(N^{-1}\right), \text { and } \\
A_{13}= & \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[u_{i t} x_{i t}^{(4) \prime} B_{U}^{(4)}-u_{i t} x_{i t}^{(2) \prime} B_{U}^{(2)}\right]+o_{P}\left(N^{-1}\right)=\frac{1}{T} \sum_{t=1}^{T} \bar{u}_{\cdot t}^{2}+o_{P}\left(N^{-1}\right) .
\end{aligned}
$$

It follows that

$$
\begin{equation*}
N\left[C V_{2,4}-C V_{2,2}\right]=\frac{2}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t}^{2}-\frac{N}{T} \sum_{t=1}^{T} \bar{u}_{t}^{2}+o_{P}(1) \xrightarrow{P} 2 \bar{\sigma}_{u}^{2}-\bar{\sigma}_{u 2}^{2}, \tag{A.13}
\end{equation*}
$$

where the convergence holds by Assumptions A.1(i) and A.2(ii).
By (A.9), (A.11), and (A.13), we have $P\left(C V_{2,2}<C V_{2, m}\right) \rightarrow 1$ as $(N, T) \rightarrow \infty$ for $m=1,3,4$ provided $\bar{\sigma}_{u 2}^{2}<2 \bar{\sigma}_{u}^{2}$.

Case 3: Model 3 is the true model. This case parallels Case 2 and we can analogously show that

$$
\begin{aligned}
C V_{3,1}-C V_{3,3} \xrightarrow{P} c_{\lambda, X} & >0, \\
C V_{3,2}-C V_{3,3} \xrightarrow{P} c_{\lambda, X_{\alpha}} & >0, \\
T\left[C V_{3,4}-C V_{3,3}\right] \xrightarrow{P} 2 \bar{\sigma}_{u}^{2}-\bar{\sigma}_{u 1}^{2} & >0,
\end{aligned}
$$

provided $\bar{\sigma}_{u 1}^{2}<2 \bar{\sigma}_{u}^{2}$. Then $P\left(C V_{3,3}<C V_{3, m}\right) \rightarrow 1$ for $m=1,2,4$.

Case 4: Model 4 is the true model. In this case, Models 1-3 are underfitted and we will show that $P\left(C V_{4,4}<C V_{4, m}\right) \rightarrow 1$ for $m=1,2,3$. Let $u_{\lambda, i t}=\lambda_{t}+u_{i t}, u_{\alpha \lambda, i t}=\alpha_{i}+\lambda_{t}+u_{i t}$, $U_{\lambda}=\left(u_{\lambda, 11}, \ldots, u_{\lambda, 1 T}, \ldots, u_{\lambda, N 1}, \ldots, u_{\lambda, N T}\right)^{\prime}$, and $U_{\alpha \lambda}=\left(u_{\alpha \lambda, 11}, \ldots, u_{\alpha \lambda, 1 T}, \ldots, u_{\alpha \lambda, N 1}, \ldots, u_{\alpha \lambda, N T}\right)^{\prime}$. Note that $U_{\alpha \lambda}=D_{\alpha} \underline{\alpha}+D_{\lambda} \underline{\lambda}+U$, where $\underline{\lambda}=\left(\lambda_{1}, \ldots, \lambda_{T-1}\right)^{\prime}$. Let $B_{U_{\lambda}}^{(m)}=\left(X^{(m) \prime} X^{(m)}\right)^{-1} X^{(m) \prime} U_{\lambda}$ and $B_{U_{\alpha \lambda}}^{(m)}=\left(X^{(m)^{\prime}} X^{(m)}\right)^{-1} X^{(m) \prime} U_{\alpha \lambda}$ for $m=1,2,3,4$. Following the steps to obtain (A.4), now we can show that

$$
\begin{equation*}
y_{i t}-\hat{y}_{i t}^{(1)}=u_{\alpha \lambda, i t}-x_{i t}^{\prime}\left(\hat{\beta}_{i t}^{(1)}-\beta^{(1)}\right)=c_{i t, 1}\left(u_{\alpha \lambda, i t}-x_{i t}^{\prime} B_{U_{\alpha \lambda}}^{(1)}\right) \tag{A.14}
\end{equation*}
$$

As in Case 2, we can show that by Assumptions A. 1 and A.3(iii),

$$
\begin{aligned}
C V_{4,1}= & \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 1}^{2}\left[u_{\alpha \lambda, i t}-x_{i t}^{\prime} B_{U_{\alpha \lambda}}^{(1)}\right]^{2} \\
= & \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[\alpha_{i}+\lambda_{t}-x_{i t}^{\prime}\left(X^{\prime} X\right)^{-1} X^{\prime}\left(D_{\alpha} \underline{\alpha}+D_{\lambda} \underline{\lambda}\right)\right]^{2}+\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t}^{2}+o_{P}(1) \\
& \xrightarrow[\rightarrow]{P} c_{\alpha \lambda, X}+\bar{\sigma}_{u}^{2}
\end{aligned}
$$

Similarly, we have by Assumptions A. 1 and A.3(iii)

$$
\begin{aligned}
C V_{4,2} & =\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 2}^{2}\left[u_{\lambda, i t}-x_{i t}^{(2) \prime} B_{U_{\lambda}}^{(2)}\right]^{2} \\
& =\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[\lambda_{t}-x_{i t}^{(2) \prime}\left(X^{(2) \prime} X^{(2)}\right)^{-1} X^{(2) \prime} D_{\lambda} \underline{\lambda}\right]^{2}+\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t}^{2}+o_{P}(1) \xrightarrow{P} c_{\lambda, X_{\alpha}}+\bar{\sigma}_{u}^{2} \\
C V_{4,3} & =\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 3}^{2}\left[u_{\alpha, i t}-x_{i t}^{(3) \prime} B_{U_{\alpha}}^{(3)}\right]^{2} \\
& =\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[\alpha_{i}-x_{i t}^{(3) \prime}\left(X^{(3) \prime} X^{(3)}\right)^{-1} X^{(3) \prime} D_{\alpha} \underline{\alpha}\right]^{2}+\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t}^{2}+o_{P}(1) \xrightarrow{P} c_{\alpha, X_{\lambda}}+\bar{\sigma}_{u}^{2}, \\
C V_{4,4} & =\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 4}\left[u_{i t}-x_{i t}^{(4) \prime} B_{U}^{(4)}\right]^{2}+\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t}^{2}+o_{P}(1) \xrightarrow{P} \bar{\sigma}_{u}^{2} .
\end{aligned}
$$

Then $P\left(C V_{4,4}<C V_{4, m}\right) \rightarrow 1$ as $(N, T) \rightarrow \infty$ for $m=1,2,3$.
Proof of Theorem 2.2. As before, we will use $C V_{l, m}^{b c}$ to denote $C V^{b c}(m)$ when the true model is given by Model $l$.

Case 1: Model 1 is the true model. We will show that $P\left(C V_{1,1}^{b c}<C V_{1, m}^{b c}\right) \rightarrow 1$ for $m=2,3,4$. Since $\breve{\beta}_{i t}^{(m)}=\hat{\beta}_{i t}^{(m)}$ and $\breve{y}_{i t}^{(m)}=\hat{y}_{i t}^{(m)}$ for $m=1,3$, we have by (A.4)

$$
\begin{equation*}
y_{i t}-\breve{y}_{i t}^{(m)}=y_{i t}-\hat{y}_{i t}^{(m)}=c_{i t, m}\left(u_{i t}-x_{i t}^{(m) \prime} B_{U}^{(m)}\right) \text { for } m=1,3 \tag{A.15}
\end{equation*}
$$

By (2.5) and (A.3)-(A.4), we have

$$
\begin{aligned}
x_{i t}^{(m) \prime}\left(\breve{\beta}_{i t}^{(m)}-\beta^{(m)}\right) & =x_{i t}^{(m) \prime}\left(\hat{\beta}_{i t}^{(m)}-\beta^{(m)}\right)-x_{i t}^{(m) \prime} \vec{\beta}_{i t}^{(m)} \\
& =-\frac{h_{i t}^{(m)}}{1-h_{i t}^{(m)}} u_{i t}+\frac{1}{1-h_{i t}^{(m)}} x_{i t}^{(m) \prime} B_{U}^{(m)}-x_{i t}^{(m) \prime} \vec{\beta}_{i t}^{(m)},
\end{aligned}
$$

and

$$
\begin{equation*}
y_{i t}-\breve{y}_{i t}^{(m)}=u_{i t}-x_{i t}^{(m) \prime}\left(\breve{\beta}_{i t}^{(m)}-\beta^{(m)}\right)=c_{i t, m}\left(u_{i t}-x_{i t}^{(m) \prime} B_{U}^{(m)}\right)+x_{i t}^{(m) \prime} \vec{\beta}_{i t}^{(m)} \text { for } m=2,4 \tag{A.16}
\end{equation*}
$$

It follows that

$$
C V_{1, m}^{b c}=\left\{\begin{array}{l}
\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, m}^{2}\left(u_{i t}-x_{i t}^{(m) \prime} B_{U}^{(m)}\right)^{2} \text { for } m=1,3 \\
\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(c_{i t, m}\left(u_{i t}-x_{i t}^{(m) \prime} B_{U}^{(m)}\right)+x_{i t}^{(m) \prime} \vec{\beta}_{i t}^{(m)}\right)^{2} \text { for } m=2,4
\end{array}\right.
$$

We first study $C V_{1,2}^{b c}-C V_{1,1}^{b c}$. We make the following decomposition:

$$
\begin{align*}
C V_{1,2}^{b c}-C V_{1,1}^{b c}= & \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[\left(c_{i t, 2}\left(u_{i t}-x_{i t}^{(2) \prime} B_{U}^{(2)}\right)+x_{i t}^{(2) \prime} \vec{\beta}_{i t}^{(2)}\right)^{2}-c_{i t, 1}^{2}\left(u_{i t}-x_{i t}^{(1) \prime} B_{U}^{(1)}\right)^{2}\right] \\
= & \left(C V_{1,2}-C V_{1,1}\right) \\
& +\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(x_{i t}^{(2) \prime} \vec{\beta}_{i t}^{(2)}\right)^{2}+\frac{2}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 2}\left(u_{i t}-x_{i t}^{(2) \prime} B_{U}^{(2)}\right) x_{i t}^{(2) \prime} \vec{\beta}_{i t}^{(2)} \\
\equiv & \left(C V_{1,2}-C V_{1,1}\right)+R_{1}+2 R_{2}, \text { say. } \tag{A.17}
\end{align*}
$$

where by (A.5) we have

$$
\begin{equation*}
T\left[C V_{1,2}-C V_{1,1}\right]=\frac{2}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t}^{2}-\frac{T}{N} \sum_{i=1}^{N} \bar{u}_{i .}^{2}+o_{P}(1) \xrightarrow{P} 2 \bar{\sigma}_{u}^{2}-\bar{\sigma}_{u 1}^{2} \tag{A.18}
\end{equation*}
$$

To study $R_{1}$ and $R_{2}$, let $h_{\alpha, i t}=d_{\alpha, i t}^{\prime}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} d_{\alpha, i t}$. Noting that $\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1}=T^{-1}\left(I_{N-1}-\frac{1}{N} \iota_{N-1} \iota_{N-1}^{\prime}\right)$ by (B.1), $h_{\alpha, i t}=T^{-1} d_{\alpha, i t}^{\prime}\left(I_{N-1}-\frac{1}{N} \iota_{N-1} \iota_{N-1}^{\prime}\right) d_{\alpha, i t}=\frac{N-1}{N T}$. By the updated formula for OLS estimation,

$$
\begin{aligned}
\zeta_{\alpha, i t} & =\left(D_{\alpha}^{\prime} D_{\alpha}-d_{\alpha, i t} d_{\alpha, i t}^{\prime}\right)^{-1}\left[D_{\alpha}^{\prime} X-d_{\alpha, i t} x_{i t}^{\prime}\right] \\
& =\left[\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1}+\frac{1}{1-h_{\alpha, i t}}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} d_{\alpha, i t} d_{\alpha, i t}^{\prime}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1}\right]\left[D_{\alpha}^{\prime} X-d_{\alpha, i t} x_{i t}^{\prime}\right] \\
& =\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} X+\frac{1}{1-h_{\alpha, i t}}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} d_{\alpha, i t} d_{\alpha, i t}^{\prime}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} X-\frac{1}{1-h_{\alpha, i t}}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} d_{\alpha, i t} x_{i t}^{\prime}
\end{aligned}
$$

and

$$
\begin{aligned}
d_{\alpha, i t}^{\prime} \zeta_{\alpha, i t} & =d_{\alpha, i t}^{\prime}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} X+\frac{h_{\alpha, i t}}{1-h_{\alpha, i t}} d_{\alpha, i t}^{\prime}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} X-\frac{h_{\alpha, i t}}{1-h_{\alpha, i t}} x_{i t}^{\prime} \\
& =\frac{1}{1-h_{\alpha, i t}} d_{\alpha, i t}^{\prime}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} X-\frac{h_{\alpha, i t}}{1-h_{\alpha, i t}} x_{i t}^{\prime}
\end{aligned}
$$

Then

$$
\begin{aligned}
R_{1} & =\frac{1}{N T^{3}} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[x_{i t}^{\prime} \hat{b}_{1}^{(2)}+d_{\alpha, i t}^{\prime} \zeta_{\alpha, i t} \hat{b}_{1}^{(2)}\right]^{2} \\
& =\frac{1}{N T^{3}} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[\operatorname{vec}\left(x_{i t} x_{i t}^{\prime}\right)\right]^{\prime} \operatorname{vec}\left(\hat{b}_{1}^{(2)} \hat{b}_{1}^{(2) \prime}\right)+o_{P}\left(T^{-2}\right)=O_{P}\left(T^{-2}\right)
\end{aligned}
$$

For $R_{2}$, we have $R_{2}=\frac{1}{T} \bar{R}_{2} \hat{b}_{1}^{(2)}$, where

$$
\begin{aligned}
\bar{R}_{2}= & \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 2}\left(u_{i t}-x_{i t}^{(2) \prime} B_{U}^{(2)}\right)\left(x_{i t}^{\prime}+d_{\alpha, i t}^{\prime} \zeta_{\alpha, i t}\right) \\
= & \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 2} u_{i t} x_{i t}^{\prime}-\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 2} x_{i t}^{(2) \prime} B_{U}^{(2)} x_{i t}^{\prime}+\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 2} u_{i t} d_{\alpha, i t}^{\prime} \zeta_{\alpha, i t} \\
& -\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 2} x_{i t}^{(2) \prime} 5 B_{U}^{(2)} d_{\alpha, i t}^{\prime} \zeta_{\alpha, i t} \\
\equiv & R_{21}-R_{22}+R_{23}-R_{24} .
\end{aligned}
$$

By the triangle inequality and (A.2),

$$
\begin{aligned}
\left\|R_{21}\right\| & \leq\left\|\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t} x_{i t}^{\prime}\right\|+\max _{i, t}\left|c_{i t, 2}-1\right| \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left\|u_{i t} x_{i t}^{\prime}\right\| \\
& =O_{P}\left((N T)^{-1 / 2}\right)+O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right)=O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right)
\end{aligned}
$$

By (A.2) and Lemma A.5(ii)

$$
\begin{aligned}
\left\|R_{22}\right\| & =\left\|\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 2} \eta_{i t}^{(2)} x_{i t}^{\prime}\right\| \\
& \leq \max _{i, t}\left|c_{i t, 2}\right|\left\{\left\|\frac{1}{N T^{2}} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(\eta_{i t}^{(2)}\right)^{2}\right\|\right\}\left\{\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left\|x_{i t}\right\|^{2}\right\}^{1 / 2} \\
& =O_{P}\left(\frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i .}^{2}+O_{P}\left((N T)^{-1}+T^{-2}\right)\right)^{1 / 2} O_{P}(1)=O_{P}\left(T^{-1 / 2}\right) .
\end{aligned}
$$

To improve the probability bound for $R_{22}$, we make the following decomposition

$$
R_{22}=\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} \eta_{i t}^{(2)} x_{i t}^{\prime}+\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(c_{i t, 2}-1\right) \eta_{i t}^{(2)} x_{i t}^{\prime} \equiv R_{22,1}+R_{22,2}
$$

It is easy to show that $R_{22,2} \leq \max _{i, t}\left|c_{i t, 2}-1\right| \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left\|\eta_{i t}^{(2)} x_{i t}^{\prime}\right\|=O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right)$ $\cdot O_{P}\left(T^{-1 / 2}\right)=O_{P}\left(T^{-3 / 2}+N^{-1 / 2} T^{-1}\right)$ by (A.2) and the rough above bound for $\left\|R_{22}\right\|$. Let $s_{2}$ denote a $k \times(k+N-1)$ selection matrix such that $x_{i t}=s_{2} x_{i t}^{(2)}$. Then

$$
R_{22,1}^{\prime}=\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} s_{2} x_{i t}^{(2)} x_{i t}^{(2) \prime}\left(X^{(2) \prime} X^{(2)}\right)^{-1} X^{(2) \prime} U=\frac{1}{N T} s_{2} X^{(2) \prime} U=\frac{1}{N T} X^{\prime} U=O_{P}\left((N T)^{-1 / 2}\right)
$$

It follows that $R_{22}=O_{P}\left(T^{-3 / 2}+(N T)^{-1 / 2}\right)$. For $R_{23}$, we can apply (A.2) and show that

$$
\begin{aligned}
R_{23} & =\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 2} u_{i t}\left[\frac{1}{1-h_{\alpha, i t}} d_{\alpha, i t}^{\prime}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} X-\frac{h_{\alpha, i t}}{1-h_{\alpha, i t}} x_{i t}^{\prime}\right] \\
& =\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t} d_{\alpha, i t}^{\prime}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} X+O_{P}\left(T^{-1}\left(T^{-1}+(N T)^{-1 / 2}\right)=O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right)\right.
\end{aligned}
$$

where the last equality follows from Lemma A.4(i). Next, $R_{24}=\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} x_{i t}^{(2) \prime} B_{U}^{(2)} d_{\alpha, i t}^{\prime} \zeta_{\alpha, i t}$ $+\frac{1}{N T^{2}} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(c_{i t, 2}-1\right) x_{i t}^{(2) \prime} B_{U}^{(2)} d_{\alpha, i t}^{\prime} \zeta_{\alpha, i t} \equiv R_{24,1}+R_{24,2}$. Note that

$$
\begin{aligned}
\left\|R_{24,2}\right\| & \leq \max _{i, t}\left|c_{i t, 2}-1\right|\left\{\left\|\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(\eta_{i t}^{(2)}\right)^{2}\right\|\right\}^{1 / 2}\left\{\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left\|d_{\alpha, i t}^{\prime} \zeta_{\alpha, i t}\right\|^{2}\right\}^{1 / 2} \\
& =O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right) O_{P}\left(T^{-1 / 2}\right) O_{P}(1)=O_{P}\left(T^{-1 / 2}\left(T^{-1}+(N T)^{-1 / 2}\right)\right.
\end{aligned}
$$

In addition, using (A.2) we can readily show that

$$
\begin{aligned}
R_{24,1} & =\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} x_{i t}^{(2) \prime}\left(X^{(2) \prime} X^{(2)}\right)^{-1} X^{(2) \prime} U\left[\frac{1}{1-h_{\alpha, i t}} d_{\alpha, i t}^{\prime}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} X-\frac{h_{\alpha, i t}}{1-h_{\alpha, i t}} x_{i t}^{\prime}\right] \\
& =\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} U^{\prime} X^{(2)}\left(X^{(2)^{\prime}} X^{(2)}\right)^{-1} x_{i t}^{(2)} d_{\alpha, i t}^{\prime}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} X+O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right) \\
& \equiv \bar{R}_{24,1}+O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right),
\end{aligned}
$$

where

$$
\begin{aligned}
\bar{R}_{24,1} & =\frac{1}{N T} U^{\prime} X^{(2)}\left(X^{(2) \prime} X^{(2)}\right)^{-1} X^{(2) \prime} P_{D_{\alpha}} X \\
& =\frac{1}{N T}\left(U^{\prime} X, U^{\prime} D_{\alpha}\right)\left(\begin{array}{cc}
X_{D_{\alpha}}^{*} & -X_{D_{\alpha}}^{*} B_{\alpha} \\
-B_{\alpha}^{\prime} X_{D_{\alpha}}^{*} & \left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1}+B_{\alpha}^{\prime} X_{D}^{*} B_{\alpha}
\end{array}\right)\left[\begin{array}{c}
X^{\prime} P_{D_{\alpha}} X \\
D_{\alpha}^{\prime} X
\end{array}\right] \\
& =\frac{1}{N T}\left\{U^{\prime} X X_{D_{\alpha}}^{*} X^{\prime} P_{D_{\alpha}} X-U^{\prime} P_{D_{\alpha}} X X_{D_{\alpha}}^{*} X^{\prime} P_{D_{\alpha}} X+U^{\prime} P_{D_{\alpha}} X\right\} \\
& \equiv R_{24,11}-R_{24,12}+R_{24,13}
\end{aligned}
$$

where we recall that $X_{D}^{*}=\left(X^{\prime} M_{D} X\right)^{-1}$ and $B_{\alpha}=X^{\prime} D_{\alpha}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1}$. By Lemma A.4(i), we can readily show that

$$
\begin{aligned}
R_{24,11} & =\left(\frac{1}{N T} U^{\prime} X\right)\left(N T X_{D_{\alpha}}^{*}\right) \frac{1}{N T} X^{\prime} P_{D_{\alpha}} X=O_{P}\left((N T)^{-1 / 2}\right) \\
R_{24,12} & =\left(\frac{1}{N T} U^{\prime} P_{D_{\alpha}} X\right)\left(N T X_{D_{\alpha}}^{*}\right) \frac{1}{N T} X^{\prime} P_{D_{\alpha}} X=O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right) \\
R_{24,13} & =\frac{1}{N T} U^{\prime} P_{D_{\alpha}} X=O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right)
\end{aligned}
$$

Then $R_{24,1}=O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right), R_{24}=O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right)$ and $R_{2}=T^{-1} O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right)$.
Then

$$
\begin{equation*}
T\left[R_{1}+2 R_{2}\right]=O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right) \tag{A.19}
\end{equation*}
$$

Combining (A.17)-(A.19) yields

$$
\begin{equation*}
T\left[C V_{1,2}^{b c}-C V_{1,1}^{b c}\right]=\frac{2}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t}^{2}-\frac{T}{N} \sum_{i=1}^{N} \bar{u}_{i .}^{2}+o_{P}(1) \xrightarrow{P} 2 \bar{\sigma}_{u}^{2}-\bar{\sigma}_{u 1}^{2} \tag{A.20}
\end{equation*}
$$

Next, by the proof of Theorem 2.1,

$$
\begin{equation*}
N\left[C V_{1,3}^{b c}-C V_{1,1}^{b c}\right]=N\left[C V_{1,3}-C V_{1,1}\right] \xrightarrow{P} 2 \bar{\sigma}_{u}^{2}-\bar{\sigma}_{u 2}^{2} \tag{A.21}
\end{equation*}
$$

Note that

$$
\begin{align*}
C V_{1,4}^{b c}-C V_{1,1}^{b c}= & \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[\left(c_{i t, 4}\left(u_{i t}-x_{i t}^{(4) \prime} B_{U}^{(4)}\right)+x_{i t}^{(2) \prime} \vec{\beta}_{i t}^{(2)}\right)^{2}-c_{i t, 1}^{2}\left(u_{i t}-x_{i t}^{(1) \prime} B_{U}^{(1)}\right)^{2}\right] \\
= & \left(C V_{1,4}-C V_{1,1}\right) \\
& +\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(x_{i t}^{(4) \prime} \vec{\beta}_{i t}^{(4)}\right)^{2}+\frac{2}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 4}\left(u_{i t}-x_{i t}^{(4) \prime} B_{U}^{(4)}\right) x_{i t}^{(4)} \vec{\beta}_{i t}^{(4)} \\
\equiv & \left(C V_{1,4}-C V_{1,1}\right)+R_{3}+2 R_{4}, \tag{A.22}
\end{align*}
$$

where by (A.7)

$$
\begin{align*}
& (N \wedge T)\left[C V_{1,4}-C V_{1,1}\right] \\
= & (N \wedge T)\left[\left(T^{-1}+N^{-1}\right) \frac{2}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t}^{2}-\frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i \cdot}^{2}-\frac{1}{T} \sum_{t=1}^{T} \bar{u}_{\cdot t}^{2}\right]+o_{P}(1) \xrightarrow{P} c_{\sigma} . \tag{A.23}
\end{align*}
$$

To study $R_{3}$ and $R_{4}$, let $h_{\alpha \lambda, i t}=d_{\alpha \lambda, i t}^{\prime}\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}\right)^{-1} d_{\alpha \lambda, i t}$. Noting that $\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}\right)^{-1}=\operatorname{diag}\left(T^{-1}\left(I_{N-1}-\right.\right.$ $\left.\left.\frac{1}{N} \iota_{N-1} \iota_{N-1}^{\prime}\right), N^{-1}\left(I_{T-1}-\frac{1}{T} \iota_{T-1} \iota_{T-1}^{\prime}\right)\right)$,

$$
\begin{aligned}
h_{\alpha \lambda, i t} & =T^{-1} d_{\alpha, i t}^{\prime}\left(I_{N-1}-\frac{1}{N} \iota_{N-1} \iota_{N-1}^{\prime}\right) d_{\alpha, i t}+N^{-1} d_{\lambda, i t}^{\prime}\left(I_{T-1}-\frac{1}{T} \iota_{T-1} \iota_{T-1}^{\prime}\right) d_{\lambda, i t} \\
& =\frac{N-1}{N T}+\frac{T-1}{N T}=\frac{N+T-2}{N T} .
\end{aligned}
$$

By the updated formula for OLS estimators,

$$
\begin{aligned}
\zeta_{\alpha \lambda, i t}= & \left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}-d_{\alpha \lambda, i t} d_{\alpha \lambda, i t}^{\prime}\right)^{-1}\left[D_{\alpha \lambda}^{\prime} X-d_{\alpha \lambda, i t} x_{i t}^{\prime}\right] \\
= & {\left[\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}\right)^{-1}+\frac{1}{1-h_{\alpha \lambda, i t}}\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}\right)^{-1} d_{\alpha \lambda, i t} d_{\alpha \lambda, i t}^{\prime}\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}\right)^{-1}\right]\left[D_{\alpha \lambda}^{\prime} X-d_{\alpha \lambda, i t} x_{i t}^{\prime}\right] } \\
= & \left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}\right)^{-1} D_{\alpha \lambda}^{\prime} X+\frac{1}{1-h_{\alpha \lambda, i t}}\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}\right)^{-1} d_{\alpha \lambda, i t} d_{\alpha \lambda, i t}^{\prime}\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}\right)^{-1} D_{\alpha \lambda}^{\prime} X \\
& -\frac{1}{1-h_{\alpha \lambda, i t}}\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}\right)^{-1} d_{\alpha \lambda, i t} x_{i t}^{\prime},
\end{aligned}
$$

and $d_{\alpha \lambda, i t}^{\prime} \zeta_{\alpha \lambda, i t}=\frac{1}{1-h_{\alpha \lambda, i t}} d_{\alpha \lambda, i t}^{\prime}\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}\right)^{-1} D_{\alpha \lambda}^{\prime} X-\frac{h_{\alpha \lambda, i t}}{1-h_{\alpha \lambda, i t}} x_{i t}^{\prime}$. Then $R_{3}=\frac{1}{N T^{3}} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[x_{i t} \hat{t}_{1}^{(4)}\right.$ $\left.+d_{\alpha \lambda, i t}^{\prime} \zeta_{\alpha \lambda, i t} \hat{b}_{1}^{(4)}\right]^{2}=\frac{1}{N T^{3}} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[\operatorname{vec}\left(x_{i t} x_{i t}^{\prime}\right)\right]^{\prime} \operatorname{vec}\left(\hat{b}_{1}^{(4)} \hat{b}_{1}^{(4) \prime}\right)+o_{P}\left(T^{-2}\right)=O_{P}\left(T^{-2}\right)$. For $R_{4}$, we have $R_{4}=\frac{1}{T} \bar{R}_{4} \hat{b}_{1}^{(4)}$,

$$
\begin{aligned}
\bar{R}_{4} \equiv & \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 4}\left(u_{i t}-x_{i t}^{(4) \prime} B_{U}^{(4)}\right)\left(x_{i t}^{\prime}+d_{\alpha \lambda, i t}^{\prime} \zeta_{\alpha \lambda, i t}\right) \\
= & \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 4} u_{i t} x_{i t}^{\prime}-\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 4} x_{i t}^{(4) \prime} B_{U}^{(4)} x_{i t}^{\prime} \\
& +\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 4} u_{i t} d_{\alpha \lambda, i t}^{\prime} \zeta_{\alpha \lambda, i t}-\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 4} x_{i t}^{(4) \prime} B_{U}^{(4)} d_{\alpha \lambda, i t}^{\prime} \zeta_{\alpha \lambda, i t} \\
\equiv & R_{41}-R_{42}+R_{43}-R_{44} .
\end{aligned}
$$

As in the analysis of $R_{21}$ and $R_{22}$, we can apply (A.2) and Lemma A.5(iv) to obtain

$$
\begin{aligned}
\left\|R_{41}\right\| & \leq\left\|\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t} x_{i t}^{\prime}\right\|+\max _{i, t}\left|c_{i t, 4}-1\right| \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left\|u_{i t} x_{i t}^{\prime}\right\| \\
& =O_{P}\left((N T)^{-1 / 2}\right)+O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right)=O_{P}\left(T^{-1}+N^{-1}\right)
\end{aligned}
$$

and

$$
\begin{aligned}
\left\|R_{42}\right\| & =\left\|\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 4} \eta_{i t}^{(4)} x_{i t}^{\prime}\right\| \\
& \leq \max _{i, t}\left|c_{i t, 4}\right|\left\{\left\|\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(\eta_{i t}^{(4)}\right)^{2}\right\|\right\}\left\{\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left\|x_{i t}\right\|^{2}\right\}^{1 / 2} \\
& =O_{P}\left(\frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i .}^{2}+\frac{1}{T} \sum_{t=1}^{T} \bar{u}_{\cdot t}^{2}+O_{P}\left((N T)^{-1}+T^{-2}\right)\right)^{1 / 2} O_{P}(1)=O_{P}\left(T^{-1 / 2}+N^{-1 / 2}\right) .
\end{aligned}
$$

To improve the probability bound for $R_{42}$, we make the following decomposition:

$$
R_{42}=\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} \eta_{i t}^{(4)} x_{i t}^{\prime}+\frac{1}{N T^{2}} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(c_{i t, 4}-1\right) \eta_{i t}^{(4)} x_{i t}^{\prime} \equiv R_{42,1}+R_{42,2}
$$

It is easy to show that $R_{42,2} \leq \max _{i, t}\left|c_{i t, 4}-1\right| \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left\|\eta_{i t}^{(4)} x_{i t}^{\prime}\right\|=O_{P}\left(T^{-1}+N^{-1}\right) O_{P}\left(T^{-1 / 2}\right.$ $\left.+N^{-1 / 2}\right)=O_{P}\left(T^{-3 / 2}+N^{-3 / 2}\right)$ by (A.2) and the above rough bound for $\left\|R_{42}\right\|$. Let $s_{4}$ denote a $k \times(k+N+T-2)$ selection matrix such that $x_{i t}=s_{4} x_{i t}^{(4)}$. Then

$$
R_{42,1}^{\prime}=\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} s_{4} x_{i t}^{(4)} x_{i t}^{(4) \prime}\left(X^{(4) \prime} X^{(4)}\right)^{-1} X^{(4) \prime} U=\frac{1}{N T} s_{4} X^{(4) \prime} U=\frac{1}{N T} X^{\prime} U=O_{P}\left((N T)^{-1 / 2}\right) .
$$

Then $R_{42}=O_{P}\left(T^{-3 / 2}+N^{-3 / 2}+(N T)^{-1 / 2}\right)=O_{P}\left(N^{-1}+T^{-1}\right)$. For $R_{43}$, we can apply (A.2) and show that

$$
\begin{aligned}
R_{43} & =\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 4} u_{i t}\left[\frac{1}{1-h_{\alpha \lambda, i t}} d_{\alpha \lambda, i t}^{\prime}\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}\right)^{-1} D_{\alpha \lambda}^{\prime} X-\frac{h_{\alpha \lambda, i t}}{1-h_{\alpha \lambda, i t}} x_{i t}^{\prime}\right] \\
& =\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t} d_{\alpha \lambda, i t}^{\prime}\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}\right)^{-1} D_{\alpha \lambda}^{\prime} X+O_{P}\left(N^{-1}+T^{-1}\right) \\
& =O_{P}\left(N^{-1}+T^{-1}\right)+O_{P}\left(N^{-1}+T^{-1}\right)=O_{P}\left(N^{-1}+T^{-1}\right),
\end{aligned}
$$

where the last line follows from Lemma A.4(iii). Note that $R_{44}=\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} x_{i t}^{(4) \prime} B_{U}^{(4)} d_{\alpha \lambda, i t}^{\prime} \zeta_{\alpha \lambda, i t}$ $+\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(c_{i t, 4}-1\right) x_{i t}^{(4) \prime} B_{U}^{(4)} d_{\alpha \lambda, i t}^{\prime} \zeta_{\alpha \lambda, i t} \equiv R_{44,1}+R_{44,2}$. For the second term, we have

$$
\begin{aligned}
\left\|R_{44,2}\right\| & \leq \max _{i, t}\left|c_{i t, 4}-1\right|\left\{\left\|\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(\eta_{i t}^{(4)}\right)^{2}\right\|\right\}^{1 / 2}\left\{\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left\|d_{\alpha \lambda, i t}^{\prime} \zeta_{\alpha \lambda, i t}\right\|^{2}\right\}^{1 / 2} \\
& =O_{P}\left(N^{-1}+T^{-1}\right) O_{P}\left(N^{-1 / 2}+T^{-1 / 2)}\right) O_{P}(1)=O_{P}\left(N^{-3 / 2}+T^{-3 / 2}\right) .
\end{aligned}
$$

For the first term, we can apply (A.2) to obtain that

$$
\begin{aligned}
R_{44,1} & =\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} x_{i t}^{(4) \prime}\left(X^{(4) \prime} X^{(4)}\right)^{-1} X^{(4)^{\prime}} U\left[\frac{1}{1-h_{\alpha \lambda, i t}} d_{\alpha \lambda, i t}^{\prime}\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}\right)^{-1} D_{\alpha \lambda}^{\prime} X-\frac{h_{\alpha \lambda, i t}}{1-h_{\alpha \lambda, i t}} x_{i t}^{\prime}\right] \\
& =\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} U^{\prime}\left(X^{(4)^{\prime}} X^{(4)}\right)^{-1} X^{(4) \prime} x_{i t}^{(4)} d_{\alpha, i t}^{\prime}\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}\right)^{-1} D_{\alpha \lambda}^{\prime} X+O_{P}\left(N^{-1}+T^{-1}\right) \\
& \equiv \bar{R}_{44,1}+O_{P}\left(N^{-1}+T^{-1}\right),
\end{aligned}
$$

where $\bar{R}_{44,1}=\frac{1}{N T} U^{\prime}\left(X^{(4) \prime} X^{(4)}\right)^{-1} X^{(4) \prime} D_{\alpha}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} X$. Following the analysis of $\bar{R}_{24,1}$ and using Lemmas A. 2 and A.4(iii), we can show that $\bar{R}_{44,1}=O_{P}\left(N^{-1}+T^{-1}\right)$. Then $R_{44}=O_{P}\left(N^{-1}+T^{-1}\right)$ and $R_{4}=T^{-1} O_{P}\left(N^{-1}+T^{-1}\right)$. It follows that

$$
\begin{equation*}
(N \wedge T)\left[R_{3}+2 R_{4}\right]=(N \wedge T) O_{P}\left(T^{-1}\left(N^{-1}+T^{-1}\right)\right)=O_{P}\left(T^{-1}\right) . \tag{A.24}
\end{equation*}
$$

Combining (A.22)-(A.24) yields

$$
\begin{align*}
& (N \wedge T)\left[C V_{1,4}^{b c}-C V_{1,1}^{b c}\right] \\
= & (N \wedge T)\left[\left(T^{-1}+N^{-1}\right) \frac{2}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t}^{2}-\frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i \cdot}^{2}-\frac{1}{T} \sum_{t=1}^{T} \bar{u}_{\cdot t}^{2}\right]+o_{P}(1) \xrightarrow{P} c_{\sigma} . \tag{A.25}
\end{align*}
$$

Combining (A.20), (A.21) and (A.25) yields $P\left(C V_{1,1}^{b c}<C V_{1, m}^{b c}\right) \rightarrow 1$ for $m=2,3,4$ provided $\max \left(\bar{\sigma}_{u 1}^{2}, \bar{\sigma}_{u 2}^{2}\right)<2 \bar{\sigma}_{u}^{2}$.

Case 2: Model 2 is the true model. We will show that $P\left(C V_{2,2}^{b c}<C V_{2, m}^{b c}\right) \rightarrow 1$ for $m=1,3,4$. Noting that $\breve{\beta}_{i t}^{(1)}=\hat{\beta}_{i t}^{(1)}$, we have $C V_{2,1}^{b c}=C V_{2,1} \xrightarrow{P} c_{\alpha, X}+\bar{\sigma}_{u}^{2}$ by the proof of Theorem 2.1. In addition, we can readily show $C V_{2,2}^{b c}=\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(y_{i t}-\breve{y}_{i t}^{(2)}\right)^{2}=\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 2}^{2}\left(u_{i t}-x_{i t}^{(2) \prime} B_{U}^{(2)}+\right.$ $\left.x_{i t}^{(2) \prime} \vec{\beta}_{i t}^{(2)}\right)^{2}=\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t}^{2}+o_{P}(1) \xrightarrow{P} \bar{\sigma}_{u}^{2}$. It follows that

$$
\begin{equation*}
C V_{2,1}^{b c}-C V_{2,2}^{b c} \xrightarrow{P} c_{\alpha, X}>0 \tag{A.26}
\end{equation*}
$$

For $C V_{2,3}^{b c}$, observing that $\breve{\beta}_{i t}^{(3)}=\hat{\beta}_{i t}^{(3)}$, we have $C V_{2,3}^{b c}=C V_{2,3} \xrightarrow{P} c_{\alpha, X_{\lambda}}+\bar{\sigma}_{u}^{2}$ by the proof of Theorem 2.1. It follows that

$$
\begin{equation*}
C V_{2,3}^{b c}-C V_{2,2}^{b c} \xrightarrow{P} c_{\alpha, X_{\lambda}}>0 \tag{A.27}
\end{equation*}
$$

To study $C V_{2,4}^{b c}$, note that

$$
\begin{equation*}
y_{i t}-\breve{y}_{i t}^{(m)}=u_{i t}-x_{i t}^{(m) \prime}\left(\breve{\beta}_{i t}^{(m)}-\beta^{(m)}\right)=c_{i t, m}\left(u_{i t}-x_{i t}^{(m) \prime} B_{U}^{(m)}\right)+x_{i t}^{(m) \prime} \vec{\beta}_{i t}^{(m)} \text { for } m=2,4, \tag{A.28}
\end{equation*}
$$

where the last $T-1$ elements of $\beta^{(4)}$ are all zeros when Model 2 is the true model. Then

$$
\begin{align*}
& C V_{2,4}^{b c}-C V_{2,2}^{b c} \\
= & \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left\{\left[c_{i t, 4}\left(u_{i t}-x_{i t}^{(4) \prime} B_{U}^{(4)}\right)+x_{i t}^{(4) \prime} \vec{\beta}_{i t}^{(4)}\right]^{2}-\left[c_{i t, 2}\left(u_{i t}-x_{i t}^{(2) \prime} B_{U}^{(2)}\right)+x_{i t}^{(2) \prime} \vec{\beta}_{i t}^{(2)}\right]^{2}\right\} \\
= & \left(C V_{2,4}-C V_{2,2}\right)+\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[\left(x_{i t}^{(4) \prime} \vec{\beta}_{i t}^{(4)}\right)^{2}-\left(x_{i t}^{(2) \prime} \vec{\beta}_{i t}^{(2)}\right)^{2}\right] \\
& +\frac{2}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[c_{i t, 4}\left(u_{i t}-x_{i t}^{(4) \prime} B_{U}^{(4)}\right) x_{i t}^{(4)} \vec{\beta}_{i t}^{(4)}-c_{i t, 2}\left(u_{i t}-x_{i t}^{(2) \prime} B_{U}^{(2)}\right) x_{i t}^{(2) \prime} \vec{\beta}_{i t}^{(2)}\right] \\
\equiv & \left(C V_{2,4}-C V_{2,2}\right)+R_{5}+2 R_{6}, \tag{A.29}
\end{align*}
$$

where by (A.13) we have

$$
\begin{equation*}
N\left[C V_{2,4}-C V_{2,2}\right]=\frac{2}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t}^{2}-\frac{N}{T} \sum_{t=1}^{T} \bar{u}_{\cdot t}^{2}+o_{P}(1) \xrightarrow{P} 2 \bar{\sigma}_{u}^{2}-\bar{\sigma}_{u 2}^{2} \tag{A.30}
\end{equation*}
$$

To study $R_{5}$ and $R_{6}$, recall that $h_{\alpha \lambda, i t}=d_{\alpha \lambda, i t}^{\prime}\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}\right)^{-1} d_{\alpha \lambda, i t}=\frac{N+T-2}{N T}$ and $d_{\alpha \lambda, i t}^{\prime} \zeta_{\alpha \lambda, i t}=$ $\frac{1}{1-h_{\alpha \lambda, i t}} d_{\alpha \lambda, i t}^{\prime}\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}\right)^{-1} D_{\alpha \lambda}^{\prime} X-\frac{h_{\alpha \lambda, i t}}{1-h_{\alpha \lambda, i t}} x_{i t}^{\prime}$. Then we can show that

$$
\begin{aligned}
R_{5} & =\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[\left(x_{i t}^{(4) \prime} \vec{\beta}_{i t}^{(4)}\right)^{2}-\left(x_{i t}^{(2) \prime} \vec{\beta}_{i t}^{(2)}\right)^{2}\right] \\
& =\frac{1}{N T^{3}} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[\left(x_{i t}^{\prime} \hat{b}_{1}^{(4)}+d_{\alpha \lambda, i t}^{\prime} \zeta_{\alpha \lambda, i t} \hat{b}_{1}^{(4)}\right)^{2}-\left(x_{i t}^{\prime} \hat{b}_{1}^{(2)}+d_{\alpha, i t}^{\prime} \zeta_{\alpha, i t} \hat{b}_{1}^{(2)}\right)^{2}\right] \\
& =\frac{1}{N T^{3}} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[\operatorname{vec}\left(x_{i t} x_{i t}^{\prime}\right)\right]^{\prime} \operatorname{vec}\left(\hat{b}_{1}^{(4)} \hat{b}_{1}^{(4) \prime}-\hat{b}_{1}^{(2)} \hat{b}_{1}^{(2) \prime}\right)+T^{-2} O_{P}\left(N^{-1}+T^{-1}\right)=O_{P}\left(T^{-2}\right),
\end{aligned}
$$

which is $o_{P}\left(N^{-1}\right)$ provided $N / T^{2}=o(1)$. Under the additional condition that $\sqrt{N T} \frac{1}{T}\left(\hat{b}_{1}^{(m)}-b_{1}^{(m)}\right)=$ $o_{P}(1)$ for $m=2,4$, noting that $b_{1}^{(2)}=b_{1}^{(4)}$ when Model 2 is the true model, we have $\frac{1}{T}\left(\hat{b}_{1}^{(4)}-\hat{b}_{1}^{(2)}\right)=$ $\frac{1}{T}\left[\left(\hat{b}_{1}^{(4)}-b_{1}^{(4)}\right)-\left(\hat{b}_{1}^{(2)}-b_{1}^{(2)}\right)\right]=o_{P}\left((N T)^{-1 / 2}\right)$. This implies that $R_{5}=O_{P}\left(\frac{1}{T^{2}}\left\|\hat{b}_{1}^{(4)} \hat{b}_{1}^{(4) \prime}-\hat{b}_{1}^{(2)} \hat{b}_{1}^{(2)}\right\|\right)=$ $o_{P}\left((N T)^{-1}+T^{-1}(N T)^{-1 / 2}\right)$, which is $o_{P}\left(N^{-1}\right)$ under the weaker condition $N / T^{3}=O(1)$.

By the definition of $\vec{\beta}_{i t}^{(2)}$ in (2.5) and that of $\vec{\beta}_{i t}^{(4)}$ in (2.6), we have

$$
\begin{aligned}
R_{6} & =\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[c_{i t, 4}\left(u_{i t}-x_{i t}^{(4) \prime} B_{U}^{(4)}\right) x_{i t}^{(4) \prime} \vec{\beta}_{i t}^{(4)}-c_{i t, 2}\left(u_{i t}-x_{i t}^{(2) \prime} B_{U}^{(2)}\right) x_{i t}^{(2) \prime} \vec{\beta}_{i t}^{(2)}\right] \\
& =\frac{1}{T}\left(\bar{R}_{4} \hat{b}_{1}^{(4)}-\bar{R}_{2} \hat{b}_{1}^{(2)}\right)=T^{-1}\left[O_{P}\left(N^{-1}+T^{-1}\right)-O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right)\right]=T^{-1} O_{P}\left(N^{-1}+T^{-1}\right),
\end{aligned}
$$

where $\bar{R}_{4}=\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 4}\left(u_{i t}-x_{i t}^{(4) \prime} B_{U}^{(4)}\right)\left(x_{i t}^{\prime}+d_{\alpha \lambda, i t}^{\prime} \zeta_{\alpha \lambda, i t}\right)=O_{P}\left(N^{-1}+T^{-1}\right)$ and $\bar{R}_{2}=$ $\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 2}\left(u_{i t}-x_{i t}^{(2) \prime} B_{U}^{(2)}\right)\left(x_{i t}^{\prime}+d_{\alpha, i t}^{\prime} \zeta_{\alpha, i t}\right)=O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right)$. Note $R_{6}=o_{P}\left(N^{-1}\right)$ under the weaker condition $N / T^{2}=o(1)$. To obtain a better control on the probability bound for $R_{6}$
under the additional condition that $\sqrt{N T} \frac{1}{T}\left(\hat{b}_{1}^{(m)}-b_{1}^{(m)}\right)=o_{P}(1)$ for $m=2$, 4, we make the following expansion:

$$
R_{6}=\frac{1}{T}\left(\bar{R}_{4}-\bar{R}_{2}\right) \hat{b}_{1}^{(4)}+\frac{1}{T} \bar{R}_{2}\left(\hat{b}_{1}^{(4)}-\hat{b}_{1}^{(2)}\right) \equiv \frac{1}{T} R_{61} \hat{b}_{1}^{(4)}+R_{62},
$$

where $R_{61} \equiv \bar{R}_{4}-\bar{R}_{2}$ and $R_{62} \equiv \bar{R}_{2} \frac{1}{T}\left(\hat{b}_{1}^{(4)}-\hat{b}_{1}^{(2)}\right)=O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right) o_{P}\left((N T)^{-1 / 2}\right)=o_{P}\left(N^{-1}\right)$ if $N / T^{3}=O(1)$. Using (A.2), we can readily show that

$$
\begin{aligned}
R_{61}= & \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(u_{i t}-x_{i t}^{(4) \prime} B_{U}^{(4)}\right)\left(x_{i t}^{\prime}+d_{\alpha \lambda, i t}^{\prime} \zeta_{\alpha \lambda, i t}\right)-\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(u_{i t}-x_{i t}^{(2) \prime} B_{U}^{(2)}\right)\left(x_{i t}^{\prime}+d_{\alpha, i t}^{\prime} \zeta_{\alpha, i t}\right) \\
& +O_{P}\left(\left(N^{-1}+T^{-1}\right)^{2}\right)+O_{P}\left(\left(T^{-1}+(N T)^{-1 / 2}\right)^{2}\right) \\
= & -\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(x_{i t}^{(4) \prime} B_{U}^{(4)}-x_{i t}^{(2) \prime} B_{U}^{(2)}\right) x_{i t}^{\prime}+\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t}\left(d_{\alpha \lambda, i t}^{\prime} \zeta_{\alpha \lambda, i t}-d_{\alpha, i t}^{\prime} \zeta_{\alpha, i t}\right) \\
& -\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(x_{i t}^{(4) \prime} B_{U}^{(4)} d_{\alpha \lambda, i t}^{\prime} \zeta_{\alpha \lambda, i t}-x_{i t}^{(2) \prime} B_{U}^{(2)} d_{\alpha, i t}^{\prime} \zeta_{\alpha, i t}\right)+O_{P}\left(N^{-2}+T^{-2}\right) \\
\equiv & -R_{61,1}+R_{61,2}-R_{61,3}+O_{P}\left(N^{-2}+T^{-2}\right) .
\end{aligned}
$$

Using the definitions of the selection matrices $s_{4}$ and $s_{2}$ defined above, we have $R_{61,1}^{\prime}=\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}$ $\left(s_{4} x_{i t}^{(4)} x_{i t}^{(4) \prime} B_{U}^{(4)}-s_{2} x_{i t}^{(2)} x_{i t}^{(2) \prime} B_{U}^{(2)}\right)=\frac{1}{N T}\left(s_{4} X^{(4) \prime} U-s_{2} X^{(2) \prime} U\right)=\frac{1}{N T}\left(X^{\prime} U-X^{\prime} U\right)=0$. For $R_{61,2}$, we apply the fact that $d_{\alpha \lambda, i t}^{\prime} \zeta_{\alpha \lambda, i t}=\frac{1}{1-h_{\alpha \lambda, i t}} d_{\alpha \lambda, i t}^{\prime}\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}\right)^{-1} D_{\alpha \lambda}^{\prime} X-\frac{h_{\alpha \lambda, i t}}{1-h_{\alpha \lambda, i t}} x_{i t}^{\prime}$ and $d_{\alpha, i t}^{\prime} \zeta_{\alpha, i t}=$ $\frac{1}{1-h_{\alpha, i t}} d_{\alpha, i t}^{\prime}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} X-\frac{h_{\alpha, i t}}{1-h_{\alpha, i t}} x_{i t}^{\prime}$ and (A.2) to obtain that

$$
\begin{aligned}
R_{61,2} & =\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t}\left(d_{\alpha \lambda, i t}^{\prime} \zeta_{\alpha \lambda, i t}-d_{\alpha, i t}^{\prime} \zeta_{\alpha, i t}\right) \\
& =\bar{R}_{61,2}+O_{P}\left(\left(N^{-1}+T^{-1}\right)^{2}\right)+O_{P}\left(\left(T^{-1}+(N T)^{-1 / 2}\right)^{2}\right)=\bar{R}_{61,2}+O_{P}\left(N^{-2}+T^{-2}\right),
\end{aligned}
$$

where $\bar{R}_{61,2}=\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t}\left[d_{\alpha \lambda, i t}^{\prime}\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}\right)^{-1} D_{\alpha \lambda}^{\prime} X-d_{\alpha, i t}^{\prime}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} X\right]$. By Lemma A.4(i) and (iii) and Assumptions A.1(iii) and A.2(iv), $\bar{R}_{61,2}=\frac{1}{T} \sum_{t=1}^{T} \bar{u}_{. t} \bar{x}_{. t}^{\prime}-\bar{u} . . \bar{x}_{.}^{\prime}=O_{P}\left(N^{-1}+(N T)^{-1 / 2}\right)$. Then $R_{61,2}=O_{P}\left(N^{-1}+(N T)^{-1 / 2}\right)$. For $R_{61,3}$, we have

$$
R_{61,3}=\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(x_{i t}^{(4) \prime} B_{U}^{(4)} d_{\alpha \lambda, i t}^{\prime} \zeta_{\alpha \lambda, i t}-x_{i t}^{(2) \prime} B_{U}^{(2)} d_{\alpha, i t}^{\prime} \zeta_{\alpha, i t}\right)=\bar{R}_{61,3}+O_{P}\left(N^{-2}+T^{-2}\right)
$$

where $\bar{R}_{61,3}=\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[B_{U}^{(4) \prime} x_{i t}^{(4)} d_{\alpha \lambda, i t}^{\prime}\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}\right)^{-1} D_{\alpha \lambda}^{\prime} X-B_{U}^{(2) \prime} x_{i t}^{(2)} d_{\alpha, i t}^{\prime}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} X\right]$. Note that $\bar{R}_{61,3}=\frac{1}{N T} U^{\prime}\left[X^{(4)}\left(X^{(4) \prime} X^{(4)}\right)^{-1} X^{(4) \prime} P_{D_{\alpha \lambda}}-X^{(2)}\left(X^{(2) \prime} X^{(2)}\right)^{-1} X^{(2) \prime} P_{D_{\alpha}}\right] X \equiv \bar{R}_{61,31}-\bar{R}_{61,32}$.

By Lemma A.1,

$$
\begin{aligned}
& \bar{R}_{61,32} \\
= & \frac{1}{N T} U^{\prime}\left(X, D_{\alpha}\right) \\
& \times\left(\begin{array}{cc}
X_{D_{\alpha}}^{*} & -X_{D_{\alpha}}^{*} X^{\prime} D_{\alpha}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} \\
-\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} X X_{D_{\alpha}}^{*} & \left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1}\left[I_{N-1}+D_{\alpha}^{\prime} X X_{D_{\alpha}}^{*} X^{\prime} D_{\alpha}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1}\right]
\end{array}\right)\binom{X^{\prime} P_{D_{\alpha}} X}{D_{\alpha}^{\prime} X} \\
= & \frac{1}{N T} U^{\prime}\left(X X_{D_{\alpha}}^{*} X^{\prime}-P_{D_{\alpha}} X X_{D_{\alpha}}^{*} X^{\prime}+X X_{D_{\alpha}}^{*} X^{\prime} P_{D_{\alpha}}+P_{D_{\alpha}}+P_{D_{\alpha}} X X_{D_{\alpha}}^{*} X^{\prime} P_{D_{\alpha}}\right) P_{D_{\alpha}} X \\
= & \frac{1}{N T}\left\{U^{\prime} P_{D_{\alpha}} X+2 U^{\prime} X X_{D_{\alpha}}^{*} X^{\prime} P_{D_{\alpha}} X\right\}=\frac{1}{N T} U^{\prime} P_{D_{\alpha}} X+O_{P}\left((N T)^{-1 / 2}\right),
\end{aligned}
$$

where we use the fact that $\left(\frac{1}{N T} U^{\prime} X\right)\left(N T X_{D_{\alpha}}^{*}\right)\left(\frac{1}{N T} X^{\prime} P_{D_{\alpha}} X\right)=O_{P}\left((N T)^{-1 / 2}\right)$. Similarly, by Lemma A. 2

$$
\begin{aligned}
\bar{R}_{61,31}= & \frac{1}{N T} U^{\prime}\left(X, D_{\alpha}, D_{\lambda}\right) \\
& \times\left(\begin{array}{cc}
X_{D_{\alpha \lambda}}^{*} & -X_{D_{\alpha \lambda}}^{*} B_{\alpha} \\
-B_{\alpha}^{\prime} X_{D_{\alpha \lambda}}^{*} & \left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1}+B_{\alpha}^{\prime} X_{D_{\alpha \lambda}}^{*} B_{\alpha} \\
-B_{\lambda}^{\prime} X_{D_{\alpha \lambda}}^{*} & B_{\lambda}^{\prime} X_{D_{\alpha \lambda}}^{*} B_{\alpha} \\
& \left(D_{\lambda}^{\prime} D_{\lambda}\right)^{-1}+B_{\lambda}^{\prime} X_{D_{\alpha \lambda}}^{*} B_{D_{\alpha \lambda}}^{*} B_{\lambda}
\end{array}\right)\left(\begin{array}{c}
X^{\prime} \\
D_{\alpha}^{\prime} \\
D_{\lambda}^{\prime}
\end{array}\right) P_{D_{\alpha \lambda}} X \\
= & \frac{1}{N T} U^{\prime}\left\{X X_{D_{\alpha \lambda}}^{*} X^{\prime}+D_{\alpha}\left(\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1}+B_{\alpha}^{\prime} X_{D_{\alpha \lambda}}^{*} B_{\alpha}\right) D_{\alpha}^{\prime}+D_{\lambda}\left(\left(D_{\lambda}^{\prime} D_{\lambda}\right)^{-1}+B_{\lambda}^{\prime} X_{D_{\alpha \lambda}}^{*} B_{\lambda}\right) D_{\lambda}^{\prime}\right. \\
& \left.-2 D_{\alpha} B_{\alpha}^{\prime} X_{D_{\alpha \lambda}}^{*} X^{\prime}-2 D_{\lambda} B_{\lambda}^{\prime} X_{D_{\alpha \lambda}}^{*} X^{\prime}+2 D_{\lambda} B_{\lambda}^{\prime} X_{D_{\alpha \lambda}}^{*} B_{\alpha} D_{\alpha}^{\prime}\right\} P_{D_{\alpha \lambda}} X \\
= & \frac{1}{N T} U^{\prime}\left\{X X_{D_{\alpha \lambda}}^{*} X^{\prime} P_{D_{\alpha \lambda}}+P_{D_{\alpha}}+P_{D_{\alpha}} X X_{D_{\alpha \lambda}}^{*} X^{\prime} P_{D_{\alpha}}+P_{D_{\lambda}}+P_{D_{\lambda}} X X_{D_{\alpha \lambda}}^{*} X^{\prime} P_{D_{\lambda}}\right. \\
& \left.-2 P_{D_{\alpha}} X X_{D_{\alpha \lambda}}^{*} X^{\prime} P_{D_{\alpha \lambda}}-2 P_{D_{\lambda}} X X_{D_{\alpha \lambda}}^{*} X^{\prime} P_{D_{\alpha \lambda}}+2 P_{D_{\lambda}} X X_{D_{\alpha \lambda}}^{*} X^{\prime} P_{D_{\alpha}}\right\} X \\
= & \frac{1}{N T} U^{\prime} P_{D_{\alpha}} X+O_{P}\left((N T)^{-1 / 2}+N^{-1}\right),
\end{aligned}
$$

where we use the notation defined in Lemma A. 2 with $D_{1}$ and $D_{2}$ replaced by $D_{\alpha}$ and $D_{\lambda}$, respectively. It follows that $\bar{R}_{61,3}=O_{P}\left((N T)^{-1 / 2}+N^{-1}\right)$ and $R_{61,3}=O_{P}\left((N T)^{-1 / 2}+N^{-1}\right)$. Consequently, we have shown that $R_{61}=O_{P}\left((N T)^{-1 / 2}+N^{-1}\right)$ and $R_{6}=\frac{1}{T} R_{61} \hat{b}_{1}^{(4)}+R_{62}=T^{-1} O_{P}\left((N T)^{-1 / 2}+N^{-1}\right)=$ $o_{P}\left(N^{-1}\right)$ provided that $N / T^{3}=o(1)$. In sum, under Scenario (1): $\hat{b}_{1}^{(m)}=O_{P}(1)$ for $m=2,4$ and $N / T^{2}=o(1)$, we have

$$
\begin{equation*}
N\left[R_{5}+2 R_{6}\right]=N O_{P}\left(T^{-1}\left(N^{-1}+T^{-1}\right)\right)=o_{P}(1) \tag{A.31}
\end{equation*}
$$

and under Scenario (2): $\hat{b}_{1}^{(m)}=O_{P}(1), \sqrt{N T} \frac{1}{T}\left(\hat{b}_{1}^{(m)}-b_{1}^{(m)}\right)=o_{P}(1)$ for $m=2,4$, and $N / T^{3}=O(1)$, we have

$$
\begin{equation*}
N\left[R_{5}+2 R_{6}\right]=N o_{P}\left((N T)^{-1}+N^{-1 / 2} T^{-3 / 2}\right)=o_{P}(1) \tag{A.32}
\end{equation*}
$$

Combining (A.29)-(A.32) yields that

$$
\begin{equation*}
N\left[C V_{2,4}^{b c}-C V_{2,4}^{b c}\right]=\frac{2}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t}^{2}-\frac{N}{T} \sum_{t=1}^{T} \bar{u}_{\cdot t}^{2}+o_{P}(1) \xrightarrow{P} 2 \bar{\sigma}_{u}^{2}-\bar{\sigma}_{u 2}^{2} \tag{A.33}
\end{equation*}
$$

By (A.26), (A.27), and (A.33), we have $P\left(C V_{2,2}^{b c}<C V_{2, m}^{b c}\right) \rightarrow 1$ as $(N, T) \rightarrow \infty$ for $m=1,3,4$ provided $\bar{\sigma}_{u 2}^{2}<2 \bar{\sigma}_{u}^{2}$.

Case 3: Model 3 is the true model. Noting that $C V_{3, m}^{b c}=C V_{3, m}$ for $m=1$, 3 , we have

$$
\begin{equation*}
C V_{3,1}^{b c}-C V_{3,3}^{b c}=C V_{3,1}-C V_{3,3} \xrightarrow{P} c_{\lambda, X}>0 \tag{A.34}
\end{equation*}
$$

Next we want to show that

$$
\begin{equation*}
C V_{3,2}^{b c}-C V_{3,3}^{b c} \xrightarrow{P} c_{\lambda, X_{\alpha}}>0 \tag{A.35}
\end{equation*}
$$

Let $u_{\lambda, i t}\left(=\lambda_{t}+u_{i t}\right)$ and $B_{U_{\lambda}}^{(2)}$ be defined as in the proof of Theorem 2.1. Note that

$$
\begin{aligned}
C V_{3,2}^{b c} & =\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[c_{i t, 2}\left(u_{\gamma, i t}-x_{i t}^{(2) \prime} B_{U_{\lambda}}^{(2)}\right)+x_{i t}^{(2) \prime} \vec{\beta}_{i t}^{(2)}\right]^{2} \\
& =C V_{3,2}+\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(x_{i t}^{(2) \prime} \vec{\beta}_{i t}^{(2)}\right)^{2}+\frac{2}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 2}\left(u_{\gamma, i t}-x_{i t}^{(2) \prime} B_{U_{\lambda}}^{(2)}\right) x_{i t}^{(2) \prime} \vec{\beta}_{i t}^{(2)},
\end{aligned}
$$

where $C V_{3,2}=\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[c_{i t, 2}\left(u_{\gamma, i t}-x_{i t}^{(2) \prime} B_{U_{\lambda}}^{(2)}\right)\right]^{2} \xrightarrow{P} c_{\lambda, X_{\alpha}}+\bar{\sigma}_{u}^{2}$ by the proof of Theorem 2.1. It is easy to show that the last two terms in the last display are $O_{P}\left(T^{-2}\right)$ and $O_{P}\left(T^{-1}\right)$, respectively. In addition, $C V_{3,3}^{b c}=C V_{3,3}=\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[c_{i t, 3}\left(u_{i t}-x_{i t}^{(3) \prime} B_{U}^{(3)}\right)\right]^{2} \xrightarrow{P} \bar{\sigma}_{u}^{2}$. Consequently, (A.35) follows.

Now, we show that

$$
\begin{equation*}
T\left[C V_{3,4}^{b c}-C V_{3,3}^{b c}\right] \xrightarrow{P} 2 \bar{\sigma}_{u}^{2}-\bar{\sigma}_{u 1}^{2}>0 \tag{A.36}
\end{equation*}
$$

provided $\bar{\sigma}_{u 1}^{2}<2 \bar{\sigma}_{u}^{2}$. Note that

$$
\begin{aligned}
& C V_{3,4}^{b c}-C V_{3,3}^{b c} \\
= & \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[c_{i t, 4}\left(u_{i t}-x_{i t}^{(4) \prime} B_{U}^{(4)}\right)+x_{i t}^{(4) \prime} \vec{\beta}_{i t}^{(4)}\right]^{2}-\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 3}^{2}\left[u_{i t}-x_{i t}^{(3) \prime} B_{U}^{(3)}\right]^{2} \\
= & \left(C V_{3,4}-C V_{3,3}\right)+\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[x_{i t}^{(4) \prime} \vec{\beta}_{i t}^{(4)}\right]^{2}+\frac{2}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 4}\left[u_{i t}-x_{i t}^{(4) \prime} B_{U}^{(4)}\right] x_{i t}^{(4) \prime} \vec{\beta}_{i t}^{(4)} \\
\equiv & \left(C V_{3,4}-C V_{3,3}\right)+R_{7}+2 R_{8}
\end{aligned}
$$

where $T\left[C V_{3,4}-C V_{3,3}\right] \xrightarrow{P} 2 \bar{\sigma}_{u}^{2}-\bar{\sigma}_{u 1}^{2}$ by the proof of Theorem 2.1. Apparently, $R_{7}=\frac{1}{N T^{3}} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[\left(x_{i t}^{\prime}+\right.\right.$ $\left.\left.d_{\alpha \lambda, i t}^{\prime} \zeta_{\alpha \lambda, i t}\right) \hat{b}_{1}^{(4)}\right]^{2}=O_{P}\left(T^{-2}\right)$. For $R_{8}$, we can apply (A.2) to show that

$$
R_{8}=\frac{1}{N T^{2}} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 4}\left[u_{i t}-x_{i t}^{(4) \prime} B_{U}^{(4)}\right]\left(x_{i t}^{\prime}+d_{\alpha \lambda, i t}^{\prime} \zeta_{\alpha \lambda, i t}\right) \hat{b}_{1}^{(4)}=\frac{1}{T} \bar{R}_{8} \hat{b}_{1}^{(4)}+T^{-1} O_{P}\left(N^{-1}+T^{-1}\right)
$$

where $\bar{R}_{8}=\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[u_{i t}-x_{i t}^{(4) \prime} B_{U}^{(4)}\right]\left(x_{i t}^{\prime}+d_{\alpha \lambda, i t}^{\prime} \zeta_{\alpha \lambda, i t}\right)$. By straightforward calculations, we can show that $\bar{R}_{8}=O_{P}\left(N^{-1}+T^{-1}\right)$. Then

$$
\begin{equation*}
T\left[R_{7}+2 R_{8}\right]=O_{P}\left(N^{-1}+T^{-1}\right) \tag{А.37}
\end{equation*}
$$

Consequently, (A.36) follows. Combining (A.34), (A.35), and (A.36), we conclude that $P\left(C V_{3,3}^{b c}<C V_{3, m}^{b c}\right) \rightarrow$ 1 for $m=1,2,4$.

Case 4: Model 4 is the true model. We will show that $P\left(C V_{4,4}^{b c}<C V_{4, m}^{b c}\right) \rightarrow 1$ for $m=1,2,3$. Let $u_{\lambda, i t}, u_{\alpha \lambda, i t}, U_{\lambda}, U_{\alpha \lambda}, B_{U_{\lambda}}^{(m)}$ and $B_{U_{\alpha \lambda}}^{(m)}$ be as defined in the proof of Theorem 2.1. Noting that no bias correction is needed for Models 1 and 3, we have by the proof of Theorem 2.1,

$$
C V_{4,1}^{b c}=C V_{4,1} \xrightarrow{P} c_{\alpha \lambda, X}+\bar{\sigma}_{u}^{2} \text { and } C V_{4,3}^{b c}=C V_{4,3} \xrightarrow{P} c_{\alpha, X_{\lambda}}+\bar{\sigma}_{u}^{2}
$$

Next, we study $C V_{4,2}^{b c}$. Note that

$$
\begin{aligned}
C V_{4,2}^{b c} & =\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[c_{i t, 2}\left(u_{\lambda, i t}-x_{i t}^{(2) \prime} B_{U_{\lambda}}^{(2)}\right)+x_{i t}^{(2) \prime} \vec{\beta}_{i t}^{(2)}\right]^{2} \\
& =C V_{4,2}+\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(x_{i t}^{(2) \prime} \vec{\beta}_{i t}^{(2)}\right)^{2}+\frac{2}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 2}\left(u_{\lambda, i t}-x_{i t}^{(2) \prime} B_{U_{\lambda}}^{(2)}\right) x_{i t}^{(2) \prime} \vec{\beta}_{i t}^{(2)}
\end{aligned}
$$

where $C V_{4,2}=\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 2}^{2}\left[u_{\lambda, i t}-x_{i t}^{(2) \prime} B_{U_{\lambda}}^{(2)}\right]^{2} \xrightarrow{P} c_{\lambda, X_{\alpha}}+\bar{\sigma}_{u}^{2}$ by the proof of Theorem 2.1. It is straightforward to show that the second and third terms in the last display are $O_{P}\left(T^{-2}\right)$ and $O_{P}\left(T^{-1}\right)$, respectively. Then we have $C V_{4,2}^{b c} \xrightarrow{P} c_{\lambda, X_{\alpha}}+\bar{\sigma}_{u}^{2}$. For $C V_{4,4}^{b c}$, we have

$$
\begin{aligned}
C V_{4,4}^{b c} & =\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[c_{i t, 4}\left(u_{i t}-x_{i t}^{(4) \prime} B_{U}^{(4)}\right)+x_{i t}^{(4) \prime} \vec{\beta}_{i t}^{(4)}\right]^{2} \\
& =C V_{4,2}^{b c}+\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(x_{i t}^{(4) \prime} \vec{\beta}_{i t}^{(4)}\right)^{2}+\frac{2}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} c_{i t, 4}\left(u_{i t}-x_{i t}^{(4) \prime} B_{U}^{(4)}\right) x_{i t}^{(4) \prime} \vec{\beta}_{i t}^{(4)}
\end{aligned}
$$

where $C V_{4,2}^{b c}=\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left[c_{i t, 4}\left(u_{i t}-x_{i t}^{(4) \prime} B_{U}^{(4)}\right)\right]^{2} \xrightarrow{P} \bar{\sigma}_{u}^{2}$ by the proof of Theorem 2.1. It is straightforward to show that the second and third terms in the last display are $O_{P}\left(T^{-2}\right)$ and $O_{P}\left(T^{-1}\right)$, respectively. It follows that $C V_{4,4}^{b c} \xrightarrow{P} \bar{\sigma}_{u}^{2}$. Consequently, we must have $P\left(C V_{4,4}^{b c}<C V_{4, m}^{b c}\right) \rightarrow 1$ as $(N, T) \rightarrow \infty$ for $m=1,2,3$.

To prove Theorem 2.3, we introduce some notation and three new lemmas. The proofs of these lemmas can be found in the online supplement. Let $\hat{\mathbf{u}}_{i}=\left(\hat{u}_{i, p+1}, \ldots, \hat{u}_{i, T}\right)^{\prime}, \hat{\mathbf{U}}=\left(\hat{\mathbf{u}}_{1}^{\prime}, \ldots, \hat{\mathbf{u}}_{N}^{\prime}\right)^{\prime}$, $\hat{\mathbf{z}}_{i}=\left(\underline{\hat{u}}_{i, p}, \ldots, \underline{\hat{u}}_{i, T-1}\right)^{\prime}$ and $\hat{\mathbf{Z}}=\left(\hat{\mathbf{z}}_{1}^{\prime}, \ldots, \hat{\mathbf{z}}_{N}^{\prime}\right)^{\prime}$, where $\underline{\hat{u}}_{i, t}=\underline{\hat{u}}_{i, t}^{(4)}=\left(\hat{u}_{i t}^{(4)}, \ldots, \hat{u}_{i, t-p+1}^{(4)}\right)^{\prime}$ for $t=p, \ldots, T-1$. Let $\mathbf{u}_{i}=\left(u_{i, p+1}, \ldots, u_{i, T}\right)^{\prime}, \mathbf{U}=\left(\mathbf{u}_{1}^{\prime}, \ldots, \mathbf{u}_{N}^{\prime}\right)^{\prime}, z_{i}=\left(\underline{\ddot{u}}_{i, p}, \ldots, \underline{\ddot{u}}_{i, T-1}\right)^{\prime}$ and $\mathbf{Z}=\left(\mathbf{z}_{1}^{\prime}, \ldots, \mathbf{z}_{N}^{\prime}\right)^{\prime}$, where $\underline{\ddot{u}}_{i, t}=\left(\ddot{u}_{i t}, \ldots, \ddot{u}_{i, t-p+1}\right)^{\prime}$ and $\ddot{u}_{i t}=u_{i t}-\bar{u}_{i} .-\bar{u}_{. t}+\bar{u}_{.}$. for $t=p, \ldots, T-1$. Let $\ddot{y}_{i t}=y_{i t}-\bar{y}_{i .}-\bar{y}_{. t}+\bar{y}_{. .}$, where $\bar{y}_{i}$, $\bar{y}_{. t}$, and $\bar{y} .$. are defined analogously to $\bar{u}_{i}$, $\bar{u}_{. t}$, and $\bar{u}_{. .}$. Let $\breve{x}_{i t}^{(m)}=x_{i t}^{(m)}-\underline{x}_{i, t-1}^{(m)} \boldsymbol{\rho}$ where $\underline{x}_{i, t-1}^{(m)}=\left(x_{i, t-1}^{(m)}, \ldots, x_{i t-p}^{(m)}\right)$ for $m=1,2,3,4$.

Lemma A. 7 Suppose Assumptions A.1, A.2 and A.4 hold. Then $\|\hat{\boldsymbol{\rho}}-\boldsymbol{\rho}\|=O_{P}\left(p \delta_{N T}\right)$.
Lemma A. 8 Let $K_{m N T}=\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t} \breve{x}_{i t}^{(m) \prime}\left(X^{(m) \prime} X^{(m)}\right)^{-1} X^{(m) \prime} U$ for $m=1,2,3,4$. Suppose that Assumptions A.1, A.2(iii)-(iv), A.4(iii), and A.5(iii)-(iv) hold. Then
(i) $K_{1 N T}=O_{P}\left((N T)^{-1}\right)$,
(ii) $K_{2 N T}=\frac{\Phi(1)}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t} \bar{u}_{i} .+O_{P}\left((N T)^{-1}+T^{-2}\right)$,
(iii) $K_{3 N T}=\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t} \Phi(L) \bar{u}_{\cdot t}+O_{P}\left((N T)^{-1}+N^{-2}\right)$,
(iv) $K_{4 N T}=\frac{\Phi(1)}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t} \bar{u}_{i} .+\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t} \Phi(L) \bar{u}_{. t}+O_{P}\left(N^{-2}+T^{-2}\right), K_{4 N T}-$ $K_{2 N T}=\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t} \Phi(L) \bar{u}_{\cdot t}+O_{P}\left((N T)^{-1}+N^{-2}\right)$, and $K_{4 N T}-K_{3 N T}=\frac{\Phi(1)}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t} \bar{u}_{i}$. $+O_{P}\left((N T)^{-1}+T^{-2}\right)$.
 Suppose that Assumptions A.1, A.2(iii)-(iv), A.4(iii), and A.5(iii)-(iv) hold. Then
(i) $L_{1 N T}=O_{P}\left((N T)^{-1}\right)$,
(ii) $L_{2 N T}=(\Phi(1))^{2} \frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i}^{2}+O_{P}\left((N T)^{-1}+T^{-2}\right)$,
(iii) $L_{3 N T}=\frac{1}{T_{p}} \sum_{t=p+1}^{T}\left[\Phi(L) \bar{u}_{. t}\right]^{2}+O_{P}\left((N T)^{-1}+N^{-2}\right)$,
(iv) $L_{4 N T}=(\Phi(1))^{2} \frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i .}^{2}+\frac{1}{T_{p}} \sum_{t=p+1}^{T}[\Phi(L) \bar{u} . t]^{2}+O_{P}\left(T^{-2}+N^{-2}\right), L_{4 N T}-L_{2 N T}=$ $\frac{1}{T_{p}} \sum_{t=p+1}^{T}\left[\Phi(L) \bar{u}_{. t}\right]^{2}+O_{P}\left((N T)^{-1}+N^{-2}\right)$, and $L_{4 N T}-L_{3 N T}=[\Phi(1)]^{2} \frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i}^{2}+O_{P}\left((N T)^{-1}+T^{-2}\right)$.

Proof of Theorem 2.3. Noting that $\left(y_{i t}-\hat{\boldsymbol{\rho}}^{\prime} \underline{y}_{i, t-1}\right)-\left(\hat{y}_{i t}^{(m)}-\hat{\boldsymbol{\rho}}^{\prime} \hat{\underline{\underline{y}}}_{i, t-1}^{(m)}\right)=\left(y_{i t}-\boldsymbol{\rho}^{\prime} \underline{y}_{i, t-1}\right)-\left(\hat{y}_{i t}^{(m)}-\right.$ $\left.\boldsymbol{\rho}^{\prime} \underline{\hat{y}}_{i, t-1}^{(m)}\right)+(\hat{\boldsymbol{\rho}}-\boldsymbol{\rho})^{\prime}\left(\underline{\hat{y}}_{i, t-1}^{(m)}-\underline{y}_{i, t-1}\right)$, we have

$$
\begin{aligned}
C V^{*}(m)= & \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}\left[\left(y_{i t}-\hat{\boldsymbol{\rho}}^{\prime} \underline{y}_{i, t-1}\right)-\left(\hat{y}_{i t}^{(m)}-\hat{\boldsymbol{\rho}}_{\underline{\prime}}^{\hat{y}_{i, t-1}}(m)\right]^{2}\right. \\
= & \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}\left[\left(y_{i t}-\boldsymbol{\rho}^{\prime} \underline{y}_{i, t-1}\right)-\left(\hat{y}_{i t}^{(m)}-\boldsymbol{\rho}^{\prime} \hat{\underline{y}}_{i, t-1}^{(m)}\right)\right]^{2} \\
& +\frac{(\hat{\boldsymbol{\rho}}-\boldsymbol{\rho})^{\prime}}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}\left(\hat{\underline{y}}_{i, t-1}^{(m)}-\underline{y}_{i, t-1}\right)\left(\hat{\underline{y}}_{i, t-1}^{(m)}-\underline{y}_{i, t-1}\right)^{\prime}(\hat{\boldsymbol{\rho}}-\boldsymbol{\rho}) \\
& +\frac{2(\hat{\boldsymbol{\rho}}-\boldsymbol{\rho})^{\prime}}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}\left(\hat{\underline{y}}_{i, t-1}^{(m)}-\underline{y}_{i, t-1}\right)\left[\left(y_{i t}-\boldsymbol{\rho}^{\prime} \underline{y}_{i, t-1}\right)-\left(\hat{y}_{i t}^{(m)}-\boldsymbol{\rho}^{\prime} \hat{\underline{y}}_{i, t-1}^{(m)}\right)\right] \\
\equiv & C V_{1}^{*}(m)+C V_{2}^{*}(m)+2 C V_{3}^{*}(m) .
\end{aligned}
$$

As in the proof of Theorem 2.1, we will use $C V_{l, m}^{*}$ and $C V_{l, m}^{*}(j)$ to denote $C V^{*}(m)$ and $C V_{j}^{*}(m)$ when the true model is Model $l$. Note that $C V_{l, m}^{*}=\sum_{j=1}^{3} C V_{l, m}^{*}(j)$.

Case 1: Model 1 is the true model. In this case, Models 2-4 are all overfitted models and we will show that $P\left(C V_{1,1}^{*}<C V_{1, m}^{*}\right) \rightarrow 1$ for $m=2,3,4$. When Model 1 is the true model, we have by (A.4)

$$
\begin{align*}
\left(y_{i t}-\boldsymbol{\rho}^{\prime} \underline{y}_{i, t-1}\right)-\left(\hat{y}_{i t}^{(m)}-\boldsymbol{\rho}^{\prime} \underline{\hat{y}}_{i, t-1}^{(m)}\right) & =c_{i t, m}\left[u_{i t}-x_{i t}^{(m) \prime} B_{U}^{(m)}\right]-\sum_{j=1}^{p} \rho_{j} c_{i, t-j, m}\left[u_{i, t-j}-x_{i, t-j}^{(m) \prime} B_{U}^{(m)}\right] \\
& =c_{i t, m}\left[v_{i t}-\breve{x}_{i t}^{(m) \prime} B_{U}^{(m)}\right]+\sum_{j=1}^{p} \rho_{j} \varkappa_{i t, m, j}\left[u_{i, t-j}-x_{i, t-j}^{(m) \prime} B_{U}^{(m)}\right](\mathrm{A} \tag{А.38}
\end{align*}
$$

where $c_{i t, m}=\left(1-h_{i t}^{(m)}\right)^{-1}$, and $\varkappa_{i t, m, j}=c_{i t, m}-c_{i, t-j, m}$ for $m=1,2,3,4$ and $j=1, \ldots, p$. By Lemma A.6, we have

$$
\begin{equation*}
\max _{i, t}\left|\varkappa_{i t, m, j}\right|=O_{P}\left(\delta_{m N T}\right) \text { for } m=1,2,3,4 \text { and } j=1, \ldots, p . \tag{A.39}
\end{equation*}
$$

Note that

$$
\begin{aligned}
C V_{1, m}^{*}(1)= & \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} c_{i t, m}^{2}\left[v_{i t}-\breve{x}_{i t}^{(m) \prime} B_{U}^{(m)}\right]^{2}+\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}\left\{\sum_{j=1}^{p} \rho_{j} \varkappa_{i t, m, j}\left[u_{i, t-j}-x_{i, t-j}^{(m) \prime} B_{U}^{(m)}\right]\right\}^{2} \\
& +\frac{2}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \sum_{j=1}^{p} \rho_{j} c_{i t, m} \varkappa_{i t, m, j}\left[v_{i t}-\breve{x}_{i t}^{(m) \prime} B_{U}^{(m)}\right]\left[u_{i, t-j}-x_{i, t-j}^{(m) \prime} B_{U}^{(m)}\right] \\
\equiv & C V_{1, m}^{*}(1,1)+C V_{1, m}^{*}(1,2)+2 C V_{1, m}^{*}(1,3), \text { say. }
\end{aligned}
$$

We first study $C V_{1,2}^{*}(1)-C V_{1,1}^{*}(1)$. Following the study of $C V_{1,2}-C V_{1,1}$ in the proof of Theorem 2.1, we can readily apply Lemmas A.8(i)-(ii) and A.9(i)-(ii), Assumptions A.4(ii) and A.5(i) to show that

$$
\begin{aligned}
T_{p}\left[C V_{1,2}^{*}(1,1)-C V_{1,1}^{*}(1,1)\right]= & \frac{2}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t}^{2}+\frac{T_{p} \Phi(1)^{2}}{N} \sum_{i=1}^{N} \bar{u}_{i \cdot}^{2}-\frac{2 \Phi(1)}{N} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t} \bar{u}_{i .}+o_{P}(1) \\
= & \frac{2}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t}^{2}+\frac{T_{p} \Phi(1)^{2}}{N} \sum_{i=1}^{N} \bar{u}_{i \cdot}^{2}-\frac{2 T_{p} \Phi(1)}{N} \sum_{i=1}^{N} \bar{v}_{i} \cdot \bar{u}_{i .}+o_{P}(1) \\
= & \left(\frac{2}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t}^{2}-\frac{T_{p}}{N} \sum_{i=1}^{N} \bar{v}_{i .}^{2}\right)+\frac{T_{p}}{N} \sum_{i=1}^{N}\left[\bar{v}_{i} .-\Phi(1) \bar{u}_{i} \cdot\right]^{2}+o_{P}(1) \\
& \xrightarrow{P} 2 \bar{\sigma}_{v}^{2}-\bar{\sigma}_{v 1}^{2},
\end{aligned}
$$

where we use the fact that $\bar{v}_{i}=\frac{1}{T_{p}} \sum_{t=p+1}^{T} v_{i t}=\frac{1}{T_{p}} \sum_{t=p+1}^{T}\left(u_{i t}-\underline{u}_{i, t-1}^{\prime} \rho\right)=\Phi(1) \bar{u}_{i} .+O_{P}\left(T^{-1}\right)$. Similarly, using (A.39) and following the analysis of $C V_{1,2}-C V_{1,1}$, we can readily show that $T_{p}\left[C V_{1,2}^{*}(1,2)\right.$ $\left.-C V_{1,1}^{*}(1,2)\right]=o_{P}(1)$ and $T_{p}\left[C V_{1,2}^{*}(1,3)-C V_{1,1}^{*}(1,3)\right]=o_{P}(1)$. It follows that $T_{p}\left[C V_{1,2}^{*}(1)-C V_{1,1}^{*}(1)\right]$ $\xrightarrow{P} 2 \bar{\sigma}_{v}^{2}-\bar{\sigma}_{v 1}^{2}$.

By (A.4) and (A.38),

$$
\begin{aligned}
C V_{1, m}^{*}(2) & =\frac{(\hat{\boldsymbol{\rho}}-\boldsymbol{\rho})^{\prime}}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}\left(\underline{\hat{y}}_{i, t-1}^{(m)}-\underline{y}_{i, t-1}\right)\left(\hat{\underline{y}}_{i, t-1}^{(m)}-\underline{y}_{i, t-1}\right)^{\prime}(\hat{\boldsymbol{\rho}}-\boldsymbol{\rho}) \\
& =\sum_{j_{1}=1}^{p} \sum_{j_{2}=1}^{p}\left(\hat{\rho}_{j_{1}}-\rho_{j_{1}}\right)\left(\hat{\rho}_{j_{2}}-\rho_{j_{2}}\right) D_{1, m}\left(1, j_{1}, j_{2}\right), \text { and } \\
C V_{1, m}^{*}(3) & =\frac{(\hat{\boldsymbol{\rho}}-\boldsymbol{\rho})^{\prime}}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}\left(\underline{\hat{y}}_{i, t-1}^{(m)}-\underline{y}_{i, t-1}\right)\left[\left(y_{i t}-\boldsymbol{\rho}^{\prime} \underline{y}_{i, t-1}\right)-\left(\hat{y}_{i t}^{(m)}-\boldsymbol{\rho}^{\prime} \hat{\underline{y}}_{i, t-1}^{(m)}\right)\right] \\
& =\sum_{j_{1}=1}^{p}\left(\hat{\rho}_{j_{1}}-\rho_{j_{1}}\right)\left\{D_{1, m}\left(2, j_{1}\right)+D_{1, m}\left(3, j_{1}\right)\right\},
\end{aligned}
$$

where

$$
\begin{aligned}
D_{1, m}\left(1, j_{1}, j_{2}\right) & =\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} c_{i, t-j_{1}, m} c_{i, t-j_{2}, m}\left[u_{i, t-j_{1}}-x_{i, t-j_{1}}^{(m) \prime} B_{U}^{(m)}\right]\left[u_{i, t-j_{2}}-x_{i, t-j_{2}}^{(m) \prime} B_{U}^{(m)}\right], \\
D_{1, m}\left(2, j_{1}\right) & =\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} c_{i, t-j_{1}, m} c_{i t, m}\left[u_{i, t-j_{1}}-x_{i, t-j_{1}}^{(m) \prime} B_{U}^{(m)}\right]\left[u_{i t}-\breve{x}_{i t}^{(m) \prime} B_{U}^{(m)}\right], \\
D_{1, m}\left(3, j_{1}\right) & =\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \sum_{j=1}^{p} \rho_{j} c_{i, t-j_{1}, m} \varkappa_{i t, m, j}\left[u_{i, t-j_{1}}-x_{i, t-j_{1}}^{(m) \prime} B_{U}^{(m)}\right]\left[u_{i, t-j}-x_{i, t-j}^{(m) \prime} B_{U}^{(m)}\right] .
\end{aligned}
$$

As in the analysis of $C V_{1,2}-C V_{1,1}$, we can readily show that $D_{1,2}\left(1, j_{1}, j_{2}\right)-D_{1,1}\left(1, j_{1}, j_{2}\right)=$ $O_{P}\left(T^{-1}\right)$ and $D_{1, m}\left(\ell, j_{1}\right)=O_{P}\left((N T)^{-1}\right)$ for $\ell=2,3$ uniformly in $j_{1}, j_{2}=1, \ldots, p$. Then by Lemma A. 7

$$
\begin{aligned}
& T_{p}\left[C V_{1,2}^{*}(2)-C V_{1,1}^{*}(2)\right]=p\|\hat{\boldsymbol{\rho}}-\boldsymbol{\rho}\|^{2} O_{P}(1)=O_{P}\left(p^{3} \delta_{N T}^{2}\right)=o_{P}(1), \text { and } \\
& T_{p}\left[C V_{1,2}^{*}(3)-C V_{1,1}^{*}(3)\right]=\sqrt{p}\|\hat{\boldsymbol{\rho}}-\boldsymbol{\rho}\| O_{P}(1)=O_{P}\left(p^{3 / 2} \delta_{N T}\right)=o_{P}(1) .
\end{aligned}
$$

In sum, we have

$$
\begin{align*}
T_{p}\left[C V_{1,2}^{*}-C V_{1,1}^{*}\right]= & \left(\frac{2}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t}^{2}-\frac{T_{p}}{N} \sum_{i=1}^{N} \bar{v}_{i \cdot}^{2}\right)+\frac{T_{p}}{N} \sum_{i=1}^{N}\left[\bar{v}_{i} .-\Phi(1) \bar{u}_{i} \cdot\right]^{2}+o_{P}(1) \\
& \xrightarrow{P} 2 \bar{\sigma}_{v}^{2}-\bar{\sigma}_{v 1}^{2} \tag{A.40}
\end{align*}
$$

Similarly, by using Lemma A.8(i) and (iii), Lemma A.9(i) and (iii), Assumptions A.4(ii) and A.5(ii) we can show that

$$
\begin{align*}
T_{p}\left[C V_{1,3}^{*}-C V_{1,1}^{*}\right]= & \left(\frac{2}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t}^{2}-\frac{N}{T_{p}} \sum_{t=p+1}^{T} \bar{v}_{\cdot t}^{2}\right)+\frac{N}{T_{p}} \sum_{t=p+1}^{T}\left[\bar{v}_{\cdot t}-\Phi(L) \bar{u}_{\cdot t}\right]^{2}+o_{P}(1) \\
& \xrightarrow{P} 2 \bar{\sigma}_{v}^{2}-\bar{\sigma}_{v 2}^{2} \tag{A.41}
\end{align*}
$$

where we use the fact that $\bar{v}_{\cdot t}=\frac{1}{N} \sum_{i=1}^{N} v_{i t}=\frac{1}{N} \sum_{i=1}^{N} \Phi(L) u_{i t}=\Phi(L) \bar{u}_{. t}$. By using Lemma A.8(iv) and Lemma A.9(i) and (iv),

$$
\begin{align*}
& \left(N \wedge T_{p}\right)\left[C V_{1,4}-C V_{1,1}\right] \\
= & \left(N \wedge T_{p}\right)\left\{\left(T_{p}^{-1}+N^{-1}\right) \frac{2}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t}^{2}-\frac{1}{N} \sum_{i=1}^{N} \bar{v}_{i \cdot}^{2}-\frac{1}{T_{p}} \sum_{t=p+1}^{T} \bar{v}_{\cdot t}^{2}\right\}+o_{P}(1) \\
& \xrightarrow{P} 2(1+c) \bar{\sigma}_{v}^{2}-\left(\bar{\sigma}_{v 1}^{2}+c \bar{\sigma}_{v 2}^{2}\right) 1\left\{c_{1} \geq 1\right\}-\left(c \bar{\sigma}_{v 1}^{2}+\bar{\sigma}_{v 2}^{2}\right) 1\left\{c_{1}<1\right\} \tag{A.42}
\end{align*}
$$

where $c=\lim _{(N, T) \rightarrow \infty}\left(\frac{N}{T_{p}} \wedge \frac{T_{p}}{N}\right)$ and $c_{1}=\lim _{(N, T) \rightarrow \infty} \frac{N}{T_{p}}$. Combining (A.40)-(A.42) yields $P\left(C V_{1,1}^{*}\right.$ $\left.<C V_{1, m}^{*}\right) \rightarrow 1$ for $m=2,3,4$ provided $\max \left(\bar{\sigma}_{v 1}^{2}, \bar{\sigma}_{v 2}^{2}\right)<2 \bar{\sigma}_{v}^{2}$.

Case 2: Model 2 is the true model. In this case, Model 1 is underfitted, Model 3 is misspecified, and Model 4 is overfitted; and we will show that $P\left(C V_{2,2}^{*}<C V_{2, m}^{*}\right) \rightarrow 1$ for $m=1,3,4$. Let $u_{\alpha, i t}$
and $U_{\alpha}$ be as defined in the proof of Theorem 2.1. Following the steps to obtain (A.8), we can show that

$$
\begin{align*}
\left(y_{i t}-\hat{y}_{i t}^{(1)}\right)-\boldsymbol{\rho}^{\prime}\left(\underline{y}_{i, t-1}-\hat{\hat{y}}_{i, t-1}^{(1)}\right) & =c_{i t, 1}\left[u_{\alpha, i t}-x_{i t}^{\prime} B_{U_{\alpha}}^{(1)}\right]-\sum_{j=1}^{p} \rho_{j} c_{i, t-j, 1}\left[u_{\alpha, i t-j}-x_{i, t-j}^{\prime} B_{U_{\alpha}}^{(1)}\right] \\
& =c_{i t, 1}\left[\Phi(1) \alpha_{i}+v_{i t}-\breve{x}_{i t}^{\prime} B_{U_{\alpha}}^{(1)}\right]+\sum_{j=1}^{p} \rho_{j} \varkappa_{i t, 1, j}\left[u_{\alpha, i t-j}-x_{i, t-j}^{\prime} B_{U_{\alpha}}^{(1)}\right] \cdot(A) \tag{A.43}
\end{align*}
$$

where $B_{U_{\alpha}}^{(m)}=\left(X^{(m) \prime} X^{(m)}\right)^{-1} X^{(m) \prime} U_{\alpha}$ for $m=1,2,3,4$. Then

$$
\begin{aligned}
C V_{2,1}^{*}= & \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} c_{i t, 1}^{2}\left[\Phi(1) \alpha_{i}+v_{i t}-\breve{x}_{i t}^{\prime} B_{U_{\alpha}}^{(1)}\right]^{2} \\
& +\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}\left\{\sum_{j=1}^{p} \rho_{j} \varkappa_{i t, 1, j}\left[u_{\alpha, i t-j}-x_{i, t-j}^{\prime} B_{U_{\alpha}}^{(1)}\right]\right\}^{2} \\
& +\frac{2}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \sum_{j=1}^{p} c_{i t, 1} \varkappa_{i t, 1, j}\left[\Phi(1) \alpha_{i}+v_{i t}-\breve{x}_{i t}^{\prime} B_{U_{\alpha}}^{(1)}\right]\left[u_{\alpha, i t-j}-x_{i, t-j}^{\prime} B_{U_{\alpha}}^{(1)}\right] \\
\equiv & D_{2,1}(1)+D_{2,1}(2)+2 D_{2,1}(3), \text { say. }
\end{aligned}
$$

It is easy to show that by Assumptions A.1, A.4(ii)-(iv), and A.6(i)
$D_{2,1}(1)=\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}\left[\Phi(1) \alpha_{i}-\breve{x}_{i t}^{\prime}\left(X^{\prime} X\right)^{-1} X^{\prime} D_{\alpha} \underline{\alpha}\right]^{2}+\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t}^{2}+o_{P}(1) \xrightarrow{P} c_{\alpha, X}^{*}+\bar{\sigma}_{v}^{2}$.
In addition, $D_{2, \ell}(2)=o_{P}(1)$ for $\ell=2,3$. Thus $C V_{2,1}^{*}=c_{\alpha, X}^{*}+\bar{\sigma}_{v}^{2}$. Following the analysis in Case 1 and noting that

$$
\begin{aligned}
\left(y_{i t}-\hat{y}_{i t}^{(2)}\right)-\boldsymbol{\rho}^{\prime}\left(\underline{y}_{i, t-1}-\underline{\hat{y}}_{i, t-1}^{(2)}\right) & =c_{i t, 2}\left[u_{i t}-x_{i t}^{(2) \prime} B_{U}^{(2)}\right]-\sum_{j=1}^{p} \rho_{j} c_{i, t-j, 2}\left[u_{i, t-j}-x_{i, t-j}^{(2) \prime} B_{U}^{(2)}\right] \\
& =c_{i t, 2}\left[v_{i t}-\breve{x}_{i t}^{(2) \prime} B_{U}^{(2)}\right]+\sum_{j=1}^{p} \rho_{j} \varkappa_{i t, 2, j}\left[u_{i, t-j}-x_{i, t-j}^{(2) \prime} B_{U}^{(2)}\right],
\end{aligned}
$$

we can readily show that $C V_{2,2}^{*}=\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t}^{2}+o_{P}(1) \xrightarrow{P} \bar{\sigma}_{v}^{2}$. It follows that

$$
\begin{equation*}
C V_{2,1}^{*}-C V_{2,2}^{*} \xrightarrow{P} c_{\alpha, X}^{*}>0 \tag{A.44}
\end{equation*}
$$

To study $C V_{2,3}^{*}$, noting that

$$
\begin{align*}
& \left(y_{i t}-\hat{y}_{i t}^{(3)}\right)-\boldsymbol{\rho}^{\prime}\left(\underline{y}_{i, t-1}-\hat{\hat{y}}_{i, t-1}^{(3)}\right) \\
= & c_{i t, 3}\left[u_{\alpha, i t}-x_{i t}^{(3) \prime} B_{U_{\alpha}}^{(3)}\right]-\sum_{j=1}^{p} \rho_{j} c_{i, t-j, 3}\left[u_{\alpha, i t-j}-x_{i, t-1}^{(3) \prime} B_{U_{\alpha}}^{(3)}\right] \\
= & c_{i t, 3}\left[\Phi(1) \alpha_{i}+v_{i t}-\breve{x}_{i t}^{(3) \prime} B_{U_{\alpha}}^{(3)}\right]+\sum_{j=1}^{p} \rho_{j} \varkappa_{i t, 3, j}\left[u_{\alpha, i t-j}-x_{i, t-j}^{(3) \prime} B_{U_{\alpha}}^{(3)}\right], \tag{A.45}
\end{align*}
$$

we can follow the analysis of $C V_{2,1}^{*}$ and show that by Assumptions A.4(ii)-(iv) and A.6(i)

$$
\begin{aligned}
C V_{2,3}^{*}= & \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}\left[\left(y_{i t}-\hat{y}_{i t}^{(3)}\right)-\boldsymbol{\rho}^{\prime}\left(\underline{y}_{i, t-1}-\underline{\hat{y}}_{i, t-1}^{(3)}\right)\right]^{2} \\
= & \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}\left[\Phi(1) \alpha_{i}+v_{i t}-\breve{x}_{i t}^{(3) \prime} B_{U_{\alpha}}^{(3)}\right]^{2}+o_{P}(1) \\
= & \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}\left[\Phi(1) \alpha_{i}-\breve{x}_{i t}^{(3) \prime \prime}\left(X^{(3) \prime} X^{(3)}\right)^{-1} X^{(3) \prime} D_{\alpha} \underline{\alpha}\right]^{2}+\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t}^{2}+o_{P}(1) \\
& \xrightarrow[\rightarrow]{P} c_{\alpha, X_{\lambda}}^{*}+\bar{\sigma}_{v}^{2},
\end{aligned}
$$

It follows that

$$
\begin{equation*}
C V_{2,3}^{*}-C V_{2,2}^{*} \xrightarrow{P} c_{\alpha, X_{\lambda}}^{*}>0 . \tag{A.46}
\end{equation*}
$$

To study $C V_{2,4}^{*}$, noting that

$$
\begin{align*}
\left(y_{i t}-\hat{y}_{i t}^{(4)}\right)-\boldsymbol{\rho}^{\prime}\left(\underline{y}_{i, t-1}-\underline{\hat{y}}_{i, t-1}^{(4)}\right) & =c_{i t, 4}\left[u_{i t}-x_{i t}^{(4) \prime} B_{U}^{(4)}\right]-\sum_{j=1}^{p} \rho_{j} c_{i, t-j, 4}\left[u_{i, t-j}-x_{i, t-j}^{(4) \prime} B_{U}^{(4)}\right] \\
& =c_{i t, 4}\left[v_{i t}-\breve{x}_{i t}^{(4) \prime} B_{U}^{(4)}\right]+\sum_{j=1}^{p} \rho_{j} \varkappa_{i t, 4, j}\left[u_{i, t-j}-x_{i, t-j}^{(4) \prime} B_{U}^{(4)}\right] \tag{A.47}
\end{align*}
$$

we have

$$
\begin{aligned}
& C V_{2,4}^{*}-C V_{2,2}^{*} \\
= & \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}\left[c_{i t, 4}^{2}\left(v_{i t}-\breve{x}_{i t}^{(4) \prime} B_{U}^{(4)}\right)^{2}-c_{i t, 2}^{2}\left(v_{i t}-\breve{x}_{i t}^{(2) \prime} B_{U}^{(2)}\right)^{2}\right] \\
& +\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}\left[\left(\sum_{j=1}^{p} \rho_{j} \varkappa_{i t, 4, j}\left[u_{i, t-j}-x_{i, t-j}^{(4) \prime} B_{U}^{(4)}\right]\right)^{2}-\left(\sum_{j=1}^{p} \rho_{j} \varkappa_{i t, 2, j}\left[u_{i, t-j}-x_{i, t-j}^{(2) \prime} B_{U}^{(2)}\right]\right)^{2}\right] \\
& +\frac{2}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \sum_{j=1}^{p} \rho_{j}\left[c_{i t, 4} \varkappa_{i t, 4, j}\left(v_{i t}-\breve{x}_{i t}^{(4) \prime} B_{U}^{(4)}\right)\left(u_{i, t-j}-x_{i, t-j}^{(4) \prime} B_{U}^{(4)}\right)\right. \\
& \left.-c_{i t, 2} \varkappa_{i t, 2, j}\left(v_{i t}-\breve{x}_{i t}^{(2) \prime} B_{U}^{(2)}\right)\left(u_{i, t-j}-x_{i, t-j}^{(2) \prime} B_{U}^{(2)}\right)\right] \equiv D_{2,4}(1)+D_{2,4}(2)+2 D_{2,4}(3), \text { say. }
\end{aligned}
$$

For $D_{2,4}(1)$, we make further decomposition:

$$
\begin{aligned}
D_{2,4}(1)= & \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}\left(c_{i t, 4}^{2}-c_{i t, 2}^{2}\right) v_{i t}^{2}+\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}\left[c_{i t, 4}^{2}\left(\breve{x}_{i t}^{(4) \prime} B_{U}^{(4)}\right)^{2}-c_{i t, 2}^{2}\left(\breve{x}_{i t}^{(2) \prime} B_{U}^{(2)}\right)^{2}\right] \\
& -\frac{2}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t}\left[c_{i t, 4}^{2} \breve{x}_{i t}^{(4) \prime} B_{U}^{(4)}-c_{i t, 2}^{2} \breve{x}_{i t}^{(2) \prime} B_{U}^{(2)}\right] \\
\equiv & D_{2,4}(1,1)+D_{2,4}(1,2)-2 D_{2,4}(1,3), \text { say. }
\end{aligned}
$$

Following the analysis of $C V_{1,4}^{*}-C V_{1,1}^{*}$ in Case 1 and that of $C V_{2,4}-C V_{2,1}$ in the proof of Theorem 2.1, and applying Lemmas A.8(ii) and (iv) and A.9, (A.2) and (A.39), we can readily show that

$$
\begin{aligned}
D_{2,4}(1,1) & =N^{-1} \frac{2}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t}^{2}+o_{P}\left(N^{-1}\right), \\
D_{2,4}(1,2) & =\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}\left[\left(\breve{x}_{i t}^{(4) \prime} B_{U}^{(4)}\right)^{2}-\left(\breve{x}_{i t}^{(2) \prime} B_{U}^{(2)}\right)^{2}\right]+o_{P}\left(N^{-1}\right)=\frac{1}{T_{p}} \sum_{t=p+1}^{T}\left[\Phi(L) \bar{u}_{\cdot t}\right]^{2}+o_{P}\left(N^{-1}\right), \\
D_{2,4}(1,3) & =\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t}\left[\breve{x}_{i t}^{(4) \prime} B_{U}^{(4)}-\breve{x}_{i t}^{(2) \prime} B_{U}^{(2)}\right]+o_{P}\left(N^{-1}\right)=\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t} \Phi(L) \bar{u}_{\cdot t}+o_{P}\left(N^{-1}\right) .
\end{aligned}
$$

It follows that $N \cdot D_{2,4}(1)=\frac{2}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t}^{2}-\frac{N}{T_{p}} \sum_{t=p+1}^{T} v_{\cdot t}^{2}+\frac{N}{T_{p}} \sum_{t=p+1}^{T}\left[v_{\cdot t}-\Phi(L) \bar{u}_{\cdot t}\right]^{2}+o_{P}(1)$. Similarly, we can show that $D_{2,4}(\ell)=o_{P}\left(N^{-1}\right)$ for $\ell=2,3$. Consequently, we have by Assumptions A.4(ii) and A.5(ii)

$$
\begin{equation*}
N\left[C V_{2,4}^{*}-C V_{2,2}^{*}\right]=\frac{2}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t}^{2}-\frac{N}{T_{p}} \sum_{t=p+1}^{T} v_{\cdot t}^{2}+o_{P}(1) \xrightarrow{P} 2 \bar{\sigma}_{v}^{2}-\bar{\sigma}_{v 2}^{2} . \tag{A.48}
\end{equation*}
$$

By (A.44), (A.46), and (A.48), we have $P\left(C V_{2,2}^{*}<C V_{2, m}^{*}\right) \rightarrow 1$ as $(N, T) \rightarrow \infty$ for $m=1,3,4$ provided $\bar{\sigma}_{v 2}^{2}<2 \bar{\sigma}_{v}^{2}$.

Case 3: Model 3 is the true model. This case parallels Case 2 and we can follow the analysis in Case 2 and show that $P\left(C V_{3,3}^{*}<C V_{3, m}^{*}\right) \rightarrow 1$ for $m=1,2,4$. The details are omitted for brevity.

Case 4: Model 4 is the true model. In this case, Models 1-3 are underfitted and we will show that $P\left(C V_{4,4}^{*}<C V_{4, m}^{*}\right) \rightarrow 1$ for $m=1,2,3$. Let $u_{\lambda, i t}, u_{\alpha \lambda, i t}, U_{\lambda}$, and $U_{\alpha \lambda}$ be as defined in the proof of Theorem 2.1. Following the steps to obtain (A.38), now we can show that

$$
\begin{align*}
& \left(y_{i t}-\hat{y}_{i t}^{(1)}\right)-\boldsymbol{\rho}^{\prime}\left(\underline{y}_{i, t-1}-{\underset{\underline{y}}{i, t-1}}_{(1)}^{p}\right) \\
= & c_{i t, 1}\left[u_{\alpha \lambda, i t}-x_{i t}^{\prime} B_{U_{\alpha \lambda}}^{(1)}\right]-\sum_{j=1}^{p} \rho_{j} c_{i, t-j, 1}\left[u_{\alpha \lambda, i, t-j}-x_{i, t-j}^{\prime} B_{U_{\alpha \lambda}}^{(1)}\right] \\
= & c_{i t, 1}\left[\Phi(1) \alpha_{i}+\Phi(L) \lambda_{t}+v_{i t}-\breve{x}_{i t}^{\prime} B_{U_{\alpha \lambda}}^{(1)}\right]+\sum_{j=1}^{p} \rho_{j} \varkappa_{i t, 1, j}\left[u_{\alpha \lambda, i, t-j}-x_{i, t-j}^{\prime} B_{U_{\alpha \lambda}}^{(1)}\right], \tag{A.49}
\end{align*}
$$

where $B_{U_{\alpha \lambda}}^{(m)}=\left(X^{(m)^{\prime}} X^{(m)}\right)^{-1} X^{(m)^{\prime}} U_{\alpha \lambda}$ for $m=1,2,3,4$. As in Case 2 , we can show that by Assumptions A.4(ii)-(iv) and A.6(iii),

$$
\begin{aligned}
C V_{4,1}^{*}= & \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}\left[\Phi(1) \alpha_{i}+\Phi(L) \lambda_{t}-\breve{x}_{i t}^{\prime}\left(X^{\prime} X\right)^{-1} X^{\prime}\left(D_{\alpha} \underline{\alpha}+D_{\lambda} \underline{\lambda}\right)\right]^{2}+\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t}^{2} \\
& +o_{P}(1) \xrightarrow{P} c_{\alpha \lambda, X}^{*}+\bar{\sigma}_{v}^{2}
\end{aligned}
$$

Similarly, we have

$$
\begin{aligned}
C V_{4,2}^{*}= & \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}\left[\Phi(L) \lambda_{t}-\breve{x}_{i t}^{(2) \prime}\left(X^{(2) \prime} X^{(2)}\right)^{-1} X^{(2) \prime} D_{\lambda} \underline{\lambda}\right]^{2}+\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t}^{2}+o_{P}(1) \\
& \xrightarrow{P} c_{\lambda, X_{\alpha}}^{*}+\bar{\sigma}_{v}^{2}, \\
C V_{4,3}^{*}= & \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}\left[\Phi(1) \alpha_{i}-\breve{x}_{i t}^{(3) \prime}\left(X^{(3) \prime} X^{(3)}\right)^{-1} X^{(3) \prime} D_{\alpha} \underline{\alpha}\right]^{2}+\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t}^{2}+o_{P}(1) \\
& \xrightarrow[\rightarrow]{P} c_{\alpha, X_{\lambda}}^{*}+\bar{\sigma}_{v}^{2},
\end{aligned}
$$

and $C V_{4,4}^{*}=\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t}^{2}+o_{P}(1) \xrightarrow{P} \bar{\sigma}_{v}^{2}$. Then $P\left(C V_{4,4}^{*}<C V_{4, m}^{*}\right) \rightarrow 1$ as $(N, T) \rightarrow \infty$ for $m=1,2,3$.

## B Proofs of the Technical Lemmas

Proof of Lemma A.1. Noting that $X_{D}^{\prime} X_{D}=\left(\begin{array}{cc}X^{\prime} X & X^{\prime} D \\ D^{\prime} X & D^{\prime} D\end{array}\right)$, the lemma follows from the standard inversion formula for a $2 \times 2$ partitioned matrix. See, e.g., Bernstein (2005, p.45).

Proof of Lemma A.2. By Lemma A.1,

$$
\left(X_{D}^{\prime} X_{D}\right)^{-1}=\left(\begin{array}{cc}
X_{D}^{*} & -X_{D}^{*} X^{\prime} D\left(D^{\prime} D\right)^{-1} \\
-\left(D^{\prime} D\right)^{-1} D^{\prime} X X_{D}^{*} & \left(D^{\prime} D\right)^{-1}+\left(D^{\prime} D\right)^{-1} D^{\prime} X X_{D}^{*} X^{\prime} D\left(D^{\prime} D\right)^{-1}
\end{array}\right) .
$$

Noting that $D_{1}^{\prime} D_{2}=0$, we have $\left(D^{\prime} D\right)^{-1}=\left(\begin{array}{cc}\left(D_{1}^{\prime} D_{1}\right)^{-1} & \\ & \left(D_{2}^{\prime} D_{2}\right)^{-1}\end{array}\right)$, and $X^{\prime} D\left(D^{\prime} D\right)^{-1}=$ $X^{\prime}\left(D_{1}\left(D_{1}^{\prime} D_{1}\right)^{-1}, D_{2}\left(D_{2}^{\prime} D_{2}\right)^{-1}\right)=\left(B_{1}, B_{2}\right)$. Combining the above results yields the desired result.

Proof of Lemma A.3. (i) Noting that $D_{\alpha}^{\prime} D_{\alpha}=T\left(I_{N-1}+\iota_{N-1} \iota_{N-1}^{\prime}\right)$, we have

$$
\begin{equation*}
\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1}=T^{-1}\left(I_{N-1}-\frac{1}{N} \iota_{N-1} \iota_{N-1}^{\prime}\right) \tag{B.1}
\end{equation*}
$$

and

$$
\begin{aligned}
D_{\alpha}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} & =T^{-1}\left(\binom{I_{N-1}}{-\iota_{N-1}^{\prime}} \otimes \iota_{T}\right)\left(I_{N-1}-\frac{1}{N} \iota_{N-1} \iota_{N-1}^{\prime}\right)\left(\left(\begin{array}{ll}
I_{N-1} & \left.\left.-\iota_{N-1}\right) \otimes \iota_{T}^{\prime}\right) \\
& =T^{-1}\left(\binom{I_{N-1}-\frac{1}{N} \iota_{N-1} \iota_{N-1}^{\prime}}{-\frac{1}{N} \iota_{N-1}^{\prime}} \otimes \iota_{T}\right)\left(\left(\begin{array}{ll}
I_{N-1} & \left.\left.-\iota_{N-1}\right) \otimes \iota_{T}^{\prime}\right) \\
& =\left(\begin{array}{cc}
I_{N-1}-\frac{1}{N} \iota_{N-1} \iota_{N-1}^{\prime} & -\frac{1}{N} \iota_{N-1} \\
-\frac{1}{N} \iota_{N-1}^{\prime} & \frac{N-1}{N}
\end{array}\right) \otimes\left(\iota_{T} \iota_{T}^{\prime} / T\right) .
\end{array} .\right.\right.
\end{array} . \begin{array}{c}
\end{array}\right) .\right.
\end{aligned}
$$

By straightforward but tedious algebra we can show that

$$
\begin{aligned}
U^{\prime} D_{\alpha}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} U= & \frac{1}{N T^{2}} \underline{u}_{N-1}^{\prime}\left[\left(I_{N-1}-\frac{1}{N} \iota_{N-1} \iota_{N-1}^{\prime}\right) \otimes\left(\iota_{T} \iota_{T}^{\prime}\right)\right] \underline{u}_{N-1} \\
& -\frac{1}{N T^{2}}\left\{\frac{2}{N} \underline{u}_{N-1}^{\prime}\left[\iota_{N-1} \otimes\left(\iota_{T} \iota_{T}^{\prime}\right)\right] u_{N}-\frac{N-1}{N} u_{N}^{\prime} \iota_{T} \iota_{T}^{\prime} u_{N}\right\} \\
= & {\left[\frac{1}{N} \sum_{i=1}^{N-1} \bar{u}_{i .}^{2}-\left(\frac{1}{N} \sum_{i=1}^{N-1} \bar{u}_{i .}^{2}\right)^{2}\right]-\frac{2}{N^{2}} \sum_{i=1}^{N-1} \bar{u}_{i} \cdot \bar{u}_{N .}+\frac{N-1}{N^{2}} \bar{u}_{N .}^{2} . } \\
= & \frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i .}^{2}-\bar{u}_{. .}^{2} .
\end{aligned}
$$

The result then follows from Assumption A.1(iii).
(ii) The proof is analogous to that of (i) and thus omitted. The main difference is that one now applies

$$
D_{\lambda}\left(D_{\lambda}^{\prime} D_{\lambda}\right)^{-1} D_{\lambda}^{\prime}=\left(\iota_{N} \iota_{N}^{\prime} / N\right) \otimes\left(\begin{array}{cc}
I_{T-1}-\frac{1}{N} \iota_{T-1} \iota_{T-1}^{\prime} & -\frac{1}{N} \iota_{T-1} \\
-\frac{1}{N} \iota_{T-1}^{\prime} & \frac{T-1}{T}
\end{array}\right) .
$$

(iii) Noting that $D_{\alpha \lambda}\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}\right)^{-1} D_{\alpha \lambda}^{\prime}=D_{\alpha}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime}+D_{\lambda}\left(D_{\lambda}^{\prime} D_{\lambda}\right)^{-1} D_{\lambda}^{\prime}$ by the fact $D_{\alpha}^{\prime} D_{\lambda}=0$, we have

$$
\begin{aligned}
\frac{1}{N T} U^{\prime} D_{\alpha \lambda}\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}\right)^{-1} D_{\alpha \lambda}^{\prime} U & =\frac{1}{N T} U^{\prime} D_{\alpha}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} U+\frac{1}{N T} U^{\prime} D_{\lambda}\left(D_{\lambda}^{\prime} D_{\lambda}\right)^{-1} D_{\lambda}^{\prime} U \\
& =\left(\frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i .}^{2}-\bar{u}_{. .}^{2}\right)+\left(\frac{1}{T} \sum_{t=1}^{T} \bar{u}_{. t}^{2}-\bar{u}_{.2}^{2}\right) \\
& =\frac{1}{N} \sum_{i=1}^{N} \bar{u}_{.}^{2}+\frac{1}{T} \sum_{t=1}^{T} \bar{u}_{. t}^{2}-O_{P}\left((N T)^{-1}\right),
\end{aligned}
$$

where the second equality follows from the results in (i)-(ii) and the last equality follows by Assumption A.1(iii).

Proof of Lemma A.4. (i) Following the proof of Lemma A.3(i), we have

$$
\begin{aligned}
& \frac{1}{N T} X^{\prime} D_{\alpha}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} U \\
= & \frac{1}{N T}\left\{\underline{x}_{N-1}^{\prime}\left[\left(I_{N-1}-\frac{1}{N} \iota_{N-1} \iota_{N-1}^{\prime}\right) \otimes\left(\iota_{T} \iota_{T}^{\prime}\right)\right] \underline{u}_{N-1}-\frac{1}{N} x_{N-1}^{\prime}\left[\iota_{N-1}^{\prime} \otimes\left(\iota_{T} \iota_{T}^{\prime}\right)\right] \underline{u}_{N-1}\right. \\
& \left.-\frac{1}{N} \underline{x}_{N-1}^{\prime}\left[\iota_{N-1} \otimes\left(\iota_{T} \iota_{T}^{\prime}\right)\right] u_{N}+\frac{N-1}{N} x_{N}^{\prime} \iota_{T} \iota_{T}^{\prime} u_{N}\right\} \\
= & {\left[\frac{1}{N} \sum_{i=1}^{N-1} \bar{x}_{i} \cdot \bar{u}_{i} \cdot-\frac{1}{N^{2}} \sum_{i=1}^{N-1} \bar{x}_{i} \cdot \sum_{i=1}^{N-1} \bar{u}_{i} \cdot\right]-\frac{1}{N^{2}} \bar{x}_{N} \cdot \sum_{i=1}^{N-1} \bar{u}_{i} \cdot-\frac{1}{N^{2}} \sum_{i=1}^{N-1} \bar{x}_{i} \cdot \bar{u}_{N .}+\frac{N-1}{N^{2}} \bar{x}_{N} \cdot \bar{u}_{N .} . } \\
= & \frac{1}{N} \sum_{i=1}^{N} \bar{x}_{i} \cdot \bar{u}_{i} .-\bar{x} . . \bar{u} . .=\frac{1}{N} \sum_{i=1}^{N} \bar{x}_{i} \cdot \bar{u}_{i} .-O_{P}\left((N T)^{-1 / 2}\right)=O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right),
\end{aligned}
$$

where we use the fact that $\frac{1}{N} \sum_{i=1}^{N} \bar{x}_{i} \cdot \bar{u}_{i} .=O_{P}\left(T^{-1}\right)$ and $\bar{u} . .=O_{P}\left((N T)^{-1 / 2}\right)$ by Assumptions A.2(iii) and A.1(iii).
(ii) The proof is analogous to that of (i) and thus omitted.
(iii) Noting that $D_{\alpha \lambda}\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}\right)^{-1} D_{\alpha \lambda}^{\prime}=D_{\alpha}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime}+D_{\lambda}\left(D_{\lambda}^{\prime} D_{\lambda}\right)^{-1} D_{\lambda}^{\prime}$, the results follow from (i)-(ii).
Proof of Lemma A.5. (i) $J_{1 N T} \leq\left\|\left(\frac{1}{N T} X^{\prime} X\right)^{-1}\right\|\left\|\frac{1}{N T} X^{\prime} U\right\|^{2}=O_{P}\left(\frac{1}{N T}\right)$ by Assumption A.1(iii)(iv).
(ii) By Lemma A. 1 with $D=D_{\alpha}$, we have

$$
\begin{aligned}
J_{2 N T} & =\frac{1}{N T}\left(U^{\prime} X, U^{\prime} D_{\alpha}\right)\left(\begin{array}{cc}
X_{D_{\alpha}}^{*} & -X_{D_{\alpha}}^{*} B_{\alpha} \\
-B_{\alpha}^{\prime} X_{D_{\alpha}}^{*} & \left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1}+B_{\alpha}^{\prime} X_{D}^{*} B_{\alpha}
\end{array}\right)\binom{X^{\prime} U}{D_{\alpha}^{\prime} U} \\
& =\frac{1}{N T}\left(U^{\prime} X X_{D_{\alpha}}^{*}-U^{\prime} D_{\alpha} B_{\alpha}^{\prime} X_{D_{\alpha}}^{*},-U^{\prime} X X_{D_{\alpha}}^{*} B_{\alpha}+U^{\prime} D_{\alpha}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1}+U^{\prime} D_{\alpha} B_{\alpha}^{\prime} X_{D_{\alpha}}^{*} B_{\alpha}\right)\binom{X^{\prime} U}{D_{\alpha}^{\prime} U} \\
& =\frac{1}{N T}\left(U^{\prime} X X_{D_{\alpha}}^{*} X^{\prime} U-2 U^{\prime} D_{\alpha} B_{\alpha}^{\prime} X_{D_{\alpha}}^{*} X^{\prime} U+U^{\prime} D_{\alpha}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} U+U^{\prime} D_{\alpha} B_{\alpha}^{\prime} X_{D_{\alpha}}^{*} B_{\alpha} D_{\alpha}^{\prime} U\right) \\
& \equiv J_{2 N T, 1}-2 J_{2 N T, 2}+J_{2 N T, 3}+J_{2 N T, 4}, \text { say, }
\end{aligned}
$$

where $B_{\alpha}=X^{\prime} D_{\alpha}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1}$. As in (i), we can show that $J_{2 N T, 1}=O_{P}\left((N T)^{-1}\right)$ by Assumption A.1(iii)-(iv). By Lemma A.4(i) and Assumptions A.1(iii)-(iv) and A.2(iii) and using $X_{D_{\alpha}}^{*}=$ $\left(X^{\prime} M_{D_{\alpha}} X\right)^{-1}$,

$$
\begin{aligned}
& J_{2 N T, 1}=\frac{1}{N T} U^{\prime} D_{\alpha} B_{\alpha}^{\prime} X_{D_{\alpha}}^{*} X^{\prime} U \\
& =\frac{1}{N T} U^{\prime} D_{\alpha}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} X\left(\frac{1}{N T} X^{\prime} M_{D_{\alpha}} X\right)^{-1} \frac{1}{N T} X^{\prime} U \\
& =\left(\frac{1}{N} \sum_{i=1}^{N} \bar{x}_{i} \cdot \bar{u}_{i} .-\bar{x} . . \bar{u} . .\right)^{\prime} O_{P}(1) O_{P}\left((N T)^{-1 / 2}\right) \\
& =O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right) O_{P}\left((N T)^{-1 / 2}\right)=O_{P}\left((N T)^{-1}+T^{-2}\right) \text {, and } \\
& J_{2 N T, 4}=\frac{1}{N T} U^{\prime} D_{\alpha} B_{\alpha}^{\prime} X_{D_{\alpha}}^{*} B_{\alpha} D_{\alpha}^{\prime} U \\
& =\frac{1}{N T} U^{\prime} D_{\alpha}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} X\left(\frac{1}{N T} X^{\prime} M_{D_{\alpha}} X\right)^{-1} \frac{1}{N T} X^{\prime} D_{\alpha}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} U \\
& =\left(\frac{1}{N} \sum_{i=1}^{N} \bar{x}_{i} . \bar{u}_{i} .-\bar{x} . . \bar{u} . .\right)^{\prime}\left(\frac{1}{N T} X^{\prime} M_{D_{\alpha}} X\right)^{-1}\left(\frac{1}{N} \sum_{i=1}^{N} \bar{x}_{i} . \bar{u}_{i} .-\bar{x} . . \bar{u} . .\right) \\
& =O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right) O_{P}(1) O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right)=O_{P}\left(T^{-2}+(N T)^{-1}\right) \text {. }
\end{aligned}
$$

By Lemma A.3(i),

$$
J_{2 N T, 3}=\frac{1}{N T} U^{\prime} D_{\alpha}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} U=\frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i .}^{2}-\bar{u}_{. .}^{2}=\frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i .}^{2}-O_{P}\left((N T)^{-1}\right) .
$$

It follows that $J_{2 N T}=\frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i}^{2}+O_{P}\left(T^{-2}+(N T)^{-1}\right)$.
(iii) The proof is analogous to that of (ii) and thus omitted.
(iv) By Lemma A. 2

$$
\begin{aligned}
J_{4 N T}= & \frac{1}{N T} U^{\prime} X^{(4)}\left(X^{(4) \prime} X^{(4)}\right)^{-1} X^{(4) \prime} U \\
= & \frac{1}{N T}\left(U^{\prime} X, U^{\prime} D_{\alpha}, U^{\prime} D_{\lambda}\right) \\
& \times\left(\begin{array}{ccc}
X_{D_{\alpha \lambda}}^{*} & -X_{D_{\alpha \lambda}}^{*} B_{\alpha} & -X_{D_{\alpha \lambda}}^{*} B_{\lambda} \\
-B_{\alpha}^{\prime} X_{D_{\alpha \lambda}}^{*} & \left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1}+B_{\alpha}^{\prime} X_{D_{\alpha \lambda}}^{*} B_{\alpha} & B_{\alpha}^{\prime} X_{D_{\alpha \lambda}}^{*} B_{\lambda} \\
-B_{\lambda}^{\prime} X_{D_{\alpha \lambda}}^{*} & B_{\lambda}^{\prime} X_{D_{\alpha \lambda}}^{*} B_{\alpha} & \left(D_{\lambda}^{\prime} D_{\lambda}\right)^{-1}+B_{\lambda}^{\prime} X_{D_{\alpha \lambda}}^{*} B_{\lambda}
\end{array}\right)\left(\begin{array}{c}
X^{\prime} U \\
D_{\alpha}^{\prime} U \\
D_{\lambda}^{\prime} U
\end{array}\right) \\
= & \frac{1}{N T}\left\{U^{\prime} X X_{D_{\alpha \lambda}}^{*} X^{\prime} U+U^{\prime} D_{\alpha}\left(\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1}+B_{\alpha}^{\prime} X_{D_{\alpha \lambda}}^{*} B_{\alpha}\right) D_{\alpha}^{\prime} U\right. \\
& +U^{\prime} D_{\lambda}\left(\left(D_{\lambda}^{\prime} D_{\lambda}\right)^{-1}+B_{\lambda}^{\prime} X_{D_{\alpha \lambda}}^{*} B_{\lambda}\right) D_{\lambda}^{\prime} U-2 U^{\prime} D_{\alpha} B_{\alpha}^{\prime} X_{D_{\alpha \lambda}}^{*} X^{\prime} U \\
& \left.-2 U^{\prime} D_{\lambda} B_{\lambda}^{\prime} X_{D_{\alpha \lambda}}^{*} X^{\prime} U+2 U^{\prime} D_{\lambda} B_{\lambda}^{\prime} X_{D_{\alpha \lambda}}^{*} B_{\alpha} D_{\alpha}^{\prime} U\right\} \\
\equiv & J_{4 N T, 1}+J_{4 N T, 2}+J_{4 N T, 3}-2 J_{4 N T, 4}-2 J_{4 N T, 5}+2 J_{4 N T, 6}, \text { say, }
\end{aligned}
$$

where $D_{\alpha \lambda}=\left(D_{\alpha}, D_{\lambda}\right)$ and $B_{\ell}=X^{\prime} D_{\ell}\left(D_{\ell}^{\prime} D_{\ell}\right)^{-1}$ for $\ell=\alpha, \lambda$. By Assumption A.1(iii)-(iv),

$$
J_{4 N T, 1} \leq\left\|\left(\frac{1}{N T} X^{\prime} M_{D_{\alpha \lambda}} X\right)^{-1}\right\|\left\|\frac{1}{N T} X^{\prime} U\right\|^{2}=O_{P}\left((N T)^{-1}\right)
$$

By Lemmas A.3(i) and A.4(i) and Assumption A.1(iii),

$$
\begin{aligned}
J_{4 N T, 2} & =\frac{1}{N T} U^{\prime} D_{\alpha}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} U+\frac{1}{N T} U^{\prime} D_{\alpha} B_{\alpha}^{\prime} X_{D_{\alpha \lambda}}^{*} B_{\alpha} D_{\alpha}^{\prime} U \\
& =\frac{1}{N T} U^{\prime} D_{\alpha}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} U+\frac{1}{N T} U^{\prime} D_{\alpha} B_{\alpha}^{\prime}\left(\frac{1}{N T} X^{\prime} M_{D_{\alpha \lambda}} X\right)^{-1} \frac{1}{N T} B_{\alpha} D_{\alpha}^{\prime} U \\
& =\left(\frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i .}^{2}-\bar{u}_{. .}^{2}\right)+O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right) O_{P}(1) O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right) \\
& =\frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i .}^{2}+O_{P}\left(T^{-2}+(N T)^{-1}\right)
\end{aligned}
$$

By Lemmas A.3(ii) and A.4(ii) and Assumption A.1(iii),

$$
\begin{aligned}
J_{4 N T, 3} & =\frac{1}{N T} U^{\prime} D_{\lambda}\left(D_{\lambda}^{\prime} D_{\lambda}\right)^{-1} D_{\lambda}^{\prime} U+\frac{1}{N T} U^{\prime} D_{\lambda} B_{\lambda}^{\prime}\left(\frac{1}{N T} X^{\prime} M_{D_{\alpha \lambda}} X\right)^{-1} \frac{1}{N T} B_{\lambda} D_{\lambda}^{\prime} U \\
& =\left(\frac{1}{T} \sum_{t=1}^{T} \bar{u}_{\cdot t}^{2}-\bar{u}_{. .}^{2}\right)+O_{P}\left(N^{-1}+(N T)^{-1 / 2}\right) O_{P}(1) O_{P}\left(N^{-1}+(N T)^{-1 / 2}\right) \\
& =\frac{1}{T} \sum_{t=1}^{T} \bar{u}_{\cdot t}^{2}+O_{P}\left(N^{-2}+(N T)^{-1}\right)
\end{aligned}
$$

In addition, by Lemma A.4(i)-(ii) and Assumption A.1(iii)-(iv), we have

$$
\begin{aligned}
J_{4 N T, 4} & =\frac{1}{N T} U^{\prime} D_{\alpha} B_{\alpha}^{\prime}\left(\frac{1}{N T} X^{\prime} M_{D_{\alpha \lambda}} X\right)^{-1} \frac{1}{N T} X^{\prime} U \\
& =O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right) O_{P}(1) O_{P}\left((N T)^{-1 / 2}\right)=O_{P}\left(T^{-2}+(N T)^{-1}\right), \\
J_{4 N T, 5} & =\frac{1}{N T} U^{\prime} D_{\lambda} B_{\lambda}^{\prime}\left(\frac{1}{N T} X^{\prime} M_{D_{\alpha \lambda}} X\right)^{-1} \frac{1}{N T} X^{\prime} U \\
& =O_{P}\left(N^{-1}+(N T)^{-1 / 2}\right) O_{P}(1) O_{P}\left((N T)^{-1 / 2}\right)=O_{P}\left(N^{-2}+(N T)^{-1}\right), \\
J_{4 N T, 6} & =\frac{1}{N T} U^{\prime} D_{\lambda} B_{\lambda}^{\prime}\left(\frac{1}{N T} X^{\prime} M_{D_{\alpha \lambda}} X\right)^{-1} \frac{1}{N T} B_{\alpha} D_{\alpha}^{\prime} U \\
& =O_{P}\left(N^{-1}+(N T)^{-1 / 2}\right) O_{P}(1) O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right)=O_{P}\left(N^{-2}+T^{-2}\right) .
\end{aligned}
$$

It follows that $J_{4 N T}=\frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i}^{2}+\frac{1}{T} \sum_{t=1}^{T} \bar{u}_{. t}^{2}+O_{P}\left(N^{-2}+T^{-2}\right)$. In addition, we can show that $J_{4 N T}-J_{2 N T}=\frac{1}{T} \sum_{t=1}^{T} \bar{u}_{. t}^{2}+O_{P}\left(N^{-2}+(N T)^{-1}\right)$ and $J_{4 N T}-J_{3 N T}=\frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i .}^{2}+O_{P}\left(N^{-2}+T^{-2}\right)$.

Proof of Lemma A.6. (i) $\max _{i, t} h_{i t}^{(1)}=\max _{i, t} x_{i t}^{\prime}\left(X^{\prime} X\right)^{-1} x_{i t} \leq\left[\lambda_{\min }\left((N T)^{-1} X^{\prime} X\right)\right]^{-1}(N T)^{-1} \max _{i, t}$ $\left\|x_{i t}\right\|^{2}=O_{P}\left((N T)^{-1 / 2}\right)$ by Assumption A.1(ii) and (iv).
(ii) Let $d_{\alpha, i t}^{\prime}$ denote a typical row of $D_{\alpha}$ such that $D_{\alpha}=\left(d_{\alpha, 11}, \ldots, d_{\alpha, 1 T}, \ldots, d_{\alpha, N 1}, \ldots, d_{\alpha, N T}\right)^{\prime}$.

Then

$$
\begin{align*}
h_{i t}^{(2)} & =x_{i t}^{(2) \prime}\left(X^{(2) \prime} X^{(2)}\right)^{-1} x_{i t}^{(2)} \\
& =\left(x_{i t}^{\prime}, d_{\alpha, i t}^{\prime}\right)\left(\begin{array}{cc}
X^{\prime} X & X^{\prime} D_{\alpha} \\
D_{\alpha}^{\prime} X & D_{\alpha}^{\prime} D_{\alpha}
\end{array}\right)^{-1}\binom{x_{i t}}{d_{\alpha, i t}} \\
& =\left(x_{i t}^{\prime}, d_{\alpha, i t}^{\prime}\right)\left(\begin{array}{cc}
X_{D_{\alpha}}^{*} & -X_{D_{\alpha}}^{*} B_{\alpha} \\
-B_{\alpha}^{\prime} X_{D_{\alpha}}^{*} & \left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1}+B_{\alpha}^{\prime} X_{D_{\alpha}}^{*} B_{\alpha}
\end{array}\right)\binom{x_{i t}}{d_{\alpha, i t}} \\
& =d_{\alpha, i t}^{\prime}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} d_{\alpha, i t}+x_{i t}^{\prime} X_{D_{\alpha}}^{*} x_{i t}-d_{\alpha, i t}^{\prime} B_{\alpha}^{\prime} X_{D_{\alpha}}^{*} x_{i t}-x_{i t}^{\prime} X_{D_{\alpha}}^{*} B_{\alpha} d_{\alpha, i t}+d_{\alpha, i t}^{\prime} B_{\alpha}^{\prime} X_{D_{\alpha}}^{*} B_{\alpha} d_{\alpha, i t} \\
& =d_{\alpha, i t}^{\prime}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} d_{\alpha, i t}+\left(x_{i t}-B_{\alpha} d_{\alpha, i t}\right)^{\prime} X_{D_{\alpha}}^{*}\left(x_{i t}-B_{\alpha} d_{\alpha, i t}\right) . \tag{B.2}
\end{align*}
$$

For $i \leq N-1, d_{\alpha, i t}$ contains 1 in one place and zeros elsewhere, implying that $d_{\alpha, i t}^{\prime}\left(I_{N-1}-\frac{1}{N} \iota_{N-1} \iota_{N-1}^{\prime}\right)$ $\times d_{\alpha, i t}=1-\frac{1}{N}=\frac{N-1}{N}$ for any $i \leq N-1$ and $t=1, \ldots, T$. When $i=N$, we have

$$
d_{\alpha, N t}^{\prime}\left(I_{N-1}-\frac{1}{N} \iota_{N-1} \iota_{N-1}^{\prime}\right) d_{\alpha, N t}=\iota_{N-1}^{\prime}\left(I_{N-1}-\frac{1}{N} \iota_{N-1} \iota_{N-1}^{\prime}\right) \iota_{N-1}=\frac{N-1}{N} \text { for } t=1, \ldots, T \text {. }
$$

These observations, in conjunction with (B.1), imply that

$$
\begin{equation*}
d_{\alpha, i t}^{\prime}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} d_{\alpha, i t}=T^{-1} d_{\alpha, i t}^{\prime}\left(I_{N-1}-\frac{1}{N} \iota_{N-1} \iota_{N-1}^{\prime}\right) d_{\alpha, i t}=T^{-1} \frac{N-1}{N} \text { for all } i, t \tag{B.3}
\end{equation*}
$$

Next, notice that

$$
\begin{aligned}
\max _{i, t}\left(x_{i t}-B_{\alpha} d_{\alpha, i t}\right)^{\prime} X_{D_{\alpha}}^{*}\left(x_{i t}-B_{\alpha} d_{\alpha, i t}\right) & \leq \epsilon_{1 N T} \max _{i, t} \frac{1}{N T}\left(x_{i t}-B_{\alpha} d_{\alpha, i t}\right)^{\prime}\left(x_{i t}-B_{\alpha} d_{\alpha, i t}\right) \\
& \leq \epsilon_{1 N T} \max _{i, t} \frac{2}{N T}\left\{\left\|x_{i t}\right\|^{2}+d_{\alpha, i t}^{\prime} B_{\alpha}^{\prime} B_{\alpha} d_{\alpha, i t}\right\},
\end{aligned}
$$

where $\epsilon_{1 N T}=\left[\lambda_{\min }\left(\frac{1}{N T} X^{\prime} M_{D_{\alpha}} X\right)\right]^{-1}=O_{P}$ (1) by Assumption A.1(iv). By Assumption A.1(ii) and Markov inequality,

$$
\max _{i, t} \frac{1}{N T}\left\|x_{i t}\right\|^{2}=\frac{1}{N T} O_{P}\left((N T)^{1 / 2}\right)=O_{P}\left((N T)^{-1 / 2}\right)
$$

For $\frac{1}{N T} d_{\alpha, i t}^{\prime} B_{\alpha}^{\prime} B_{\alpha} d_{\alpha, i t}$, we have

$$
\begin{aligned}
& \max _{i, t} \frac{1}{N T} d_{\alpha, i t}^{\prime} B_{\alpha}^{\prime} B_{\alpha} d_{\alpha, i t} \\
= & \max _{i, t} \frac{1}{N T} \operatorname{tr}\left\{d_{\alpha, i t}^{\prime}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1 / 2}\left[\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1 / 2} D_{\alpha}^{\prime} X X^{\prime} D_{\alpha}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1 / 2}\right]\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1 / 2} d_{\alpha, i t}\right\} \\
\leq & \max _{i, t} d_{\alpha, i t}^{\prime}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} d_{\alpha, i t} \frac{1}{N T} \operatorname{tr}\left(\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1 / 2} D_{\alpha}^{\prime} X X^{\prime} D_{\alpha}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1 / 2}\right) \\
= & T^{-1} \frac{N-1}{N} \frac{1}{N T} \operatorname{tr}\left(X X^{\prime} D_{\alpha}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime}\right) \\
\leq & T^{-1} \frac{N-1}{N} \frac{1}{N T} \operatorname{tr}\left(X^{\prime} X\right)=O_{P}\left(T^{-1}\right),
\end{aligned}
$$

where the last inequality follows from the fact that $D_{\alpha}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime}$ is a projection matrix with maximum eigenvalue 1. It follows that $h_{i t}^{(2)}=T^{-1} \frac{N-1}{N}+\left(x_{i t}-B_{\alpha} d_{\alpha, i t}\right)^{\prime} X_{D_{\alpha}}^{*}\left(x_{i t}-B_{\alpha} d_{\alpha, i t}\right)$ and $\max _{i, t} h_{i t}^{(2)}=O_{P}\left((N T)^{-1 / 2}+T^{-1}\right)$.
(iii) Let $d_{\lambda, i t}^{\prime}$ denote a typical row of $D_{\lambda}$ such that $D_{\lambda}=\left(d_{\lambda, 11}, \ldots, d_{\lambda, 1 T}, \ldots, d_{\lambda, N 1}, \ldots, d_{\lambda, N T}\right)^{\prime}$. Following the analysis in (ii), we can show that

$$
\begin{equation*}
h_{i t}^{(3)}=d_{\lambda, i t}^{\prime}\left(D_{\lambda}^{\prime} D_{\lambda}\right)^{-1} d_{\lambda, i t}+\left(x_{i t}-B_{\lambda} d_{\lambda, i t}\right)^{\prime} X_{D_{\lambda}}^{*}\left(x_{i t}-B_{\lambda} d_{\lambda, i t}\right) \tag{B.4}
\end{equation*}
$$

and

$$
\begin{equation*}
d_{\alpha, i t}^{\prime}\left(I_{T-1}-\frac{1}{T} \iota_{T-1} \iota_{T-1}^{\prime}\right) d_{\alpha, i t}=\frac{T-1}{T} \text { for all } i, t \tag{B.5}
\end{equation*}
$$

Noting that

$$
\begin{equation*}
D_{\lambda}^{\prime} D_{\lambda}=N\left(I_{T-1}+\iota_{T-1} \iota_{T-1}^{\prime}\right) \text { and }\left(D_{\lambda}^{\prime} D_{\lambda}\right)^{-1}=N^{-1}\left(I_{T-1}-\frac{1}{T} \iota_{T-1} \iota_{T-1}^{\prime}\right) \tag{B.6}
\end{equation*}
$$

we have

$$
\begin{equation*}
d_{\lambda, i t}^{\prime}\left(D_{\lambda}^{\prime} D_{\lambda}\right)^{-1} d_{\lambda, i t}=N^{-1} \frac{T-1}{T} \tag{B.7}
\end{equation*}
$$

In addition, following the arguments as used in the analysis of $\left(x_{i t}-B_{\alpha} d_{\alpha, i t}\right)^{\prime} X_{D_{\alpha}}^{*}\left(x_{i t}-B_{\alpha} d_{\alpha, i t}\right)$ and (B.6), we have
$\max _{i, t}\left(x_{i t}-B_{\lambda} d_{\lambda, i t}\right)^{\prime} X_{D_{\alpha}}^{*}\left(x_{i t}-B_{\lambda} d_{\lambda, i t}\right) \leq \epsilon_{2 N T} \max _{i, t} \frac{2}{N T}\left(\left\|x_{i t}\right\|^{2}+d_{\lambda, i t}^{\prime} B_{\lambda}^{\prime} B_{\lambda} d_{\lambda, i t}\right)=O_{P}\left((N T)^{-1 / 2}+N^{-1}\right)$,
where $\epsilon_{2 N T}=\left[\lambda_{\min }\left(\frac{1}{N T} X^{\prime} M_{D_{\lambda}} X\right)\right]^{-1}=O_{P}(1)$ by Assumption A.1(iv). It follows that $h_{i t}^{(3)}=$ $N^{-1} \frac{T-1}{T}+\left(x_{i t}-B_{\lambda} d_{\lambda, i t}\right)^{\prime} X_{D_{\lambda}}^{*}\left(x_{i t}-B_{\lambda} d_{\lambda, i t}\right)$ and $\max _{i, t} h_{i t}^{(3)}=O_{P}\left((N T)^{-1 / 2}+N^{-1}\right)$.
(iv) Let $d_{\alpha \lambda, i t}^{\prime}$ denote a typical row of $D_{\alpha \lambda}$ such that $D_{\alpha \lambda}=\left(d_{\alpha \lambda, 11}, \ldots, d_{\alpha \lambda, 1 T}, \ldots, d_{\alpha \lambda, N 1}, \ldots, d_{\alpha \lambda, N T}\right)^{\prime}$. Following the analysis in (ii), we can show that

$$
\begin{equation*}
h_{i t}^{(4)}=d_{\alpha \lambda, i t}^{\prime}\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}\right)^{-1} d_{\alpha \lambda, i t}+\left(x_{i t}-B_{\alpha \lambda} d_{\alpha \lambda, i t}\right)^{\prime} X_{D_{\alpha \lambda}}^{*}\left(x_{i t}-B_{\alpha \lambda} d_{\alpha \lambda, i t}\right) . \tag{B.8}
\end{equation*}
$$

Noting that $D_{\alpha \lambda}=\left(D_{\alpha}, D_{\lambda}\right)$ and $D_{\alpha}^{\prime} D_{\lambda}=0$, we have

$$
\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}\right)^{-1}=\left(\begin{array}{ll}
\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} & \\
& \left(D_{\lambda}^{\prime} D_{\lambda}\right)^{-1}
\end{array}\right) .
$$

Then

$$
\begin{align*}
d_{\alpha \lambda, i t}^{\prime}\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}\right)^{-1} d_{\alpha \lambda, i t} & =d_{\alpha, i t}^{\prime}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} d_{\alpha, N t}+d_{\lambda, i t}^{\prime}\left(D_{\lambda}^{\prime} D_{\lambda}\right)^{-1} d_{\lambda, i t} \\
& =T^{-1} \frac{N-1}{N}+N^{-1} \frac{T-1}{T} \text { for all } i, t . \tag{B.9}
\end{align*}
$$

In addition, following the arguments as used in the analysis of $\left(x_{i t}-B_{\alpha} d_{\alpha, i t}\right)^{\prime} X_{D_{\alpha}}^{*}\left(x_{i t}-B_{\alpha} d_{\alpha, i t}\right)$ and (B.9), we can show that

$$
\begin{aligned}
\max _{i, t}\left(x_{i t}-B_{\alpha \lambda} d_{\alpha \lambda, i t}\right)^{\prime} X_{D_{\alpha \lambda}}^{*}\left(x_{i t}-B_{\alpha \lambda} d_{\alpha \lambda, i t}\right) & \leq \epsilon_{3 N T} \max _{i, t} \frac{2}{N T}\left\{\left\|x_{i t}\right\|^{2}+d_{\alpha \lambda, i t}^{\prime} B_{\alpha \lambda}^{\prime} B_{\alpha \lambda} d_{\alpha \lambda, i t}\right\} \\
& =O_{P}\left((N T)^{-1 / 2}+N^{-1}+T^{-1}\right)=O_{P}\left(N^{-1}+T^{-1}\right),
\end{aligned}
$$

where $\epsilon_{3 N T}=\left[\lambda_{\min }\left(\frac{1}{N T} X^{\prime} M_{D_{\alpha \lambda}} X\right)\right]^{-1}=O_{P}(1)$ by Assumption A.1(iv). It follows that $h_{i t}^{(4)}=$ $T^{-1} \frac{N-1}{N}+N^{-1} \frac{T-1}{T}+\left(x_{i t}-B_{\alpha \lambda} d_{\alpha \lambda, i t}\right)^{\prime} X_{D_{\alpha \lambda}}^{*}\left(x_{i t}-B_{\alpha \lambda} d_{\alpha \lambda, i t}\right)$ and $\max _{i, t} h_{i t}^{(4)}=O_{P}\left(N^{-1}+T^{-1}\right)$.
(v) Note that

$$
\begin{aligned}
& \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(x_{i t}-B_{\alpha} d_{\alpha, i t}\right)^{\prime} X_{D_{\alpha}}^{*}\left(x_{i t}-B_{\alpha} d_{\alpha, i t}\right) u_{i t}^{2} \\
\leq & \frac{2 \epsilon_{1 N T}}{N T}\left\{\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} x_{i t}^{\prime} x_{i t} u_{i t}^{2}+\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} d_{\alpha, i t}^{\prime} B_{\alpha}^{\prime} B_{\alpha} d_{\alpha, i t} u_{i t}^{2}\right\} \equiv \frac{2 \epsilon_{1 N T}}{N T}\left(I I_{1}+I I_{2}\right), \text { say. }
\end{aligned}
$$

Note that $I I_{1}=O_{P}(1)$ by Assumption A.1(i)-(ii) and Markov and Jensen inequalities. For $I I_{2}$, observing that $X^{\prime} D_{\alpha}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} d_{\alpha, i t}=\bar{x}_{i} .-\bar{x}$. ., we have by Assumption A.1(i)-(ii)

$$
\begin{aligned}
I I_{2} & \leq \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} d_{\alpha, i t}^{\prime}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} X X^{\prime} D_{\alpha}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} d_{\alpha, i t} u_{i t}^{2} \\
& =\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(\bar{x}_{i .}-\bar{x}_{. .}\right)^{\prime}\left(\bar{x}_{i .}-\bar{x}_{. .}\right) u_{i t}^{2} \\
& \leq\left\{\frac{1}{N} \sum_{i=1}^{N}\left\|\bar{x}_{i .}-\bar{x}_{. .}\right\|^{4}\right\}^{1 / 2}\left\{\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} u_{i t}^{4}\right\}^{1 / 2}=O_{P}(1)
\end{aligned}
$$

because we can readily show that $\frac{1}{N} \sum_{i=1}^{N}\left\|\bar{x}_{i .}-\bar{x} . .\right\|^{4} \leq \frac{8}{N} \sum_{i=1}^{N}\left\|\bar{x}_{i} .\right\|^{4}+8\|\bar{x} . .\|^{4}=O_{P}$ (1) under Assumption A.1(ii). It follows that $\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(x_{i t}-B_{\alpha} d_{\alpha, i t}\right)^{\prime} X_{D_{\alpha}}^{*}\left(x_{i t}-B_{\alpha} d_{\alpha, i t}\right) u_{i t}^{2}=$ $O_{P}\left((N T)^{-1}\right)$
(vi) The proof of (vi) is analogous to that of (v). The major difference is now we need to apply the fact that $X^{\prime} D_{\lambda}\left(D_{\lambda}^{\prime} D_{\lambda}\right)^{-1} d_{\lambda, i t}=\bar{x}_{. t}-\bar{x} \ldots$
(vii) Note that

$$
\begin{aligned}
& \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(x_{i t}-B_{\alpha \lambda} d_{\alpha \lambda, i t}\right)^{\prime} X_{D_{\alpha \lambda}}^{*}\left(x_{i t}-B_{\alpha \lambda} d_{\alpha \lambda, i t}\right) u_{i t}^{2} \\
\leq & \frac{2 \epsilon_{3 N T}}{N T}\left\{\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} x_{i t}^{\prime} x_{i t} u_{i t}^{2}+\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} d_{\alpha \lambda, i t}^{\prime} B_{\alpha \lambda}^{\prime} B_{\alpha \lambda} d_{\alpha \lambda, i t} u_{i t}^{2}\right\} \equiv \frac{2 \epsilon_{3 N T}}{N T}\left(I I_{1}+I I_{3}\right), \text { say. }
\end{aligned}
$$

We know that $I I_{1}=O_{P}(1)$. For $I I_{3}$, observing that $X^{\prime} D_{\alpha \lambda}\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}\right)^{-1} d_{\alpha \lambda, i t}=\bar{x}_{i}+\bar{x}_{\cdot t}-2 \bar{x} .$. , we have by Assumption A.1(i)-(ii)

$$
\begin{aligned}
I I_{2} & \leq \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} d_{\alpha \lambda, i t}^{\prime}\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}\right)^{-1} D_{\alpha \lambda}^{\prime} X X^{\prime} D_{\alpha \lambda}\left(D_{\alpha \lambda}^{\prime} D_{\alpha \lambda}\right)^{-1} d_{\alpha \lambda, i t} u_{i t}^{2} \\
& =\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(\bar{x}_{i \cdot}+\bar{x}_{\cdot t}-2 \bar{x}_{. .}\right)^{\prime}\left(\bar{x}_{i .}+\bar{x}_{\cdot t}-2 \bar{x}_{. .}\right) u_{i t}^{2} \\
& \leq \frac{3}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(\left\|\bar{x}_{i \cdot}\right\|^{2}+\left\|\bar{x}_{\cdot t}\right\|^{2}+4\left\|\bar{x}_{. .}\right\|^{2}\right) u_{i t}^{2}=O_{P}(1)
\end{aligned}
$$

Consequently, $\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T}\left(x_{i t}-B_{\alpha \lambda} d_{\alpha \lambda, i t}\right)^{\prime} X_{D_{\alpha \lambda}}^{*}\left(x_{i t}-B_{\alpha \lambda} d_{\alpha \lambda, i t}\right) u_{i t}^{2}=O_{P}\left((N T)^{-1}\right)$.
Proof of Lemma A.7. Let $\|A\|_{\text {sp }}$ denotes the spectral norm of $A$. Note that

$$
\begin{align*}
\hat{\boldsymbol{\rho}}-\boldsymbol{\rho} & =\left(\hat{\mathbf{Z}}^{\prime} \hat{\mathbf{Z}}\right)^{-1} \hat{\mathbf{Z}}^{\prime} \hat{\mathbf{U}}-\boldsymbol{\rho} \\
& =\left[\left(\hat{\mathbf{Z}}^{\prime} \hat{\mathbf{Z}}\right)^{-1}-\left(\mathbf{Z}^{\prime} \mathbf{Z}\right)^{-1}\right] \hat{\mathbf{Z}}^{\prime} \hat{\mathbf{U}}+\left(\mathbf{Z}^{\prime} \mathbf{Z}\right)^{-1}\left(\hat{\mathbf{Z}}^{\prime} \hat{\mathbf{U}}-\mathbf{Z}^{\prime} \mathbf{U}\right)+\left[\left(\mathbf{Z}^{\prime} \mathbf{Z}\right)^{-1} \mathbf{Z}^{\prime} \mathbf{U}-\boldsymbol{\rho}\right] . \tag{B.10}
\end{align*}
$$

It suffices to show that (i) $\frac{1}{N T_{p}}\left\|\hat{\mathbf{Z}}^{\prime} \hat{\mathbf{Z}}-\mathbf{Z}^{\prime} \mathbf{Z}\right\|_{\mathrm{sp}}=O_{P}\left(p \delta_{N T}\right)$, (ii) $\left\|\frac{1}{N T_{p}} \mathbf{Z}^{\prime} \mathbf{Z}-\Gamma_{p}\right\|_{\mathrm{sp}}=o_{P}(1)$, (iii) $\frac{1}{N T_{p}}\left\|\hat{\mathbf{Z}}^{\prime} \hat{\mathbf{U}}-\mathbf{Z}^{\prime} \mathbf{U}\right\|=O_{P}\left(p^{1 / 2} \delta_{N T}\right)$, and (iv) $\left\|\left(\mathbf{Z}^{\prime} \mathbf{Z}\right)^{-1} \mathbf{Z}^{\prime} \mathbf{U}-\boldsymbol{\rho}\right\|=O_{P}\left(p^{1 / 2} \delta_{N T}\right)$. To see this, note that the last term in (B.10) is bounded the desired probability order by (iv). The second term in (B.10) is bounded above by

$$
\begin{aligned}
\left\|\left(\mathbf{Z}^{\prime} \mathbf{Z}\right)^{-1}\left(\hat{\mathbf{Z}}^{\prime} \hat{\mathbf{U}}-\mathbf{Z}^{\prime} \mathbf{U}\right)\right\| & \leq\left\|\left(\mathbf{Z}^{\prime} \mathbf{Z}\right)^{-1}\right\|_{\mathrm{sp}}\left\|\hat{\mathbf{Z}}^{\prime} \hat{\mathbf{U}}-\mathbf{Z}^{\prime} \mathbf{U}\right\| \\
& =\left[\lambda_{\min }\left(\frac{1}{N T_{p}} \mathbf{Z}^{\prime} \mathbf{Z}\right)\right]^{-1} \frac{1}{N T_{p}}\left\|\hat{\mathbf{Z}}^{\prime} \hat{\mathbf{U}}-\mathbf{Z}^{\prime} \mathbf{U}\right\| \\
& \leq\left[\lambda_{\min }\left(\Gamma_{p}\right)+\left\|\frac{1}{N T_{p}} \mathbf{Z}^{\prime} \mathbf{Z}-\Gamma_{p}\right\|\right]^{-1} \frac{1}{N T_{p}}\left\|\hat{\mathbf{Z}}^{\prime} \hat{\mathbf{U}}-\mathbf{Z}^{\prime} \mathbf{U}\right\| \\
& =O_{P}(1) O_{P}\left(p^{1 / 2} \delta_{N T}\right)=O_{P}\left(p^{1 / 2} \delta_{N T}\right)
\end{aligned}
$$

where the second inequality follows from the eigenvalue stability inequality, and the last line follows from the fact that $\lambda_{\min }\left(\Gamma_{p}\right)$ is bounded away from zero in probability. For the first term in (B.10), we have

$$
\begin{aligned}
\left\|\left[\left(\hat{\mathbf{Z}}^{\prime} \hat{\mathbf{Z}}\right)^{-1}-\left(\mathbf{Z}^{\prime} \mathbf{Z}\right)^{-1}\right] \hat{\mathbf{Z}}^{\prime} \hat{\mathbf{U}}\right\| & \leq\left\|\left(\frac{1}{N T_{p}} \hat{\mathbf{Z}}^{\prime} \hat{\mathbf{Z}}\right)^{-1}-\left(\frac{1}{N T_{p}} \mathbf{Z}^{\prime} \mathbf{Z}\right)^{-1}\right\|_{\mathrm{sp}} \frac{1}{N T_{p}}\left\{\left\|\mathbf{Z}^{\prime} \mathbf{U}\right\|+\left\|\hat{\mathbf{Z}}^{\prime} \hat{\mathbf{U}}^{\prime}-\mathbf{Z}^{\prime} \mathbf{U}\right\|\right\} \\
& =O_{P}\left(p \delta_{N T}\right) O_{P}\left(1+p^{1 / 2} \delta_{N T}\right)=O_{P}\left(p \delta_{N T}\right)
\end{aligned}
$$

where we use the fact that by (i)-(iii),

$$
\begin{aligned}
\left\|\left(\frac{1}{N T_{p}} \hat{\mathbf{Z}}^{\prime} \hat{\mathbf{Z}}\right)^{-1}-\left(\frac{1}{N T_{p}} \mathbf{Z}^{\prime} \mathbf{Z}\right)^{-1}\right\|_{\mathrm{sp}} & =\left\|\left(\frac{1}{N T_{p}} \hat{\mathbf{Z}}^{\prime} \hat{\mathbf{Z}}\right)^{-1} \frac{1}{N T_{p}}\left(\hat{\mathbf{Z}}^{\prime} \hat{\mathbf{Z}}-\mathbf{Z}^{\prime} \mathbf{Z}\right)\left(\frac{1}{N T_{p}} \mathbf{Z}^{\prime} \mathbf{Z}\right)^{-1}\right\|_{\mathrm{sp}} \\
& \leq\left[\lambda_{\min }\left(\frac{1}{N T_{p}} \hat{\mathbf{Z}}^{\prime} \hat{\mathbf{Z}}\right) \lambda_{\min }\left(\frac{1}{N T_{p}} \mathbf{Z}^{\prime} \mathbf{Z}\right)\right]^{-1} \frac{1}{N T_{p}}\left\|\hat{\mathbf{Z}}^{\prime} \hat{\mathbf{Z}}-\mathbf{Z}^{\prime} \mathbf{Z}\right\|_{\mathrm{sp}} \\
& =O_{P}(1) O_{P}\left(p \delta_{N T}\right),
\end{aligned}
$$

and that $\frac{1}{N T_{p}}\left\|\mathbf{Z}^{\prime} \mathbf{U}\right\|=O_{P}(1)$ under Assumption A.4. Next, we show (i)-(iv) in turn.
To show (i), we reparametrize Model 4 as

$$
y_{i t}=x_{i t}^{* \prime} \beta^{*}+\alpha_{i}^{*}+\lambda_{t}+u_{i t}
$$

where $x_{i t}^{*}$ and $\beta^{*}$ correspond to $x_{i t}$ and $\beta$ after one removes the constant term, and $\alpha_{i}^{*}$ incorporates the intercept term now. Let $\ddot{x}_{i t}^{*}=x_{i t}^{*}-\bar{x}_{.}^{*}-\bar{x}_{. t}^{*}+\bar{x}_{. .}^{*}$, where $\bar{x}_{i .}^{*}$, $\bar{x}_{. t}^{*}$, and $\bar{x}_{. .}^{*}$ are defined analogously to $\bar{u}_{i}$, $\bar{u}_{\cdot t}$, and $\bar{u} \ldots$ Let $\ddot{y}_{i}=\left(\ddot{y}_{i 1}, \ldots, \ddot{y}_{i T}\right)^{\prime}$ and $\ddot{Y}=\left(\ddot{y}_{1}, \ldots, \ddot{y}_{N}\right)^{\prime}$. Define $\ddot{x}_{i}, \ddot{X}, \ddot{u}_{i}$ and $\ddot{U}$ analogously. After eliminating the individual and time effects $\alpha_{i}^{*}$ and $\lambda_{t}$ from the above regression through the within and time-demeaned transformation, we can obtain the two-way within estimator of $\beta^{*}$ given by $\hat{\beta}^{*}=\left(\ddot{X}^{\prime} \ddot{X}\right)^{-1} \ddot{X}^{\prime} \ddot{Y}$. Then $\hat{u}_{i t}^{(4)}$ can be equivalently represented as

$$
\begin{equation*}
\widehat{\ddot{u}}_{i t}=\ddot{y}_{i t}-\hat{\beta}^{* \prime} \ddot{x}_{i t}^{*}=\ddot{u}_{i t}-\left(\hat{\beta}^{*}-\beta^{*}\right)^{\prime} \ddot{x}_{i t}^{*}, \tag{B.11}
\end{equation*}
$$

Under Assumptions A.1(iii)-(iv) and A.2(iii)-(iv), we can readily show that $\hat{\beta}^{*}-\beta^{*}=O_{P}\left(\delta_{N T}\right)$. Recall that $\underline{\ddot{u}}_{i, t}=\left(\ddot{u}_{i t}, \ldots, \ddot{u}_{i, t-p+1}\right)^{\prime}$. Let $\widehat{\ddot{\ddot{u}}}_{i, t}=\left(\widehat{\ddot{u}}_{i, t}, \ldots \widehat{\ddot{u}}_{i, t-p+1}\right)^{\prime}$. Then

$$
\begin{aligned}
& \frac{1}{N T_{p}}\left(\hat{\mathbf{Z}}^{\prime} \hat{\mathbf{Z}}-\mathbf{Z}^{\prime} \mathbf{Z}\right)=\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}\left(\widehat{\underline{\tilde{u}}}_{i, t} \widehat{\underline{\tilde{u}}}_{i, t}^{\prime}-\underline{\ddot{u}}_{i, t} \underline{\underline{u}}_{i, t}^{\prime}\right) \\
& =\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}\left(\widehat{\underline{\tilde{u}}}_{i, t}-\underline{\underline{u}}_{i, t}\right)\left(\widehat{\underline{\tilde{u}}}_{i, t}-\underline{\underline{u}}_{i, t}\right)^{\prime}+\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}\left(\widehat{\underline{\tilde{u}}}_{i, t}-\underline{\ddot{u}}_{i, t}\right) \ddot{\underline{u}}_{i, t}^{\prime} \\
& +\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \ddot{\underline{u}}_{i, t}\left(\widehat{\underline{\tilde{u}}}_{i, t}-\underline{\underline{u}}_{i, t}\right)^{\prime} \\
& \equiv \vartheta_{1}+\vartheta_{2}+\vartheta_{3} \text {, say. }
\end{aligned}
$$

Noting that $\widehat{\underline{u}}_{i, t}-\underline{\ddot{u}}_{i, t}=-\underline{\ddot{x}}_{i t}^{*}\left(\hat{\beta}^{*}-\beta^{*}\right)$ where $\underline{\ddot{x}}_{i t}^{*}=\left(\ddot{x}_{i t}^{*}, \ldots, \ddot{x}_{i, t-p+1}^{*}\right)^{\prime}$, we have

$$
\left\|\vartheta_{1}\right\| \leq\left\|\hat{\beta}^{*}-\beta^{*}\right\|^{2}\left\|\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \ddot{\ddot{x}}_{i t}^{*} \ddot{\underline{x}}_{i t}^{* \prime}\right\|=O_{P}\left(p \delta_{N T}^{2}\right)
$$

For $\vartheta_{2}$, we have

$$
\begin{aligned}
\left\|\vartheta_{2}\right\|^{2} & =\frac{1}{\left(N T_{p}\right)^{2}}\left\|\sum_{i=1}^{N} \sum_{t=p+1}^{T} \ddot{\underline{x}}_{i t}^{*}\left(\hat{\beta}^{*}-\beta^{*}\right) \ddot{\underline{u}}_{i, t}^{\prime}\right\|^{2} \\
& =\frac{1}{\left(N T_{p}\right)^{2}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \sum_{i_{1}=1}^{N} \sum_{t_{1}=p+1}^{T} \operatorname{tr}\left\{\left(\hat{\beta}^{*}-\beta^{*}\right) \ddot{\underline{u}}_{i, t}^{\prime} \ddot{\underline{u}}_{i_{1}, t_{1}}\left(\hat{\beta}^{*}-\beta^{*}\right)^{\prime} \underline{\underline{x}}_{i_{1} t_{1}}^{* \prime} \ddot{\underline{x}}_{i t}^{*}\right\} \\
& =\left(\hat{\beta}^{*}-\beta^{*}\right)^{\prime} \Theta_{2}\left(\hat{\beta}^{*}-\beta^{*}\right),
\end{aligned}
$$

where $\Theta_{2}=\frac{1}{\left(N T_{p}\right)^{2}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \sum_{i_{1}=1}^{N} \sum_{t_{1}=p+1}^{T} \ddot{\ddot{u}}_{i, t}^{\prime} \ddot{\underline{u}}_{i_{1}, t_{1}} \ddot{\ddot{x}}_{i t}^{*} \ddot{\underline{\ddot{x}}}_{i_{1}}^{*}$. . Observe that under Assumption A.1(i)-(ii)

$$
E\left\|\Theta_{2}\right\|_{\mathrm{sp}} \leq E \operatorname{tr}\left(\Theta_{2}\right)=\frac{1}{\left(N T_{p}\right)^{2}} \sum_{j=0}^{p-1} \sum_{l=0}^{p-1} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \sum_{i_{1}=1}^{N} \sum_{t_{1}=p+1}^{T} E\left(\ddot{u}_{i, t-j} \ddot{u}_{i_{1}, t_{1}-j} \ddot{x}_{i, t-l}^{* \prime} \ddot{\underline{x}}_{i_{1}, t_{1}-l}^{*}\right)=O\left(p^{2}\right) .
$$

It follows that $\left\|\Theta_{2}\right\|_{\text {sp }}=O_{P}\left(p^{2}\right)$ and $\left\|\vartheta_{2}\right\| \leq\left\|\hat{\beta}^{*}-\beta^{*}\right\|\left\|\Theta_{2}\right\|_{\text {sp }}^{1 / 2}=O_{P}\left(p \delta_{N T}\right)$. Similarly, $\left\|\vartheta_{3}\right\|=$ $\left\|\vartheta_{2}\right\|=O_{P}\left(p \delta_{N T}\right)$. [When $x_{i t}$ is strictly exogenous, we can show that $E \operatorname{tr}\left(\Theta_{2}\right)=O\left(p^{2} \delta_{N T}\right)$ and then $\left\|\vartheta_{3}\right\|=\left\|\vartheta_{2}\right\| \leq\left\|\hat{\beta}^{*}-\beta^{*}\right\|\left\|\Theta_{2}\right\|_{\mathrm{sp}}^{1 / 2}=O_{P}\left(p \delta_{N T}^{2}\right)=o_{P}\left(p^{1 / 2} \delta_{N T}\right)$.] Then (i) follows.

To show (ii), we note that $\frac{1}{N T_{p}} \mathbf{Z}^{\prime} \mathbf{Z}=\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \ddot{\underline{u}}_{i, t-1} \ddot{\underline{u}}_{i, t-1}^{\prime}$, where $\underline{\underline{u}}_{i, t-1}=\left(\ddot{u}_{i, t-1}, \ldots, \ddot{u}_{i, t-p}\right)^{\prime}$. Noting that $\ddot{u}_{i t}=u_{i t}-\bar{u}_{i}$. $-\bar{u}_{. t}+\bar{u}$. for each $(i, t)$, the $(j, l)$ th element of $\frac{1}{N T_{p}} \mathbf{Z}^{\prime} \mathbf{Z}$ is given by

$$
\begin{aligned}
\frac{1}{N T_{p}}\left[\mathbf{Z}^{\prime} \mathbf{Z}\right]_{j, l} & =\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \ddot{u}_{i, t-j} \ddot{u}_{i, t-l} \\
& =\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}\left(u_{i, t-j}-\bar{u}_{i \cdot} .\right)\left(u_{i, t-l}-\bar{u}_{i \cdot} .\right)-\frac{1}{T_{p}} \sum_{t=p+1}^{T}\left(\bar{u}_{., t-j}-\bar{u}_{. .}\right)\left(\bar{u}_{., t-l}-\bar{u}_{. .}\right) \\
& =\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} u_{i, t-j} u_{i, t-l}+\left[B_{2}\right]_{j, l} \equiv\left[B_{1}\right]_{j, l}+\left[B_{2}\right]_{j, l},
\end{aligned}
$$

where $\left[B_{2}\right]_{j, l}=-\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} u_{i, t-j} \bar{u}_{i} .-\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \bar{u}_{i} . u_{i, t-l}+\frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i}^{2} .-\frac{1}{T_{p}} \sum_{t=p+1}^{T}$ $\bar{u}_{., t-j} \bar{u}_{, t-l}+\frac{1}{T_{p}} \sum_{t=p+1}^{T} \bar{u}_{, t-j} \bar{u}_{. .}+\frac{1}{T_{p}} \sum_{t=p+1}^{T} \bar{u} . \bar{u}_{., t-l}-\left(\bar{u}_{. .}\right)^{2},\left[B_{\ell}\right]_{j, l}$ denotes the $(j, l)$ th element of $B_{\ell}$ for $\ell=1,2$, and $B_{\ell}$ 's are implicitly defined. It is easy to show that $\left\|B_{2}\right\|=O_{P}\left(p \delta_{N T}^{-1}\right)$. Consequently, we have

$$
\left\|\frac{1}{N T_{p}} \mathbf{Z}^{\prime} \mathbf{Z}-\Gamma_{p}\right\|=\left\|\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \ddot{\underline{u}}_{i, t-1} \ddot{\underline{u}}_{i, t-1}^{\prime}-\Gamma_{p}\right\| \leq\left\|B_{2}\right\|=O_{P}\left(p \delta_{N T}^{-1}\right)=o_{P}(1) .
$$

The analysis of (iii) is similar to that in (i) and thus omitted.
Lastly, we show (iv) Let $\bar{v}_{. t}=\bar{u}_{. t}-\rho^{\prime} \underline{\bar{u}}_{\cdot, t-1}$ where $\underline{\bar{u}}_{\cdot, t-1}=\left(\bar{u}_{., t-1}, \ldots, \bar{u}_{, t-p}\right)^{\prime}$. Noting that $\ddot{u}_{i t}=$ $u_{i t}-\bar{u}_{i .}-\bar{u}_{. t}+\bar{u}_{. .}$and $\ddot{u}_{i, t-1}=u_{i, t-1}-\bar{u}_{i .}-\bar{u}_{., t-1}+\bar{u} .$. , we have

$$
\begin{aligned}
\ddot{u}_{i t}-\rho^{\prime} \underline{\underline{u}}_{i, t-1} & =\left(u_{i t}-\rho^{\prime} \underline{u}_{i, t-1}\right)-\Phi(1) \bar{u}_{i}-\left(\bar{u}_{. t}-\rho^{\prime} \underline{\underline{u}}_{, t-1}\right)+\Phi(1) \bar{u}_{.} \\
& =v_{i t}-\Phi(1) \bar{u}_{i}-\bar{v}_{. t}+\Phi(1) \bar{u}_{. .}
\end{aligned}
$$

Then

$$
\begin{aligned}
\left(\mathbf{Z}^{\prime} \mathbf{Z}\right)^{-1} \mathbf{Z}^{\prime} \mathbf{U}-\boldsymbol{\rho}= & \left(\sum_{i=1}^{N} \sum_{t=p+1}^{T} \underline{u}_{i, t-1} \underline{\underline{u}}_{i, t-1}^{\prime}\right)^{-1} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \underline{u}_{i, t-1} \ddot{u}_{i t}-\boldsymbol{\rho} \\
= & \left(\sum_{i=1}^{N} \sum_{t=p+1}^{T} \ddot{\underline{u}}_{i, t-1} \underline{\ddot{u}}_{i, t-1}^{\prime}\right)^{-1} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \ddot{\underline{u}}_{i, t-1}\left[v_{i t}-\Phi(1) \bar{u}_{i .}-\bar{v}_{\cdot t}+\Phi(1) \bar{u}_{. .}\right] \\
= & \left(\sum_{i=1}^{N} \sum_{t=p+1}^{T} \underline{u}_{i, t-1} \underline{\underline{u}}_{i, t-1}^{\prime}\right)^{-1} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \underline{u}_{i, t-1} v_{i t} \\
& -\Phi(1)\left(\sum_{i=1}^{N} \sum_{t=p+1}^{T} \ddot{u}_{i, t-1} \underline{\ddot{u}}_{i, t-1}^{\prime}\right)^{-1} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \underline{\underline{u}}_{i, t-1} \bar{u}_{i} .
\end{aligned}
$$

where the third equality follows from the fact that $\sum_{i=1}^{N} \ddot{u}_{i t}=0$ for each $t$. Noting that $\sum_{t=1}^{T} \ddot{u}_{i t}=0$ for each $i$, we can readily apply Assumptions A.1(i), (iii) and A.2(iii)-(iv) and show that $\| \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}$ $\underline{\ddot{u}}_{i, t-1} \bar{u}_{i} \cdot \|=O_{P}\left(p^{1 / 2} T^{-1}\right)$. For example, the first element of $\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \underline{\ddot{u}}_{i, t-1} \bar{u}_{i}$. is

$$
\begin{aligned}
\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \ddot{u}_{i, t-1} \bar{u}_{i} . & =\frac{1}{N T_{p}} \sum_{i=1}^{N}\left(\sum_{t=1}^{T} \ddot{u}_{i t}-\sum_{s=1}^{p-1} \ddot{u}_{i s}-\ddot{u}_{i T}\right) \bar{u}_{i} . \\
& =\frac{-1}{N T_{p}} \sum_{i=1}^{N} \sum_{s=1}^{p-1} \ddot{u}_{i s} \bar{u}_{i} .-\frac{1}{N T} \sum_{i=1}^{N} \ddot{u}_{i T} \bar{u}_{i} .=O_{P}\left(T^{-1}\right) .
\end{aligned}
$$

Similarly, we can show that $\left\|\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \underline{\ddot{u}}_{i, t-1} v_{i t}\right\|=\left\|\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \underline{u}_{i, t-1} v_{i t}\right\|+O_{P}\left(p^{1 / 2} \delta_{N T}\right)$ $=O_{P}\left(p^{1 / 2} \delta_{N T}\right)$ under Assumptions A.1(iii), A.4(iii), and A.5(i)-(ii). Then we have $\left\|\left(\mathbf{Z}^{\prime} \mathbf{Z}\right)^{-1} \mathbf{Z}^{\prime} \mathbf{U}-\boldsymbol{\rho}\right\|$ $=O_{P}\left(p^{1 / 2} \delta_{N T}\right)$.
Proof of Lemma A.8. (i) Noting that $\breve{x}_{i t}^{(1)}=x_{i t}-\underline{x}_{i, t-1} \boldsymbol{\rho}=\boldsymbol{\Phi}(L) x_{i t} \equiv \breve{x}_{i t}$ where $\underline{x}_{i, t-1}=$ $\left(x_{i, t-1}, \ldots ., x_{i, t-p}\right)$, we can readily apply Assumptions A.1(iv)-(v) and A.4(iii) to show that

$$
\begin{aligned}
K_{1 N T} & =\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t} \breve{x}_{i t}^{\prime}\left(\frac{1}{N T} X^{\prime} X\right)^{-1} \frac{1}{N T} X^{\prime} U \\
& =O_{P}\left((N T)^{-1 / 2}\right) O_{P}(1) O_{P}\left((N T)^{-1 / 2}\right)=O_{P}\left((N T)^{-1}\right)
\end{aligned}
$$

(ii) Note that $\breve{x}_{i t}^{(2)}=x_{i t}^{(2)}-\underline{x}_{i, t-1}^{(2)} \rho=\left(\left(x_{i t}-\underline{x}_{i, t-1} \rho\right)^{\prime},\left(d_{\alpha, i t}-\underline{d}_{\alpha, i t-1} \rho\right)^{\prime}\right)^{\prime} \equiv\left(\breve{x}_{i t}^{\prime}, \breve{d}_{\alpha, i t}^{\prime}\right)^{\prime}$ where
$\underline{d}_{\alpha, i t-1}=\left(d_{\alpha, i t-1}, \ldots, d_{\alpha, i t-p}\right)$. By Lemma A. 1 with $D=D_{\alpha}$, we have

$$
\begin{aligned}
K_{2 N T}= & \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t} \breve{x}_{i t}^{(2) \prime}\left(X^{(2) \prime} X^{(2)}\right)^{-1} X^{(2) \prime} U \\
= & \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t}\left(\breve{x}_{i t}^{\prime}, \breve{d}_{\alpha, i t}^{\prime}\right)\left(\begin{array}{cc}
X_{D_{\alpha}}^{*} & -X_{D_{\alpha}}^{*} B_{\alpha} \\
-B_{\alpha}^{\prime} X_{D_{\alpha}}^{*} & \left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1}+B_{\alpha}^{\prime} X_{D}^{*} B_{\alpha}
\end{array}\right)\binom{X^{\prime} U}{D_{\alpha}^{\prime} U} \\
= & \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t}\left\{\breve{x}_{i t}^{\prime} X_{D_{\alpha}}^{*} X^{\prime} U-\breve{d}_{\alpha, i t}^{\prime} B_{\alpha}^{\prime} X_{D_{\alpha}}^{*} X^{\prime} U-\breve{x}_{i t}^{\prime} X_{D_{\alpha}}^{*} B_{\alpha} D_{\alpha}^{\prime} U+\breve{d}_{\alpha, i t}^{\prime}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} U\right. \\
& \left.+\breve{d}_{\alpha, i t}^{\prime} B_{\alpha}^{\prime} X_{D_{\alpha}}^{*} B_{\alpha} D_{\alpha}^{\prime} U\right\} \\
\equiv & K_{2 N T, 1}-K_{2 N T, 2}-K_{2 N T, 3}+K_{2 N T, 4}+K_{2 N T, 5}, \text { say. }
\end{aligned}
$$

As in (i), we can show that $K_{2 N T, 1}=O_{P}\left((N T)^{-1}\right)$ by Assumption A.1(iv)-(v). Observing that $d_{\alpha, i t}^{\prime}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} \times D_{\alpha}^{\prime} X=\left(\bar{x}_{i} .-\bar{x} . .\right)^{\prime}$ for each $(i, t)$, we have

$$
\begin{aligned}
\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t} \breve{d}_{\alpha, i t}^{\prime} B_{\alpha}^{\prime} & =\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t}\left(d_{\alpha, i t}-\underline{d}_{\alpha, i t-1} \boldsymbol{\rho}\right)^{\prime}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} X \\
& =\frac{\Phi(1)}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t}\left(\bar{x}_{i .}-\bar{x}_{. .}\right)^{\prime}=O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right)
\end{aligned}
$$

by Assumptions A.4(iii) and A.5(iii). It follows that

$$
\begin{aligned}
K_{2 N T, 2} & \leq\left\|\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t} \breve{d}_{\alpha, i t}^{\prime} B_{\alpha}^{\prime}\right\|\left\|\left(\frac{1}{N T} X^{\prime} M_{D_{\alpha}} X\right)^{-1}\right\|\left\|\frac{1}{N T} X^{\prime} U\right\| \\
& =O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right) O_{P}(1) O_{P}\left((N T)^{-1 / 2}\right)=O_{P}\left(T^{-2}+(N T)^{-1}\right)
\end{aligned}
$$

Similarly, we can show that

$$
\begin{aligned}
K_{2 N T, 3} & \leq\left\|\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t} \breve{x}_{i t}^{\prime}\right\|\left\|\left(\frac{1}{N T} X^{\prime} M_{D_{\alpha}} X\right)^{-1}\right\|\left\|\frac{1}{N T} B_{\alpha} D_{\alpha}^{\prime} U\right\| \\
& =O_{P}\left((N T)^{-1 / 2}\right) O_{P}(1) O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right)=O_{P}\left(T^{-2}+(N T)^{-1}\right), \\
K_{2 N T, 5} & \leq\left\|\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t} \breve{d}_{\alpha, i t}^{\prime} B_{\alpha}^{\prime}\right\|\left\|\left(\frac{1}{N T} X^{\prime} M_{D_{\alpha}} X\right)^{-1}\right\|\left\|\frac{1}{N T} B_{\alpha} D_{\alpha}^{\prime} U\right\| \\
& =O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right) O_{P}(1) O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right)=O_{P}\left(T^{-2}+(N T)^{-1}\right), \text { and } \\
K_{2 N T, 4} & =\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t} \breve{d}_{\alpha, i t}^{\prime}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} U=\frac{\Phi(1)}{N T_{p+1}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t}\left(\bar{u}_{i .}-\bar{u}_{. .}\right) \\
& =\frac{\Phi(1)}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t} \bar{u}_{i .}+O_{P}\left((N T)^{-1}\right) .
\end{aligned}
$$

It follows that $K_{2 N T}=\frac{\Phi(1)}{N T_{p+1}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t} \bar{u}_{i} .+O_{P}\left((N T)^{-1}+T^{-2}\right)$.
(iii) The proof is analogous to that of (ii). The major difference is that we need to use the expression $\breve{x}_{i t}^{(3)}=x_{i t}^{(3)}-\underline{x}_{i, t-1}^{(3)} \rho=\left(\left(x_{i t}-\underline{x}_{i, t-1} \boldsymbol{\rho}\right)^{\prime},\left(d_{\lambda, i t}-\underline{d}_{\lambda, i t-1} \rho\right)^{\prime}\right)^{\prime} \equiv\left(\breve{x}_{i t}^{\prime}, \breve{d}_{\lambda, i t}^{\prime}\right)^{\prime}$ with $\underline{d}_{\lambda, i t-1}=$ $\left(d_{\lambda, i t-1}, \ldots, d_{\lambda, i t-p}\right)$ and the fact that $d_{\lambda, i t}^{\prime}\left(D_{\lambda}^{\prime} D_{\lambda}\right)^{-1} D_{\lambda}^{\prime} X=\left(\bar{x}_{. t}-\bar{x}_{\text {.. }}\right)^{\prime}$ for each $(i, t)$ to obtain

$$
\begin{aligned}
\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t} \breve{d}_{\lambda, i t}^{\prime} B_{\lambda}^{\prime} & =\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t}\left(d_{\lambda, i t}-\underline{d}_{\lambda, i t-1} \boldsymbol{\rho}\right)^{\prime}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} X \\
& =\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t}\left[\left(\bar{x}_{t \cdot t}-\bar{x} . .\right)^{\prime}-\boldsymbol{\rho}^{\prime}\left(\bar{x}_{\cdot t-1}-\bar{x} . . \iota_{p}^{\prime}\right)^{\prime}\right]
\end{aligned}
$$

where $\underline{\bar{x}}_{\cdot t-1}=\left(\bar{x}_{\cdot t-1}, \ldots, \bar{x} \cdot t-p\right)$. The dominant term then becomes

$$
\begin{aligned}
\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t} \breve{d}_{\lambda, i t}^{\prime}\left(D_{\lambda}^{\prime} D_{\lambda}\right)^{-1} D_{\lambda}^{\prime} U & =\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t}\left[\left(\bar{u}_{. t}-\bar{u}_{. .}\right)-\rho^{\prime}\left(\underline{\bar{u}}_{. t-1}-\bar{u}_{. . \iota_{p}}\right)\right] \\
& =\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t} \Phi(L) \bar{u}_{. t}+O_{P}\left((N T)^{-1}+N^{-2}\right),
\end{aligned}
$$

where $\underline{\bar{u}}_{\cdot t-1}=\left(\bar{u}_{\cdot t-1}, \ldots, \bar{u}_{\cdot t-p}\right)^{\prime}$.
(iv) The proof is a combination of (ii)-(iii) as in that of Lemma A.5.

Proof of Lemma A.9. (i) Noting that $\breve{x}_{i t}^{(1)}=x_{i t}-\underline{x}_{i, t-1} \boldsymbol{\rho} \equiv \breve{x}_{i t}$, we can readily apply Assumptions A.1(iv)-(v) and A.4(i) to show that

$$
\begin{aligned}
L_{1 N T} & =U^{\prime} X\left(X^{\prime} X\right)^{-1} \frac{1}{N T} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \breve{x}_{i t} \breve{x}_{i t}^{\prime}\left(X^{\prime} X\right)^{-1} X^{\prime} U \\
& \leq\left\|\left(\frac{1}{N T} X^{\prime} X\right)^{-1}\right\|^{2}\left\|\frac{1}{N T} X^{\prime} U\right\|^{2}\left\|\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \breve{x}_{i t} \breve{x}_{i t}^{\prime}\right\|=O_{P}\left((N T)^{-1}\right)
\end{aligned}
$$

(ii) By Lemma A. 1 with $D=D_{\alpha}$ and using $\breve{x}_{i t}^{(2)} \breve{x}_{i t}^{(2) \prime}=\left(\begin{array}{cc}\breve{x}_{i t} \breve{x}_{i t}^{\prime} & \breve{x}_{i t} \breve{d}_{\alpha, i t}^{\prime} \\ \breve{d}_{\alpha, i t} \breve{x}_{i t}^{\prime} & \breve{d}_{\alpha, i t} \breve{d}_{\alpha, i t}^{\prime}\end{array}\right)$, we have

$$
\begin{aligned}
L_{2 N T}= & U^{\prime} X^{(2)}\left(X^{(2) \prime} X^{(2)}\right)^{-1} \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \breve{x}_{i t}^{(2)} \breve{x}_{i t}^{(2) \prime}\left(X^{(2) \prime} X^{(2)}\right)^{-1} X^{(2) \prime} U \\
= & \left(U^{\prime} X, U^{\prime} D_{\alpha}\right)\left(\begin{array}{cc}
X_{D_{\alpha}}^{*} & -X_{D_{\alpha}}^{*} B_{\alpha} \\
-B_{\alpha}^{\prime} X_{D_{\alpha}}^{*} & \left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1}+B_{\alpha}^{\prime} X_{D}^{*} B_{\alpha}
\end{array}\right) \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \breve{x}_{i t}^{(2)} \breve{x}_{i t}^{(2) \prime} \\
& \times\left(\begin{array}{cc}
X_{D_{\alpha}}^{*} & -X_{D_{\alpha}}^{*} B_{\alpha} \\
-B_{\alpha}^{\prime} X_{D_{\alpha}}^{*} & \left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1}+B_{\alpha}^{\prime} X_{D}^{*} B_{\alpha}
\end{array}\right)\binom{X^{\prime} U}{D_{\alpha}^{\prime} U} \\
= & \left(\zeta_{1}^{\prime}, \zeta_{2}^{\prime}\right) \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \breve{x}_{i t}^{(2)} \breve{x}_{i t}^{(2) \prime}\binom{\zeta_{1}}{\zeta_{2}} \\
= & \zeta_{1}^{\prime} \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \breve{x}_{i t} \breve{x}_{i t}^{\prime} \zeta_{1}+\zeta_{2}^{\prime} \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \breve{d}_{\alpha, i t} \breve{d}_{\alpha, i t}^{\prime} \zeta_{2}+2 \zeta_{1}^{\prime} \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \breve{x}_{i t} \breve{d}_{\alpha, i t}^{\prime} \zeta_{2} \\
\equiv & L_{2 N T, 1}+L_{2 N T, 2}+2 L_{2 N T, 3}, \text { say, }
\end{aligned}
$$

where $\zeta_{1}=X_{D_{\alpha}}^{* \prime} X^{\prime} U-X_{D_{\alpha}}^{* \prime} B_{\alpha} D_{\alpha}^{\prime} U$ and $\zeta_{2}=-B_{\alpha}^{\prime} X_{D_{\alpha}}^{* \prime} X^{\prime} U+\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} U+B_{\alpha}^{\prime} X_{D_{\alpha}}^{* \prime} B_{\alpha} D_{\alpha}^{\prime} U$. It is easy to show that $L_{2 N T, 1}=O_{P}\left((N T)^{-1}+T^{-2}\right)$ by Assumptions A.1(iv)-(v) and Lemma A.4(i). For $L_{2 N T, 2}$, we have $L_{2 N T, 2}=L_{2 N T, 21}+L_{2 N T, 22}+L_{2 N T, 23}-2 L_{2 N T, 24}-2 L_{2 N T, 25}+2 L_{2 N T, 26}$, where

$$
\begin{aligned}
& L_{2 N T, 21}=U^{\prime} X X_{D_{\alpha}}^{*} B_{\alpha} \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \breve{d}_{\alpha, i t} \breve{d}_{\alpha, i t}^{\prime} B_{\alpha}^{\prime} X_{D_{\alpha}}^{* \prime} X^{\prime} U \\
& L_{2 N T, 22}=U^{\prime} D_{\alpha}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \breve{d}_{\alpha, i t} \breve{d}_{\alpha, i t}^{\prime}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} U \\
& L_{2 N T, 23}=U^{\prime} D_{\alpha} B_{\alpha}^{\prime} X_{D_{\alpha}}^{*} B_{\alpha} \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \breve{d}_{\alpha, i t} \breve{d}_{\alpha, i t}^{\prime} B_{\alpha}^{\prime} X_{D_{\alpha}}^{* \prime} B_{\alpha} D_{\alpha}^{\prime} U \\
& L_{2 N T, 24}=U^{\prime} X X_{D_{\alpha}}^{*} B_{\alpha} \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \breve{d}_{\alpha, i t} \breve{d}_{\alpha, i t}^{\prime}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} U \\
& L_{2 N T, 25}=U^{\prime} X X_{D_{\alpha}}^{*} B_{\alpha} \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \breve{d}_{\alpha, i t} \breve{d}_{\alpha, i t}^{\prime} B_{\alpha}^{\prime} X_{D_{\alpha}}^{* \prime} B_{\alpha} D_{\alpha}^{\prime} U
\end{aligned}
$$

and

$$
L_{2 N T, 26}=U^{\prime} D_{\alpha}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \breve{d}_{\alpha, i t} \breve{d}_{\alpha, i t}^{\prime} B_{\alpha}^{\prime} X_{D_{\alpha}}^{* \prime} B_{\alpha} D_{\alpha}^{\prime} U .
$$

Noting that $\breve{d}_{\alpha, i t}^{\prime} B_{\alpha}^{\prime}=\breve{d}_{\alpha, i t}^{\prime}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} X=\Phi(1)\left(\bar{x}_{i} .-\bar{x} . .\right)^{\prime}$, we have

$$
B_{\alpha} \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \breve{d}_{\alpha, i t} \breve{d}_{\alpha, i t}^{\prime} B_{\alpha}^{\prime}=\Phi(1)^{2} \frac{1}{N} \sum_{i=1}^{N}\left(\bar{x}_{i .}-\bar{x}_{. .}\right)\left(\bar{x}_{i .}-\bar{x}_{. .}\right)^{\prime}=O_{P}(1) .
$$

This result, in conjunction with Assumption A.1(iv)-(v) and Lemma A.5(i), implies that

$$
\begin{aligned}
& L_{2 N T, 21} \leq\left\|B_{\alpha} \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \breve{d}_{\alpha, i t} \breve{d}_{\alpha, i t}^{\prime} B_{\alpha}^{\prime}\right\|\left\|\left(\frac{1}{N T} X^{\prime} M_{D_{\alpha}} X\right)^{-1}\right\|^{2}\left\|\frac{1}{N T} X^{\prime} U\right\|^{2}=O_{P}\left((N T)^{-1}\right), \\
& L_{2 N T, 23} \leq\left\|B_{\alpha} \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \breve{d}_{\alpha, i t} \breve{d}_{\alpha, i t}^{\prime} B_{\alpha}^{\prime}\right\|\left\|\left(\frac{1}{N T} X^{\prime} M_{D_{\alpha}} X\right)^{-1}\right\|^{2}\left\|\frac{1}{N T} B_{\alpha} D_{\alpha}^{\prime} U\right\|^{2}=O_{P}\left(T^{-2}+(N T)^{-1}\right) .
\end{aligned}
$$

Noting that $\breve{d}_{\alpha, i t}^{\prime}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} U=\Phi(1)\left(\bar{u}_{i .}-\bar{u} ..\right)$, we have

$$
\begin{aligned}
L_{2 N T, 22} & =U^{\prime} D_{\alpha}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} \frac{1}{N} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \breve{d}_{\alpha, i t} \breve{d}_{\alpha, i t}^{\prime}\left(D_{\alpha}^{\prime} D_{\alpha}\right)^{-1} D_{\alpha}^{\prime} U=\Phi(1)^{2} \frac{1}{N} \sum_{i=1}^{N}\left(\bar{u}_{i .}-\bar{u}_{. .}\right)^{2} \\
& =\Phi(1)^{2} \frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i .}^{2}+O_{P}\left((N T)^{-1}\right) .
\end{aligned}
$$

Analogously, we can show that $L_{2 N T, 2 j}=O_{P}\left(T^{-2}+(N T)^{-1}\right)$ for $j=4,5,6$ and $L_{2 N T, 3}=O_{P}\left(T^{-2}+\right.$ $\left.(N T)^{-1}\right)$. It follows that $L_{2 N T}=\Phi(1)^{2} \frac{1}{N} \sum_{i=1}^{N} \bar{u}_{i .}^{2}+O_{P}\left((N T)^{-1}+T^{-2}\right)$.
(iii) The proof is analogous to that of (ii) with the major difference as outlined in the proof of Lemma A.8(iii).
(iv) The proof is a combination of (ii) and (iii) as in that of Lemma A.5(iv) and thus omitted.

## C Verification of Some Assumptions

In this section, we verify Assumptions A.2(iii)-(iv) and A.4-A. 5 based on some primitive conditions.

## C. 1 Verification of the rate conditions in Assumption A.2(iii)-(iv)

In this subsection, we verify the rate conditions in Assumption A.2(iii)-(iv). Recall that we use $C$ to denote a generic positive constant whose value can change across lines. Let $x_{i t}^{*}=x_{i t}-E\left(x_{i t}\right)$. To verify the rate conditions in Assumption A.2(iii)-(iv), we add the following assumptions.
Assumption A.2* (i) $\max _{1 \leq i \leq N} E\left\|\frac{1}{T} \sum_{t=1}^{T} \sum_{s=1}^{T} x_{i t}^{*} u_{i s}\right\|^{2} \leq C$;
(ii) $\max _{1 \leq t \leq T} E\left\|\frac{1}{N} \sum_{i=1}^{N} \sum_{j=1}^{N} x_{i t}^{*} u_{j t}\right\|^{2} \leq C$;
(iii) $\frac{1}{N T} \sum_{i=1}^{N} \sum_{j=1}^{N} \sum_{t=1}^{T} \sum_{s=1}^{T}\left|E\left(u_{i t} u_{j s}\right)\right| \leq C$.

The conditions of the above type are frequently assumed in the panel data literature to control weak serial and cross-section dependence; see, e.g., Bai and Ng (2002). Below we first show that Assumption A.2*, in conjunction with Assumption A.1(i)-(ii), is sufficient for Assumptions A.2(iii)-(iv), and then give more primitive conditions to ensure Assumption A. $2^{*}$ (i). Similar primitive conditions can ensure Assumption A. $2^{*}$ (ii) by relying upon some mixing conditions in random field to handle weak cross-sectional dependence.

First, we verify Assumption A.2(iii): $\frac{1}{N} \sum_{i=1}^{N} \bar{x}_{i} \cdot \bar{u}_{i} \cdot=O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right)$. Let $\bar{x}_{i \cdot}^{*}=\bar{x}_{i} \cdot-E\left(\bar{x}_{i}.\right)$. Then

$$
\frac{1}{N} \sum_{i=1}^{N} \bar{x}_{i} \cdot \bar{u}_{i} .=\frac{1}{N} \sum_{i=1}^{N} E\left(\bar{x}_{i \cdot}\right) \bar{u}_{i} \cdot+\frac{1}{N} \sum_{i=1}^{N} \bar{x}_{i}^{*} \cdot \bar{u}_{i} . \equiv A_{1}+A_{2}, \text { say. }
$$

For $A_{1}$, we have $A_{1}=\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} E\left(\bar{x}_{i}.\right) u_{i t}$. Note that $E\left(A_{1}\right)=0$ and

$$
\begin{aligned}
E\left\|A_{1}\right\|^{2} & =\frac{1}{N^{2} T^{2}} \sum_{i=1}^{N} \sum_{j=1}^{N} \sum_{t=1}^{T} \sum_{s=1}^{T} E\left(\bar{x}_{i .} .\right)^{\prime} E\left(\bar{x}_{j} .\right) E\left(u_{i t} u_{j s}\right) \\
& \leq \frac{C}{N^{2} T^{2}} \sum_{i=1}^{N} \sum_{j=1}^{N} \sum_{t=1}^{T} \sum_{s=1}^{T}\left|E\left(u_{i t} u_{j s}\right)\right|=O\left((N T)^{-1}\right)
\end{aligned}
$$

where the last equality follows from Assumption A. $2^{*}$ (iii). Then $A_{1}=O_{P}\left((N T)^{-1 / 2}\right)$ by Chebyshev inequality. For $A_{2}$, we apply the Jensen inequality and Assumption A. $2^{*}$ (i) to obtain

$$
E\left[\left\|A_{2}\right\|^{2}\right]=E\left[\left(\frac{1}{N} \sum_{i=1}^{N} \frac{1}{T^{2}} \sum_{t=1}^{T} \sum_{s=1}^{T} x_{i t}^{*} u_{i s}\right)^{2}\right] \leq \frac{1}{N} \sum_{i=1}^{N} E\left[\left(\frac{1}{T^{2}} \sum_{t=1}^{T} \sum_{s=1}^{T} x_{i t}^{*} u_{i s}\right)^{2}\right] \leq \frac{C}{T^{2}}
$$

It follows that $A_{2}=O_{P}\left(T^{-1}\right)$ by Chebyshev inequality. In sum, we have shown $\frac{1}{N} \sum_{i=1}^{N} \bar{x}_{i} \cdot \bar{u}_{i}$. $=$ $O_{P}\left(T^{-1}+(N T)^{-1 / 2}\right)$.

Next, we verify Assumption A.2(iv): $\frac{1}{T} \sum_{t=1}^{T} \bar{x}_{t} \cdot \bar{u}_{t} \cdot=O_{P}\left(N^{-1}+(N T)^{-1 / 2}\right)$. Let $\bar{x}_{\cdot t}^{*}=\bar{x}_{\cdot t}-E\left(\bar{x}_{\cdot t}\right)$. Then

$$
\frac{1}{T} \sum_{t=1}^{T} \bar{x}_{t} \cdot \bar{u}_{t}=\frac{1}{T} \sum_{t=1}^{T} E\left(\bar{x}_{\cdot t}\right) \bar{u}_{\cdot t}+\frac{1}{T} \sum_{t=1}^{T} \bar{x}_{\cdot t}^{*} \bar{u}_{\cdot t} \equiv A_{3}+A_{4}, \text { say. }
$$

For $A_{3}$, we have $A_{3}=\frac{1}{N T} \sum_{i=1}^{N} \sum_{t=1}^{T} E\left(\bar{x}_{\cdot}\right) u_{i t}$. Note that $E\left(A_{3}\right)=0$ and

$$
\begin{aligned}
E\left(\left\|A_{3}\right\|^{2}\right) & \leq \frac{1}{N^{2} T^{2}} \sum_{i=1}^{N} \sum_{j=1}^{N} \sum_{t=1}^{T} \sum_{s=1}^{T} E\left(\bar{x}_{\cdot t}\right)^{\prime} E\left(\bar{x}_{\cdot s}\right) E\left(u_{i t} u_{j s}\right) \\
& \leq \frac{C}{N^{2} T^{2}} \sum_{i=1}^{N} \sum_{j=1}^{N} \sum_{t=1}^{T} \sum_{s=1}^{T}\left|E\left(u_{i t} u_{j s}\right)\right|=O\left((N T)^{-1}\right) \text { by Assumption A.2*(iii). }
\end{aligned}
$$

Hence $A_{3}=O_{P}\left((N T)^{-1 / 2}\right)$ by Chebyshev inequality. For $A_{4}$, we have by Jensen inequality and Assumption A.2*(ii)

$$
E\left[\left\|A_{4}\right\|^{2}\right]=E\left(\frac{1}{T} \sum_{t=1}^{T} \frac{1}{N^{2}} \sum_{i=1}^{N} \sum_{j=1}^{N} x_{i t}^{*} u_{j t}\right) \leq \frac{1}{T} \sum_{t=1}^{T} E\left(\frac{1}{N^{2}} \sum_{i=1}^{N} \sum_{j=1}^{N} x_{i t}^{*} u_{j t}\right)^{2} \leq \frac{C}{N^{2}}
$$

It follows that $A_{4}=O_{P}\left(N^{-1}\right)$ by Chebyshev inequality. In sum, we have that $\frac{1}{T} \sum_{t=1}^{T} \bar{x}_{t} \cdot \bar{u}_{t}$. $=$ $O_{P}\left(N^{-1}+(N T)^{-1 / 2}\right)$.

Now, we provide a set of sufficient primitive conditions for Assumption A.2*(i).

Assumption A.2 ${ }^{*}$ (i.a) $\max _{i, t} E\left\|x_{i t}\right\|^{4(1+\delta)}<C$ and $\max _{i, t} E\left|u_{i t}\right|^{4(1+\delta)}<\infty$ for some $\delta>0$;
(i.b) For each $i=1, \ldots, N,\left\{\left(x_{i t}, u_{i t}\right), t \geq 1\right\}$ is a strong stationary strong mixing process with mixing coefficients $\alpha_{i}(\cdot)$ such that $\max _{i} \sum_{\tau=1}^{T} \tau^{2} \alpha_{i}(\tau)^{\delta /(1+\delta)}<C$ for some $C<\infty$.

Assumption A.2*(i.a) strengthens the moment conditions in Assumption A.1(i)-(ii) slightly for the application of Davydov inequality. Assumption A. $2^{*}(\mathrm{i} . \mathrm{b})$ requires that $\left\{\left(x_{i t}, u_{i t}\right), t \geq 1\right\}$ be strong mixing. This condition is a standard condition assumed for dynamic panels when the individual effect is assumed to be fixed. For example, for a dynamic panel autoregressive process of order one $(\operatorname{PAR}(1))$, it is strong mixing with the mixing coefficient $\alpha_{i}(\tau)$ decaying to zero at a rate proportional to $|\rho|^{\tau}$ as long as the autoregressive coefficient $\rho$ is strictly less than 1 in absolute value. In this case, Assumption A. $2^{*}(\mathrm{i} . \mathrm{b})$ is automatically satisfied for all $\rho \in(-1,1)$. If the individual effect is random, then we can replace the strong mixing condition by the corresponding conditional mixing condition: $\left\{\left(x_{i t}, u_{i t}\right), t \geq 1\right\}$ is conditionally strong mixing with mixing coefficients $\alpha_{i}(\cdot)$ given the individual effect. See Prakasa Rao (2009) for the definition of conditional strong mixing, and Hahn and Kuersteiner (2011) and Su and Chen (2013) for the applications of conditional strong mixing in dynamic panels.

We now show that Assumption A. $2^{*}(\mathrm{i} . \mathrm{a})$-(i.b) is sufficient for Assumption A. $2^{*}(\mathrm{i})$. By CauchySchwarz inequality,

$$
\max _{i} E\left\|\frac{1}{T} \sum_{t=1}^{T} \sum_{s=1}^{T} x_{i t}^{*} u_{i s}\right\|^{2} \leq 2 \max _{i} E\left\|\frac{1}{T} \sum_{t=1}^{T} x_{i t}^{*} u_{i t}\right\|^{2}+2 \max _{i} E\left\|\frac{1}{T} \sum_{1 \leq t \neq s \leq T} x_{i t}^{*} u_{i s}\right\|^{2}
$$

It is easy to see that under Assumption A1(i)-(ii), the first term on the right hand side of the above equation is bounded from the above by

$$
\max _{i} \frac{2}{T} \sum_{t=1}^{T} E\left\|x_{i t}^{*} u_{i t}\right\|^{2} \leq 2 \max _{i, t} E\left\|x_{i t}^{*} u_{i t}\right\|^{2} \leq C
$$

For the second term, by straightforward moment calculations for second-order degenerate U-statitics (see, e.g., Lemma A.2(ii) in Gao (2007, p.194)), we have $2 \max _{i} E\left\|\frac{1}{T} \sum_{1 \leq t \neq s \leq T} x_{i t}^{*} u_{i s}\right\|^{2} \leq C$ under Assumption A.2*(i.a)-(i.b). Consequently, $\max _{i} E\left\|\frac{1}{T} \sum_{t=1}^{T} \sum_{s=1}^{T} x_{i t}^{*} u_{i s}\right\|^{2} \leq C$ for some $C<\infty$.

## C. 2 Verification of Assumptions A. 4 and A. 5

In this subsection, we verify the conditions in Assumption A.4(ii)-(iv) and A.5(i)-(iv) under some primitive conditions when $\left\{u_{i t}, t \geq 1\right\}$ is a generic stationary and invertible ARMA process. For simplicity, we focus on the case where $u_{i t}$ 's are independent along the cross-section dimension.

The invertibility of the ARMA process implies that we can write $\left\{u_{i t}, t \geq 1\right\}$ as an AR $(\infty)$ process and approximate it by an $\operatorname{AR}(p)$ process for sufficiently large $p$ :

$$
\begin{aligned}
u_{i t} & =\sum_{j=1}^{\infty} \rho_{j} u_{i, t-j}+e_{i t}=\left(\sum_{j=1}^{p} \rho_{j} u_{i, t-j}\right)+\left(\sum_{j=p+1}^{\infty} \rho_{j} u_{i, t-j}+e_{i t}\right) \\
& =\boldsymbol{\rho}^{\prime} \underline{u}_{i, t-1}+v_{i t}
\end{aligned}
$$

where $\boldsymbol{\rho}=\left(\rho_{1}, \ldots, \rho_{p}\right)^{\prime}, \underline{u}_{i, t-1}=\left(u_{i, t-1}, \ldots, u_{i, t-p}\right)^{\prime}, v_{i t}=v_{i t, p}+e_{i t}, v_{i t, p}=\sum_{j=p+1}^{\infty} \rho_{j} u_{i, t-j}$ signifies the approximation error, and $e_{i t}$ is the error term with mean zero and variance $\sigma_{i, e}^{2}$. Note that $v_{i t, p}=0$ if $\left\{u_{i t}, t \geq 1\right\}$ is an autoregressive process of order $p$ or less. Let $e_{t}=\left(e_{1 t}, \ldots, e_{N t}\right)^{\prime}$ and $x_{t}=\left(x_{1 t}, \ldots, x_{N t}\right)^{\prime}$. Let $\kappa_{i}\left(0, s_{1}, \ldots, s_{a-1}\right)$ denote the $a$ th order joint cumulant of $\left(e_{i 0}, e_{i s_{1} \ldots} \ldots, e_{i s_{a-1}}\right)$ where $s_{1}, \ldots, s_{a-1}$, and $a$ are integers. Let $\Phi(\cdot)$ be defined as in Section 2.3.
Assumption A.4* (i) $\sum_{j=1}^{\infty} \rho_{j} z^{j} \neq 0$ for any complex number $z$ with $|z| \leq 1, \sum_{j=1}^{\infty}\left|\rho_{j}\right|<\infty$, $p^{3 / 2}\left(N^{-1}+T^{-1}\right)=o(1)$, and $(N T)^{1 / 2} \sum_{j=p+1}^{\infty}\left|\rho_{j}\right|=O(1)$.
(ii) For each $i,\left\{e_{i t}, t \geq 1\right\}$ is strictly stationary and ergodic such that $E\left(e_{i t} \mid \mathcal{F}_{t-1}\right)=0$ where $\mathcal{F}_{t-1}=\sigma\left(e_{t-1}, e_{t-2}, \ldots, x_{t}, x_{t-1} \ldots\right)$ is the $\sigma$-field generated by $\left\{e_{t-1}, e_{t-2}, \ldots, x_{t}, x_{t-1} \ldots\right\}, E\left(e_{i t}^{2}\right)=\sigma_{i, e}^{2}$, and $\max _{i} \sum_{s_{1}=-\infty}^{\infty} \cdots \sum_{s_{a-1}=-\infty}^{\infty} \kappa_{i}\left(0, s_{1}, \ldots, s_{a-1}\right)<C$ for $a=2,3,4 ;\left\{x_{i t}, e_{i t}, \alpha_{i}\right\}$ are independent along the individual dimension; $\frac{1}{N} \sum_{i=1}^{N} \sigma_{i, e}^{2} \rightarrow \bar{\sigma}_{e}^{2}$ as $N \rightarrow \infty$.
(iii) $E\left(e_{i t} \alpha_{i}\right)=0, E\left(e_{i t} \mid e_{t-1}, e_{t-2}, \ldots, \lambda_{t}, \lambda_{t-1}, \ldots\right)=0, E\left(\alpha_{i}^{4}\right) \leq C$, and $E\left(\lambda_{t}^{4}\right) \leq C$.

Assumption A.4*(i) is similar to Assumption A.4(i) except that now we do not impose any condition on $\lambda_{\text {min }}\left(\Gamma_{p}\right)$ but require $(N T)^{1 / 2} \sum_{j=p+1}^{\infty}\left|\rho_{j}\right|=O(1)$. Following Lee, Okui and Shintani (2018, LOS hereafter), we can easily show that the condition on $\lambda_{\min }\left(\Gamma_{p}\right)$ is satisfied under Assumption A. $4^{*}$ (i)-(ii). The condition $(N T)^{1 / 2} \sum_{j=p+1}^{\infty}\left|\rho_{j}\right|=O(1)$ is weaker than the requirement that $(N T)^{1 / 2} \sum_{j=p+1}^{\infty}\left|\rho_{j}\right|=o(1)$ in LOS because we do not consider bias correction in our setup. Assumption A. $4^{*}$ (ii) imposes that $e_{i t}$ 's are independent along the individual dimension and a martingale difference sequence (m.d.s.) along the time dimension. The independence assumption can be relaxed to allow for certain weak form cross-sectional dependence at more lengthy arguments. The m.d.s. sequence is also assumed in Gonçalves and Kilian (2007) in the time series setup and it is weaker than the i.i.d. requirement in Lewis and Reinsel (1985) and LOS. Note that Assumption A.4*(ii) implies that $\left\{u_{i t}, t \geq 1\right\}$ is a stationary process for each $i$, and can be represented by an infinite order moving average $(\mathrm{MA}(\infty))$ process, and the approximation error $v_{i t, p}=\sum_{j=p+1}^{\infty} \rho_{j} u_{i, t-j}$ is well behaved in the sense of mean square errors. Assumption A.4*(iii) is used to verify A.4(iv).

First, we verify Assumption A.4(ii). Assumption A.4*(i)-(ii) ensures that $\left\{u_{i t}\right\}$ has mean zero and finite fourth moment and $E\left(v_{i t}\right)=\sum_{j=p+1}^{\infty} \rho_{j} E\left(u_{i, t-j}\right)+E\left(e_{i t}\right)=0$. Let $c_{\rho}=\sum_{j=p+1}^{\infty}\left|\rho_{j}\right|$. Then $v_{i t, p}=0$ if $c_{\rho}=0$. Without loss of generality, we assume that $c_{\rho}>0$. Note that Assumption A. $4^{*}$ (i) implies that $c_{\rho}=O\left((N T)^{-1 / 2}\right)=o(1)$ and $\sum_{j=p+1}^{\infty}\left|\rho_{j}\right|^{4} \leq \max _{j \geq p+1}\left|\rho_{j}\right|^{3} c_{\rho} \leq c_{\rho}^{4}=o(1)$. Then by Jensen inequality

$$
\begin{aligned}
\max _{i, t} E\left(v_{i t, p}^{4}\right) & =\max _{i, t} E\left(\sum_{j=p+1}^{\infty} \rho_{j} u_{i, t-j}\right)^{4} \leq c_{\rho}^{4} \max _{i, t} E\left(\frac{1}{c_{\rho}} \sum_{j=p+1}^{\infty}\left|\rho_{j}\right|\left|u_{i, t-j}\right|\right)^{4} \\
& \leq c_{\rho}^{3} \max _{i, t} \sum_{j=p+1}^{\infty}\left|\rho_{j}\right|^{4} E\left(u_{i, t-j}^{4}\right) \leq C c_{\rho}^{3} \sum_{j=p+1}^{\infty}\left|\rho_{j}\right|^{4}=o(1)
\end{aligned}
$$

It follows that $\max _{i, t} E\left(v_{i t}^{4}\right) \leq 8 \max _{i, t} E\left(v_{i t, p}^{4}\right)+8 \max _{i, t} E\left(e_{i t}^{4}\right) \leq C<\infty$. In addition, by the law of large numbers, we have $\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} e_{i t}^{2}=\bar{\sigma}_{e}^{2}+o_{P}(1)$, where $\bar{\sigma}_{e}^{2}=\lim _{N \rightarrow \infty} \frac{1}{N} \sum_{i=1}^{N} \sigma_{i, e}^{2}$. So in this case, $\bar{\sigma}_{v}^{2}=\bar{\sigma}_{e}^{2}$.

Next, we verify Assumption A.4(iii) for $\zeta_{i t}=\breve{x}_{i t}$ as the case for $\zeta_{i t}=1$ is easier. Noting that $\breve{x}_{i t}=x_{i t}-\underline{x}_{i, t-1} \rho$, we have

$$
\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \breve{x}_{i t} v_{i t}=\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \breve{x}_{i t} v_{i t, p}+\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \breve{x}_{i t} e_{i t} \equiv b_{1,1}+b_{1,2}, \text { say. }
$$

Note that

$$
\begin{aligned}
E\left\|b_{1,1}\right\| & \leq \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} E\left\|\breve{x}_{i t} v_{i t, p}\right\| \leq \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}\left\{E\left\|\breve{x}_{i t}\right\|^{2}\right\}^{1 / 2}\left\{E\left\|v_{i t, p}^{2}\right\|\right\}^{1 / 2} \\
& \leq C \sum_{j=p+1}^{\infty}\left|\rho_{j}\right|=O\left((N T)^{-1 / 2}\right)
\end{aligned}
$$

where we use the fact that

$$
\begin{aligned}
\max _{i, t} E\left\|\breve{x}_{i t}\right\|^{2} & =2 \max _{i, t} E\left\|x_{i t}\right\|^{2}+2 \max _{i, t} E\left\|\underline{x}_{i, t-1} \rho\right\|^{2} \\
& \leq 2 \max _{i, t} E\left\|x_{i t}\right\|^{2}+2 \max _{i, t} \sum_{j=1}^{p} \sum_{j_{1}=1}^{p} \rho_{j} \rho_{j_{1}} E\left(x_{i, t-j}^{\prime} x_{i, t-j_{1}}\right) \\
& \leq 2 \max _{i, t} E\left\|x_{i t}\right\|^{2}\left\{1+\left(\sum_{j=1}^{\infty}\left|\rho_{j}\right|\right)^{2}\right\} \leq C<\infty
\end{aligned}
$$

and that by Assumption A. $4^{*}(\mathrm{i})$,

$$
\max _{i, t} E\left(v_{i t, p}^{2}\right)=\max _{i, t} \sum_{j=p+1}^{\infty} \sum_{j^{\prime}=p+1}^{\infty} \rho_{j} \rho_{j^{\prime}} E\left(u_{i, t-j} u_{i, t-j^{\prime}}\right) \leq C\left(\sum_{j=p+1}^{\infty}\left|\rho_{j}\right|\right)^{2}=O\left((N T)^{-1}\right)
$$

It follows that $b_{1,1}=O_{P}\left((N T)^{-1 / 2}\right)$ by Markov inequality. For $b_{1,2}$, we have $E\left(b_{1,2}\right)=0$ and for any nonrandom vector $\omega \in \mathbb{R}^{k}$ with $\|\omega\|=1$,

$$
\begin{aligned}
\operatorname{Var}\left(\omega^{\prime} b_{1,2}\right) & =\frac{1}{\left(N T_{p}\right)^{2}} \omega^{\prime} \sum_{i=1}^{N} \operatorname{Var}\left(\sum_{t=p+1}^{T} \breve{x}_{i t} e_{i t}\right) \omega=\frac{1}{\left(N T_{p}\right)^{2}} \omega^{\prime} \sum_{i=1}^{N} \sum_{t=p+1}^{T} \sum_{s=p+1}^{T} E\left(\breve{x}_{i t} \breve{x}_{i s}^{\prime} e_{i t} e_{i s}\right) \omega \\
& =\frac{1}{\left(N T_{p}\right)^{2}} \omega^{\prime} \sum_{i=1}^{N} \sum_{t=p+1}^{T} E\left(\breve{x}_{i t} \breve{x}_{i t}^{\prime} e_{i t}^{2}\right) \omega=O\left(\left(N T_{p}\right)^{-1}\right)
\end{aligned}
$$

Then $b_{1,2}=O_{P}\left((N T)^{-1 / 2}\right)$ by Chebyshev inequality. Consequently, we have shown that $\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}$ $\breve{x}_{i t} v_{i t}=O_{P}\left((N T)^{-1 / 2}\right)$. Analogously, we can verify the last condition in A.4(iii).

Next, we verify Assumption A.4(iv). Note that

$$
\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t} \alpha_{i}=\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t, p} \alpha_{i}+\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} e_{i t} \alpha_{i} \equiv b_{2,1}+b_{2,2}
$$

By Assumption A.4*(iii), we have $E\left(b_{2,2}\right)=0$ and $\operatorname{Var}\left(b_{22}\right)=\frac{1}{\left(N T_{p}\right)^{2}} \sum_{i=1}^{N} E\left(\sum_{t=p+1}^{T} e_{i t} \alpha_{i}\right)^{2}=$ $O\left(N^{-1}\right)$. So $b_{2,2}=o_{P}(1) . b_{2,1}=o_{P}(1)$ by Markov inequality and the fact that

$$
E\left|b_{2,1}\right| \leq \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} E\left|v_{i t, p} \alpha_{i}\right| \leq \frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T}\left\{E\left(\alpha_{i}^{2}\right) E\left(v_{i t, p}^{2}\right)\right\}^{1 / 2} \leq C \sum_{j=p+1}^{\infty}\left|\rho_{j}\right|=o(1) .
$$

Similarly, we have

$$
\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t}\left[\Phi(L) \lambda_{t}\right]=\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} v_{i t, p}\left[\Phi(L) \lambda_{t}\right]+\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} e_{i t}\left[\Phi(L) \lambda_{t}\right] \equiv b_{3,1}+b_{3,2} .
$$

Following the analysis of $b_{2,1}$, we can readily show that $b_{3,1}=o_{P}(1)$ by Markov inequality. For $b_{3,2}$, we have $E\left(b_{3,2}\right)=0$ and

$$
\operatorname{Var}\left(b_{3,2}\right)=\frac{1}{N^{2} T_{p}^{2}} \sum_{i=1}^{N} \sum_{i_{1}=1}^{N} \sum_{t=p+1}^{T} E\left(e_{i t} e_{i_{1} t}\left[\Phi(L) \lambda_{t}\right]^{2}\right)=O\left(T^{-1}\right) .
$$

So $b_{3,2}=o_{P}(1)$.
Next, we verify that Assumption A.5(i) is satisfied with $\bar{\sigma}_{v, 1}^{2}=\bar{\sigma}_{e}^{2}$. Noting that $\bar{v}_{i} .=\frac{1}{T_{p}} \sum_{t=p+1}^{T}\left(v_{i t, p}\right.$ $\left.+e_{i t}\right)=\bar{v}_{i, p}+\bar{e}_{i}$. with $\bar{v}_{i, p}=\frac{1}{T_{p}} \sum_{t=p+1}^{T} v_{i t, p}$ and $\bar{e}_{i} .=\frac{1}{T_{p}} \sum_{t=p+1}^{T} e_{i t}$, we have

$$
\frac{T_{p}}{N} \sum_{i=1}^{N}\left(\bar{v}_{i .}\right)^{2}=\frac{T_{p}}{N} \sum_{i=1}^{N}\left(\bar{v}_{i, p}\right)^{2}+\frac{T_{p}}{N} \sum_{i=1}^{N} \bar{e}_{i .}^{2}+\frac{2 T_{p}}{N} \sum_{i=1}^{N} \bar{v}_{i, p} \bar{e}_{i .} \equiv a_{1,1}+a_{1,2}+a_{1,3}, \text { say. }
$$

$a_{1,1}=o_{P}(1)$ by Markov inequality and the fact that

$$
\begin{aligned}
E\left(a_{1,1}\right) & =\frac{T_{p}}{N} \sum_{i=1}^{N} E\left(\frac{1}{T_{p}} \sum_{t=p+1}^{T} v_{i t, p}\right)^{2} \leq \frac{1}{N} \sum_{i=1}^{N} \sum_{t=p+1}^{T} E\left(v_{i t, p}^{2}\right) \leq T \max _{i, t} E\left(v_{i t, p}^{2}\right) \\
& \leq C\left(\sqrt{T} \sum_{j=p+1}^{\infty}\left|\rho_{j}\right|\right)^{2}=o(1)
\end{aligned}
$$

By Assumption A. $4^{*}(\mathrm{ii}), E\left(a_{1,2}\right)=\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} E\left(e_{i t}^{2}\right)=\frac{1}{N T_{p}} \sum_{i=1}^{N} \sigma_{i, e}^{2}=\bar{\sigma}_{e}^{2}+o(1)$ and

$$
\operatorname{Var}\left(a_{1,2}\right)=\frac{T_{p}}{N^{2}} \operatorname{Var}\left\{\sum_{i=1}^{N}\left(\frac{1}{T_{p}} \sum_{t=p+1}^{T} e_{i t}\right)^{2}\right\}=\frac{1}{N^{2} T_{p}} \sum_{i=1}^{N} \operatorname{Var}\left\{\left(\sum_{t=p+1}^{T} e_{i t}\right)^{2}\right\}=O\left(N^{-1}\right) .
$$

It follows that $a_{1,2}=\bar{\sigma}_{e}^{2}+o_{P}(1)$. By the Cauchy-Schwarz inequality, $a_{1,3} \leq 2\left(a_{1,1} a_{1,2}\right)^{1 / 2}=o_{P}(1)$. Then $\frac{T_{p}}{N} \sum_{i=1}^{N}\left(\bar{v}_{i} .\right)^{2}=\bar{\sigma}_{e}^{2}+o_{P}(1)$.

Next, we verify that Assumption A.5(ii) is satisfied with $\bar{\sigma}_{v, 2}^{2}=\bar{\sigma}_{e}^{2}$. Noting that $\bar{v}_{\cdot t}=\frac{1}{N} \sum_{i=1}^{N}\left(v_{i t, p}\right.$ $\left.+e_{i t}\right)=\bar{v}_{\cdot t, p}+\bar{e}_{. t}$ with $\bar{v}_{\cdot t, p}=\frac{1}{N} \sum_{i=1}^{N} v_{i t, p}$ and $\bar{e}_{\cdot t}=\frac{1}{N} \sum_{i=1}^{N} e_{i t}$, we have

$$
\frac{N}{T_{p}} \sum_{t=p+1}^{T}\left(\bar{v}_{\cdot t}\right)^{2}=\frac{N}{T_{p}} \sum_{t=p+1}^{T}\left(\bar{v}_{t, t p}\right)^{2}+\frac{N}{T_{p}} \sum_{t=p+1}^{T} \bar{e}_{t}^{2}+\frac{2 N}{T_{p}} \sum_{t=p+1}^{T} \bar{v}_{\cdot t, p} \bar{e}_{\cdot t} \equiv a_{2,1}+a_{2,2}+a_{2,3} \text {, say. }
$$

$a_{2,1}=o_{P}(1)$ by Markov inequality and the fact that

$$
\begin{aligned}
E\left(a_{2,1}\right) & =\frac{N}{T_{p}} \sum_{t=p+1}^{T} E\left(\frac{1}{N} \sum_{i=1}^{N} v_{i t, p}\right)^{2} \leq \frac{1}{T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} E\left(v_{i t, p}^{2}\right) \leq N \max _{i, t} E\left(v_{i t, p}^{2}\right) \\
& \leq C\left(\sqrt{N} \sum_{j=p+1}^{\infty}\left|\rho_{j}\right|\right)^{2}=o(1) .
\end{aligned}
$$

By Assumption A. $4^{*}(\mathrm{ii}), E\left(a_{2,2}\right)=\frac{1}{N T_{p}} \sum_{i=1}^{N} \sum_{t=p+1}^{T} E\left(e_{i t}^{2}\right)=\frac{1}{N T_{p}} \sum_{i=1}^{N} \sigma_{i, e}^{2}=\bar{\sigma}_{e}^{2}+o(1)$ and

$$
\operatorname{Var}\left(a_{2,2}\right)=\frac{N}{T_{p}^{2}} \operatorname{Var}\left\{\sum_{t=p+1}^{T}\left(\frac{1}{N} \sum_{i=1}^{N} e_{i t}\right)^{2}\right\}=\frac{1}{N T_{p}^{2}} \sum_{t=p+1}^{T} \operatorname{Var}\left\{\left(\sum_{i=1}^{N} e_{i t}\right)^{2}\right\}=O\left(T^{-1}\right) .
$$

It follows that $a_{2,2}=\bar{\sigma}_{e}^{2}+o_{P}(1)$. By Cauchy-Schwarz inequality, $a_{2,3} \leq 2\left(a_{2,1} a_{2,2}\right)^{1 / 2}=o_{P}(1)$. Then $\frac{N}{T_{p}} \sum_{t=p+1}^{T}\left(\bar{v}_{\cdot t}\right)^{2}=\bar{\sigma}_{e}^{2}+o_{P}(1)$.

To verify Assumption A.5(iii), note that

$$
\frac{1}{N} \sum_{i=1}^{N} \bar{x}_{i} \cdot \bar{v}_{i} .=\frac{1}{N T^{2}} \sum_{i=1}^{N} \sum_{t=1}^{T} \sum_{s=1}^{T} E\left(x_{i t}\right) v_{i s}+\frac{1}{N T^{2}} \sum_{i=1}^{N} \sum_{t=1}^{T} \sum_{s=1}^{T} x_{i t}^{*} v_{i s} \equiv a_{3,1}+a_{3,2} \text {, say. }
$$

For $a_{3,1}$, we have

$$
a_{3,1}=\frac{1}{N T^{2}} \sum_{i=1}^{N} \sum_{t=1}^{T} \sum_{s=1}^{T} E\left(x_{i t}\right) v_{i s, p}+\frac{1}{N T^{2}} \sum_{i=1}^{N} \sum_{t=1}^{T} \sum_{s=1}^{T} E\left(x_{i t}\right) e_{i s} \equiv a_{3,11}+a_{3,12} \text {, say. }
$$

Under Assumption A. $4^{*}(\mathrm{i})$-(ii), we can readily show that $a_{3,12}=O_{P}\left((N T)^{-1 / 2}\right)$ by Chebyshev inequality. For $a_{3,11}$, we have

$$
E\left|a_{3,1}\right| \leq \frac{1}{N T^{2}} \sum_{i=1}^{N} \sum_{t=1}^{T} \sum_{s=1}^{T}\left\|E\left(x_{i t}\right)\right\|\left|E\left(v_{i s, p}\right)\right| \leq C \max _{i, s}\left[E\left\|v_{i s, p}^{2}\right\|\right]^{1 / 2}=O\left((N T)^{-1 / 2}\right) .
$$

Then $a_{3,1}=O_{P}\left((N T)^{-1 / 2}\right)$. For $a_{3,2}$, we have

$$
a_{3,2}=\frac{1}{N T^{2}} \sum_{i=1}^{N} \sum_{t=1}^{T} \sum_{s=1}^{T} x_{i t}^{*} v_{i s, p}+\frac{1}{N T^{2}} \sum_{i=1}^{N} \sum_{t=1}^{T} \sum_{s=1}^{T} x_{i t}^{*} e_{i s} \equiv a_{3,21}+a_{3,22} \text {, say. }
$$

Following the verification of Assumption A.2(iii), we can readily show that $a_{3,22}=O_{P}\left(T^{-1}\right)$. For $a_{3,21}$, we have
$E\left\|a_{3,21}\right\| \leq \frac{1}{N T^{2}} \sum_{i=1}^{N} \sum_{t=1}^{T} \sum_{s=1}^{T}\left\|E\left(x_{i t}^{*} v_{i s, p}\right)\right\| \leq C \max _{i, s} \sum_{i=1}^{N} \sum_{t=1}^{T} \sum_{s=1}^{T}\left[E\left(v_{i s, p}^{2}\right)\right]^{1 / 2} \leq C \sum_{j=p+1}^{\infty}\left|\rho_{j}\right|=O\left((N T)^{-1 / 2}\right)$.
It follows that $a_{3,2}=O_{P}\left((N T)^{-1 / 2}+T^{-1}\right)$ and $\frac{1}{N} \sum_{i=1}^{N} \bar{x}_{i} \cdot \bar{v}_{i}=O_{P}\left((N T)^{-1 / 2}+T^{-1}\right)$.

To verify Assumption A.5(iv), note that

$$
\frac{1}{T_{p}} \bar{x}_{\mathrm{t}} \bar{v}_{. t}=\frac{1}{N^{2} T_{p}} \sum_{t=p+1}^{T} \sum_{i=1}^{N} \sum_{j=1}^{N} E\left(x_{i t}\right) v_{j t}+\frac{1}{N^{2} T_{p}} \sum_{t=p+1}^{T} \sum_{i=1}^{N} \sum_{j=1}^{N} x_{i t}^{*} v_{j t} \equiv a_{4,1}+a_{4,2}, \text { say. }
$$

For $a_{4,1}$, we have

$$
a_{4,1}=\frac{1}{N^{2} T_{p}} \sum_{t=p+1}^{T} \sum_{i=1}^{N} \sum_{j=1}^{N} E\left(x_{i t}\right) v_{j s, p}+\frac{1}{N^{2} T_{p}} \sum_{t=p+1}^{T} \sum_{i=1}^{N} \sum_{j=1}^{N} E\left(x_{i t}\right) e_{j t} \equiv a_{4,11}+a_{4,12} \text {, say. }
$$

Following the analysis of $a_{2,1}$, we can readily show that $a_{4,12}=O_{P}\left((N T)^{-1 / 2}\right)$ by Chebyshev inequality. For $a_{4,11}$, we have

$$
E\left|a_{4,1}\right| \leq \frac{1}{N^{2} T_{p}} \sum_{t=p+1}^{T} \sum_{i=1}^{N} \sum_{j=1}^{N}\left\|E\left(x_{i t}\right)\right\|\left|E\left(v_{j t, p}\right)\right| \leq C \max _{j, t}\left[E\left\|v_{j t, p}^{2}\right\|\right]^{1 / 2}=O\left((N T)^{-1 / 2}\right) .
$$

Then $a_{4,1}=O_{P}\left((N T)^{-1 / 2}\right)$. For $a_{4,2}$, we have

$$
a_{4,2}=\frac{1}{N^{2} T_{p}} \sum_{t=p+1}^{T} \sum_{i=1}^{N} \sum_{j=1}^{N} x_{i t}^{*} v_{j t, p}+\frac{1}{N^{2} T_{p}} \sum_{t=p+1}^{T} \sum_{i=1}^{N} \sum_{j=1}^{N} x_{i t}^{*} e_{j t} \equiv a_{4,21}+a_{4,22}, \text { say. }
$$

Following the verification of Assumption A.2(iv), we can readily show that $a_{4,22}=O_{P}\left(N^{-1}\right)$. For $a_{4,21}$, we have

$$
\begin{aligned}
E\left\|a_{4,21}\right\| & \leq \frac{1}{N^{2} T_{p}} \sum_{t=p+1}^{T} \sum_{i=1}^{N} \sum_{j=1}^{N} E\left(x_{i t}^{*} v_{j t, p}\right) \leq C \frac{1}{N^{2} T_{p}} \sum_{t=p+1}^{T} \sum_{i=1}^{N} \sum_{j=1}^{N}\left[E\left(v_{j t, p}^{2}\right)\right]^{1 / 2} \\
& \leq C \sum_{j=p+1}^{\infty}\left|\rho_{j}\right|=O\left((N T)^{-1 / 2}\right)
\end{aligned}
$$

It follows that $a_{4,2}=O_{P}\left((N T)^{-1 / 2}+T^{-1}\right)$ and $\frac{1}{T_{p}} \bar{x}_{t} \bar{v}_{\cdot t}=O_{P}\left((N T)^{-1 / 2}+N^{-1}\right)$.

## D Choice of $p$ in the Modified Jackknife

As discussed in Remark 11 in the main paper, there are several practical approaches to choose $p$ in the modified jackknife method.

First, we can use a "rule of thumb" and let $p$ increase with $T$, e.g., $p=\left\lfloor T^{1 / 4}\right\rfloor$, where $\left\lfloor T^{1 / 4}\right\rfloor$ is the nearest integer less than or equal to $T^{1 / 4}$.

Second, we can follow Lee, Okui, and Shintani (2018) by setting $p_{\max }=\left\lfloor T^{1 / 4}\right\rfloor$ and consider a general-to-specific testing procedure based on $t$-statistic until we reject the null. Specifically, we first run the following auxiliary regression using the pooled OLS

$$
\hat{u}_{i t}^{(4)}=\rho_{1} \hat{u}_{i, t-1}^{(4)}+\rho_{2} \hat{u}_{i, t-2}^{(4)}+\ldots+\rho_{p_{\max }} \hat{x}_{i, t-p_{\max }}^{(4)}+\tilde{v}_{i t}
$$

and test $\rho_{p_{\text {max }}}=0$ using t-statistics. If it is rejected, we conclude that $p=p_{\text {max }}$. If we fail to reject it, we eliminate the $p_{\max }$ th lag and run the regression with $p_{\max }-1$ lags, and test $\rho_{p_{\max }-1}=0$. We
continue this procedure until we reject the null. Note that here $\hat{u}_{i t}^{(4)}$,s are estimated. To take this into account, Wooldridge (2010, p. 311) argues that for the pooled OLS, we should use the fully robust standard errors (robust to both heteroskedasticity and serial correlation, see equation (7.26) in Wooldridge (2010, p. 171)). Another issue is that we need to choose the nominal level to decide whether to reject. In our simulations below, we choose the conventional $5 \%$ level.

Third, we can apply the information criteria, such as AIC and BIC, to the residuals obtained from Model $4\left(\hat{u}_{i t}^{(4)}\right)$ to determine $p$. For the implementation, see, e.g., Stock and Watson (2012, Section 14.5). In general, BIC gives a consistent estimator of $p$, and AIC tends to choose a relatively large $p$.

We conduct simulations to examine the finite sample performance of four methods above, labelled as rule of thumb, testing, AIC, and BIC, respectively. We consider three DGPs which are the same as those in Section 3.2 except that now the errors follow $\operatorname{AR}(1)$, $\operatorname{MA}(1)$ and $\operatorname{ARMA}(1,1)$ processes, respectively. Specifically, $u_{i t}$ is generated respectively as

$$
\begin{array}{ll}
\text { DGP D.1: } & u_{i t}=0.5 u_{i, t-1}+e_{i t}, \\
\text { DGP D.2: } & u_{i t}=e_{i t}+0.5 e_{i, t-1}, \text { and } \\
\text { DGP D.3: } & u_{i t}=0.75 u_{i, t-1}+e_{i t}+0.5 e_{i, t-1},
\end{array}
$$

where $e_{i t}$ is an $N(0,1)$ random variable.
Tables D1-D3 present the simulations results for DGPs D.1-D.3, respectively. For DGPs D. 1 and D. 2 with $\mathrm{AR}(1)$ and $\mathrm{MA}(1)$ errors respectively, both $\mathrm{CV}^{*}$ and $\mathrm{CV}^{* *}$ work well. For the ARMA errors, CV* works well when $T$ is large and outperforms $\mathrm{CV}^{* *}$ in general. This suggests that $\mathrm{CV}^{* *}$ which is based on the Cochrane-Orcutt procedure relies strongly on the $\operatorname{AR}(p)$ assumption more. Among the four methods of selecting $p$, there is no dominant one. When the sample size is large and $\mathrm{CV}^{*}$ is used, all four methods can select the true model with a high probability.

## E Additional Simulation Results

## E. 1 Static panel models

We consider the same DGPs as in Section 3.2 except that here $\rho=\frac{1}{4}$ or $\frac{1}{2}$. The results for $\rho=\frac{1}{4}$ and $\rho=\frac{1}{2}$ are reported Tables E1 and E2, respectively.

First, consider $\rho=\frac{1}{4}$, i.e., there is weak serial correlation in the error term. When $T$ is relatively large ( $T=10$ or $T=50$ ), our $\mathrm{CV}^{*}$ and $\mathrm{CV}^{* *}$ perform best overall, as suggested by our theory. Between CV* and CV**, it is not apparent which one dominates. For example, when the true model is Model 1, CV** outperforms CV*, but when the true model is Model 2, CV* outperforms CV**. When $T$ is small, CV** can perform poorly. CV also performs reasonably well, as our theory suggests that CV can consistently select the correct model when the serial correlation is weak ( $\rho<\frac{1}{3}$ for this DGP). When $T$ is small ( $T=5$ ), CV can even outperform $\mathrm{CV}^{*}$ and $\mathrm{CV}^{* *}$. The performance of AIC is slightly worse than that of CV. Both BIC (e.g., when the true model is Model 3 or 4) and $\mathrm{BIC}_{2}$ (e.g., when the true model is Model 3) perform poorly.

Second, consider $\rho=\frac{1}{2}$. The results are similar to those in the case of $\rho=\frac{3}{4}$ reported in the main text. In general, $\mathrm{CV}^{*}$ and $\mathrm{CV}^{* *}$ perform well when the sample size is large. The performance of CV , $\mathrm{AIC}, \mathrm{BIC}$ and $\mathrm{BIC}_{2}$ are all poor.

## E. 2 Dynamic panel models without exogenous regressors

We consider the same DGPs as in Section 3.3 except that here $\beta=\frac{1}{4}$ or $\frac{1}{2}$. The results for $\beta=\frac{1}{4}$ and $\beta=\frac{1}{2}$ are reported Tables E3 and E4, respectively. In general, the results are similar to the case of $\beta=\frac{3}{4}$ presented in the main text.

## E. 3 Dynamic panel models with exogenous regressors

We consider the same DGPs as in Section 3.4 except that here $\beta=\frac{1}{4}$ or $\frac{1}{2}$. The results for $\beta=\frac{1}{4}$ and $\beta=\frac{1}{2}$ are reported Tables E5 and E6, respectively. Again, in general, the results are similar to the case of $\beta=\frac{3}{4}$ presented in the main text.

Table D1: Frequency of the model selected with selected $p$ (DGP D.1: $u_{i t}=0.5 u_{i, t-1}+e_{i t}$ )

| Selection of lag $p$ | True M |  | Model 1 |  |  |  | Model 2 |  |  |  | Model 3 |  |  |  | Model 4 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| in CV* | Selected M |  | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 |
| and CV** |  | (N,T) |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | AIC | $(10,10)$ | . 21 | . 68 | . 01 | . 10 | . 01 | . 87 | 0 | . 12 | 0 | . 01 | . 18 | . 81 | 0 | . 02 | 0 | . 98 |
|  |  | $(50,10)$ | . 04 | . 87 | 0 | . 09 | 0 | . 91 | 0 | . 09 | 0 | 0 | . 03 | . 97 | 0 | 0 | 0 | 1 |
|  |  | $(10,50)$ | . 27 | . 72 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 22 | . 78 | 0 | 0 | 0 | 1 |
|  |  | $(50,50)$ | . 04 | . 96 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 03 | . 97 | 0 | 0 | 0 | 1 |
|  | BIC | $(10,10)$ | . 89 | . 11 | 0 | 0 | . 09 | . 91 | 0 | 0 | . 36 | . 04 | . 49 | . 10 | . 51 | . 12 | . 01 | . 36 |
|  |  | $(50,10)$ | 1 | 0 | 0 | 0 | . 20 | . 78 | . 02 | 0 | . 01 | 0 | 1 | 0 | . 43 | 0 | . 16 | . 42 |
|  |  | $(10,50)$ | . 98 | . 02 | 0 | 0 | 0 | 1 | 0 | 0 | . 39 | . 58 | . 03 | 0 | . 37 | . 62 | 0 | . 01 |
|  |  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
|  | $\mathrm{BIC}_{2}$ | $(10,10)$ | . 08 | . 67 | . 02 | . 23 | 0 | . 74 | 0 | . 25 | 0 | . 01 | . 09 | . 90 | 0 | . 01 | 0 | . 99 |
|  |  | $(50,10)$ | . 01 | . 87 | 0 | . 12 | 0 | . 88 | 0 | . 13 | 0 | 0 | . 01 | . 99 | 0 | 0 | 0 | 1 |
|  |  | $(10,50)$ | . 22 | . 77 | 0 | . 01 | 0 | . 99 | 0 | . 01 | 0 | 0 | . 18 | . 82 | 0 | 0 | 0 | 1 |
|  |  | $(50,50)$ | . 06 | . 94 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 04 | . 96 | 0 | 0 | 0 | 1 |
|  | CV | $(10,10)$ | . 25 | . 69 | . 01 | . 05 | . 01 | . 93 | 0 | . 06 | . 01 | . 02 | . 28 | . 69 | 0 | . 03 | . 01 | . 97 |
|  |  | $(50,10)$ | . 06 | . 88 | 0 | . 06 | 0 | . 94 | 0 | . 06 | 0 | 0 | . 06 | . 94 | 0 | 0 | 0 | 1 |
|  |  | $(10,50)$ | . 28 | . 72 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 29 | . 71 | 0 | 0 | 0 | 1 |
|  |  | $(50,50)$ | . 04 | . 96 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 05 | . 95 | 0 | 0 | 0 | 1 |
| $\begin{gathered} \text { rule } \\ \text { of } \\ \text { thumb } \\ \left\lfloor T^{1 / 4}\right\rfloor \end{gathered}$ | CV* | $(10,10)$ | . 58 | . 36 | . 03 | . 03 | . 03 | . 91 | 0 | . 06 | . 01 | . 01 | . 61 | . 37 | . 01 | . 01 | . 03 | . 95 |
|  |  | $(50,10)$ | . 69 | . 26 | . 03 | . 01 | 0 | . 95 | 0 | . 05 | 0 | 0 | . 74 | . 27 | 0 | 0 | 0 | 1 |
|  |  | $(10,50)$ | . 87 | . 13 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 87 | . 13 | 0 | 0 | 0 | 1 |
|  |  | $(50,50)$ | . 99 | . 01 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 99 | . 01 | 0 | 0 | 0 | 1 |
|  | CV** | $(10,10)$ | . 81 | . 14 | . 04 | . 01 | . 42 | . 51 | . 05 | . 02 | . 01 | . 01 | . 84 | . 14 | . 01 | . 01 | . 58 | . 40 |
|  |  | $(50,10)$ | . 95 | . 01 | . 05 | 0 | . 31 | . 44 | . 23 | . 02 | 0 | 0 | . 99 | . 01 | 0 | 0 | . 69 | . 31 |
|  |  | $(10,50)$ | . 93 | . 07 | 0 | 0 | . 01 | . 99 | 0 | 0 | 0 | 0 | . 95 | . 06 | 0 | 0 | . 09 | . 91 |
|  |  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| BIC | CV* | $(10,10)$ | . 25 | . 69 | . 01 | . 05 | . 01 | . 93 | 0 | . 06 | . 01 | . 02 | . 28 | . 69 | 0 | . 03 | . 01 | . 96 |
|  |  | $(50,10)$ | . 06 | . 88 | 0 | . 06 | 0 | . 94 | 0 | . 06 | 0 | 0 | . 06 | . 94 | 0 | 0 | 0 | 1 |
|  |  | $(10,50)$ | . 90 | . 10 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 90 | . 10 | 0 | 0 | 0 | 1 |
|  |  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
|  | CV** | $(10,10)$ | . 25 | . 69 | . 01 | . 05 | . 01 | . 93 | 0 | . 06 | . 01 | . 02 | . 28 | . 69 | 0 | . 03 | . 01 | . 96 |
|  |  | $(50,10)$ | . 06 | . 88 | 0 | . 06 | 0 | . 94 | 0 | . 06 | 0 | 0 | . 06 | . 94 | 0 | 0 | 0 | 1 |
|  |  | $(10,50)$ | . 95 | . 05 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 95 | . 05 | 0 | 0 | . 02 | . 98 |
|  |  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| AIC | CV* | $(10,10)$ | . 31 | . 63 | . 02 | . 05 | . 01 | . 92 | 0 | . 06 | . 01 | . 02 | . 34 | . 64 | . 01 | . 02 | . 01 | . 96 |
|  |  | $(50,10)$ | . 06 | . 88 | 0 | . 06 | 0 | . 94 | 0 | . 06 | 0 | 0 | . 06 | . 94 | 0 | 0 | 0 | 1 |
|  |  | $(10,50)$ | . 91 | . 09 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 90 | . 10 | 0 | 0 | 0 | 1 |
|  |  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
|  | CV** | $(10,10)$ | . 32 | . 62 | . 02 | . 05 | . 09 | . 84 | . 01 | . 06 | . 01 | . 02 | . 35 | . 63 | . 01 | . 02 | . 11 | . 87 |
|  |  | $(50,10)$ | . 06 | . 88 | 0 | . 06 | 0 | . 93 | 0 | . 06 | 0 | 0 | . 06 | . 94 | 0 | 0 | . 01 | . 99 |
|  |  | $(10,50)$ | . 95 | . 05 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 96 | . 04 | 0 | 0 | . 02 | . 98 |
|  |  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| Testing | CV* | $(10,10)$ | . 56 | . 38 | . 03 | . 03 | 03 | . 91 | 0 | . 06 | . 01 | 0 | . 58 | . 40 | . 01 | . 01 | 03 | . 95 |
|  |  | $(50,10)$ | . 69 | . 26 | . 03 | . 01 | 0 | . 95 | 0 | . 05 | 0 | 0 | . 74 | . 27 | 0 | 0 | 0 | 1 |
|  |  | $(10,50)$ | . 90 | 10 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 89 | . 11 | 0 | 0 | 0 | 1 |
|  |  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
|  | $\mathrm{CV}^{* *}$ | $(10,10)$ | . 74 | . 21 | . 04 | . 02 | . 40 | . 52 | . 05 | . 03 | . 01 | 0 | . 77 | . 22 | . 01 | . 01 | . 55 | . 43 |
|  |  | $(50,10)$ | . 95 | . 01 | . 05 | 0 | . 31 | . 44 | . 23 | . 02 | 0 | 0 | . 99 | . 01 | 0 | 0 | . 69 | . 31 |
|  |  | $(10,50)$ | . 94 | . 06 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 95 | . 05 | 0 | 0 | . 03 | . 97 |
|  |  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |

Table D2: Frequency of the model selected with selected $p$ (DGP D.2: $u_{i t}=e_{i t}+0.5 e_{i, t-1}$ )

| Selection of lag p | True M |  | Model 1 |  |  |  | Model 2 |  |  |  | Model 3 |  |  |  | Model 4 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| in $\mathrm{CV}^{*}$ | Sele | ted M | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 |
| and $\mathrm{CV}^{* *}$ |  | $(N, T)$ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | AIC | $(10,10)$ | . 55 | . 36 | . 04 | . 05 | . 01 | . 88 | 0 | . 11 | . 01 | . 01 | . 53 | . 45 | . 01 | . 01 | . 01 | . 97 |
|  |  | $(50,10)$ | . 59 | . 35 | . 02 | . 04 | 0 | . 92 | 0 | . 09 | 0 | 0 | . 58 | . 42 | 0 | 0 | 0 | 1 |
|  |  | $(10,50)$ | . 65 | . 35 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 57 | . 43 | 0 | 0 | 0 | 1 |
|  |  | $(50,50)$ | . 73 | . 27 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 70 | . 30 | 0 | 0 | 0 | 1 |
|  | BIC | $(10,10)$ | . 99 | . 01 | 0 | 0 | . 16 | . 84 | 0 | 0 | . 35 | . 01 | . 63 | . 01 | . 75 | . 05 | . 01 | . 19 |
|  |  | $(50,10)$ | 1 | 0 | 0 | 0 | . 46 | . 44 | . 11 | 0 | 0 | 0 | 1 | 0 | . 64 | 0 | . 29 | . 07 |
|  |  | $(10,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | . 49 | . 43 | . 08 | 0 | . 47 | . 53 | 0 | 0 |
|  |  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
|  | $\mathrm{BIC}_{2}$ | $(10,10)$ | . 29 | . 47 | . 06 | . 18 | 0 | . 74 | 0 | . 26 | 0 | 0 | . 31 | . 68 | 0 | 0 | 0 | 1 |
|  |  | $(50,10)$ | . 41 | . 49 | . 03 | . 07 | 0 | . 88 | 0 | . 12 | 0 | 0 | . 42 | . 58 | 0 | 0 | 0 | 1 |
|  |  | $(10,50)$ | . 57 | . 43 | 0 | 0 | 0 | . 99 | 0 | . 01 | 0 | 0 | . 49 | . 51 | 0 | 0 | 0 | 1 |
|  |  | $(50,50)$ | . 78 | . 22 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 75 | . 25 | 0 | 0 | 0 | 1 |
|  | CV | $(10,10)$ | . 62 | . 33 | . 03 | . 02 | . 01 | . 94 | 0 | . 05 | . 01 | . 01 | . 65 | . 33 | . 02 | . 03 | . 01 | . 94 |
|  |  | $(50,10)$ | . 68 | . 27 | . 03 | . 02 | 0 | . 94 | 0 | . 06 | 0 | 0 | . 72 | . 28 | 0 | 0 | 0 | 1 |
|  |  | $(10,50)$ | . 66 | . 34 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 66 | . 34 | 0 | 0 | 0 | 1 |
|  |  | $(50,50)$ | . 75 | . 25 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 75 | . 25 | 0 | 0 | 0 | 1 |
| $\begin{gathered} \text { rule } \\ \text { of } \\ \text { thumb } \\ \left\lfloor T^{1 / 4}\right\rfloor \end{gathered}$ | CV* | $(10,10)$ | . 82 | . 12 | . 04 | . 01 | . 04 | . 91 | 0 | . 05 | . 01 | 0 | . 86 | . 13 | . 02 | . 01 | . 04 | . 93 |
|  |  | $(50,10)$ | . 94 | . 01 | . 05 | 0 | 0 | . 94 | 0 | . 06 | 0 | 0 | . 99 | . 01 | 0 | 0 | 0 | 1 |
|  |  | $(10,50)$ | . 86 | . 14 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 87 | . 13 | 0 | 0 | 0 | 1 |
|  |  | $(50,50)$ | . 99 | . 01 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 99 | . 01 | 0 | 0 | 0 | 1 |
|  | CV** | $(10,10)$ | . 91 | . 04 | . 05 | 0 | . 46 | . 45 | . 07 | . 02 | . 01 | 0 | . 95 | . 04 | . 02 | . 01 | . 67 | . 31 |
|  |  | $(50,10)$ | . 94 | 0 | . 06 | 0 | . 33 | . 27 | . 39 | . 01 | 0 | 0 | 1 | 0 | 0 | 0 | . 84 | . 16 |
|  |  | $(10,50)$ | . 91 | . 09 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 91 | . 09 | 0 | 0 | 0 | 1 |
|  |  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| BIC | CV* | $(10,10)$ | . 62 | . 33 | . 03 | . 02 | . 01 | . 94 | 0 | . 05 | . 01 | . 01 | . 65 | . 33 | . 02 | . 03 | . 01 | . 94 |
|  |  | $(50,10)$ | . 68 | . 27 | . 03 | . 02 | 0 | . 94 | 0 | . 06 | 0 | 0 | . 72 | . 28 | 0 | 0 | 0 | 1 |
|  |  | $(10,50)$ | . 92 | . 08 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 92 | . 08 | 0 | 0 | 0 | 1 |
|  |  | $(50,50)$ | . 86 | . 14 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 86 | . 14 | 0 | 0 | 0 | 1 |
|  | CV ${ }^{* *}$ | $(10,10)$ | . 62 | . 33 | . 03 | . 02 | . 01 | . 94 | 0 | . 05 | . 01 | . 01 | . 65 | . 33 | . 02 | . 03 | . 01 | . 94 |
|  |  | $(50,10)$ | . 68 | . 27 | . 03 | . 02 | 0 | . 94 | 0 | . 06 | 0 | 0 | . 72 | . 28 | 0 | 0 | 0 | 1 |
|  |  | $(10,50)$ | . 93 | . 07 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 93 | . 07 | 0 | 0 | 0 | 1 |
|  |  | $(50,50)$ | . 86 | . 14 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 86 | . 14 | 0 | 0 | 0 | 1 |
| AIC | CV* | $(10,10)$ | . 62 | . 33 | . 03 | . 02 | . 01 | . 93 | 0 | . 06 | . 01 | . 01 | . 64 | . 34 | . 02 | . 02 | . 01 | . 95 |
|  |  | $(50,10)$ | . 68 | . 27 | . 03 | . 02 | 0 | . 94 | 0 | . 06 | 0 | 0 | . 72 | . 28 | 0 | 0 | 0 | 1 |
|  |  | $(10,50)$ | . 89 | . 11 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 90 | . 10 | 0 | 0 | 0 | 1 |
|  |  | $(50,50)$ | . 99 | . 01 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 99 | . 01 | 0 | 0 | 0 | 1 |
|  | CV*** | $(10,10)$ | . 64 | . 31 | . 04 | . 02 | . 05 | . 88 | . 01 | . 05 | . 01 | . 01 | . 67 | . 31 | . 02 | . 02 | . 08 | . 88 |
|  |  | $(50,10)$ | . 68 | . 27 | . 03 | . 02 | 0 | . 94 | 0 | . 06 | 0 | 0 | . 72 | . 28 | 0 | 0 | 0 | 1 |
|  |  | $(10,50)$ | . 93 | . 07 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 93 | . 07 | 0 | 0 | 0 | 1 |
|  |  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| Testing | CV* | $(10,10)$ | . 80 | . 15 | . 04 | . 01 | . 04 | . 91 | 0 | . 05 | . 01 | 0 | . 84 | . 15 | . 02 | . 01 | . 04 | . 93 |
|  |  | $(50,10)$ | . 94 | . 01 | . 05 | 0 | 0 | . 94 | 0 | . 06 | 0 | 0 | . 99 | . 01 | 0 | 0 | 0 | 1 |
|  |  | $(10,50)$ | . 86 | . 14 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 87 | . 13 | 0 | 0 | 0 | 1 |
|  |  | $(50,50)$ | . 99 | . 01 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 99 | . 01 | 0 | 0 | 0 | 1 |
|  | CV ${ }^{* *}$ | $(10,10)$ | . 86 | . 09 | . 05 | . 01 | . 43 | . 49 | . 06 | . 03 | . 01 | 0 | . 91 | . 08 | . 02 | . 01 | . 61 | . 36 |
|  |  | $(50,10)$ | . 94 | 0 | . 06 | 0 | . 33 | . 27 | . 39 | . 01 | 0 | 0 | 1 | 0 | 0 | 0 | . 84 | . 16 |
|  |  | $(10,50)$ | . 91 | . 09 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 91 | . 09 | 0 | 0 | 0 | 1 |
|  |  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |

Table D3: Frequency of the model selected with selected $p$ (DGP D.3: $u_{i t}=0.75 u_{i, t-1}+e_{i t}+0.5 e_{i, t-1}$ )

| Selection of lag $p$ | True M |  | Model 1 |  |  |  | Model 2 |  |  |  | Model 3 |  |  |  | Model 4 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| in CV* | Sele | ted M | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 |
| and CV** |  | $(N, T)$ |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
|  | AIC | $(10,10)$ | 0 | . 83 | 0 | . 16 | 0 | . 84 | 0 | . 16 | 0 | . 17 | 0 | . 82 | 0 | . 17 | 0 | . 82 |
|  |  | $(50,10)$ | 0 | . 87 | 0 | . 14 | 0 | . 87 | 0 | . 14 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 1 |
|  |  | $(10,50)$ | . 01 | . 95 | 0 | . 04 | 0 | . 97 | 0 | . 04 | 0 | . 32 | . 01 | . 67 | 0 | . 32 | 0 | . 68 |
|  |  | $(50,50)$ | 0 | . 97 | 0 | . 03 | 0 | . 97 | 0 | . 03 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 1 |
|  | BIC | $(10,10)$ | . 14 | . 85 | 0 | . 01 | . 06 | . 93 | 0 | . 01 | . 17 | . 66 | . 01 | . 17 | . 15 | . 68 | 0 | . 17 |
|  |  | $(50,10)$ | . 16 | . 84 | 0 | 0 | . 02 | . 98 | 0 | 0 | . 05 | . 05 | . 10 | . 80 | . 08 | . 05 | 0 | . 87 |
|  |  | $(10,50)$ | . 37 | . 63 | 0 | 0 | . 03 | . 97 | 0 | 0 | . 27 | . 73 | 0 | 0 | . 26 | . 74 | 0 | 0 |
|  |  | $(50,50)$ | . 52 | . 48 | 0 | 0 | 0 | 1 | 0 | 0 | . 20 | . 50 | . 18 | . 12 | 27 | . 56 | 0 | . 17 |
|  | $\mathrm{BIC}_{2}$ | $(10,10)$ | 0 | . 74 | 0 | . 26 | 0 | . 74 | 0 | . 26 | 0 | . 07 | 0 | . 93 | 0 | . 07 | 0 | . 93 |
|  |  | $(50,10)$ | 0 | . 84 | 0 | . 17 | 0 | . 84 | 0 | . 17 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 1 |
|  |  | $(10,50)$ | . 01 | . 93 | 0 | . 06 | 0 | . 94 | 0 | . 07 | 0 | . 21 | . 01 | . 78 | 0 | . 21 | 0 | . 79 |
|  |  | $(50,50)$ | 0 | . 98 | 0 | . 02 | 0 | . 98 | 0 | . 02 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 1 |
|  | CV | $(10,10)$ | . 01 | . 88 | 0 | . 11 | 0 | . 89 | 0 | . 11 | 0 | . 27 | . 01 | . 72 | . 01 | . 27 | 0 | . 72 |
|  |  | $(50,10)$ | 0 | . 90 | 0 | . 11 | 0 | . 90 | 0 | . 11 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 1 |
|  |  | $(10,50)$ | . 02 | . 96 | 0 | . 02 | 0 | . 98 | 0 | . 02 | 0 | . 42 | . 01 | . 56 | 0 | . 43 | 0 | . 57 |
|  |  | $(50,50)$ | 0 | . 98 | 0 | . 02 | 0 | . 98 | 0 | . 02 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 1 |
| $\begin{gathered} \text { rule } \\ \text { of } \\ \text { thumb } \\ \left\lfloor T^{1 / 4}\right\rfloor \end{gathered}$ | CV* | $(10,10)$ | . 37 | . 56 | . 03 | . 05 | . 14 | . 79 | . 01 | . 06 | . 01 | 0 | . 41 | . 58 | 0 | . 01 | . 14 | . 85 |
|  |  | $(50,10)$ | . 41 | . 51 | . 03 | . 05 | . 01 | . 90 | 0 | . 08 | 0 | 0 | . 46 | . 54 | 0 | 0 | . 01 | . 99 |
|  |  | $(10,50)$ | . 47 | . 52 | 0 | 0 | . 02 | . 97 | 0 | . 01 | 0 | 0 | . 48 | . 52 | 0 | 0 | . 01 | . 99 |
|  |  | $(50,50)$ | . 63 | . 37 | 0 | 0 | 0 | . 99 | 0 | . 01 | 0 | 0 | . 62 | . 38 | 0 | 0 | 0 | 1 |
|  | CV** | $(10,10)$ | . 76 | . 19 | . 04 | . 02 | . 72 | . 22 | . 04 | . 02 | 0 | 0 | . 81 | . 19 | 0 | 0 | . 79 | . 20 |
|  |  | $(50,10)$ | . 92 | . 03 | . 05 | 0 | . 87 | . 04 | . 09 | 0 | 0 | 0 | . 97 | . 03 | 0 | 0 | . 97 | . 03 |
|  |  | $(10,50)$ | . 82 | . 18 | 0 | 0 | . 49 | . 51 | 0 | 0 | 0 | 0 | . 82 | . 18 | 0 | 0 | . 64 | . 37 |
|  |  | $(50,50)$ | . 96 | . 04 | 0 | 0 | . 46 | . 54 | 0 | 0 | 0 | 0 | . 97 | . 03 | 0 | 0 | . 71 | . 29 |
| BIC | CV* | $(10,10)$ | . 29 | . 61 | . 02 | . 08 | . 10 | . 79 | . 01 | . 10 | . 01 | . 01 | . 33 | . 65 | 0 | . 02 | . 10 | . 88 |
|  |  | $(50,10)$ | . 38 | . 53 | . 03 | . 06 | . 01 | . 89 | 0 | . 09 | 0 | 0 | . 42 | . 58 | 0 | 0 | . 01 | . 99 |
|  |  | $(10,50)$ | . 52 | . 48 | 0 | 0 | . 03 | . 96 | 0 | . 01 | 0 | 0 | . 52 | . 48 | 0 | 0 | . 01 | . 99 |
|  |  | $(50,50)$ | . 79 | . 21 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 78 | . 22 | 0 | 0 | 0 | 1 |
|  | CV** | $(10,10)$ | . 62 | . 30 | . 03 | . 05 | . 59 | . 33 | . 03 | . 05 | 0 | . 01 | . 67 | . 31 | 0 | . 01 | . 66 | . 33 |
|  |  | $(50,10)$ | . 73 | . 21 | . 04 | . 03 | . 69 | . 21 | . 07 | . 03 | 0 | 0 | . 77 | . 23 | 0 | 0 | . 77 | . 23 |
|  |  | $(10,50)$ | . 85 | . 15 | 0 | 0 | . 56 | . 44 | 0 | 0 | 0 | 0 | . 85 | . 15 | 0 | 0 | . 69 | . 31 |
|  |  | $(50,50)$ | . 97 | . 03 | 0 | 0 | . 73 | . 27 | 0 | 0 | 0 | 0 | . 98 | . 02 | 0 | 0 | . 84 | . 16 |
| AIC | CV* | $(10,10)$ | . 17 | . 72 | . 02 | . 10 | . 05 | . 83 | . 01 | . 11 | 0 | 0 | . 21 | . 79 | 0 | 0 | . 06 | . 94 |
|  |  | $(50,10)$ | . 04 | . 85 | 0 | . 11 | 0 | . 88 | 0 | . 12 | 0 | 0 | . 04 | . 96 | 0 | 0 | 0 | 1 |
|  |  | $(10,50)$ | . 48 | . 52 | 0 | 0 | . 02 | . 97 | 0 | . 01 | 0 | 0 | . 49 | . 51 | 0 | 0 | . 01 | . 99 |
|  |  | $(50,50)$ | . 63 | . 37 | 0 | 0 | 0 | . 99 | 0 | . 01 | 0 | 0 | . 62 | . 38 | 0 | 0 | 0 | 1 |
|  | CV** | $(10,10)$ | . 56 | . 37 | . 03 | . 04 | . 50 | . 43 | . 03 | . 04 | 0 | 0 | . 64 | . 36 | 0 | 0 | . 60 | . 40 |
|  |  | $(50,10)$ | . 54 | . 40 | . 04 | . 03 | . 41 | . 49 | . 07 | . 03 | 0 | 0 | . 59 | . 41 | 0 | 0 | . 53 | . 47 |
|  |  | $(10,50)$ | . 84 | . 16 | 0 | 0 | . 53 | . 47 | 0 | 0 | 0 | 0 | . 84 | . 16 | 0 | 0 | . 67 | . 33 |
|  |  | $(50,50)$ | . 96 | . 04 | 0 | 0 | . 47 | . 53 | 0 | 0 | 0 | 0 | . 97 | . 03 | 0 | 0 | . 71 | . 29 |
| Testing | CV* | $(10,10)$ | . 37 | . 56 | . 03 | . 05 | . 14 | . 79 | . 01 | . 06 | . 01 | 0 | . 41 | . 58 | 0 | . 01 | . 14 | . 85 |
|  |  | $(50,10)$ | . 41 | . 51 | . 03 | . 05 | . 01 | . 90 | 0 | . 08 | 0 | 0 | . 46 | . 54 | 0 | 0 | . 01 | . 99 |
|  |  | $(10,50)$ | . 47 | . 52 | 0 | 0 | . 02 | . 97 | 0 | . 01 | 0 | 0 | . 48 | . 52 | 0 | 0 | . 01 | . 99 |
|  |  | $(50,50)$ | . 63 | . 37 | 0 | 0 | 0 | . 99 | 0 | . 01 | 0 | 0 | . 62 | . 38 | 0 | 0 | 0 | 1 |
|  | $\mathrm{CV}^{* *}$ | $(10,10)$ | . 76 | . 19 | . 04 | . 02 | . 72 | . 22 | . 04 | . 02 | 0 | 0 | . 81 | . 19 | 0 | 0 | . 79 | . 20 |
|  |  | $(50,10)$ | . 92 | . 03 | . 05 | 0 | . 87 | . 04 | . 09 | 0 | 0 | 0 | . 97 | . 03 | 0 | 0 | . 97 | . 03 |
|  |  | $(10,50)$ | . 82 | . 18 | 0 | 0 | . 49 | . 51 | 0 | 0 | 0 | 0 | . 82 | . 18 | 0 | 0 | . 64 | . 37 |
|  |  | $(50,50)$ | . 96 | . 04 | 0 | 0 | . 46 | . 54 | 0 | 0 | 0 | 0 | . 97 | . 03 | 0 | 0 | . 71 | . 29 |

Table E1: Frequency of the model selected: static panels, $\rho=1 / 4$

| True M |  | Model 1 |  |  |  | Model 2 |  |  |  | Model 3 |  |  |  | Model 4 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Selected M |  | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 |
| (N,T) |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| AIC | $(10,5)$ | . 53 | . 31 | . 06 | . 10 | . 02 | . 78 | . 01 | . 20 | . 03 | . 02 | . 51 | . 43 | . 02 | . 05 | . 02 | . 91 |
|  | $(50,5)$ | . 69 | . 20 | . 06 | . 05 | 0 | . 82 | 0 | . 18 | . 01 | 0 | . 73 | . 26 | 0 | 0 | 0 | 1 |
|  | $(10,10)$ | . 61 | . 32 | . 03 | . 04 | . 01 | . 89 | 0 | . 10 | . 01 | 0 | . 58 | . 42 | 0 | . 01 | . 01 | . 98 |
|  | $(50,10)$ | . 76 | . 19 | . 03 | . 02 | 0 | . 92 | 0 | . 09 | 0 | 0 | . 77 | . 24 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 72 | . 28 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 63 | . 37 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | . 86 | . 15 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 83 | . 17 | 0 | 0 | 0 | 1 |
| BIC | $(10,5)$ | . 98 | . 02 | . 01 | 0 | . 36 | . 61 | . 02 | . 01 | 25 | . 01 | . 72 | . 03 | 61 | . 04 | . 05 | . 30 |
|  | $(50,5)$ | 1 | 0 | 0 | 0 | . 53 | . 01 | . 46 | 0 | . 03 | 0 | . 97 | 0 | . 55 | 0 | . 45 | 0 |
|  | $(10,10)$ | 1 | 0 | 0 | 0 | . 11 | . 89 | 0 | 0 | 24 | 0 | . 75 | . 01 | . 65 | . 05 | . 01 | . 29 |
|  | $(50,10)$ | 1 | 0 | 0 | 0 | . 31 | . 59 | . 10 | 0 | 0 | 0 | 1 | 0 | . 51 | 0 | . 33 | . 16 |
|  | $(10,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | . 37 | . 39 | . 24 | 0 | . 38 | . 60 | 0 | . 02 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 |  | 0 | 0 | 1 |
| $\mathrm{BIC}_{2}$ | $(10,5)$ | . 20 | . 40 | . 07 | . 33 | 0 | . 58 | 0 | . 41 | . 01 | . 02 | . 23 | . 74 | 0 | . 03 | 0 | . 96 |
|  | $(50,5)$ | . 40 | . 41 | . 05 | . 14 | 0 | . 76 | 0 | . 24 | 0 | 0 | . 42 | . 58 | 0 | 0 | 0 | 1 |
|  | $(10,10)$ | . 34 | . 43 | . 08 | . 16 | 0 | . 74 | 0 | . 26 | 0 | 0 | . 37 | . 63 | 0 | 0 | 0 | 1 |
|  | $(50,10)$ | . 59 | . 33 | . 04 | . 04 | 0 | . 89 | 0 | . 11 | 0 | 0 | . 59 | . 41 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 65 | . 35 | 0 | 0 | 0 | 1 | 0 | . 01 | 0 | 0 | . 54 | . 46 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | . 88 | . 12 | 0 | 0 | 0 | 1 | 0 | 0 | 0 |  | . 87 | . 13 | 0 | 0 | 0 | 1 |
| CV | $(10,5)$ | . 67 | . 24 | . 06 | . 03 | . 04 | . 86 | . 02 | . 09 | . 05 | . 02 | . 69 | . 24 | . 09 | . 06 | . 05 | . 80 |
|  | $(50,5)$ | . 84 | . 08 | . 06 | . 01 | 0 | . 90 | 0 | . 10 | . 01 | 0 | . 90 | . 09 | 0 | 0 | 0 | 1 |
|  | $(10,10)$ | . 69 | . 27 | . 03 | . 01 | . 01 | . 95 | 0 | . 04 | . 01 | . 01 | . 71 | . 27 | 0 | . 02 | . 01 | . 97 |
|  | $(50,10)$ | . 84 | . 13 | . 03 | . 01 | 0 | . 95 | 0 | . 05 | 0 | - | . 87 | . 13 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 73 | . 27 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 72 | . 28 | 0 | 0 | 0 | 1 |
|  | (50,50) | . 87 | . 13 | 0 | 0 | 0 | 1 | 0 | 0 |  | 0 | . 87 | . 13 | 0 | 0 | 0 | 1 |
| CV* | $(10,5)$ | . 59 | . 32 | . 05 | . 04 | . 03 | . 85 | . 02 | . 10 | . 05 | . 03 | . 61 | . 31 | 08 | . 07 | . 04 | . 81 |
|  | $(50,5)$ | . 67 | . 26 | . 05 | . 03 | 0 | . 89 | 0 | . 11 | 0 | . | . 72 | . 28 | 0 | 0 | 0 | 1 |
|  | $(10,10)$ | . 72 | . 23 | . 03 | . 01 | . 01 | . 94 | 0 | . 05 | . 01 | . 01 | . 75 | . 23 | . 01 | . 02 | . 01 | . 96 |
|  | $(50,10)$ | . 89 | . 07 | . 04 | 0 | 0 | . 95 | 0 | . 05 | 0 | 0 | . 93 | . 07 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 94 | . 06 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 94 | . 06 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| CV** | $(10,5)$ | . 67 | . 24 | . 06 | . 03 | . 09 | . 79 | . 03 | . 09 | . 06 | . 03 | . 68 | . 23 | 10 | . 07 | . 10 | . 73 |
|  | $(50,5)$ | . 87 | . 06 | . 07 | . 01 | . 06 | . 77 | . 08 | . 09 | . 01 |  | . 93 | . 06 | 0 | . 01 | . 17 | . 82 |
|  | $(10,10)$ | . 74 | . 22 | . 04 | . 01 | . 10 | . 84 | . 02 | . 05 | . 01 | 0 | . 76 | . 22 | . 01 | . 02 | . 15 | . 82 |
|  | $(50,10)$ | . 90 | . 06 | . 04 | 0 | . 03 | . 88 | . 06 | . 04 | 0 | 0 | . 94 | . 06 | 0 | 0 | . 16 | . 84 |
|  | $(10,50)$ | . 95 | . 05 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 96 | . 04 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |

Table E2: Frequency of the model selected: static panels, $\rho=1 / 2$

| True M |  | Model 1 |  |  |  | Model 2 |  |  |  | Model 3 |  |  |  | Model 4 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Selected M |  | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 |
| (N,T) |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| AIC | $(10,5)$ | . 18 | . 62 | . 02 | . 18 | 01 | . 77 | 0 | . 22 | 02 | . 03 | . 17 | . 78 | 01 | . 05 | . 01 | . 94 |
|  | $(50,5)$ | . 02 | . 79 | 0 | . 19 | 0 | . 81 | 0 | . 19 | 0 | 0 | . 02 | . 98 | 0 | 0 | 0 | 1 |
|  | $(10,10)$ | . 21 | . 68 | . 01 | . 10 | . 01 | . 87 | 0 | . 12 | 0 | . 01 | . 18 | . 81 | 0 | . 02 | 0 | . 98 |
|  | $(50,10)$ | . 04 | . 87 | 0 | . 09 | 0 | . 91 | 0 | . 09 | 0 | 0 | . 03 | . 97 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 27 | . 72 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 22 | . 78 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | . 04 | . 96 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 03 | . 97 | 0 | 0 | 0 | 1 |
| BIC | $(10,5)$ | . 78 | . 21 | 0 | . 01 | . 21 | . 77 | . 01 | . 02 | . 27 | . 04 | . 47 | . 22 | . 42 | . 08 | . 03 | . 47 |
|  | $(50,5)$ | 1 | 0 | 0 | 0 | . 55 | . 16 | . 30 | 0 | . 05 | 0 | . 95 | 0 | . 62 | 0 | . 33 | . 05 |
|  | $(10,10)$ | . 89 | . 11 | 0 | 0 | . 09 | . 91 | 0 | 0 | . 36 | . 04 | . 49 | . 10 | . 51 | . 12 | . 01 | . 36 |
|  | $(50,10)$ | 1 | 0 | 0 | 0 | . 20 | . 78 | . 02 | 0 | . 01 | 0 | 1 | 0 | 43 | 0 | . 16 | . 42 |
|  | $(10,50)$ | . 98 | . 02 | 0 | 0 | 0 | 1 | 0 | 0 | . 39 | . 58 | . 03 | 0 | . 37 | . 62 | 0 | . 01 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 |  | 1 | 0 | 0 | 0 | 0 | 1 |
| $\mathrm{BIC}_{2}$ | $(10,5)$ | . 05 | . 55 | . 02 | . 39 | 0 | . 59 | 0 | . 41 | 0 | . 02 | . 05 | . 93 | 0 | . 02 | 0 | . 97 |
|  | $(50,5)$ | 0 | . 75 | 0 | . 25 | 0 | . 75 | 0 | . 25 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 1 |
|  | $(10,10)$ | . 08 | . 67 | . 02 | . 23 | 0 | . 74 | 0 | . 25 | 0 | . 01 | . 09 | . 90 | 0 | . 01 | 0 | . 99 |
|  | $(50,10)$ | . 01 | . 87 | 0 | . 12 | 0 | . 88 | 0 | . 13 | 0 |  | . 01 | . 99 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 22 | . 77 | 0 | . 01 | 0 | . 99 | 0 | . 01 | 0 | 0 | . 18 | . 82 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | . 06 | . 94 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 04 | . 96 | 0 | 0 | 0 | 1 |
| CV | $(10,5)$ | . 28 | . 63 | . 03 | . 07 | . 02 | . 89 | 0 | . 09 | . 04 | . 06 | . 30 | . 61 | . 03 | . 08 | . 02 | . 87 |
|  | $(50,5)$ | . 07 | . 82 | . 01 | . 11 | 0 | . 88 | 0 | . 12 | 0 | 0 | . 08 | . 92 | 0 | . 01 | 0 | 1 |
|  | $(10,10)$ | . 25 | . 69 | . 01 | . 05 | . 01 | . 93 | 0 | . 06 | . 01 | . 02 | . 28 | . 69 | 0 | . 03 | . 01 | . 97 |
|  | $(50,10)$ | . 06 | . 88 | 0 | . 06 | 0 | . 94 | 0 | . 06 | 0 | 0 | . 06 | . 94 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 28 | . 72 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 29 | . 71 |  | 0 | 0 | 1 |
|  | $(50,50)$ | . 04 | . 96 | 0 | 0 | 0 | 1 | 0 | , | 0 |  | . 05 | . 95 | 0 | 0 | 0 | 1 |
| CV* | $(10,5)$ | . 29 | . 62 | . 03 | . 07 | . 02 | . 88 | 0 | . 10 | . 03 | . 05 | . 31 | . 61 | . 04 | . 07 | . 03 | . 86 |
|  | $(50,5)$ | . 10 | . 79 | . 01 | . 11 | 0 | . 88 | 0 | . 12 | 0 | 0 | . 11 | . 89 | 0 | 0 | 0 | 1 |
|  | $(10,10)$ | . 56 | . 38 | . 03 | . 03 | . 03 | . 91 | 0 | . 06 | . 01 | 0 | . 58 | . 40 | . 01 | . 01 | . 03 | . 95 |
|  | $(50,10)$ | . 69 | . 26 | . 03 | . 01 | 0 | . 95 | 0 | . 05 | 0 | 0 | . 74 | . 27 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 90 | . 10 | 0 | 0 | 0 | 1 | 0 | 0 |  | 0 | . 89 | . 11 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| CV** | $(10,5)$ | . 34 | . 56 | . 04 | . 06 | . 11 | . 77 | . 02 | . 09 | . 04 | . 05 | . 36 | . 55 | . 04 | . 07 | . 13 | . 76 |
|  | $(50,5)$ | . 17 | . 71 | . 02 | . 10 | . 09 | . 76 | . 05 | . 10 | 0 | 0 | . 19 | . 80 | 0 | 0 | . 14 | . 86 |
|  | $(10,10)$ | . 74 | . 21 | . 04 | . 02 | . 40 | . 52 | . 05 | . 03 | . 01 | 0 | . 77 | . 22 | . 01 | . 01 | . 55 | . 43 |
|  | $(50,10)$ | . 95 | . 01 | . 05 | 0 | . 31 | . 44 | . 23 | . 02 | 0 | 0 | . 99 | . 01 | 0 | 0 | . 69 | . 31 |
|  | $(10,50)$ | . 94 | . 06 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 95 | . 05 | 0 | 0 | . 03 | . 97 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |

Table E3: Frequency of the model selected: dynamic panels without exogenous regressors, $\beta=1 / 4$

| True M |  | Model 1 |  |  |  | Model 2 |  |  |  | Model 3 |  |  |  | Model 4 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Selected M |  | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 |
| (N,T) |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| AIC | $(10,5)$ | . 66 | . 19 | . 08 | . 08 | . 04 | . 74 | 0 | . 21 | . 05 | . 01 | . 65 | . 29 | 0 | . 05 | . 04 | . 91 |
|  | $(50,5)$ | . 88 | . 03 | . 08 | . 01 | 0 | . 85 | 0 | . 15 | 0 | 0 | . 95 | . 04 | 0 | 0 | 0 | 1 |
|  | $(10,10)$ | . 85 | . 10 | . 04 | . 02 | . 01 | . 91 | 0 | . 09 | . 01 | 0 | . 85 | . 15 | 0 | . 01 | 0 | . 99 |
|  | $(50,10)$ | . 96 | 0 | . 04 | 0 | 0 | . 93 | 0 | . 07 | 0 | 0 | . 99 | . 01 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 95 | . 05 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 92 | . 08 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| BIC | $(10,5)$ | . 99 | 0 | 0 | 0 | . 71 | .27 | . 01 | . 01 | . 21 | 0 | . 79 | 0 | . 14 | . 04 | . 56 | . 27 |
|  | $(50,5)$ | 1 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | . 03 | 0 | . 97 | 0 | . 02 | 0 | . 98 | 0 |
|  | $(10,10)$ | 1 | 0 | 0 | 0 | . 41 | . 59 | 0 | 0 | . 11 | 0 | . 89 | 0 | . 07 | . 05 | . 31 | . 57 |
|  | $(50,10)$ | 1 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 1 | 0 |
|  | $(10,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | . 08 | 0 | . 92 | 0 | 0 | . 08 | 0 | . 92 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| $\mathrm{BIC}_{2}$ | $(10,5)$ | . 28 | . 34 | . 10 | . 28 | 0 | . 60 | 0 | . 40 | . 01 | . 01 | . 36 | . 62 | 0 | . 02 | 0 | . 98 |
|  | $(50,5)$ | . 71 | . 15 | . 09 | . 05 | 0 | . 78 | 0 | . 22 | 0 | 0 | . 79 | . 21 | 0 | 0 | 0 | 1 |
|  | $(10,10)$ | . 57 | . 22 | . 12 | . 09 | 0 | . 76 | 0 | . 24 | 0 | 0 | . 65 | . 34 | 0 | 0 | 0 | 1 |
|  | $(50,10)$ | . 92 | . 02 | . 06 | 0 | 0 | . 89 | 0 | . 11 | 0 | 0 | . 97 | . 03 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 93 | . 07 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 89 | . 12 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| CV | $(10,5)$ | . 79 | . 12 | . 08 | . 02 | . 09 | . 80 | . 01 | . 10 | . 07 | . 01 | . 81 | . 12 | . 01 | . 07 | . 13 | . 79 |
|  | $(50,5)$ | . 91 | . 01 | . 08 | 0 | 0 | . 92 | 0 | . 08 | . 01 | 0 | . 99 | . 01 | 0 | 0 | . 01 | . 99 |
|  | $(10,10)$ | . 89 | . 08 | . 03 | . 01 | . 01 | . 95 | 0 | . 04 | . 01 | 0 | . 91 | . 08 | 0 | . 01 | . 01 | . 98 |
|  | $(50,10)$ | . 96 | 0 | . 04 | 0 | 0 | . 96 | 0 | . 04 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 96 | . 05 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 96 | . 05 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| CV-BC | $(10,5)$ | . 85 | . 06 | . 08 | . 01 | . 24 | . 65 | . 03 | . 09 | . 07 | . 01 | . 87 | . 06 | . 02 | . 05 | . 30 | . 63 |
|  | $(50,5)$ | . 92 | 0 | . 08 | 0 | . 12 | . 80 | . 02 | . 06 | . 01 | 0 | . 99 | 0 | 0 | 0 | . 16 | . 84 |
|  | $(10,10)$ | . 92 | . 05 | . 03 | . 01 | . 02 | . 94 | 0 | . 04 | . 01 | 0 | . 94 | . 05 | 0 | . 01 | . 02 | . 97 |
|  | $(50,10)$ | . 96 | 0 | . 04 | 0 | 0 | . 96 | 0 | . 04 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 96 | . 04 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 96 | . 04 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |

Table E4: Frequency of the model selected: dynamic panels without exogenous regressors, $\beta=1 / 2$

| True M |  | Model 1 |  |  |  | Model 2 |  |  |  | Model 3 |  |  |  | Model 4 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Selected M |  | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 |
| (N,T) |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| AIC | $(10,5)$ | . 56 | . 27 | . 06 | . 11 | . 06 | . 73 | . 01 | . 21 | . 04 | . 02 | . 54 | . 40 | . 01 | . 04 | . 06 | . 90 |
|  | $(50,5)$ | . 78 | . 12 | . 07 | . 03 | 0 | . 85 | 0 | . 15 | 0 | 0 | . 84 | . 15 | 0 | 0 | 0 | 1 |
|  | $(10,10)$ | . 80 | . 14 | . 04 | . 02 | . 01 | . 91 | 0 | . 09 | . 01 | 0 | . 78 | . 22 | 0 | . 01 | . 01 | . 99 |
|  | $(50,10)$ | . 94 | . 02 | . 04 | 0 | 0 | . 93 | 0 | . 07 | 0 | 0 | . 98 | . 02 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 95 | . 05 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 92 | . 09 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| BIC | $(10,5)$ | . 98 | . 01 | 0 | 0 | . 82 | . 17 | . 01 | . 01 | . 21 | 0 | . 78 | . 02 | . 15 | . 03 | . 65 | . 18 |
|  | $(50,5)$ | 1 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | . 02 | 0 | . 98 | 0 | . 02 | 0 | . 98 | 0 |
|  | $(10,10)$ | 1 | 0 | 0 | 0 | . 76 | . 24 | 0 | 0 | . 12 | 0 | . 88 | 0 | . 10 | . 02 | . 64 | . 24 |
|  | $(50,10)$ | 1 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 1 | 0 |
|  | $(10,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | . 09 | 0 | . 92 | 0 | 0 | . 07 | 0 | . 93 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| $\mathrm{BIC}_{2}$ | $(10,5)$ | . 19 | . 42 | . 07 | . 32 | 0 | . 60 | 0 | . 40 | . 01 | . 02 | . 25 | . 73 | 0 | . 02 | . 01 | . 97 |
|  | $(50,5)$ | . 48 | . 35 | . 07 | . 10 | 0 | . 77 | 0 | . 23 | 0 | 0 | . 53 | . 47 | 0 | 0 | 0 | 1 |
|  | $(10,10)$ | . 51 | . 28 | . 09 | . 12 | 0 | . 76 | 0 | . 24 | 0 | 0 | . 55 | . 45 | 0 | 0 | 0 | 1 |
|  | $(50,10)$ | . 88 | . 05 | . 06 | . 01 | 0 | . 90 | 0 | . 10 | 0 | 0 | . 94 | . 06 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 92 | . 08 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 87 | . 13 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| CV | $(10,5)$ | . 70 | . 20 | . 07 | . 04 | . 13 | . 75 | . 02 | . 09 | . 06 | . 02 | . 73 | . 20 | . 01 | . 07 | . 22 | . 70 |
|  | $(50,5)$ | . 88 | . 04 | . 08 | 0 | . 03 | . 89 | . 01 | . 07 | 0 | 0 | . 97 | . 03 | 0 | 0 | . 05 | . 95 |
|  | $(10,10)$ | . 84 | . 12 | . 03 | . 01 | . 01 | . 95 | 0 | . 04 | . 01 | 0 | . 88 | . 11 | 0 | . 01 | . 03 | . 96 |
|  | $(50,10)$ | . 95 | . 01 | . 04 | 0 | 0 | . 96 | 0 | . 04 | 0 | 0 | . 99 | . 01 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 95 | . 05 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 95 | . 05 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| CV-BC | $(10,5)$ | . 79 | . 12 | . 08 | . 02 | . 39 | . 50 | . 05 | . 06 | . 06 | . 01 | . 83 | . 11 | . 03 | . 05 | . 46 | . 46 |
|  | $(50,5)$ | . 91 | . 01 | . 08 | 0 | . 40 | . 50 | . 05 | . 05 | . 01 | 0 | . 99 | 0 | 0 | 0 | . 47 | . 53 |
|  | $(10,10)$ | . 91 | . 06 | . 03 | 0 | . 09 | . 87 | . 01 | . 04 | . 01 | 0 | . 93 | . 06 | 0 | . 01 | . 14 | . 85 |
|  | $(50,10)$ | . 96 | 0 | . 04 | 0 | 0 | . 96 | 0 | . 04 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 96 | . 04 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 96 | . 04 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |

Table E5: Frequency of the model selected: dynamic panels with exogenous regressors, $\beta=1 / 4$

| True M |  | Model 1 |  |  |  | Model 2 |  |  |  | Model 3 |  |  |  | Model 4 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Selected M |  | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 |
| (N,T) |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| AIC | $(10,5)$ | . 59 | . 18 | . 11 | . 13 | . 09 | . 62 | . 04 | . 26 | . 05 | . 02 | . 60 | . 33 | . 04 | . 05 | . 11 | . 80 |
|  | $(50,5)$ | . 87 | . 03 | . 09 | . 01 | . 01 | . 77 | . 02 | . 20 | 0 | 0 | . 96 | . 04 | 0 | 0 | . 05 | . 95 |
|  | $(10,10)$ | . 81 | . 11 | . 05 | . 03 | . 01 | . 88 | . 01 | . 11 | 0 | 0 | . 80 | . 20 | . 01 | . 01 | . 02 | . 96 |
|  | $(50,10)$ | . 95 | 0 | . 04 | 0 | 0 | . 91 | 0 | . 09 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 94 | . 06 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 91 | . 09 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| BIC | $(10,5)$ | . 99 | . 01 | . 01 | 0 | . 78 | . 18 | . 03 | . 02 | . 26 | 0 | . 72 | . 02 | . 49 | . 02 | . 36 | . 13 |
|  | $(50,5)$ | 1 | 0 | 0 | 0 | . 96 | 0 | . 04 | 0 | . 03 | 0 | . 97 | 0 | . 09 | 0 | . 92 | 0 |
|  | $(10,10)$ | 1 | 0 | 0 | 0 | . 68 | . 32 | 0 | 0 | . 23 | 0 | . 77 | 0 | . 71 | . 01 | . 17 | . 11 |
|  | $(50,10)$ | 1 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 0 | 1 | 0 | . 02 | 0 | . 98 | 0 |
|  | $(10,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | . 38 | . 28 | . 33 | 0 | . 79 | . 18 | 0 | . 03 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| $\mathrm{BIC}_{2}$ | $(10,5)$ | . 26 | . 29 | . 10 | . 36 | . 01 | . 49 | . 01 | . 48 | . 02 | . 02 | . 32 | . 65 | 0 | . 03 | . 02 | . 95 |
|  | $(50,5)$ | . 72 | . 11 | . 12 | . 06 | 0 | . 71 | 0 | . 29 | 0 | 0 | . 81 | . 19 | 0 | 0 | 0 | 1 |
|  | $(10,10)$ | . 55 | . 21 | . 12 | . 13 | 0 | . 71 | 0 | . 28 | 0 | 0 | . 62 | . 38 | 0 | 0 | 0 | 1 |
|  | $(50,10)$ | . 91 | . 01 | . 07 | 0 | 0 | . 87 | 0 | . 13 | 0 | 0 | . 98 | . 02 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 92 | . 08 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 87 | . 13 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| CV | $(10,5)$ | . 79 | . 10 | . 09 | . 02 | . 31 | . 54 | . 07 | . 08 | . 10 | . 01 | . 79 | . 10 | . 16 | . 07 | . 35 | . 43 |
|  | $(50,5)$ | . 92 | 0 | . 08 | 0 | . 10 | . 73 | . 10 | . 08 | . 01 | 0 | . 99 | 0 | 0 | 0 | . 27 | . 73 |
|  | $(10,10)$ | . 91 | . 06 | . 02 | . 01 | . 03 | . 93 | . 01 | . 03 | . 01 | . 01 | . 92 | . 06 | . 03 | . 02 | . 09 | . 86 |
|  | $(50,10)$ | . 96 | 0 | . 04 | 0 | 0 | . 96 | 0 | . 04 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 95 | . 05 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 95 | . 05 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| CV-BC | $(10,5)$ | . 87 | . 02 | . 10 | . 01 | . 60 | . 22 | . 14 | . 04 | . 11 | 0 | . 87 | . 02 | . 25 | . 02 | . 59 | . 15 |
|  | $(50,5)$ | . 92 | 0 | . 08 | 0 | . 30 | . 33 | . 31 | . 06 | . 01 | 0 | . 99 | 0 | . 01 | 0 | . 66 | . 33 |
|  | $(10,10)$ | . 95 | . 03 | . 03 | 0 | . 08 | . 88 | . 01 | . 03 | . 01 | . 01 | . 95 | . 03 | . 04 | . 02 | . 18 | . 76 |
|  | $(50,10)$ | . 96 | 0 | . 04 | 0 | 0 | . 96 | 0 | . 04 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
|  | $(10,50)$ | . 96 | . 04 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 96 | . 04 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |

Table E6: Frequency of the model selected: dynamic panels with exogenous regressors. $\beta=1 / 2$

| True M |  | Model 1 |  |  |  | Model 2 |  |  |  | Model 3 |  |  |  | Model 4 |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Selected M |  | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 | M1 | M2 | M3 | M4 |
| (N.T) |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| AIC | (10.5) | . 50 | . 25 | . 09 | . 16 | . 11 | . 59 | . 04 | . 26 | . 05 | . 03 | . 50 | . 43 | . 03 | . 05 | . 13 | . 79 |
|  | (50.5) | . 81 | . 08 | . 08 | . 03 | . 04 | . 71 | . 03 | . 22 | 0 | 0 | . 87 | . 12 | 0 | 0 | . 07 | . 92 |
|  | (10.10) | . 77 | . 14 | . 05 | . 04 | . 04 | . 85 | . 01 | . 11 | 0 | 0 | . 76 | . 24 | . 01 | . 01 | . 06 | . 93 |
|  | (50.10) | . 95 | . 01 | . 04 | 0 | 0 | . 90 | 0 | . 10 | 0 | 0 | . 99 | . 01 | 0 | 0 | 0 | 1 |
|  | (10.50) | . 94 | . 06 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 90 | . 10 | 0 | 0 | 0 | 1 |
|  | (50.50) | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| BIC | (10.5) | . 97 | . 02 | . 01 | 0 | . 83 | . 14 | . 02 | . 01 | . 27 | . 01 | . 70 | . 03 | . 42 | . 02 | . 44 | . 12 |
|  | (50.5) | 1 | 0 | 0 | 0 | . 99 | 0 | . 01 | 0 | . 03 | 0 | . 97 | 0 | . 05 | 0 | . 95 | 0 |
|  | (10.10) | 1 | 0 | 0 | 0 | . 87 | . 13 | 0 | 0 | . 24 | 0 | . 76 | 0 | . 63 | . 01 | . 29 | . 07 |
|  | (50.10) | 1 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 0 | 1 | 0 | . 01 | 0 | . 99 | 0 |
|  | (10.50) | 1 | 0 | 0 | 0 | . 01 | 1 | 0 | 0 | . 40 | . 27 | . 33 | 0 | . 92 | . 06 | 0 | . 02 |
|  | (50.50) | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | . 01 | . 99 |
| $\mathrm{BIC}_{2}$ | (10.5) | . 19 | . 34 | . 07 | . 40 | . 02 | . 48 | . 01 | . 49 | . 01 | . 02 | . 23 | . 73 | 0 | . 03 | . 02 | . 94 |
|  | (50.5) | . 56 | . 22 | . 09 | . 13 | 0 | . 68 | 0 | . 32 | 0 | 0 | . 62 | . 38 | 0 | 0 | . 01 | . 99 |
|  | (10.10) | . 50 | . 26 | . 10 | . 14 | 0 | . 71 | . 01 | . 28 | 0 | 0 | . 55 | . 45 | 0 | 0 | . 01 | . 99 |
|  | (50.10) | . 89 | . 03 | . 07 | . 01 | 0 | . 86 | 0 | . 14 | 0 | 0 | . 95 | . 05 | 0 | 0 | 0 | 1 |
|  | (10.50) | . 91 | . 09 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 87 | . 14 | 0 | 0 | 0 | 1 |
|  | (50.50) | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| CV | (10.5) | . 75 | . 13 | . 08 | . 04 | . 37 | . 48 | . 07 | . 08 | . 10 | . 02 | . 75 | . 13 | . 14 | . 07 | . 40 | . 40 |
|  | (50.5) | . 90 | . 01 | . 08 | 0 | . 23 | . 58 | . 10 | . 09 | . 01 | 0 | . 98 | . 01 | 0 | 0 | . 39 | . 61 |
|  | (10.10) | . 87 | . 10 | . 02 | . 01 | . 08 | . 88 | . 01 | . 03 | . 01 | . 01 | . 88 | . 10 | . 03 | . 02 | . 18 | . 78 |
|  | (50.10) | . 96 | 0 | . 04 | 0 | 0 | . 95 | 0 | . 04 | 0 | 0 | 1 | 0 | 0 | 0 | . 01 | . 99 |
|  | (10.50) | . 95 | . 05 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 95 | . 05 | 0 | 0 | 0 | 1 |
|  | (50.50) | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| CV-BC | $(10,5)$ | . 86 | . 03 | . 10 | . 01 | . 68 | . 17 | . 12 | . 03 | . 11 | . 01 | . 86 | . 03 | . 21 | . 02 | . 66 | . 11 |
|  | $(50,5)$ | . 92 | 0 | . 08 | 0 | . 55 | . 15 | . 26 | . 04 | . 01 | 0 | . 99 | 0 | 0 | 0 | . 83 | . 17 |
|  | $(10,10)$ | . 94 | . 03 | . 03 | 0 | . 26 | . 68 | . 02 | . 04 | . 02 | . 01 | . 94 | . 04 | . 04 | . 02 | . 40 | . 54 |
|  | $(50,10)$ | . 96 | 0 | . 04 | 0 | . 04 | . 88 | . 02 | . 06 | 0 | 0 | 1 | 0 | 0 | 0 | . 11 | . 89 |
|  | $(10,50)$ | . 96 | . 04 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | . 96 | . 04 | 0 | 0 | 0 | 1 |
|  | $(50,50)$ | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |

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[^1]:    ${ }^{1}$ For our method discussed below, different identification restrictions, e.g., assuming $\alpha_{N}=0$ in Model 2 and $\lambda_{T}=0$ in Model 3, produce identical results.

[^2]:    ${ }^{2}$ Throughout the paper, we use Jackknife and CV interchangeably. Jackknife is widely used in model selection and model averaging (see, e.g., Allen (1974), Stone (1974), Geisser (1974), Wahba and Wold (1975), Li (1987), Andrews (1991), Shao (1993), Burman, Chow and Nolan (1994), Racine (2000), Hansen and Racine (2012), and Lu and Su (2015)).
    ${ }^{3}$ We only allow serial correlation in static panel models. For dynamic panel data models (e.g., panel AR(1) model), the serial correlation in the error terms (e.g., AR(1) errors) will cause the error terms to be correlated with the lagged dependent variables. We do not address the endogeneity issue in this paper.

[^3]:    ${ }^{4}$ There is a large literature on the multiple testing issue for controlling the family-wise error rate (FWER). See, e.g., Romano, Shaikh and Wolf (2010) for a review. However, to the best of our knowledge, there is no discussion on how to address this issue in the context of determining fixed effects.

[^4]:    ${ }^{5}$ As suggested by an anonymous referee, we may be able to construct two different CV criteria for the fixed effect model and random effect model separately. In principle, the value of CV based on the true model (either random effect or fixed effect) should be minimal, therefore we could distinguish whether the effects are "random" or "fixed". We leave the detailed analysis of this approach for future research.

[^5]:    ${ }^{6}$ Of course, we can consider general form of cross-sectional dependence based on certain geographic or economic distance measure. For example, we can follow the lead of Conley (1999), Kelejian and Prucha (2007), Kim and Sun (2013), Lee and Robinson (2016) and Su and Qu (2017) and specify the cross-section correlation between $u_{i t}$ and $u_{j t}$ as the diminishing function of the economic distance between units $i$ and $j: \operatorname{Corr}\left(u_{i t}, u_{j t}\right)=g\left(d_{i j}\right)$, where $g$ is a decreasing function. For example, Chen et al. (2012, p.75) specify the cross-section correlation between $u_{i t}$ and $u_{j t}$ to be $\rho^{|i-j|}$ for $1 \leq i, j \leq N$. In this case, the last condition requires $\rho<\frac{1}{3}$.

[^6]:    ${ }^{7}$ Following the standard analysis on the consistency of IC, we can show the following results: (1) $B I C$ and $B I C_{2}$ are consistent in selecting the individual or time effects under the restrictive condition that $N$ and $T$ pass to infinity at the same rate; (2) the $A I C$ is never consistent; and (3) neither $B I C$ nor $B I C_{2}$ is consistent in general when $N$ and $T$ pass to infinity at different rates.
    ${ }^{8}$ Here the error terms are homoskedastic. We have also considered the DGPs with heteroskedasticy and find that performances are similar. The details are available upon request.

[^7]:    ${ }^{9}$ The results for $\rho=\frac{1}{3}$ and $\frac{3}{4}$ are avaiable upon request.

[^8]:    ${ }^{10}$ The results for other coefficients are available upon request.

[^9]:    ${ }^{11}$ The results for other coefficients are available upon request.

