Bubbles and the Value of Innovation[†]

Valentin Haddad
UCLA and NBER

Paul Ho
Federal Reserve Bank of Richmond

Erik Loualiche
University of Minnesota

June 29, 2021

Abstract

Episodes of booming innovation coincide with intense speculation in financial markets. What can asset prices teach us about innovations during bubbles? In our theory, investor speculation about which firms will succeed creates a bubble. An innovation raises the stock price of its creator more than justified by future outcomes. However, prices of competing firms do not get penalized even though their profits suffer. These predictions do not arise in alternative theories of bubbles; we confirm them and other aspects of our model using over a million patents. Efficient innovation policy uses information from prices and real outcomes despite their disconnect.

[†]Haddad: vhaddad@ad.ucla.edu; UCLA Anderson School of Management, 110 Westwood Plaza, Los Angeles CA 90095; phone: 310-825-1814. Ho: paul.ho@rich.frb.org. Loualiche: eloualic@umn.edu.
We thank Andrew Atkeson, Markus Brunnermeier, Edouard Challe, Alexandre Corhay, Emmanuel Farhi, Nicolae Garleanu, Harrison Hong, Pablo Kurlat, Deborah Lucas, Alberto Martin, Stavros Panageas, Gill Segal, Alp Simsek, Avanidhar Subrahmanyam, Jaume Ventura, and seminar participants at Columbia University, Federal Reserve Bank of Minneapolis, Federal Reserve Bank of Richmond, HKUST, London Business School, Minnesota, MIT Sloan, Princeton, UBC Sauder, UCLA, University of Amsterdam, University of Luxembourg, Wharton, Banque de France, Bank of England, AFA, Finance in the Cloud, FIRS, Macro Finance Society meetings, NBER Asset Pricing, SED, and WFA for useful comments. The views expressed herein are those of the authors and do not necessarily represent the views of the Federal Reserve Bank of Richmond or the Federal Reserve System.

1 Introduction

What do asset prices teach us about the value of innovation? On the one hand, an efficient-markets reasoning suggests that asset prices reveal the present value of cash flows generated by an innovation. The seminal work of Kogan, Papanikolaou, Seru, and Stoffman (2017) shows that the stock return of a firm in the few days following a patent approval is a good indicator of the future economic impact of this innovation. Relatedly, Bloom, Schankerman, and Van Reenen (2013) rely on asset prices to quantify the spillovers of innovation. On the other hand, episodes of booming innovation often coincide with intense speculation in financial markets, leading to periods that have been described as bubbles (e.g., Scheinkman, 2014). This effervescent financial activity casts doubt on the use of asset prices to quantify the value of innovation precisely during times when this innovation is most prevalent. In this paper we show that disagreement among investors *about which firms will succeed* resolves this tension.

A theory of bubbles based on this idea explains the disconnect of asset prices from the fundamental consequences of innovation during speculative episodes. During bubbles, the impact of an innovation on the stock price of its creator increases relative to the real outcomes it will generate. However, the stock prices of competing firms do not get penalized even though their profits ultimately suffer. We document these patterns using over a million patents issued from 1926 through 2010 and show these properties do not arise in alternative theories of bubbles. Our theory not only rationalizes the disconnect between prices and quantities, but also provides guidance on the separate information they contain. For example, we show how a planner would use both measures to conduct efficient innovation policy.

Formally, we analyze a model in which new ideas are implemented by firms that compete with each other. We allow for a rich range of firm interactions while remaining parsimonious enough to be tractable and yield clear testable predictions. In the first stage, firms are created by raising money on financial markets; in the second stage, competition and production occur. In our baseline analysis, competition takes a simple form: only a fixed number of the best firms get to produce.[1] This assumption implies that when one firm innovates, competitors are less likely to succeed and therefore suffer. The key novel ingredient of our theory is that investors agree to disagree about which firms will be more productive. This connection is natural in the context of innovation:

[1]Section 6.3 extends the analysis to richer competitive structures which allow to capture other sources of spillovers such as on aggregate knowledge, demand, or workers.

when faced with new ideas, people disagree. For example, investors disagree on whether Twitter or Facebook is going to be the most successful social network, even though they agree on the total value of the social network industry. We introduce a parametrization of beliefs that entertains consequential disagreement about a large number of firms without succumbing to the curse of dimensionality.

Unsurprisingly, disagreement leads to a bubble (e.g., Miller, 1977; Harrison and Kreps, 1978). Each investor picks her favorite firms for her portfolio and therefore has more optimistic beliefs about her investments than the average firm.[2] This mechanism increases valuations and incentivizes more firms to enter. In the second stage, not all investors can be correct about which firms produce: prices drop and many firms fail. This rise and fall as a result of speculation echoes broad narratives of bubble episodes as well as some of their more subtle features. Disagreement is more natural in the face of new ideas, making these episodes more likely following the introduction of a broad new technology (Brunnermeier and Oehmke, 2013; Scheinkman, 2014) or among younger firms (Greenwood, Shleifer, and You, 2018). In a dynamic extension of the model, we show that they are also related to more intense trading activity (Hong and Stein, 2007; Greenwood, Shleifer, and You, 2018).

The model leads to distinctive predictions about how markets value the effect of an innovation both on the creator and on her competitors. First, speculation increases the market value of an innovation, the direct theoretical counterpart to the measure from Kogan et al. (2017). With disagreement, investors have higher valuations of their chosen firms because they expect these firms to be more productive than the average firm in the economy, even though the aggregate productivity distribution of firms is unchanged. Second, speculation attenuates the negative effect of an innovation on the market price of competitors. Each new firm induces a business-stealing effect as it potentially displaces other firms.[3] With speculation, investors believe they are investing in the most productive firms in the economy, making them less concerned about being displaced by new firms. Thus, additional firm entry is less impactful on their valuation of their chosen firms. In contrast, the effect of competition on realized profits remains unaffected since speculation affects neither the aggregate productivity distribution nor the competitive structure.[4]

[2]Van den Steen (2004) studies how disagreement and choice lead to optimism.

[3]While the term of business-stealing suggests malfeasance, it is simply the textbook name for how the entry of a new firm takes customers and profit away from existing firms, conveying a negative externality, see Acemoglu (2008).

[4]A historical episode offers an illustration of our model. In 1686, William Phips secured funding

Taken together, these two predictions stand in sharp contrast with existing theories of bubbles. First, a view that bubbles are simply the consequence of episodes of very high productivity cannot explain the disconnect between valuations and outcomes. Second, if investors disagree about aggregate outcomes rather than specific firms, overvaluation does occur but the neglect of competitive spillovers does not. Instead, valuations are driven by investors who are optimistic about the entire sector but who have no reason to ignore the competition from innovative activity. Finally, if bubbles are periods where valuations are completely unrelated to fundamentals, we should see no reaction to innovation.

The data accord with our theory. We use the universe of patents issued by public firms from 1926 through 2010 to measure the value of innovation during bubbles. We follow the literature and construct the direct value and spillovers of innovation. Specifically, we measure the private value of new innovations using the stock returns of issuing companies in the days following a patent approval, as in Kogan et al. (2017). We estimate the competitive spillovers of new innovations by using the response of firm valuations to innovations by their competitors, controlling for innovation by technologically related firms, as in Bloom, Schankerman, and Van Reenen (2013). We proxy for speculation by isolating bubble episodes, defined as industry-years that have experienced a sharp run-up in stock prices, following Greenwood, Shleifer, and You (2018). During a bubble, the market-based private value of innovation increases by 30% at the patent level and between 40% to 50% at the firm level, corroborating the model's prediction that speculation increases private value. The increase in market-based private value is not accompanied by stronger cash flow improvements. The data also support the prediction that speculation dampens market-based but not outcome-based measures of competitive spillovers. In particular, our estimates suggest that during

in England from the Second Duke of Albemarle and his syndicate to search for sunken Spanish ships in the Bahamas. He found 34 tons of treasure, yielding large returns to his investors. This successful expedition generated considerable speculation around treasure-hunting technology. The speculation was accompanied by a large spike in patenting activity for the time, with 17 patents for ways to recover underwater bounty registered between 1691 and 1693. Based on these innovations, numerous firms were introduced on equity markets and raised large amounts of capital despite competing for what was clearly a small pool of treasures. These high valuations were consistent with our notion of high market value of innovation that is unaffected by competitive spillovers in the presence of speculation. The boom was so large that it is sometimes credited for the emergence of developed equity markets in England. However, there was no corresponding increase in the realized profits of the new patents and firms. The expeditions only succeeded in finding a few worthless cannons. See Scott (1912) for background information on this episode, a landmark in the history of the stock market in the United Kingdom.

bubbles the business-stealing effect measured by asset prices completely vanishes. In our model, this disappearance occurs asymptotically for large levels of speculation. We do not see any change in the business-stealing effect measured through sales during bubbles, again in line with our theory.

Our analysis highlights the discrepancy between market- and outcome-based measures of the value of innovation during bubbles. That leaves us with an important question: which of these two is the correct economic measure? We answer from the perspective of a social planner deciding on an optimal innovation policy. We derive the optimal Pigouvian subsidy or tax on firm entry under different notions of social welfare, the choice of which is complicated by investor disagreement. On the one hand, the Pareto approach is non-paternalistic: it evaluates the welfare of each agent under her own beliefs. Under this approach, the optimal entry tax is simply the opposite of the market-based measure of spillover since asset prices accurately reflect investors' beliefs about externalities. On the other hand, a paternalistic approach evaluates welfare under a single belief, the population distribution. In this case, the optimal tax combines two components: the outcome-based measure of spillover (the real side of externalities) and the private-value distortion caused by the bubble (the overpricing relative to fundamentals). These two components can offset each other: by fostering more entry, a bubble might fix an economy that would otherwise have under-entry due to positive externalities. These results highlight that each of the measures convey crucial but distinct information about the economy.

Finally, we show that the implications of our theory extend beyond the measures discussed above. These other dimensions are interesting for their own sake and lead to further supporting evidence for our theory. The first implication is that if people disagree about what will be successful, the boundaries of the firm matter. A given investor might be optimistic about some projects of a firm but not others. Hence forming a conglomerate dilutes the ability of a firm to cater to the beliefs of its most optimistic investors, and therefore lowers its market value. We confirm empirically that the increase in the value of innovation during bubbles is less pronounced for multi-segment firms. Relatedly, our new form of disagreement also has implications for portfolio decisions. When investors disagree, they concentrate their investments towards the firms they are more positive about. This implies that portfolios are less diverse during bubbles, something we confirm empirically using 13F filings to the SEC.

In summary, while the presence of bubbles precludes a simple rational expectation view of the value of innovation, it does not mean there is nothing to learn from markets. Our framework explains how to extract information from both prices and real quantities to evaluate innovation. While our theory might not apply to each and every bubble—the housing boom of the 2000s comes to mind—the evidence we presente demonstrates its relevance.[5]

Related Literature. Our approach to representing speculation and the bubbles that ensue builds on a large body of work. The effect of belief disagreement on asset prices in the theoretical literature goes back to Miller (1977), Harrison and Kreps (1978), and Scheinkman and Xiong (2003). More recent contributions include Barberis, Greenwood, Jin, and Shleifer (2018), who emphasize the role of extrapolation, and Chinco (2020), who incorporates social interactions. Hirshleifer and Plotkin (2020) present an evolutionary theory of cultural traits leading to investment booms. We enrich this literature by focusing on disagreement at the micro level, specifically across many firms. We develop a framework that makes the high-dimensionality of this problem tractable and use it to consider implications for firm creation and innovation. Empirically, we use the methodology from Greenwood, Shleifer, and You (2018) to identify bubble episodes in stock market data. There is a broader set of empirical evidence that supports the relation between speculation, heterogeneous beliefs, and asset prices, such as Chen, Hong, and Stein (2002) or Diether, Malloy, and Scherbina (2002). Brunnermeier and Oehmke (2013) and Scheinkman (2014) review the theory and evidence.[6]

Our focus on the implications of bubbles for innovation connects us to work emphasizing the real effects of financial markets, dating back to Tobin (1969) and Hayashi (1982). Bond, Edmans, and Goldstein (2012) offer a survey. In the context of bubbles, Panageas (2015) highlights implications for investment, while Hombert and Matray (2020) focus on labor market outcomes.[7] Dong, Hirshleifer, and Teoh (2020) document effects of overvaluation on the quantity and ambitiousness of innovation at the firm level. We go beyond the direct effect of high stock prices by considering how speculation shapes the private and social values of innovation. To that end, we use data and measurement methods developed by Pakes (1986), Griliches, Pakes, and Hall (1986), Bloom, Schankerman, and Van Reenen (2013), and Kogan et al. (2017). Further-

[5]Theories à la Simsek (2013a) or Caballero and Simsek (2020) might be better suited for the analysis of aggregate bubbles.

[6]Janeway (2012) offers a first-person account of the interaction of bubbles and innovation.

[7]van Binsbergen and Opp (2019) quantify the effects of mispricing more generally.

more, our theoretical framework gives rise to a more nuanced set of tests of innovation transmission.

Naturally, there are other approaches to studying the relation between financial markets and innovation. Like us, this work builds on classic models of technological growth (e.g., Acemoglu, 2008). However, the extant literature considers different sources of asset-price fluctuation. One strand of the literature centers on uncertainty and risk compensation rather than speculation. Pastor and Veronesi (2005, 2009) offer quantitative accounts of innovation booms focused on learning. Gârleanu, Kogan, and Panageas (2012) and Kogan, Papanikolaou, and Stoffman (2020) highlight risks associated with displacement. Kung and Schmid (2015) study the long-run risk associated with innovation. Corhay, Kung, and Schmid (2015) and Loualiche (2020) measure risks associated with competition across firms. Another stream of work focuses on rational bubbles (as in Samuelson (1958) and Tirole (1985)) and whether they crowd in or crowd out investment. Farhi and Tirole (2011) and Martin and Ventura (2012) are two recent examples. Our results contribute to these lines of research by highlighting important variations in the characteristics and social implications of innovation around speculative episodes.

Finally, we contribute to the literature discussing welfare in the presence of disagreement. Heterogeneous beliefs raise the question of how to evaluate each agent's welfare.[8] One approach is to impose one common "correct" belief for welfare evaluation. Brunnermeier, Simsek, and Xiong (2014) circumvent the need to choose a specific belief by studying allocations that are efficient across all convex combinations of agents' beliefs. Davila (2020) follows this approach in the context of financial-transaction taxes. Kondor and Köszegi (2017) consider sophisticated financial products. Dávila and Walther (2021) studies prudential policy with distorted beliefs. A second approach uses the Pareto criterion and evaluates each agent's welfare under their own beliefs, which Duffie (2014) calls the "consenting-adults" criterion. We derive optimal innovation policies for both approaches and point out their differences. Interestingly, we relate the two types of welfare approaches to the measurement of both market prices and real outcomes.

The paper proceeds as follows. In Section 2, we present the main stylized facts about the value of innovation during a bubble. We introduce our model of speculation

[8]This question is closely related to the debate around the possibility that people agree to disagree; see Morris (1995) for a general perspective.

with business-stealing in Section 3 and show in Section 4 that the model predictions match the data. Section 5 studies the planner problem and Section 6 presents further predictions and supporting evidence for the model. Finally, Section 7 concludes.

2 Motivating Facts

We present two sets of stylized facts about the value of innovation during a bubble. First, we measure the value of a new innovation to its creator. Markets value innovations more during bubbles, even though these innovations do not subsequently provide higher profits or sales than usual. Second, we study how innovations affect competitors of the creator. Unlike in regular periods, we do not find any negative spillovers to the market value of competitors. There are still negative spillovers on real outcomes of competitors.

To establish these observations, we build on the seminal work of Kogan et al. (2017) and Bloom, Schankerman, and Van Reenen (2013), who develop both *market-* and *outcome-based* measures of the value of an innovation to its creator and competitors, respectively. Market-based measures use asset prices and outcome-based measures use real outcomes such as sales. We revisit their results during bubbles using the classification of Greenwood, Shleifer, and You (2018). We first review these approaches and the data construction, then report the two sets of results. Appendix Table IA.1 provides summary statistics of our data.

2.1 Methodology

Bubbles. We proxy for the presence of speculation using the empirical definition of bubbles from Greenwood, Shleifer, and You (2018). We split firms into 49 industries following the classification of Fama and French (1997). An industry-month is defined as being in a bubble if it satisfies three conditions simultaneously. First, the value-weighted portfolio of the corresponding industry experienced a return of 100% or more over the previous two years. Second, this industry's value-weighted return also exceeds the return of the market by at least 100% over the past two years. Third, the industry's value-weighted return over the past five years is larger than 50%. We aggregate to the industry-year level—the coarseness of the remainder of our data—by considering an industry-year in a bubble if the industry is in a bubble for at least a month in the year. In practice, multiple months are always in a bubble year due to the persistence of the bubble criteria. This approach identifies 74 industry-years in a bubble between 1962 and 2017.

As pointed out by Greenwood, Shleifer, and You (2018), this classification is not perfect: it is likely to miss some bubbles, but also to classify as bubbles some actual productive booms. Our interpretation of the evidence relies on the fact that the selected episodes are much more likely to be in a bubble than a typical industry-year. In line with this assumption, Greenwood, Shleifer, and You (2018) show that these episodes exhibit a constellation of characteristics consistent with a speculative bubble. In particular, in line with our focus on innovation, they find that "price run-ups ... involving younger firms [and] having higher relative returns among the younger firms ... [are] more likely to crash." Foreshadowing our theory, these industries with young and innovative firms are likely to have scarce information, making them more susceptible to the disagreement that we model.[9]

We also confirm the relevance of the bubble classification empirically for innovation. In Appendix Table IA.2, we show that there are 1.4 more patents issued within a USPTO technology class during bubbles, which translates to a 15% increase in the number of patents created in a patent class during a bubble.

The value of an innovation. We use the measures of private value of innovation from Kogan et al. (2017). Their dataset combines stock market and patent data for U.S. firms for the period from 1926 through 2010. They measure the stock market response in the three-day window after a firm is issued a new patent, controlling for the return on the market portfolio during that period. Kogan et al. (2017) also aggregate the stock market value from all the patents of a given firm every year to measure the value of innovation at the firm level. To account for the ultimate quality of each patent, Kogan et al. (2017) use the forward-looking number of citations generated by a patent for their patent-level analysis and the number of citations generated by all the patents produced by a firm in a given year for their firm-level analysis. Finally, we follow their measure of the impact of a patent on firm outcomes by studying the response of sales, profits, and productivity at horizons up to five years.

Spillovers to competitors. We also measure the spillovers from innovation on the competitors of innovating firms: how much do you lose when your competitors

[9] Other characteristics could favor creativity, such as the culture of the CEO as demonstrated in He and Hirshleifer (2020).

step ahead of you? A challenge to the estimation of this response is that related firms could also learn from this innovation, triggering a separate knowledge spillover. Bloom, Schankerman, and Van Reenen (2013) solve this issue. They regress a firm-level outcome—log market value or log future sales—on the quantity of innovation by groups of "neighboring" firms. Because the set of close competitors and the set of close innovators do not coincide, this approach separates competitive spillovers arising from firms in neighboring industries and knowledge spillovers coming from firms issuing patents in the same USPTO technology class. Specifically, they first construct distances between firms in each of these two spaces. Then, for each firm-year, they compute distance-weighted stocks of innovative capital from all other firms. The resulting firm-level exposures for competitors and other innovators are *spillsic* and *spilltech*, respectively, and regressions on these quantities measure competitive and innovative spillovers. In this paper, we focus on the competitive spillovers, but still control for innovative interactions. As will become clear when we turn to the model, the behavior of competitive spillovers is particularly informative to separate theories of bubbles.[10] When the left-hand side of the regression is log market value, this approach identifies the market-based spillover. When focusing on log sales, the coefficients identify the outcome-based spillover. Taking the log ensures that we are considering a semi-elasticity, the counterpart to the spillover in our model.

Bloom, Schankerman, and Van Reenen (2013) propose a variety of metrics for distance. We follow their construction. Proximity between two competing firms in the product market space is the correlation of the firms' distribution of sales across their industry segments. Technology proximity is analogously defined as the correlation of patent USPTO technology classes between firms, following earlier work by Jaffe (1986). The quantities of innovation by competitors and close innovators are the stocks of innovation weighted by these correlations. The stock of innovation is constructed using a perpetual-inventory approach. Both measures are extended using the Mahalanobis distance to allow for flexible weighting of the correlation between firms across different technology or product market classes. Further details on the measures of spillovers can be found in Appendix G and in Bloom, Schankerman, and Van Reenen (2013).

2.2 The Value of Innovation During Bubbles

[10] In Section 6.3, we also discuss the implications of our theory for knowledge spillovers.

Table 1
Market Value of Innovation in Bubbles

	Patent Level			Firm Level		
	(1)	(2)	(3)	(4)	(5)	(6)
Bubble	0.317***	0.315***	0.186	0.514***	0.427***	0.265**
	(0.094)	(0.094)	(0.132)	(0.114)	(0.123)	(0.134)
Log Citations		0.016***	0.014***		0.823***	0.821***
(forward looking)		(0.004)	(0.005)		(0.011)	(0.011)
Log Citations x Bubble			0.054**			0.061***
			(0.025)			(0.012)
Fixed Effects	Y, F	Y, F	Y, F	Y, F	Y, F	Y, F
Observations	1,171,806	1,171,806	1,171,806	47,886	47,886	47,886
R^2	0.68	0.68	0.68	0.89	0.94	0.94

Note: Table 1 presents panel regressions of the value of innovation, as measured in Kogan et al. (2017) at the patent and firm levels, on a dummy from Greenwood, Shleifer, and You (2018) that captures whether the firm is in an industry that is in a bubble or not. We include fixed effects for firm F and patent grant year Y. Standard errors clustered at the grant-year level are in parentheses. *, **, and *** denote significance at the 10%, 5%, and 1% levels, respectively.

The market value of innovation increases in bubbles. To study the effect of speculation on the value of innovation at the patent level, we consider the following regression specification:

$$\log \xi_{j,t} = \beta B_{j,t} + \gamma Z_{j,t} + \varepsilon_{j,t}, \tag{1}$$

where $\xi_{j,t}$ is the market value of patent j issued during year t using the market-based measure from Kogan et al. (2017). The variable $B_{j,t}$ is an indicator for whether the firm issuing patent j was in an industry experiencing a bubble during year t. As in Kogan et al. (2017), the controls $Z_{j,t}$ include the logarithm of the number of citations for the patent as well as firm and year fixed effects. The firm fixed effects ensure that our results are not driven by the type of firms or industries that go through bubbles. We run a similar regression at the firm level, replacing the private value and citation variables with their firm-level analogues.

Table 1 shows that speculation indeed increases the private value of innovation. In a bubble, the private value of innovation is 30% higher at the patent level (columns 1 and 2) and 40% to 50% higher at the firm level (columns 4 and 5). These effects are both economically and statistically significant.

The high valuation of patents during bubbles might appear mechanical because bubbles are defined by high market valuations. This is not the case. For example, the common view that bubbles are episodes in which prices are completely disconnected from fundamentals would not make such a prediction. Under this view, valuations could be high overall but would not be responsive to news of patent issuance.

In columns 3 and 6, we consider the effect of patent quality on its valuation during a bubble. This further tests that bubbles are not times where prices are disconnected from fundamentals We find that the response of market value to citations is even stronger during bubbles. This confirms that bubbles exacerbate how markets value innovations.

The effect of innovation on real outcomes during bubbles. We show that the increased valuation of innovation during bubbles is not justified by the effect on real outcomes. In Table 2, we consider how real firm outcomes—profit, sales, and productivity—respond to innovations. This is a counterpart to regression equation (1) where we replace the market value in the left hand side with these quantities. Real outcomes are observed at low frequency, thus we focus solely on the firm level specifications. Under the view that higher prices reflect improved fundamentals, the effect of innovation on prices corresponds to a higher present value of future cash flows. Therefore we measure not only the instantaneous response of quantities but also the response at longer horizons, up to five years.

Innovation does affect real outcomes. Consistent with the literature, we find that more cited patents go along with larger profits, sales, and productivity at horizons up to five years. However, the relation between citations and cash flows does not change during bubbles. The coefficient on the interaction of citations and the bubble indicator is tightly estimated around zero at horizon up to three years and remains economically small and statistically insignificant in all specifications. In addition, we do not observe a level effect during bubbles: only one out 15 coefficients is significantly different from zero.

Table 2
Profits, Sales, and Productivity at Different Horizons During Bubbles

	Horizon (years)				
	(1)	(2)	(3)	(4)	(5)
	Future Profits				
Citations	0.014***	0.021***	0.027***	0.033***	0.042***
	(0.003)	(0.004)	(0.005)	(0.006)	(0.007)
Bubble	0.032	−0.002	−0.023	−0.034	−0.037
	(0.025)	(0.035)	(0.035)	(0.042)	(0.042)
Citations x Bubble	0.001	−0.002	0.009	0.008	−0.022
	(0.012)	(0.011)	(0.014)	(0.018)	(0.020)
Fixed Effects: year, industry	Y	Y	Y	Y	Y
Observations	121,017	109,523	99,248	90,123	81,895
R^2	0.09	0.10	0.11	0.12	0.13
	Future Sales				
Citations	0.004	0.012***	0.017***	0.023***	0.028***
	(0.003)	(0.004)	(0.005)	(0.006)	(0.007)
Bubble	0.022	−0.026	−0.040	−0.047	−0.059
	(0.034)	(0.046)	(0.050)	(0.050)	(0.049)
Citations x Bubble	−0.003	0.004	−0.003	0.008	0.004
	(0.016)	(0.018)	(0.019)	(0.020)	(0.023)
Fixed Effects: year, industry	Y	Y	Y	Y	Y
Observations	120,948	109,365	99,076	89,932	81,695
R^2	0.10	0.10	0.11	0.12	0.13
	Future TFPR				
Citations	0.007***	0.007***	0.009***	0.009***	0.010***
	(0.002)	(0.002)	(0.002)	(0.002)	(0.003)
Bubble	0.026**	0.019	0.012	0.001	−0.006
	(0.010)	(0.012)	(0.012)	(0.015)	(0.018)
Citations x Bubble	0.010	−0.005	−0.017	−0.001	−0.031
	(0.015)	(0.013)	(0.017)	(0.017)	(0.023)
Fixed Effects: year, industry	Y	Y	Y	Y	Y
Observations	80,912	72,898	65,890	59,692	54,146
R^2	0.20	0.24	0.26	0.28	0.29

Note: Table 2 presents panel regressions of the future profits, sales, and productivity (TFPR) for horizons of one to five years on bubble dummy and citation measure of patent value. Detailed descriptions of the variable are in Bloom, Schankerman, and Van Reenen (2013). We use firm fixed effects F and patent grant year fixed effects Y. Standard errors clustered at the grant year level are presented in parentheses. *, **, and *** denote significance at the 10%, 5%, and 1%, respectively.

2.3 The Spillovers of Innovation on Competitors During Bubbles

Second, we turn to the effect of innovations on competitors of the creator. By focusing on competitive spillovers, we zoom in on the process of creative destruction during bubbles. As a firm reaps the benefits of its own innovation, it hurts the profits of its competitors in the process. This is known as business stealing (Acemoglu, 2008) or displacement (Gârleanu, Kogan, and Panageas, 2012) in the literature. In the previous section, we document how the market ascribes higher value to innovations. We now investigate whether the market views spillovers as more important as well during bubbles.

We test this hypothesis empirically by enriching the specification of Bloom, Schankerman, and Van Reenen (2013) to estimate spillovers conditional on a bubble:

$$\begin{aligned}\log X_{i,t} = {} & \beta\,(B_{i,t} \times \log \mathit{spillsic}_{i,t}) + \gamma_1 \log \mathit{spillsic}_{i,t} \\ & + \gamma_2 \log \mathit{spilltech}_{i,t} + \gamma_3 B_{i,t} + \delta Z_{i,t} + \varepsilon_{i,t},\end{aligned} \tag{2}$$

where $X_{i,t}$ is either the market value (Tobin's q) or output (sales normalized by an industry price index) of firm i in year t. As before, $B_{i,t}$ is an indicator of whether firm i is in an industry that experienced a bubble in year t. The controls $Z_{i,t}$ are taken from Bloom, Schankerman, and Van Reenen (2013) and include firm and year fixed effects. Taking $X_{i,t}$ to be the market value of the firm, we measure the market-based spillovers. On the other hand, for outcome-based measures of spillovers, we take $X_{i,t}$ to be firm output. The main coefficient of interest is β: how different are competitive spillovers during bubbles?

Table 3 reports the results. Columns 1 to 3 considers the effect of innovations by competitors on market value for three different approaches to measuring spillovers. The significant and negative coefficient on *spillsic* indicates that outside of bubbles, competitive spillovers have a negative effect on valuations, consistent with the results in Bloom, Schankerman, and Van Reenen (2013). The coefficient on the interaction of *spillsic* with bubbles is positive, indicating a reduction in the effect of competitive spillovers. The estimated competitive spillover in a bubble (the sum of coefficients on *spillsic* and the interaction term) is positive for the Jaffe and Mahalanobis spillover measures but negative when we instrument for the spillover as in Bloom, Schankerman, and Van Reenen (2013). In all cases this represents a considerable reduction in how

Table 3
Social Value of Innovation in Times of Bubbles

	Market-based Spillovers			Outcome-based Spillovers		
	Jaffe (1)	Mahalanobis (2)	IV Jaffe (3)	Jaffe (4)	Mahalanobis (5)	IV Jaffe (6)
Bubble x Spill-SIC	0.152***	0.200***	0.178***	0.004	−0.000	0.007***
	(0.027)	(0.037)	(0.038)	(0.009)	(0.013)	(0.002)
Spill-SIC	−0.088***	−0.103***	−0.314***	−0.021***	−0.021**	−0.044
	(0.016)	(0.033)	(0.104)	(0.006)	(0.010)	(0.046)
Spill-Tech	0.405***	0.844***	1.214***	0.175***	0.159***	0.188**
	(0.145)	(0.174)	(0.171)	(0.025)	(0.040)	(0.074)
Fixed Effects	Y, F	Y, F	Y, F	Y, F	Y, F	Y, F
Observations	8,896	8,946	8,896	8,775	8,825	8,775
R^2	0.74	0.74	0.73	0.99	0.99	0.99

Note: Table 3 presents panel regressions of firm value (log of sales or Tobin's q) on a measure of competition from Bloom, Schankerman, and Van Reenen (2013) interacted with a bubble dummy, measured as in Greenwood, Shleifer, and You (2018) that captures whether the firm is an industry that is in a bubble state or not. We control for the technological spillover measure that corresponds to the public firms that issue patent in similar technological space. We follow the specification from Table of 3 and 5 of Bloom, Schankerman, and Van Reenen (2013) and include the same controls. We use firm F and year Y fixed effects. Standard errors clustered at the year level are presented in parentheses. *, **, and *** denote significance at the 10%, 5%, and 1%, respectively.

the market assesses competitive spillovers. When a firm innovates during a bubble, the market value of its competitors does not change much.

We contrast our results on firm value to the spillovers on sales in columns 4 to 6. We find a negative and significant coefficient on *spillsic* here again confirming the results in Bloom, Schankerman, and Van Reenen (2013). Outside of bubbles firm fundamentals react negatively to innovations by competitors. Unlike the results on market valuations, the presence of a bubble does not have any effect on the spillovers to real quantities. The coefficient on the interaction of bubbles and spillovers is statistically insignificant (columns 4 and 5) and small relative to the main coefficient (columns 4, 5, and 6). In Appendix Table IA.3, we confirm the robustness of our results with a different approach to measuring spillovers based on Jaffe covariance distance metrics. Market-based spillovers disappear with speculation as investors ignore the business-stealing effect, while outcome-based spillovers are unchanged.

Taken together, these two sets of empirical results draw a fascinating picture of innovation during bubbles. For both the direct effect and spillovers, we observe a divorce between asset prices and real quantities. This challenges the notion that the two approaches convey the same information about the value of innovation. Further, there is a tension in the behavior of asset prices. On the one hand, bubbles lead to higher direct market value of innovations in a discerning way: more impactful patents receive even higher valuations during bubbles. On the other hand, market values mostly ignore negative spillovers to competitors. In the next section, we present a theory that ties all these facts together.

3 A Model of Disagreement and Innovation

We present our explanation of innovation during bubbles. The model combines the idea that bubbles stem from investor disagreement (Miller, 1977; Harrison and Kreps, 1978; Scheinkman and Xiong, 2003) with a standard framework of firm competition. We introduce a new element: investors disagree about which specific firms will succeed. For example, investors disagree not about the total value of social networks but rather the value of Facebook versus Twitter. We show that this novel type of disagreement is crucial to rationalize the empirical results of Section 2.

Figure 1 illustrates the overall structure of the model. At date 0, households work to create blueprints or new ideas. They sell the blueprints to firm creators, who implement them as firms. On financial markets, households who disagree with each other speculate on the claims to these firms' production. At date 1, firms compete and produce; households receive the payoffs from their positions in firms and consume. We now detail each of these steps. All the proofs are in Appendix Section A.

3.1 Firms

A continuum of firms, indexed by i and with total mass M_e, is created in equilibrium at date 0. At date 1, firms enter the production stage, and their productivity a_i is revealed. To capture competition across these firms, we assume that only a fixed mass M of the most productive firms is able to produce. M_e is an endogenous outcome, while M is a fixed parameter.[11] Given the cumulative distribution function of productivities

[11] Appendix Section F.2 considers an extension with a varying number of active firms.

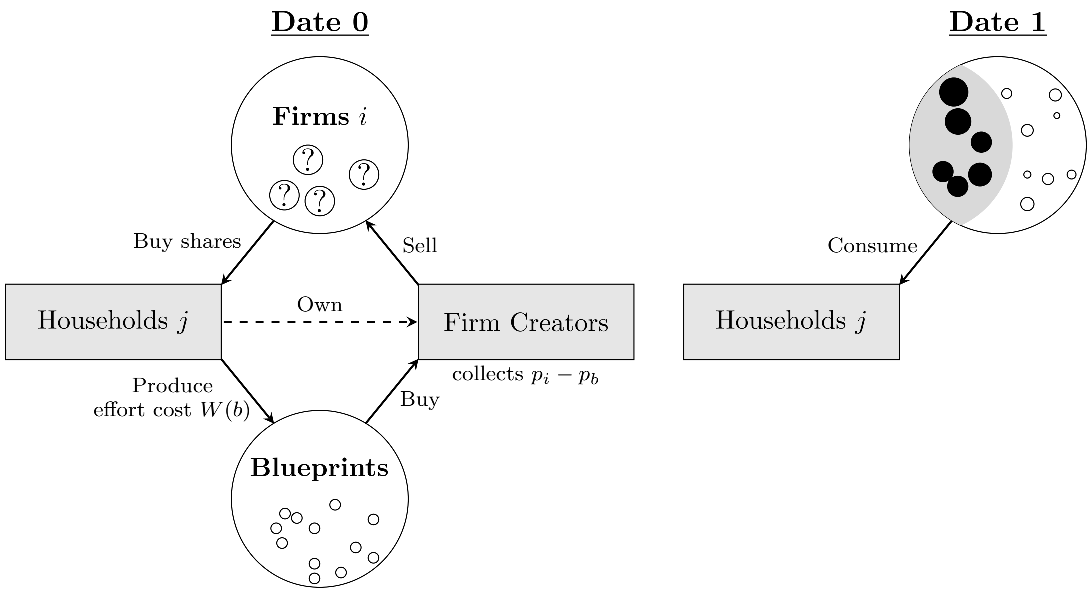

Figure 1
Summary of model structure.
The left panel represents the stage of firm creation at date $t = 0$, when blueprints are created and households buy shares in firms on financial markets based on their beliefs. The right panel represents the production stage at $t = 1$.

in the population F, only firms above a cutoff $\underline{a}$ are able to produce, with

$$\underline{a} := F^{-1}\left(1 - \frac{M}{M_e}\right). \tag{3}$$

The profits of a firm with productivity a are then given by

$$\pi(a) = a^{\eta} \cdot \mathbf{1}\left\{a \geq \underline{a}\right\}, \tag{4}$$

where η determines how differences in productivities translate into differences in generated profits, and the indicator function captures whether the firm produces or not.[12] We concentrate on situations in which $M < M_e$, so that fewer firms produce than are created; the case of $M = M_e$ is straightforward.

This allocation of production slots is the key assumption to capture the notion of business-stealing. Indeed, firms do not internalize that they might take over the slot of

[12]The fact that the marginal active firm collects positive profits improves tractability but is not crucial to our conclusions. We show in Appendix B.3 that our results also hold in a variant of the model where the marginal firm earns zero profits.

another firm. The assumption of a fixed mass of production slots is especially plausible in industries that depend heavily on innovation. For instance, intellectual property law often provides exclusive use of a technology to its inventor.[13] We can interpret the fixed production slots as corresponding to a fixed number of M processes to produce the homogeneous good. The first firm to discover a process gets its exclusive use, and the speed of discovery is perfectly correlated with the productivity type a. Alternatively, we can assume that to produce, a firm needs one unit of an indivisible good that has not been discovered yet, and that only M of these exist in nature. Again firms with a higher type a find the ingredient faster.[14] Our assumption relies more generally on scarcity in the ability to produce that is not internalized by individual firms. We show in Appendix Sections B and F how our results hold for a wide range of models of business stealing. In particular, we show that the rigidity of a fixed number of active firms M is not necessary to our conclusions.

Formally, these firms constitute the whole economy. However, one can interpret the model as representing one sector of an economy.[15] Our results would be unchanged as long as firms do not interact across sectors because we assume the presence of a quasilinear good in the next section.

3.2 Households

Households play two roles in the model. They work to create the blueprints for new firms, and they speculate on which of the new firms will succeed. Formally, there is a unit mass of households indexed by j. At date 0, household j is endowed with a fixed unit of consumption good c_0 and its share of firm creators, which we describe in the next section. In addition, each household decides how many blueprints to supply, b_j. Blueprints are produced at a convex cost $W(b_j) = f_e b_j^{\theta+1} M^{-\theta}/(\theta+1)$, where the parameter θ is the elasticity of supply of blueprints and f_e controls the level of

[13]Another motivation for the incompleteness is the difficulty of establishing markets for what has not been encountered yet. It is often the case that nobody owns something before it is discovered. For instance, how could we trade nuclear power before Henri Becquerel, Marie Curie, and Pierre Curie discovered radioactivity?

[14]Network goods or industries facing institutional constraints can face similar frictions in the allocations of productive positions that lead to a business-stealing effect—see Borjas and Doran (2012) for evidence in the context of scientific research.

[15]In an economy with multiple sectors, the inefficient levels of innovation we will show in the model are a form of misallocation.

production costs.[16] Finally, each household also decides on the number of shares to invest in each firm on the financial market, $\{s_i^j\}_i$. Households have heterogeneous beliefs about the distribution of productivity a_i for each firm i, which we describe in detail below. We assume that they can only take long positions in claims to firms.[17]

Households behave competitively and take prices as given. Hence, household j solves the problem

$$\max_{c_0, s_i^j \geq 0, b_j} \; c_0 + \mathbf{E}^j \left\{ \int s_i^j \pi_i di \right\} - W(b_j) \tag{5}$$

$$\text{s.t.} \;\; c_0 + \int s_i^j \; p_i \; di \leq 1 + p_b b_j + \Pi, \tag{6}$$

where p_i and p_b are the respective prices of firm i and blueprints, $\mathbf{E}^j$ is household j's expectation and Π denotes firm creators' aggregate profits.[18]

3.3 Beliefs

To capture the notion of speculation, we assume that households disagree about which firms will be successful. Disagreement arises naturally in innovative episodes: households must rely on their priors to evaluate new firms (or ideas) and, in the absence of data on these firms, agree to disagree.[19] In general, it is challenging to keep track of heterogeneous beliefs about an entire set of firms. We overcome this issue by imposing structure on the distribution of beliefs. Beliefs are governed by two exogenous parameters: the actual population distribution F and a scalar n for the intensity of

[16] We introduce the total mass of firms M in the blueprint production function to simplify the algebra. None of our results rely on this assumption. This assumption could only matter if one were to do comparative statics with respect to the parameter M.

[17] Such a hard constraint facilitates the analysis, but the important assumption is some limit or cost to the ability to take short positions. The importance of limits to short-selling in models of disagreement has been well-known since the work of Miller (1977), Harrison and Kreps (1978), or more recently Scheinkman and Xiong (2003). D'avolio (2002) and Jones and Lamont (2002) document empirical evidence of such short-sale constraints, with the former showing that these constraints increase with disagreement. A theoretical justification is provided by Duffie, Garleanu, and Pedersen (2002), who microfound short-sale costs using a search model.

[18] The assumption of risk neutrality does not play any role in the analysis. Formally, all our results would be identical if the objective of households were: $c_0 + \mathcal{U}^{-1}\left(\mathbf{E}^j \left\{\mathcal{U}(\int s_i^j \pi_i di)\right\}\right) - W(b_j)$, where $\mathcal{U}(.)$ is an increasing and concave function.

[19] Morris (1995) discusses arguments for heterogeneous priors, many of which are particularly applicable in our setting. Besides the lack of information about new technology, the model generates specific testable predictions for the belief structure.

disagreement. We assume that even though agents disagree about each individual firm, they agree on the population distribution of firm productivity.[20] We also assume that the population distribution F follows a Pareto distribution: $F(a) = 1 - a^{-\gamma}$ for $a \geq 1$.

A simple narrative for our specification of individual beliefs is as follows. Each household organizes firms into a continuum of packets containing n firms each and believes it knows the exact ranking of productivity draws within each packet. We assume that the composition of packets and the order of firms within packets is drawn in an i.i.d. equiprobable fashion across agents and firms, and that each firm can only be in one packet.[21] The parameter n controls the intensity of disagreement. When $n = 1$, households consider all firms to be the same, with their productivity drawn from F. As n increases, households have views on the comparison of more firms and thus have a stronger prior that the best firm in each packet will have high productivity.

In equilibrium, household j only invests in the subset of firms that it considers to be the most productive in each of their respective packets. These firms are perceived by household j to have productivity drawn from F^n, the distribution of the maximum of n independent draws from F. Since households rank firms differently, they have different beliefs about the productivity distribution of any given firm and invest in different sets of firms, as illustrated in Figure 2. Each household believes that the firms it invests in are, in expectation, more productive than the average firm in the economy.

Our analysis does not rely on the specific narrative of packet formation, even though we find it intuitively appealing. The key mechanism is that when investors disagree, they each tilt their portfolio towards their favorite firms. As disagreement increases, this specialization strengthens, and investors in each given firm become more and more optimistic about its prospects. The crux of our assumptions is to reduce the distribution of beliefs to two parameters: the actual population distribution F and a single parameter n for the intensity of disagreement. In addition, two features of these assumptions facilitate the analysis. First, while households disagree on which

[20] A motivation for focusing on disagreement across firms rather than about the aggregate is the empirical observation that high firm entry in a sector often follows disruptive innovation, either through a large technological change or the introduction of new products. New firms then conduct micro innovations to take advantage of a macro innovation (Mokyr, 1992). Empirically, these episodes appear particularly relevant to economic growth, as discussed for instance in Abernathy (1978) and Freeman (1982).

[21] Formally, there is no choice of packets for investors. This narrative is equivalent to assuming that each investor has beliefs from the cumulative distribution of the first order statistic from F for a sample of size n for a fraction $1/n$ of firms, the second order statistic for a separate fraction $1/n$, the third order statistic... The composition of these groups of size M_e/n is independent across investors.

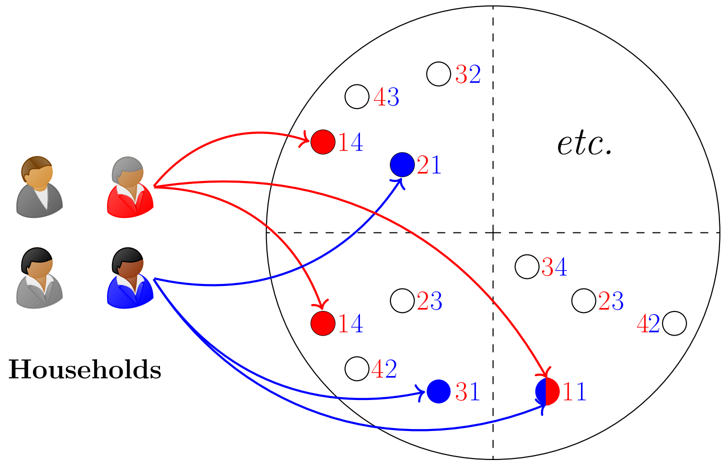

Figure 2
Households' beliefs and choice of firms to invest in.
The figure illustrates the case of $n = 4$. For this figure, the composition of each packet is identical across agents for exposition purposes. This choice does not affect the model results.

firms will succeed, they agree on the population distribution of firms. Hence, they agree on aggregate outcomes: both the threshold $\underline{a}$ and market conditions, which play a role in the richer settings of Section 6.3 and Appendix Section D. Second, beliefs are symmetric across households. This overcomes the issue of having to keep track of the entire distribution of beliefs and allocations.

3.4 Firm Creators

Finally, firm creators connect the steps of innovation and trading in financial markets. They pay households to create blueprints, and issue claims to the corresponding firms on the financial market. Formally, there is a continuum of short-lived firm creators. At date 0, each firm creator can use a unit blueprint to create a new firm, which is then sold on competitive financial markets. They participate in competitive markets for blueprints and firms, taking their respective prices p_b and p_i as given.[22] The firm creator problem at time $t = 0$ is therefore:

$$\max_{c \in \{0,1\}} c \cdot (p_i - p_b). \tag{7}$$

[22]We assume firm creators do not have any information about the firms they create.

3.5 Equilibrium

The competitive equilibrium of the economy is defined as follows. Firm creators maximize profits from selling their firms, taking prices as given. Households maximize their perceived expected utility by choosing their optimal blueprint discovery effort and an optimal portfolio allocation, taking the prices of blueprints and firms as given. Firms maximize profits given their production status. Finally, the markets for blueprints and claims to firms' profits (the stock market) clear:

$$\int b_j dj = M_e, \tag{8}$$

$$\forall i \in [0, M_e], \qquad \int s_i^j dj = 1. \tag{9}$$

Combining the equilibrium conditions yields a single equation determining the quantity of firm entry M_e:

$$W'(M_e) = V^{(n)}(M_e) = \int_{\underline{a}}^{\infty} \pi(a) dF^n(a). \tag{10}$$

In equilibrium, the marginal cost of creating an additional firm, $W'(M_e)$, is equal to the expected profits to an investor who favors it, $V^{(n)}(M_e)$. Both of these quantities are equal to the prices at which blueprints and firms trade in the economy, $p_i = p_b$. Therefore, this condition also pins down the price of new firms. We define the expected value of the firm:

$$\mathcal{I}_n(M_e, \eta) := \int_{F^{-1}(1-M/M_e)}^{\infty} a^\eta dF^n(a). \tag{11}$$

This value will play a prominent role in our analysis, with $V^{(n)}(M_e) = \mathcal{I}_n(M_e, \eta)$ in the model here.

In line with other theories with disagreement, our model yields features of bubbles: when investors disagree more, valuations are higher. In our model this comes from investors assigning a higher value to the firms they value most. As n increases, the demand for firms $V^n(.)$ shifts up. The higher demand from financial market participants increases the price of firms p_i and leads to more new firms M_e. This reflects the boom phase of a bubble: many new innovations are implemented and firms created, and prices on financial markets are high. Subsequently, however, not all investors can be right. Prices fall as output is below the level they imply. Formally, firms are priced at $\mathcal{I}_n$, under the distribution F^n, but the average output is only $\mathcal{I}_1$, under the population distribution F. This drop corresponds to the bust phase of a bubble. In Appendix C, we describe at length how our model of bubbles accounts for many other features of innovation-related bubbles. We now turn to the main focus of the paper, the value of innovation and its competitive spillovers during a bubble.

4 The Value of Innovation

We are interested in two dimensions of the effect of an innovation: the private value, which accrues to its investors, and competitive spillovers. Understanding these two notions is important because they shed light on how the process of innovation alters the economy and ultimately creates growth. We show that market-based and outcome-based measures in the model diverge in systematic ways during bubbles, in line with the empirical results from Section 2. Finally, we show that other types of bubbles cannot explain these facts.

4.1 Private Value

The private value of a firm is the value of that firm to its investors. Consider first the market-based measure of this value. Empirically, this corresponds to the change in stock price of a firm following an innovation, as we measure in Section 2.2 following Kogan et al. (2017). In the model, the market-based private value is simply the price $p_i = \mathcal{I}_n(M_e)$ at which the firm trades. This is because an innovation and a firm coincide, an assumption we make for simplicity.[23] As discussed in the previous section, this value increases during bubble episodes (large n).

The outcome-based counterpart to this metric is the actual effect of an innovation. In the data, it can be measured by changes in sales or profits following the introduction of an innovation. In the model, the realized output of the firm is the outcome-based private value. On average, the output of a firm is given by $\mathcal{I}_1(M_e)$, and all investors agree about this. In the absence of disagreement, $n = 1$, market-based and outcome-based private values coincide. However, as n increases, the two values diverge and the ratio $\mathcal{I}_n(M_e)/\mathcal{I}_1(M_e)$ increases. In other words, the increase in market value due to speculation does not reflect a commensurate increase in fundamentals.

[23]In Section 6, we come back to the distinction between innovation and firm.

The market value of an innovation increases during a bubble; this increase is not justified by a change in outcomes. These two predictions rationalize the empirical results about the value of innovation in Table 1 for the market value and Table 2 for outcome-based value. These results are the defining properties of bubbles applied to innovation. Our analysis below of the competitive spillovers in the model paints a more subtle picture than a naive theory that simply states that all valuations are higher than usual during a bubble.

4.2 Competitive Spillovers

The competitive spillovers are the effect of the introduction of a new innovation on the competitors of the innovator. Precisely, we define spillovers by the change in value of all competitors relative to the private value of innovation:

$$\textit{spillover} = \frac{\text{effect on competitors}}{\text{private value}} \tag{12}$$

Empirically, this definition coincides with estimating the elasticity of firm value to the unexpected entry of another firm, closely related to Bloom, Schankerman, and Van Reenen (2013). In our model, competition is the only source of interaction between firms. Thus, the total effect on competitors is the difference between the total effect of the innovation on the value of the economy and the private value accruing to the innovator.

Similar to the measure of private value introduced above, we consider both *market-based spillover* using asset prices and *outcome-based spillover* using output. In the model with agreement, we find no distinction between the market- and outcome-based spillovers, since the price of claims to a firm in period 0 is equal to the mean firm profits in period 1. In contrast, speculation introduces a gap between the two spillover measures consistent with the results of Section 2.3.

4.2.1 Spillovers in the Model

In the model, spillovers arise because of a business-stealing effect: a new firm that enters may take up a production slot and displace an existing firm.

Computing the spillovers in the model is challenging because the baseline model of Section 3 does not feature unexpected entry: the number of firms is deterministic in equilibrium. We overcome this challenge by introducing the possibility that some blueprints randomly fail to be implemented. Formally, after firm creators purchase blueprints but before they introduce these blueprints to public markets, a fraction of them disappear. If M_e blueprints are created, either they all succeed or a mass Δ fails, with probability $1-\varepsilon$ and ε, respectively. By focusing on the limit when ε and Δ go to zero, we trace out the equilibrium effect of the unanticipated entry of an atomistic firm on the total value of the economy.

Comparing the total market value of the economy across the two outcomes, we obtain the total effect of an extra firm on the value of the economy:

$$\lim_{\Delta\to 0} \frac{M_e V^{(n)}(M_e) - (M_e-\Delta)V^{(n)}(M_e-\Delta)}{\Delta} = V^{(n)}(M_e) + M_e V^{(n)\prime}(M_e) \tag{13}$$

The outcome-based value of this measure is simply obtained by replacing n by 1 in this expression. We recognize the two effects of introducing a new firm. The first term is the direct effect: the private value of a new firm $V^{(n)}(M_e)$. The second term is the change in the value of all other firms in response to the entry of the new firm. Each of the M_e firms in the economy sees its value decrease by $V^{(n)\prime}(M_e)$. Taking the ratio of the direct and the indirect effect, we obtain the two measures of spillover:

$$spill_{mkt} = \frac{M_e V^{(n)\prime}(M_e)}{V^{(n)}(M_e)}, \tag{14}$$

$$spill_{out} = \frac{M_e V^{(1)\prime}(M_e)}{V^{(1)}(M_e)}. \tag{15}$$

The spillovers depend on the elasticity of the value of a firm to the number of firms, $\mathcal{E}_{\mathcal{I}_n}$.[24] This elasticity is negative because of the business-stealing effect. The entry of a new firm makes all other firms less likely to produce.

In the remainder of this section, we derive properties of the spillover measures. In particular, we relate them to the intensity of speculation. Before doing so, it is worth pointing out that the spillover measures the intensity of entry externalities in the economy and, as such, corresponds to a Pigouvian tax or subsidy on entry. We return to this implication at length in Section 5.

[24]Throughout the paper, we denote the elasticity of quantity X to firm entry M_e by $\mathcal{E}_X = d\log(X)/d\log(M_e)$.

4.2.2 Outcome-Based Spillover

The outcome-based spillover is the elasticity of the average output of a firm with respect to the number of firms in the economy. We compute explicitly $spill_{out}$ from the expression of equation (15), replacing the output of a firm with $\mathcal{I}_1$:

$$spill_{out} = -\frac{\int_{\underline{a}}^{\infty} \pi(\underline{a}) dF(a)}{\int_{\underline{a}}^{\infty} \pi(a) dF(a)} = -\frac{\gamma - \eta}{\gamma}. \tag{16}$$

The ratio of the two integrals has an intuitive explanation. The numerator represents the expected amount of profits displaced by the introduction of a new firm. It is the product of the output of the marginal producing firm (the firm that will get displaced) with the probability that that firm gets displaced, $\int_{\underline{a}}^{\infty} dF(a)$. The denominator is the expected output of a new firm.

Displacement lowers aggregate output, thus $spill_{out}$ is negative. However, displacement only occurs when the new firm is more productive than an existing firm, thus $|spill_{out}| < 1$. There is a smaller spillover if the distribution of firm productivity is more dispersed (lower values of γ) or when productivity differences translate into larger output differences (larger values of η).

The outcome-based spillover $spill_{out}$ does not depend on the equilibrium number of firms M_e. Technically, this result is the consequence of specifying a power production function and a Pareto productivity distribution.[25] As the level of disagreement changes, the outcome-based spillover stays constant. This prediction provides a useful benchmark against which to evaluate the behavior of market-based spillovers. Empirically, in Section 2.3, we find that outcome-based spillovers are unchanged during bubbles, confirming this theoretical result.

4.2.3 Market-Based Spillover

The market-based spillover is the elasticity of the market value of a firm to the number of firms in the economy. In the case of agreement ($n = 1$), market value and average output coincide; therefore, market-based and outcome-based measures of spillovers are identical. However, with disagreement, the two measures diverge, and $spill_{mkt}$ is not

[25] Under a Pareto distribution, the ratio between marginal and average productivity is independent of the lower cutoff.

constant.

Proposition 1. *Speculation lowers the intensity of market-based spillovers:*

$$|spill_{mkt}(n)| < |spill_{mkt}(1)|\,, \quad \textit{for } n > 1 \tag{17}$$

Under disagreement, the market-based spillover is smaller despite the level of firm entry being higher. This seeming contradiction arises because the beliefs of households impact their valuation of equilibrium allocations. When they disagree, households only invest in their favorite firms. Therefore, each household places a lower probability on being displaced by new entrants, thereby reducing the effect of the business-stealing externality on the market prices that determine the market-based spillovers.

More formally, we can rewrite the market-based spillover from (14) in its integral form:

$$spill_{mkt}(n) = \frac{M_e V^{(n)'}(M_e)}{V^{(n)}(M_e)} = -\frac{\displaystyle\int_{\underline{a}}^{\infty} \pi(\underline{a})\frac{F_n'}{F'}(\underline{a})\, dF(a)}{\displaystyle\int_{\underline{a}}^{\infty} \pi(a)\frac{F_n'}{F'}(a)\, dF(a)}. \tag{18}$$

This ratio compares the value of displaced firms to the value of the firm displacing them, evaluated through the beliefs of their respective investors. Holding M_e and thus $\underline{a}$ constant, consider how this ratio changes with n. The numerator is the expected value of a displaced firm from the point of view of its owners. Disagreement affects this value through the change in probability weights F_n'/F' *at the threshold* $\underline{a}$. In contrast, the denominator is the profit of an average firm from the point of view of its owners. This quantity is affected by changes in the probability weights throughout the distribution *above the threshold*. Because increasing n corresponds to shifting the perceived distribution of productivities to the right, the change in probability weights is increasing as we move to higher productivities (see Appendix Figure IA.1). Such an increase affects expected profits more strongly than the value of displaced firms, decreasing the wedge. In Appendix A.1, we show that this result holds more generally with minimal assumptions on the productivity distribution $F(\cdot)$ and profit function $\pi(\cdot)$.

This proposition gives rise to a clear prediction: the market-based spillovers are lower in speculative periods. This corresponds to the result we find in Section 2.3 where, following Bloom, Schankerman, and Van Reenen (2013), we measure these

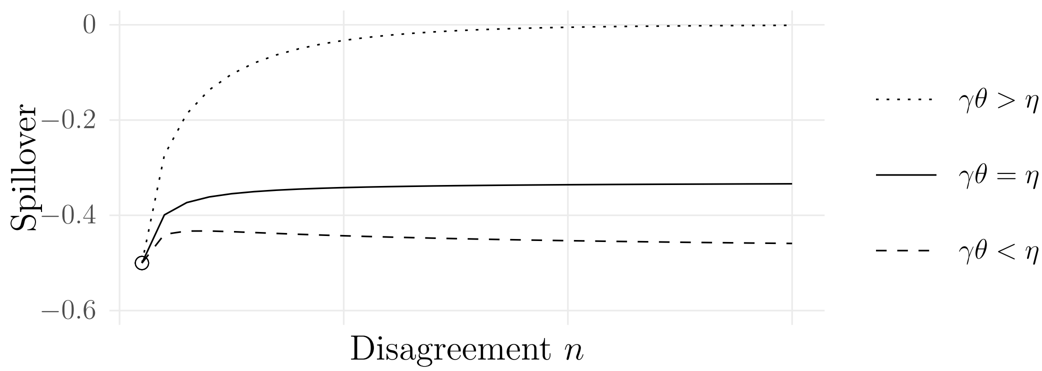

Figure 3
Market-based spillover with increasing disagreement.

spillovers by gauging the reaction of firms' valuations to variation in the amount of innovation by their competitors. In addition, we can also compare market-based and outcome-based spillovers. An immediate corollary of Proposition 1 is that the presence of speculation reduces market-based spillovers relative to outcome-based spillovers. In Section 4.3 below, we show how these results are specific to our model of bubbles and differ from other theories.

High speculation limit. We now consider the limiting case of high speculation: $n \to \infty$. This case is extreme: the total quantity of entry goes to infinity. However, it is useful because it gives rise to sharp characterizations of the spillovers, allowing us to highlight the distinction between market-based and outcome-based spillovers with disagreement.

Proposition 2. *In the high-disagreement limit ($n \to \infty$), the market-based spillover converges to a finite limit that depends on the sign of $\gamma\theta - \eta$:*

- *If $\gamma\theta > \eta$, the market-based spillover vanishes:* $\lim_{n\to\infty} spill_{mkt}(n) = 0$
- *If $\gamma\theta < \eta$, then τ converges to the spillover in the agreement case ($n = 1$):* $\lim_{n\to\infty} spill_{mkt}(n) = -\frac{\gamma-\eta}{\gamma}$
- *In the knife-edge case of $\gamma\theta = \eta$,* $\lim_{n\to\infty} spill_{mkt}(n) = \check{spill}_{mkt} > -\frac{\gamma-\eta}{\gamma}$*, where* $\check{spill}_{mkt}$ *is defined in Appendix equation* (IA.16)*.*

Figure 3 illustrates these cases.

Two forces determine the asymptotic behavior of the market-based spillover. First, with more disagreement, investors increasingly believe that the firms they invest in are in the right tail of the productivity distribution. They are therefore less concerned about the risk of being displaced by new entrants because they expect that a smaller mass of firms in their portfolio will fail to meet the entry threshold. For a given level of entry M_e, this mass converges to 0 as n goes to infinity. This is an extreme case of the result in Proposition 1.

Second, disagreement increases firm entry. For a given level of disagreement, n, as M_e converges to infinity, the M producing firms end up in the tail of both the population distribution, F, and the favorite-firm distribution, F_n. The tails of these two distributions have the same shape since $\lim_{x\to\infty} F_n'(x)/F'(x) = n$.[26] Therefore, disagreement does not affect the relative position of the marginal and average valuation in the tail. This force brings the market-based spillovers back toward the level of outcome-based spillovers.

The relative strength of the forces depends on how fast firm creation increases with speculation. If $\gamma\theta > \eta$, the first force dominates. When θ is large, the marginal cost of firm creation rises more rapidly, which reduces equilibrium entry M_e and weakens the second force. As γ increases, we have a thinner-tailed firm-productivity distribution. The size of the tail becomes less important than the relative ordering of firms, which weakens the second force. As η decreases, profits increase less with productivity, which again diminishes the importance of the second force. In the data, we find that valuations increase faster than quantities during bubbles, consistent with the case of $\gamma\theta > \eta$.[27] The relevant prediction is therefore a decrease in spillovers toward 0.

This result is robust to changes in the structure of business stealing. In Appendix B.2, we show that Proposition 2 still holds when business stealing takes a smoother form. There, we assume that profits decrease smoothly with the productivity rank of a firm. Appendix B.3 considers a situation in which firms compete for the production slots by spending on advertisement. Here again, we obtain the results of Proposition 2.

[26] This extreme value theory result is not the byproduct of power distributions but rather applies to a larger class of distributions.

[27] Specifically, we find that the valuation of innovation increases by 40% during bubbles, while the quantity of innovation increases only by 15%, so $\theta > 1$. Because $\eta < \gamma$ is always satisfied, we have $\gamma\theta > \eta$.

4.3 Comparison to Other Theories of Bubbles

We highlight how our specific model of disagreement is uniquely suited to understand the behavior of the value of innovation. While our theory shares a number of properties with existing models of bubbles, it distinguishes itself in some key dimensions.[28]

The first theory we consider is that the supposed bubbles are not actually bubbles. Rather they are periods of high valuation that arise because innovation waves have a large positive impact on the economy. In our model, this would correspond to no disagreement ($n = 1$) and a uniform increase in profits. That is, we replace equation (4) by

$$\pi(a) = A \cdot a^{\eta} \cdot \mathbf{1}\left\{a \geq \underline{a}\right\}, \tag{19}$$

where $A > 1$ represents an aggregate productivity increase. In this case, all valuations and real outcomes are shifted up by the same factor A. This would imply no differential change in market-based and outcome-based measures during bubbles, at odds with all of our empirical results.

Second, the high valuations during bubbles could reflect irrationally high expectations about the impact of innovation on the economy. Alternatively, households could have lower discount rates when evaluating the firms (Kogan, Papanikolaou, and Stoffman, 2020). These two views can be represented in our model in the same way. Output at date 1 is given by the baseline specification of equation (4). However decisions at date 0 are taken by multiplying this output by a common factor as in equation (19). In the overoptimism interpretation, A represents how much people overestimate the productivity. In the discount rate interpretation, $A = 1/(1+r)$ represents the discounting of cash flows. Both low discount rates and high optimism lead to inflated market values relative to output by the factor A, generating our results on the private value of innovation. However, this theory fails to match the divorce between market-based and output-based spillovers. Because the market-based spillover (18) is a ratio of valuations, it is unaffected by the common factor A and remains equal to the output-based spillover.

Third, bubbles could arise because of aggregate disagreement. Rather than disagreeing on the profits of Facebook versus Twitter, investors disagree on the total value of social networks. Optimists push the price of all firms up; pessimists would

[28] See Simsek (2021) for a recent survey of theories of bubbles.

like to short but cannot. Formally, we assume that half of the population thinks that aggregate productivity in equation (19) is $A = A_h$, while the other half thinks it is $A = A_l$, where $A_h > A_l$ and $(A_h + A_l)/2 = 1$ such that beliefs are correct on average. In equilibrium the price of firms is determined by the optimists and is $p = A_h \mathcal{I}_1$. This setting is exactly equivalent to the previous one and therefore suffers from the same issue. It matches the rise in valuation relative to output, but fails to account for the behavior of competitive spillovers.

Last, bubbles could be episodes in which prices have nothing to do with fundamentals. Such bubbles can arise as the consequence of irrational exhuberance (Shiller, 2015) or as a form of rational bubble (Blanchard, 1979; Tirole, 1985). This view is not helpful to understand the evidence. For example, while valuations are inflated during the bubble episodes we measure, they still respond to the announcement of fundamental news, patent approvals. In addition, the response after this news is still related to the importance of the patent as measured by citations.

Overall, while we cannot rule out a role for other models of bubbles, only our theory of disagreement across firms offers a unifying explanation for the link between innovation and bubbles.

5 Choosing the Appropriate Measure of Innovation: a Welfare Approach

Our analysis highlights the discrepancy between market- and outcome-based measures of the value of innovation during bubbles. Our model rationalizes these differences but an important question remains: which of these two is the correct measure? The answer to this question depends on what the measure is used for. One of the main reasons why measuring innovative spillovers is important is because such estimates can guide the design of policies. Therefore, in this section, we focus on a simple question: if a planner can choose a subsidy or tax on firm entry, what would it be? The presence of disagreement complicates answering this question because the choice of planner objective is not trivial. The planner must choose a set of beliefs to evaluate allocations.

We follow two approaches: a Pareto criterion and a paternalistic approach imposing common beliefs. For each approach, we map the market-based and outcome-based measures of the private value and competitive spillovers we have studied so far to an optimal tax rate. These results further emphasize the importance of acknowledging the presence of speculation and understanding the divergence between measurement approaches. However, we warn the reader that these are not immediate policy recommendations; our model ignores sources of spillovers other than competition. Section 6.3 and Appendix Section D show how to extend our framework to a richer set of spillovers.

5.1 Non-Paternalistic Approach

A classic approach to welfare evaluation is the Pareto criterion. An allocation improves overall welfare if all agents in the economy favor it. This criterion is not paternalistic: moving away from the competitive equilibrium requires the support of all agents in the economy. In other words, the optimal tax policy under the Pareto criterion is one that would receive support by all agents in a vote.[29] Interestingly in our case, this approach does not take a stand on what are correct beliefs but rather lets each individual agent evaluate their own utility.

Not having to choose beliefs is a useful feature in the situations we study. We are interested in episodes when there is little information about new firms. Households thus rely on their priors to evaluate these firms, and there is no way to forecast who is correct. The Pareto criterion respects this difficulty. The planner is no better judge of firms' futures than any investor. In contrast, a paternalistic approach might be more appropriate when heterogeneous beliefs are viewed as inherently inefficient due to a failure of communication or the irrationality of some agents.

Our model is symmetric: despite households having different beliefs, they each have the same evaluation of their own utility. This symmetry facilitates solving for the optimal allocations because the problem reduces to maximizing the utility of all households in the economy. The planner chooses a tax τ for each additional firm created from blueprints, rebated as a lump sum to households.[30] The optimal tax can

[29] This interpretation provides a positive—as opposed to normative—view of these results as the outcome of political decision-making.

[30] We could also consider a more general constrained planner problem. In this general version, the planner allocates date-1 consumption. Consumption plans must be linear combinations of firm profits with positive coefficients. The positive coefficients reflect our assumptions ruling out short-selling and derivative contracts. In the model in Section 3, the allocation chosen by a planner with a linear tax is Pareto optimal for the general constrained planner. It is the most efficient allocation if we impose additionally that welfare weights are equal across agents.

be obtained from a standard Pigouvian taxation problem:

$$\max_{\tau} \mathcal{U}_j = 1 + M_e \mathbf{E}^j \{\pi_i\} - W(M_e). \tag{20}$$

The planner chooses the tax rate that equalizes private incentives to create firms with their social value according to the planner's objective. When a firm creator introduces a new firm, she pays $(1-\tau)p_i$. Hence, the optimal tax rate is $\tau = 1 - \frac{\text{social value}}{p_i}$. Social value for the non-paternalistic planner is given by changes in expected utility, which correspond to market prices. This yields the following simple expression for the optimal tax:

$$\tau_{pareto} = -spill_{mkt}. \tag{21}$$

Therefore, for a non-paternalistic planner, the market-based spillover, rather than the outcome-based spillover, is a sufficient statistic for the optimal tax.

We have seen that the market-based spillover is often very different with agreement than with disagreement. Our framework thus implies that one should not use estimates from normal market conditions to draw policy conclusions during bubbles. From a positive perspective, the distinction explains why policies to reduce firm entry may not receive support during bubbles—because of the absence of market-based spillovers—, even when investors agree that there is excess entry. Further, if the only available data is on outcomes, one should use a framework like ours to convert these estimates into their market-based counterparts.

5.2 Paternalistic Approach

Alternatively, one could follow a paternalistic approach by assuming that the planner knows the "true" distribution and evaluates allocations under this distribution. A benefit of the paternalistic approach is that, from the perspective of social choice, it resolves the tension that not all beliefs can be right at the same time. Brunnermeier, Simsek, and Xiong (2014) propose an improvement on this approach that avoids taking a stance on the true distribution. In their work, the planner considers efficiency across any convex combination of agents' beliefs. We follow their approach and look for the optimal tax policy under the belief-neutral social welfare criterion, where we use the utilitarian social welfare function.[31]

In our setting, all agents agree ex-ante (before firms are even created) on the population distribution of firm productivity. Therefore, the total social welfare is the same under any combination of agents' beliefs because they collectively receive total output. The only difference across beliefs is how output is distributed and thus who receives it, which is irrelevant for social welfare. In summary, any convex combination of agents' beliefs leads to the same tax decision.

The paternalistic planner maximizes social welfare—total expected utility—under the population distribution F, which coincides with aggregate consumption net of entry costs, $\mathcal{C} - W(M_e)$. As before, this is a standard Pigouvian taxation problem, except that now social value is the marginal effect of entry on output rather than on households' perception of utility. The optimal tax becomes:

$$\tau_{pater} = 1 - (spill_{out} + 1)\frac{\text{private value}_{out}}{\text{private value}_{mkt}}. \tag{22}$$

Two aspects drive the choice of policy. First, the planner accounts for outcome-based spillovers. This is the flip-side of the Pareto planner problem: directly using estimates of spillovers measured using market values leads to incorrect inference. If these estimates are the only ones available, one should use a theoretical framework to convert them into outcome-based spillovers.

Second, there is a wedge between the private value on markets—which shapes incentives to create firms—and the private value according to the planner's beliefs. We have seen that the bubble inflates market-based private value relative to outcome-based private value. As a result, this second force will generally push toward taxing entry in order to lean against what the planner views as excessive valuations. In particular, if outcome-based spillovers are positive, implying that there is under-entry absent disagreement, a bubble can actually push the economy toward efficiency.[32]

In summary, the taxation results further highlight that bubbles not only lead to spurts of innovations but also fundamentally change their valuation. With agreement innovation policy is easy because the two planner objectives coincide and so do the outcome- and market-based measures of spillovers, eventually leading to the same optimal tax. Valuing innovation in a bubble is significantly more challenging: neither

[31] Brunnermeier, Simsek, and Xiong (2014) also introduce a notion of belief-neutral Pareto efficiency. However it is not directly informative in our setting: no tax policy is belief-neutral Pareto efficient.

[32] Such a situation can arise with knowledge externalities as in Appendix E.3.

the measurement nor the choice of a policy objective are straightforward. Still, our framework shows a way to value innovation during bubbles.

6 Further Implications

While the central focus of this paper is the role of bubbles for the private value of innovation and its competitive spillovers, the implications of our new framework for speculation are not limited to these two dimensions. In this section, we highlight some of the many other ramifications of our theory. We explore how this type of speculation interacts with the boundaries of the firm, how it modifies portfolio choice decisions, and how it alters other consequences of innovation, such as for the labor market. Last, we discuss how the effect we documented allow not only a better identification of bubbles but also to more finely classify the type of speculation. In the interest of space, we only sketch out these additional implications and leave the details to the appendix.

6.1 Disagreement and the Boundaries of the Firm

A unique prediction of our model is that the boundaries of the firm matter for valuations. Under the alternative theories discussed in Section 4.3, these boundaries are irrelevant for asset prices: valuations are the sum of cash flows under the common belief. For example, the value of two firms merged is equal to the sum of these two standalone firms' value, a case of the Modigliani-Miller theorem. This is not the case in our model of disagreement. In our model, each firm is valued under the beliefs of the investors who are the most optimistic about it, but the most optimistic investor for two different firms will in general be different. As a result, the valuation of the combined firm will be lower than or equal to the sum of valuations of the standalone firms. For example, if you combine all the firms in the economy, the value of this conglomerate becomes $M_e\mathcal{I}_1$, instead the sum of all firm values when they trade separately $M_e\mathcal{I}_n$.[33]

Narrow firms, as opposed to firms that span multiple product lines, cater to specific investors who tend to have strong belief in their success.[34] Thus, we expect a "conglomerate discount" on the value of innovation in times of bubbles: in the presence of

[33] Equivalent to forming a conglomerate, one could considerate a world where investors were forced to hold the market portfolio and not individual firms.

[34] Simsek (2013b) shows that with investor disagreement, profitable financial innovation facilitates betting on disagreement.

disagreement or bubbles, multiple-product firms experience a smaller increase in the value of their innovation than narrow firms.[35]

To test this prediction empirically, we measure diversity with the variable $Segments_{j,t}$, defined as the number of four-digit NAICS industries that a firm is active in. We collect this information from the Compustat Segments files. We augment the regression of equation (1) with $B_{j,t} \times Segments_{j,t}$.[36] As predicted, we find in Table 4 that the greater the number of segments, the less the private value of innovation increases in a bubble, as indicated by the significantly negative coefficient on the $B_{j,t} \times Segments_{j,t}$ regressor. Moreover, the effect of a bubble on the value of a patent for a firm with more than one segment is not statistically significant. Qualitatively, we find the same results at the patent level and firm level.

6.2 Portfolio Holdings

Disagreement across investors about which firms will succeed also has implications for portfolio decisions. When investors disagree, they concentrate their investments in the firms they are more positive about. This implies that portfolios are less diverse during bubbles. Our model makes a sharp prediction about this concentration. For a level n of disagreement, each investor only invests in a fraction $1/n$ of the firms. Stronger disagreement leads to more concentrated portfolios.

In the data, this relation is not as simple. For example, investors invest in multiple industries at the same time and have incentives to diversify their portfolios. To quantify the link between ownership concentration and bubbles within an industry, we focus on specialized investors.

We start from the 13F filings of portfolio positions. Each institution with over \$100 million invested in stocks must report their holdings quarterly to the SEC. We scrape this information from the EDGAR website between 2000 and 2016 as described in Backus, Conlon, and Sinkinson (2019), Backus, Conlon, and Sinkinson (2020), and Haddad, Huebner, and Loualiche (2021). Then, we restrict our attention to institution-industry pairs with over 20% of the institution's holdings in this industry in order to focus on specialized investors. We compute three measures of concentration: the ratio of number of stocks held to number of stocks available in this industry, the Herfindahl

[35] Reed, Saffi, and Van Wesep (2020) provide empirical evidence of a similar conglomerate discount in stock valuations. Huang et al. (2020) document a similar discount in portfolios.

[36] Appendix Table IA.5 shows that the results are robust to using a definition of different segments using six-digit NAICS industries.

Table 4
Diversity and Private Value of Innovation in Bubbles

	Patent Level			Firm Level		
	(1)	(2)	(3)	(4)	(5)	(6)
Bubble x Segments	−0.612***	−0.600***	−0.533***	−0.473***	−0.402***	−0.307***
(NAICS 4 digits)	(0.157)	(0.155)	(0.148)	(0.109)	(0.080)	(0.069)
Bubble	1.471***	1.441***	1.335***	1.576***	1.431***	1.180***
	(0.198)	(0.192)	(0.205)	(0.267)	(0.323)	(0.288)
Segments	0.309***	0.305***	0.296***	0.062	0.015	0.014
(NAICS 4 digits)	(0.097)	(0.096)	(0.100)	(0.043)	(0.045)	(0.037)
Log Citations		0.047***	0.044***		0.044***	0.044***
(forward looking)		(0.010)	(0.009)		(0.009)	(0.009)
Log Market Cap			0.154***			0.286***
(lagged)			(0.040)			(0.046)
Fixed Effects	Y, F	Y, F	Y, F	Y, F	Y, F	Y, F
Observations	180,636	180,636	177,911	10,426	10,426	10,256
R^2	0.72	0.72	0.72	0.88	0.93	0.94

Note: Table 4 presents panel regressions of the value of innovation, as measured in Kogan et al. (2017) at the patent and firm levels, on a bubble dummy interacted with the number of industries spanned by the different segments of the parent firm. The bubble dummy is from Greenwood, Shleifer, and You (2018) and captures whether the firm is in an industry that is in a bubble or not. Compustat segments are measured at the four-digit NAICS code level from the Compustat segments file. We control for the forward-looking number of citations generated by a patent (or firm) from Kogan et al. (2017), and the lagged market capitalization of the firm. We include fixed effects for firm F and patent grant year Y. Standard errors clustered at the grant-year level are in parentheses. *, **, and *** denote significance at the 10%, 5%, and 1% levels, respectively.

index of portfolio shares in this industry, and the top 4 concentration ratio.[37]

We regress these statistics on the Bubble indicator and report the results in Table 5. Column 1 is the baseline effect, column 2 includes industry fixed effects, column 3 includes date fixed effects, and column 4 combines the two types of fixed effects. The results overwhelmingly support an increase in portfolio concentration during bubbles. When an industry is in a bubble, each investor holds a smaller fraction of the number of stocks available in an industry, with a higher Herfindahl index, and larger share coming from her largest 4 positions.

[37] All these measures are computed within the institution-industry pair. We first compute portfolio shares for the investor within the industry. The Herfindahl index is the sum of squared portfolio positions. The top 4 concentration ratio is the sum of the 4 largest positions.

Table 5
Ownership and Bubbles

	(1)	(2)	(3)	(4)
	Fraction of Stock Holdings in Industry			
Bubble	-0.033^{***}	-0.041^{***}	-0.015^{**}	-0.021^{**}
	(0.008)	(0.010)	(0.006)	(0.008)
Fixed Effects	No	Industry	Date	Industry, Date
Observations	473,195	470,075	473,195	470,075
R^2	0.01	0.50	0.18	0.66
	Herfindahl of Industry Portfolio Concentration			
Bubble	0.234^{***}	0.066^{***}	0.260^{***}	0.070^{***}
	(0.035)	(0.015)	(0.035)	(0.014)
Fixed Effects	No	Industry	Date	Industry, Date
Observations	473,195	470,075	473,195	470,075
R^2	0.03	0.95	0.04	0.95
	Concentration Ratio of Industry Portfolio Concentration			
Bubble	0.144^{***}	-0.000	0.165^{***}	0.006^{***}
	(0.012)	(0.002)	(0.012)	(0.002)
Fixed Effects	No	Industry	Date	Industry, Date
Observations	473,195	470,075	473,195	470,075
R^2	0.02	0.98	0.03	0.98

Note: Table 5 presents a regression of portfolio concentration within an industry on a bubble dummy in that industry-year. The bubble dummy corresponds to bubble detected across Fama-French 49 industries according to the methodology outlined in Greenwood, Shleifer, and You (2018). Portfolio concentration is measured using the SEC 13F filings.

6.3 Other Sources of Spillovers

Competition is only one of the many ways through which the effect of an innovation are felt in the economy. When a firm innovates, it not only affects shareholders but also workers (see, e.g., Kogan et al. (2020) for recent evidence). Moreover, a new product alters consumers' choice over their entire consumption basket (Blanchard and Kiyotaki, 1987). Finally, others can learn from this innovation, as emphasized by Romer (1986). We incorporate these three prominent sources of spillovers in our theory in Appendix

D. We briefly discuss their implications here.

Impact on workers. What happens if firms must hire workers to produce? Specifically, we assume that firms' production functions are isoelastic in date-1 labor, and that this labor is provided in fixed supply by households. In this case, a fraction of the surplus created by new firms accrues to workers. Innovation creates jobs. Because investors on financial markets do not take into account this job creation when deciding to start a new firm, this creates a positive externality, commonly known as the appropriability effect.[38] However, the increased labor demand pushes wages up, making it more difficult for other firms to hire workers, a negative externality. We show that under outcome-based measures, these exernalities exactly cancel out. In contrast, with market-based metrics, the negative externality from increased input prices is overweighted relative to the positive appropriability spillovers. Intuitively, while firm values are inflated, wage expectations are not since wages are determined by the state of the aggregate labor market at date 1, which households agree on.

Knowledge and aggregate demand. When a firm innovates, some of its ideas can be reused to make all other firms more productive. Similarly, when households have access to more complementary goods, they are more eager to consume. The first effect is referred to as a knowledge spillover, which we can represent by a boost to firm productivity when the average productivity in the economy is larger. The second effect is a demand externality, which arises naturally when the firms produce differentiated goods as in Dixit and Stiglitz (1977). Both of these effects are macroeconomic spillovers: they affect all firms in the same way. Disagreement in our model therefore does not affect investors' perceptions of these spillovers even though they view their own firms to be more productive. Formally, the spillovers do not depend on n whether they are measured using outcomes or market values.

Implications for the social value of innovation. These new results further showcase a property we saw in our baseline analysis: bubbles are periods of not only high valuations, but also substantive changes in how investors perceive interactions in the economy. The above discussion highlights how this change manifests itself differently for different sources of externality. This implies that the social value of innovation—the

[38]This name comes from the fact that workers appropriate part of the surplus from the new firm.

sum of all spillovers from innovation—can have radically different properties in and out of a bubble, measured using outcomes or market values.

Appendix Proposition D.1 presents a simple expression for the total spillover that holds for all these model specifications, as well as further generalizations discussed in Appendix F. In this general framework, the divorce between market-based and outcome-based measures of spillovers with disagreement can take even more radical forms than in our baseline analysis. The total market-based spillover only relies on micro elasticities (e.g., how individual firm profits respond to firm entry), while the outcome-based spillover only depends on macro elasticities (e.g., how aggregate output responds to firm entry). The two measures often respond in opposite directions to various properties of the economy such as the labor share or the dispersion of productivity. They can even have opposite sign: market-based measures signal under-innovation while outcome-based measures signal over-innovation, or the converse.[39]

6.4 Classifying Bubbles

Greenwood, Shleifer, and You (2018) propose identifying bubbles using a constellation of empirical properties that characterize them. Bubble episodes do not only present a rapid rise in the price, but also a number of other features such as tilt towards younger firms and a high volume of trading. The properties emphasized in this paper add to this list. In particular, we have discussed how bubbles are associated with a disconnect between financial markets and real quantities for both the direct value of innovation and its effect on competitors. This section has further highlighted differential effects for conglomerates and changes in portfolio concentration.

However, not all bubbles are the same. As discussed in Section 4.3, different mechanisms can engender bubbles with different consequences. Thus, it is important to distinguish among these different types of bubbles. We show that disagreement about which firms will succeed plays a prominent role during innovation booms. This was not the type of mechanism that caused the housing bubble of the 2000s. As such our test is helpful not only to detect bubbles but also to detect a specific type of bubbles.

In the spirit of building a finer classification of bubbles, Greenwood, Shleifer, and You (2018) separate episodes of price booms that end in a crash or not. While this approach introduces look-ahead bias, it creates more separation between episodes of high investor speculation and rationally high expectations. In Appendix Table IA.6, we

[39]We refer to Section D.3 for complete statements of these properties.

ask whether the disappearance of market-based spillovers is more pronounced during these episodes. We repeat the analysis of Table 3 by distinguishing bubbles that do or do not crash.[40] While statistical power is limited once we split the sample, the results suggest a more important role for our mechanism when bubbles do crash.

7 Conclusion

Speculation and innovation often coincide. A naive view of the role of speculation and the bubbles it generates is that they do not matter for the innovation process even though they disrupt financial markets. In contrast, we argue that there is structure in these disruptions—innovation and speculation interact systematically. Failing to understand and account for this interaction can distort our qualitative and quantitative understanding of the private and social values of innovation, leading to erroneous answers to both positive and normative questions about innovation.

To that end, the paper introduces a model of the interaction between innovation and speculation. Our theory makes sharp predictions for the value of innovation under market- and outcome-based measures. We study the impact of disagreement on both the private and social values of innovation. The structure of the model reflects reality. During bubbles, information from financial markets and real outcomes about the value of innovation diverge from each other in the direction predicted by our theory. Extending the work of Kogan et al. (2017), we find that asset prices indicate increases in the private value of innovation during bubbles, with no commensurate increase in outcome-based measures. Using the method of Bloom, Schankerman, and Van Reenen (2013), we show that competitive spillovers disappear during bubbles when measured in financial markets but remain unchanged when looking at sales.

Thus, accounting for the link between speculation and innovation is a fruitful enterprise. Our paper provides the first steps toward digging deeper, showing how our framework can entertain many sources of innovative spillovers and highlighting broad principles of their interaction with disagreement. We also explain how to map data to innovation policy decisions in periods of disagreement. Another avenue suggested by our work is the use of financial market regulation as a novel form of innovation policy.[41] We look forward to seeing the future implementation of these ideas improve

[40] The presence of look-ahead bias prevents us from extending our other results whose focus is on future real quantities.

[41] Jørring et al. (2017) discuss the example of Food and Drug Administration hedges to share risk

our understanding of the outcomes of innovation.

in medical innovation. Our results show that disagreement can dramatically change the consequences of such instruments both in terms of outcomes and welfare.

References

Abernathy, W.J. 1978. *The Productivity Dilemma: Roadblock to Innovation in the Automobile Industry.* Johns Hopkins University Press, Baltimore, Md.

Acemoglu, Daron. 2008. *Introduction to Modern Economic Growth.* Princeton University Press.

Backus, Matthew, Christopher Conlon, and Michael Sinkinson. 2019. "Common Ownership in America: 1980-2017." Working Paper 25454, National Bureau of Economic Research.

Backus, Matthew, Christopher T Conlon, and Michael Sinkinson. 2020. "Common Ownership Data: Scraped SEC form 13F filings for 1999-2017."

Barberis, Nicholas, Robin Greenwood, Lawrence Jin, and Andrei Shleifer. 2018. "Extrapolation and Bubbles." *Journal of Financial Economics* 129 (2):203–227.

Blanchard, Olivier Jean. 1979. "Speculative Bubbles, Crashes and Rational Expectations." *Economics Letters* 3 (4):387–389.

Blanchard, Olivier Jean and Nobuhiro Kiyotaki. 1987. "Monopolistic Competition and the Effects of Aggregate Demand." *American Economic Review* 77 (4):647–666.

Bloom, Nicholas, Mark Schankerman, and John Van Reenen. 2013. "Identifying Technology Spillovers and Product Market Rivalry." *Econometrica* 81 (4):1347–1393.

Bond, Philip, Alex Edmans, and Itay Goldstein. 2012. "The Real Effects of Financial Markets." *Annual Review of Financial Economics* 4 (1):339–360.

Borjas, George J. and Kirk B. Doran. 2012. "The Collapse of the Soviet Union and the Productivity of American Mathematicians." *Quarterly Journal of Economics* 127 (3):1143–1203.

Brunnermeier, Markus K. 2016. "Bubbles." In *Banking Crises.* London: Palgrave Macmillan UK, 28–36.

Brunnermeier, Markus K and Martin Oehmke. 2013. "Bubbles, Financial Crises, and Systemic Risk." In *Handbook of the Economics of Finance*, vol. 2. Elsevier, 1221–1288.

Brunnermeier, Markus K., Alp Simsek, and Wei Xiong. 2014. "A Welfare Criterion for Models with Distorted Beliefs." *Quarterly Journal of Economics* 129 (4):1753–1797.

Caballero, Ricardo J and Alp Simsek. 2020. "A Risk-Centric Model of Demand Recessions and Speculation." *Quarterly Journal of Economics* 135 (3):1493–1566.

Chen, Joseph, Harrison Hong, and Jeremy C. Stein. 2002. "Breadth of Ownership and Stock Returns." *Journal of Financial Economics* 66 (2):171–205.

Chinco, Alex. 2020. "The Madness of Crowds and the Likelihood of Bubbles." Working paper, University of Illinois.

Corhay, Alexandre, Howard Kung, and Lukas Schmid. 2015. "Markups, Competition and Asset Prices." Working paper, Duke University.

Davila, Eduardo. 2020. "Optimal Financial Transaction Taxes." Working paper, Yale University.

Dávila, Eduardo and Ansgar Walther. 2021. "Prudential Policy with Distorted Beliefs." Working Paper 28879, National Bureau of Economic Research.

D'avolio, Gene. 2002. "The Market for Borrowing Stock." *Journal of Financial Economics* 66 (2-3):271–306.

Diether, Karl B., Christopher J. Malloy, and Anna Scherbina. 2002. "Differences of Opinion and the Cross Section of Stock Returns." *Journal of Finance* 57 (5):2113–2141.

Dixit, Avinash K and Joseph E. Stiglitz. 1977. "Monopolistic Competition and Optimum Product Diversity." *American Economic Review* 67 (3):297–308.

Dong, Ming, David Hirshleifer, and Siew Teoh. 2020. "Stock Market Overvaluation, Moon Shots, and Corporate Innovation." Working paper, UC Irvine.

Duffie, Darrell. 2014. "Challenges to a Policy Treatment of Speculative Trading Motivated by Differences in Beliefs." *Journal of Legal Studies* 43 (S2):S173–S182.

Duffie, Darrell, Nicolae Garleanu, and Lasse Heje Pedersen. 2002. "Securities Lending, Shorting, and Pricing." *Journal of Financial Economics* 66 (2-3):307–339.

Fama, Eugene F and Kenneth R French. 1997. "Industry Costs of Equity." *Journal of Financial Economics* 43 (2):153–193.

Farhi, Emmanuel and Jean Tirole. 2011. "Bubbly Liquidity." *The Review of Economic Studies* 79 (2):678–706.

Freeman, Christopher. 1982. *The Economics of Industrial Innovation*. MIT Press.

Gârleanu, Nicolae, Leonid Kogan, and Stavros Panageas. 2012. "Displacement Risk and Asset Returns." *Journal of Financial Economics* 105 (3):491–510.

Greenwood, Robin, Andrei Shleifer, and Yang You. 2018. "Bubbles for Fama." *Journal of Financial Economics* .

Griliches, Zvi, Ariel Pakes, and Bronwyn H. Hall. 1986. "The Value of Patents as Indicators of Inventive Activity." Working Paper 2083, National Bureau of Economic Research.

Haddad, Valentin, Paul Huebner, and Erik Loualiche. 2021. "How Competitive is the Stock Market? Theory, Evidence from Portfolios, and Implications for the Rise of Passive Investing." Working paper, UCLA Anderson.

Harrison, J. Michael and David M. Kreps. 1978. "Speculative Investor Behavior in a Stock Market with Heterogeneous Expectations." *Quarterly Journal of Economics* 92 (2):323–336.

Hayashi, F. 1982. "Tobin's Marginal q and Average q: A Neoclassical Interpretation." *Econometrica* 50 (1):213–224.

He, Zhaozhao and David Hirshleifer. 2020. "The Exploratory Mindset and Corporate Innovation." *Journal of Financial and Quantitative Analysis* :1–43.

Hellwig, Martin and Andreas Irmen. 2001. "Endogenous Technical Change in a Competitive Economy." *Journal of Economic Theory* 101 (1):1–39.

Hirshleifer, David and Joshua Plotkin. 2020. "Moonshots, Investment Booms, and Selection Bias in the Transmission of Cultural Traits." Working Paper 27735, National Bureau of Economic Research.

Hombert, Johan and Adrien Matray. 2020. "Technology Boom, Labor Reallocation, and Human Capital Depreciation." Working paper, HEC.

Hong, Harrison and Jeremy C. Stein. 2007. "Disagreement and the Stock Market." *Journal of Economic Perspectives* 21 (2):109–128.

Huang, Shiyang, Byoung-Hyoun Hwang, Dong Lou, and Chengxi Yin. 2020. "Offsetting Disagreement and Security Prices." *Management Science*.

Jaffe, Adam. 1986. "Technological Opportunity and Spillovers of R&D: Evidence from Firms' Patents, Profits, and Market Value." *American Economic Review* 76 (5):984–1001.

Janeway, W.H. 2012. *Doing Capitalism in the Innovation Economy: Markets, Speculation and the State*. Cambridge University Press.

Jones, Charles M and Owen A Lamont. 2002. "Short-Sale Constraints and Stock Returns." *Journal of Financial Economics* 66 (2-3):207–239.

Jørring, Adam, Andrew W. Lo, Tomas J. Philipson, Manita Singh, and Richard T. Thakor. 2017. "Sharing R&D Risk in Healthcare via FDA Hedges." Working Paper 23344, National Bureau of Economic Research.

Kogan, Leonid, Dimitris Papanikolaou, Lawrence D. W. Schmidt, and Jae Song. 2020. "Technological Innovation and Labor Income Risk." Working Paper 26964, National Bureau of Economic Research.

Kogan, Leonid, Dimitris Papanikolaou, Amit Seru, and Noah Stoffman. 2017. "Technological Innovation, Resource Allocation, and Growth." *Quarterly Journal of Economics* 132 (2):665–712.

Kogan, Leonid, Dimitris Papanikolaou, and Noah Stoffman. 2020. "Left Behind: Creative Destruction, Inequality, and the Stock Market." *Journal of Political Economy* 128 (3):855–906.

Kondor, Péter and Botond Köszegi. 2017. "Cursed Financial Innovation." Working paper, CEU.

Kung, Howard and Lukas Schmid. 2015. "Innovation, Growth, and Asset Prices." *Journal of Finance* 70 (3):1001–1037.

Lerner, A. P. 1934. "The Concept of Monopoly and the Measurement of Monopoly Power." *Review of Economic Studies* 1 (3):157–175.

Loualiche, Erik. 2020. "Asset Pricing with Entry and Imperfect Competition." Working paper, University of Minnesota.

Martin, Alberto and Jaume Ventura. 2012. "Economic Growth with Bubbles." *American Economic Review* 102 (6):3033–3058.

Melitz, Marc J. 2003. "The Impact of Trade on Intra-Industry Reallocations and Aggregate Industry Productivity." *Econometrica* 71 (6):1695–1725.

Miller, Edward M. 1977. "Risk, Uncertainty, and Divergence of Opinion." *Journal of Finance* 32 (4):1151–1168.

Mokyr, Joel. 1992. *The Lever of Riches: Technological Creativity and Economic Progress*. Oxford University Press.

Morris, Stephen. 1995. "The Common Prior Assumption in Economic Theory." *Economics and Philosophy* 11 (2):227–253.

Pakes, Ariel. 1986. "Patents as Options: Some Estimates of the Value of Holding European Patent Stocks." *Econometrica* 54 (4):755–784.

Panageas, Stavros. 2015. "The Neoclassical Theory of Investment in Speculative Markets." Working paper, UCLA.

Pastor, Lubos and Pietro Veronesi. 2005. "Rational IPO Waves." *Journal of Finance* 60 (4):1713–1757.

———. 2009. “Technological Revolutions and Stock Prices.” *American Economic Review* 99 (2):1451–1483.

Reed, Adam V., Pedro A. C. Saffi, and Edward D. Van Wesep. 2020. “Short-Sales Constraints and the Diversification Puzzle.” *Management Science*.

Romer, Paul M. 1986. “Increasing Returns and Long-Run Growth.” *Journal of Political Economy* 94 (5):1002–1037.

Romer, Paul M. 1990. “Endogenous Technological Change.” *Journal of Political Economy* 98 (5):71–102.

Samuelson, Paul A. 1958. “An Exact Consumption-Loan Model of Interest with or without the Social Contrivance of Money.” *Journal of Political Economy* 66 (6):467–482.

Scheinkman, J.A. 2014. *Speculation, Trading, and Bubbles*. Kenneth J. Arrow Lecture Series. Columbia University Press.

Scheinkman, Jose A. and Wei Xiong. 2003. “Overconfidence and Speculative Bubbles.” *Journal of Political Economy* 111 (6):1183–1220.

Scott, William Robert. 1912. *The Constitution and Finance of English, Scottish and Irish Joint-stock Companies to 1720*, vol. 1. Cambridge University Press.

Shiller, R.J. 2015. *Irrational Exuberance: Revised and Expanded Third Edition*. Princeton University Press.

Simsek, Alp. 2013a. “Belief Disagreements and Collateral Constraints.” *Econometrica* 81 (1):1–53.

———. 2013b. “Speculation and Risk Sharing with New Financial Assets.” *Quarterly Journal of Economics* 128 (3):1365–1396.

———. 2021. “The Macroeconomics of Financial Speculation.” *Annual Review of Economics* 13.

Tirole, Jean. 1985. “Asset Bubbles and Overlapping Generations.” *Econometrica* 53 (6):1499–1528.

Tobin, James. 1969. “A General Equilibrium Approach to Monetary Theory.” *Journal of Money, Credit and Banking* 1 (1):15–29.

van Binsbergen, Jules H. and Christian C. Opp. 2019. “Real Anomalies.” *Journal of Finance* 74 (4):1659–1706.

Van den Steen, Eric. 2004. “Rational Overoptimism (and Other Biases).” *American Economic Review* 94 (4):1141–1151.

Yu, Jialin. 2011. "Disagreement and Return Predictability of Stock Portfolios." *Journal of Financial Economics* 99 (1):162–183.

Internet Appendix

A Derivations for the Model of Section 3

A.1 General Results

We first express the spillovers in integral form, then prove Proposition 1 for general functions F and π.

A.1.1 General Formulas

The market-based spillover is

$$spill_{mkt}(n; M_e) = [M_e V^{(n)'}(M_e)]/[V^{(n)}(M_e)].$$

The numerator and denominator have interpretable expressions. First rewrite the denominator in the following integral form:

$$\begin{aligned} V^{(n)} &= \int_{F^{-1}}^{\infty} \pi(x) dF_n(x) \\ &= \int_{F^{-1}}^{\infty} \pi\left(x\right) \frac{F_n'}{F'}\left(x\right) dF(x), \end{aligned} \tag{IA.1}$$

where we denote $F^{-1}(1 - M/M_e)$ by F^{-1} for convenience. Now the numerator can be written:

$$M_e \frac{dV^{(n)}}{dM_e} = \frac{M}{M_e} \cdot \pi\left[F^{-1}\right] \cdot \frac{F_n'}{F'}\left[F^{-1}\right] \tag{IA.2}$$

$$= -\int_{F^{-1}}^{\infty} \pi\left[F^{-1}\right] \frac{F_n'}{F'}\left[F^{-1}\right] dF(x). \tag{IA.3}$$

This leads to the following formula for the market-based spillover:

$$spill_{mkt}(n) = -\frac{\int_{F^{-1}}^{\infty} \pi\left[F^{-1}\right] \frac{F_n'}{F'}\left[F^{-1}\right] dF(x)}{\int_{F^{-1}}^{\infty} \pi\left(x\right) \frac{F_n'}{F'}\left(x\right) dF(x)}. \tag{IA.4}$$

A.1.2 Comparing Spillovers

Lemma A.1. *Holding M_e constant, the market-based spillover is larger with agreement than with disagreement.*

Proof. First recall the market-based spillover $spill_{mkt}(n; M_e) = \frac{M_e V^{(n)'}(M_e)}{V^{(n)}(M_e)}$. We have the derivative:

$$V^{(n)'} = -\frac{1}{M_e}\frac{M}{M_e}\pi\left[F^{-1}\right] \cdot n\left(1 - \frac{M}{M_e}\right)^{n-1},$$

and we can bound $V^{(n)}$:

$$\begin{aligned} V^{(n)} &= \int_{F^{-1}}^{\infty} \pi(x) n F^{n-1}(x) dF(x) \\ &\geq \int_{F^{-1}}^{\infty} \pi(x) n F^{n-1}\left[F^{-1}\right] dF(x) \\ &\geq n \left(1 - \frac{M}{M_e}\right)^{n-1} \int_{F^{-1}}^{\infty} \pi(x) dF(x). \end{aligned}$$

Therefore, we are able to bound the market-based spillover for a given M_e and n:

$$|spill_{mkt}(n; M_e)| \leq -\frac{\int_{F^{-1}}^{\infty} \pi\left[F^{-1}\right] dF(x)}{\int_{F^{-1}}^{\infty} \pi(x) dF(x)} \leq |spill_{mkt}(1; M_e)|, \tag{IA.5}$$

where the second inequality comes from the definition of $spill_{mkt}(1; M_e)$. ∎

A.2 Power Case Derivations

We now outline the derivations for the case we focus on in the main text, with $F(a) = 1 - a^{-\gamma}$ and $\pi(a) = a^{\eta} \cdot \mathbf{1}\left\{a \geq \underline{a}\right\}$.

First, define

$$\underline{a} = F^{-1}\left(1 - \frac{M}{M_e}\right) = \left(\frac{M_e}{M}\right)^{1/\gamma}.$$

The ex-ante value of a firm $V^{(n)}(M_e)$ is:

$$\begin{aligned} V^{(n)}(M_e) &= \int_{\left(\frac{M_e}{M}\right)^{\frac{1}{\gamma}}}^{\infty} x^{\eta} \gamma n x^{-\gamma-1} \left(1 - x^{-\gamma}\right)^{n-1} dx && \text{(IA.6)} \\ &= \gamma n \underline{a}^{\eta-\gamma} \int_{1}^{\infty} t^{\eta-\gamma-1} \left(1 - \underline{a}^{-\gamma} t^{-\gamma}\right)^{n-1} dt. && \text{(IA.7)} \end{aligned}$$

The first derivative with respect to entrants is:

$$\frac{dV^{(n)}}{dM_e} = -\frac{1}{M_e} \cdot \frac{M}{M_e} \left(\frac{M_e}{M}\right)^{\frac{\eta}{\gamma}} \cdot n \left(1 - \frac{M}{M_e}\right)^{n-1}. \tag{IA.8}$$

It is convenient to express $-M_e V^{(n)\prime}(M_e)$ as:

$$-M_e V^{(n)\prime}(M_e) = \underline{a}^{\eta-\gamma} \cdot n \left(1 - \underline{a}^{-\gamma}\right)^{n-1}. \tag{IA.9}$$

A.2.1 Spillovers and Firm Entry under Agreement

Lemma A.2. *The outcome-based spillover does not depend on the level of entry:*

$$spill_{out}(M_e) = -\frac{\gamma - \eta}{\gamma}. \tag{IA.10}$$

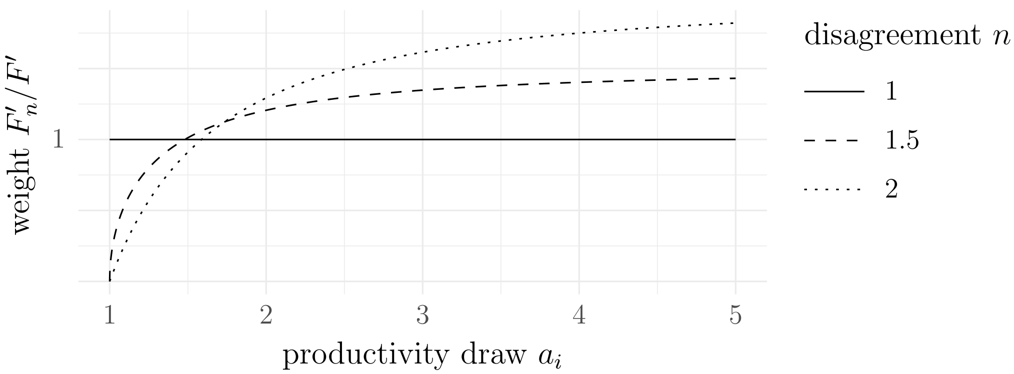

Figure IA.1
Distortion of productivity weights F'_n/F'

The level of entry is:

$$\frac{M_e}{M} = \left(f_e \frac{\gamma - \eta}{\gamma}\right)^{-\frac{\gamma}{\gamma(\theta+1)-\eta}}. \tag{IA.11}$$

Proof. The value of a firm is:

$$\begin{aligned} V^{(1)}(M_e) &= \gamma \underline{a}^{\eta-\gamma} \int_1^\infty t^{\eta-\gamma-1} dt \\ &= \frac{\gamma}{\gamma-\eta} \underline{a}^{\eta-\gamma} = \frac{\gamma}{\gamma-\eta} \left(\frac{M_e}{M}\right)^{\frac{\eta-\gamma}{\gamma}}. \end{aligned} \tag{IA.12}$$

From equation (IA.9) with $n = 1$, we have the numerator of the spillover:

$$-M_e \frac{dV^{(1)}}{dM_e} = \left(\frac{M_e}{M}\right)^{\frac{\eta-\gamma}{\gamma}}, \tag{IA.13}$$

which leads directly to the desired formula (IA.10) for the outcome-based spillover. Finally, we can rewrite equation (10):

$$f_e \left(\frac{M_e}{M}\right)^\theta = \frac{\gamma}{\gamma-\eta} \left(\frac{M_e}{M}\right)^{\frac{\eta-\gamma}{\gamma}},$$

which reduces to (IA.11) as desired. ∎

A.2.2 Disagreement Lowers Market-Based Spillovers

Proposition 1 follows directly from Lemma A.1 and Lemma A.2. In particular, we have

$$|spill_{mkt}(n; M_e)| \leq |spill_{mkt}(1; M_e)| = |spill_{out}(M_e)| = |spill_{out}(M'_e)| \tag{IA.14}$$

for any M'_e, and, in particular, the M'_e corresponding to the equilibrium entry under agreement. The inequality is from Lemma A.1; the first equality is from the definition of $spill_{mkt}$ and $spill_{out}$; and the last equality is from Lemma A.2.

A.2.3 Disagreement Asymptotics

Lemma A.3. *If $\theta \geq 0$, then as disagreement increases ($n \to \infty$), the mass of entrants also increases and goes to infinity:* $\lim_{n\to\infty} M_e = \infty$.

Proof. We define $\underline{a}_n = (M_e/M)^{1/\gamma}$, where M_e now depends on n, and show that $\underline{a}_n \to \infty$. Equation (10) implies an implicit definition of the sequence $\underline{a}_n$:

$$f_e \underline{a}_n^{\gamma(\theta+1)-\eta} = \gamma n \int_1^\infty t^{\eta-\gamma-1} \left(1 - \underline{a}_n^{-\gamma} t^{-\gamma}\right)^{n-1} dt.$$

Suppose $\underline{a}_n$ has a finite limit that is strictly larger than zero, i.e., $\underline{a}_\infty > 0$.[42] Then there exists N large enough such that $\forall n > N$, $\underline{a}_n > A = \underline{a}_\infty - \epsilon > 0$. We obtain a lower bound for the right-hand side of the implicit equation above:

$$\begin{aligned} I_n &= \gamma n \int_1^\infty t^{\eta-\gamma-1} \left(1 - \underline{a}^{-\gamma} t^{-\gamma}\right)^{n-1} dt \\ &> \gamma n \int_1^\infty t^{\eta-\gamma-1} \left(1 - A^{-\gamma} t^{-\gamma}\right)^{n-1} dt. \end{aligned}$$

Consider an arbitrary threshold T_n that depends on n and satisfies:

$$\begin{aligned} I_n &> \gamma n \int_{T_n}^\infty t^{\eta-\gamma-1} \left(1 - A^{-\gamma} t^{-\gamma}\right)^{n-1} dt \\ &> \gamma n \left(1 - A^{-\gamma} T_n^{-\gamma}\right)^{n-1} \int_{T_n}^\infty t^{\eta-\gamma-1} dt \\ &= \frac{\gamma}{\gamma - \eta} \cdot n \cdot T_n^{\eta-\gamma} \left(1 - A^{-\gamma} T_n^{-\gamma}\right)^{n-1}. \end{aligned}$$

Choose the threshold $T_n = n^{1/\gamma}$. The bound becomes:

$$\begin{aligned} I_n &> \frac{\gamma}{\gamma - \eta} \cdot n^{\frac{\eta}{\gamma}} \exp\left(-(n-1)\log(1 - A^{-\gamma} n^{-1})\right) \\ &> \frac{\gamma}{\gamma - \eta} \cdot n^{\frac{\eta}{\gamma}} \exp\left(-(n-1)A^{-\gamma} n^{-1} + \mathcal{O}(n^{-1})\right). \end{aligned}$$

Since $\gamma(\theta+1) - \eta \geq \gamma - \eta > 0$, this implies $I_n \to \infty$, contradicting $\underline{a}_\infty < \infty$. ∎

Lemma A.4 (Asymptotics for firm creation)**.** *In the high-disagreement limit ($n \to \infty$), we have the following asymptotics for the mass of firms created, M_e:*

- *If $\gamma\theta < \eta$, then* $M_e/M = \left(\frac{1}{f_e} \frac{\gamma}{\gamma-\eta} \cdot n\right)^{\frac{\gamma}{\gamma(\theta+1)-\eta}}$.
- *If $\gamma\theta = \eta$, then* $\lim_{n\to\infty} M_e/M = \alpha_\infty n$, *where α_∞ is a constant defined below.*

Proof. Substituting $\underline{a}$ into (10), we have:

$$\begin{aligned} f_e &= \gamma \underline{a}^{\eta-\gamma(\theta+1)} n \int_1^\infty t^{\eta-\gamma-1} \left(1 - \underline{a}^{-\gamma} t^{-\gamma}\right)^{n-1} dt \\ &\simeq \gamma \underline{a}^{\eta-\gamma(\theta+1)} n \int_1^\infty t^{\eta-\gamma-1} \exp\left(-(n-1)\underline{a}^{-\gamma} t^{-\gamma}\right) dt, \end{aligned}$$

[42] Since the mass of firms producing cannot be higher than the mass of firms created, $\underline{a}_n \geq 1$.

where we have used the fact that $\underline{a} \to \infty$ from Lemma A.4, and $\log(1-x) = -x + \mathcal{O}(x^2)$. To find a solution, we guess the asymptotics of $\underline{a}(n)$. We rewrite $\underline{a} = \alpha(n) n^{1/(\gamma(1+\theta)-\eta)}$ and show that $\alpha(n)$ converges to a finite limit α. The above equation becomes:

$$f_e = \gamma \alpha(n)^{\eta-\gamma(\theta+1)} \int_1^{\infty} t^{\eta-\gamma-1} \exp\left(-\alpha(n)^{-\gamma} \frac{n-1}{n^{\frac{\gamma}{\gamma(1+\theta)-\eta}}} t^{-\gamma}\right) dt.$$

Suppose $\gamma\theta < \eta$. Then the exponential term converges to zero and we have:

$$f_e = \gamma \alpha^{\eta-\gamma(\theta+1)} \int_1^{\infty} t^{\eta-\gamma-1} = \alpha^{\eta-\gamma(\theta+1)} \frac{\gamma}{\gamma-\eta},$$

such that we have the following asymptotics for firm entry:

$$\frac{M_e}{M} = \left(\frac{1}{f_e} \frac{\gamma}{\gamma-\eta} \cdot n\right)^{\frac{\gamma}{\gamma(\theta+1)-\eta}}. \tag{IA.15}$$

Suppose $\gamma\theta = \eta$. Then $\underline{a}$ is defined by:

$$f_e = \gamma \underline{a}_n^{-\gamma} n \int_1^{\infty} t^{\eta-\gamma-1} \left(1 - \underline{a}^{-\gamma} t^{-\gamma}\right)^{n-1} dt.$$

Since $\underline{a} = (M_e/M)^{1/\gamma}$, it is sufficient to guess and verify that $\underline{a}_n = \alpha(n)^{-1/\gamma} n^{1/\gamma}$, and $\alpha(n)$ has a finite limit α_∞ defined by:

$$\begin{aligned} f_e &= \gamma \alpha(n) \int_1^{\infty} t^{\eta-\gamma-1} \exp\left(-(n-1)(\alpha(n) n^{-1} + \mathcal{O}(\alpha(n)^2 n^{-2})) t^{-\gamma}\right) dt \\ &\xrightarrow[n\to\infty]{} \gamma \alpha_\infty \int_1^{\infty} t^{\eta-\gamma-1} e^{-\alpha_\infty t^{-\gamma}} dt, \end{aligned}$$

where we take the limit when $n \to \infty$. The outcome-based spillover implies:

$$\begin{aligned} f_e &> \gamma \alpha_\infty e^{-\alpha_\infty} \int_1^{\infty} t^{\eta-\gamma-1} dt \\ &> \alpha_\infty e^{-\alpha_\infty} \frac{\gamma}{\gamma-\eta}, \end{aligned}$$

and thus

$$\frac{\alpha_\infty e^{-\alpha_\infty}}{f_e} < \frac{\gamma-\eta}{\gamma}, \tag{IA.16}$$

which implies a finite bound on α_∞. ∎

Using the asymptotics derived in Lemma A.4, we now prove Proposition 2.

Proof. **(Proposition 2)** Suppose $\gamma\theta < \eta$. Substitute the asymptotics derived in equation (IA.15) into the formula for the market-based spillover:

$$spill_{mkt}(n; M_e) = -\frac{\frac{M}{M_e}\left(\frac{M_e}{M}\right)^{\frac{\eta}{\gamma}} n \left(1 - \frac{M}{M_e}\right)^{n-1}}{f_e \left(\frac{M_e}{M}\right)^{\theta}} \tag{IA.17}$$

$$\simeq -\frac{1}{f_e} \cdot f_e \frac{\gamma - \eta}{\gamma} \frac{1}{n} \cdot n \left(1 - \frac{M}{M_e}\right)^{n-1} \to -\frac{\gamma - \eta}{\gamma}, \tag{IA.18}$$

where we have used the fact that $(1 - M/M_e)^{n-1} \to 1$.[43] The market-based spillover therefore converges to the outcome-based spillover in this case.

Now suppose $\gamma\theta > \eta$. We write the market-based spillover directly:

$$spill_{mkt}(n; M_e) = -\frac{n\underline{a}^{\eta-\gamma}(1 - \underline{a}^{-\gamma})^{n-1}}{f_e \underline{a}^{\gamma\theta}}.$$

First suppose $\underline{a} \to \infty$. We rewrite the competitive equilibrium condition (10):

$$n\underline{a}^{-\gamma} = \frac{f_e \underline{a}^{\gamma\theta-\eta}}{\gamma \int_1^\infty t^{\eta-\gamma-1}(1 - \underline{a}^{-\gamma} t^{-\gamma})^{n-1} dt}.$$

The denominator is bounded from above by $\gamma \int_1^\infty t^{\eta-\gamma-1} dt$, which implies $n\underline{a} \to \infty$. Using a first-order approximation, we have:

$$(1 - \underline{a}^{-\gamma})^{n-1} \simeq \exp\left(-n\underline{a}^{-\gamma}\right).$$

Therefore, the market-based spillover in the limit is:

$$spill_{mkt}(n) \simeq -\frac{n\underline{a}^{-\gamma} \exp\left(-n\underline{a}^{-\gamma}\right)}{f_e \underline{a}^{\gamma\theta-\eta}} \to 0, \tag{IA.19}$$

since the numerator goes to zero and the denominator goes to infinity. Suppose instead that $\underline{a}$ has a finite limit. We obtain the expression for $spill_{mkt}$:

$$spill_{mkt}(n) = -\frac{n(1 - \underline{a}^{-\gamma})^{n-1}}{f_e \underline{a}^{\gamma(1+\theta)-\eta}} = -\frac{n \exp\left((n-1)\log(1 - \underline{a}^{-\gamma})\right)}{f_e \underline{a}^{\gamma(1+\theta)-\eta}} \to 0, \tag{IA.20}$$

since the denominator has a finite limit and the numerator goes to 0.

Lastly, consider the case where $\gamma\theta = \eta$. The spillover expression simplifies to:

$$spill_{mkt}(n) = -\frac{1}{f_e} \cdot n\underline{a}^{-\gamma}\left(1 - \underline{a}^{-\gamma}\right)^{n-1}.$$

[43]This follows from $(1 - M/M_e)^{n-1} = \exp\left[-(n-1)\log(M_e/M)\right]$ and using the asymptotics derived above for $\gamma\theta < \eta$: $(1 - M/M_e)^{n-1} = \exp\left[-(n-1)\left(f_e^{-1}\frac{\gamma}{\gamma-\eta} n\right)^{-\frac{\gamma}{\gamma(1+\theta)-\eta}}\right] \to 1.$

Using Lemma A.4 and the result that $\underline{a}^{-\gamma} = \alpha(n)/n$, and $\alpha(n) \to \alpha_\infty$, we have:

$$spill_{mkt}(n) \simeq -\frac{1}{f_e}\alpha(n)\exp\left(-(n-1)\alpha(n)/n\right) \tag{IA.21}$$

$$\simeq -\frac{1}{f_e}\alpha(n)\exp\left(-\alpha(n)\right) \to -\frac{1}{f_e}\alpha_\infty e^{-\alpha_\infty}. \tag{IA.22}$$

Moreover, using Lemma A.4, this also proves that in the limit, the magnitude of the market-based spillover $|spill_{mkt}|$ is less than that of the outcome-based spillover $|spill_{out}| = (\gamma - \eta)/\gamma$. ∎

B Extensions to the Baseline Model

B.1 Speculation with Dynamics

To capture the fact that investors' views change over time, we consider a dynamic version of the model in Section 3. The dynamic model produces predictions about the volume of trading and the length of a bubble that are consistent with documented facts in Hong and Stein (2007) and Greenwood, Shleifer, and You (2018).

We incorporate dynamics by assuming that, instead of producing at date 1, firms produce at some stochastic date T. At each date t, the economy enters the production stage with probability ψ^{-1}, and stays in the development stage with probability $1-\psi^{-1}$. At each date $t<T$ before production, firms engage into some development activity with productivity $a_{i,t}$ that is unknown. With some probability ϑ, they change their activity and receive a new productivity draw independent from their past productivity.[44] With probability $1-\vartheta$, firms' productivity stays the same as last period and $a_{i,t}=a_{i,t-1}$.

Dynamic overvaluation. In equilibrium, the price of each firm exceeds the maximum valuation of its cash flow by any specific investor in the economy. At any point in time, an investor ranking the firm first in a packet attains this maximum valuation, which we denote as $p_{i,t}^{max}$. The difference between the two valuations is

$$p_{i,t}-p_{i,t}^{max}=(\mathcal{I}_n-\mathcal{I}_1)\cdot\psi\ \frac{\vartheta(\psi-1)}{1+\vartheta(\psi-1)}>0. \qquad \text{(IA.23)}$$

This difference comes from the fact that when firms change their activities, the current investor will typically not favor firm i anymore. On average, a household investing in firm i values it as a typical firm in the economy, with $\mathcal{I}_1$, rather than a favorite, with $\mathcal{I}_n$.

Predictions. The dynamic overvaluation has implications for trading volume and the length of a bubble. Each time households exchange firms signals a change in who values them most, a mechanism reminiscent of the models of Harrison and Kreps (1978) and Scheinkman and Xiong (2003). From (IA.23), we can see that the strength of the overvaluation is increasing in the volume per period ϑ and the length of the bubble ψ.[45]

B.2 Generalizing the Business-Stealing Effect

We now consider more general functions for the business-stealing effect. In particular, suppose the expected profit of a firm with productivity a is:

$$\pi(a)=a^{\eta}\delta\left(r(a,M_e)\right),$$

where $r(a,M_e)\equiv(1-F(a))\,M_e$ is the ranking of the firm, or the mass of firms with productivity greater than a. We can interpret δ as being the probability of producing conditional on a firm's ranking r. The main text focused on the special case of $\delta(r)=\mathbf{1}\left\{r\leq M\right\}$.

We continue to focus on the case with $F(a)=1-a^{-\gamma}$.

[44] The change of firms' activity before production captures, for instance, the pivot of startups in the early stages of their development.

[45] For instance, when $\vartheta\ll\psi^{-1}\ll 1$, the overvaluation is proportional to $\vartheta\psi^2$.

B.2.1 Outcome-Based Spillover

Lemma B.1. *The outcome-based spillover does not depend on the level of entry:*

$$spill_{out} = -\frac{\gamma - \eta}{\gamma}. \tag{IA.24}$$

Proof. Under agreement, $n = 1$, and we can derive an exact solution for the mass of firms entering in equilibrium M_e. Integrating by parts, the value of a firm is:

$$\begin{aligned} V^{(1)}(M_e) &= \int_1^\infty \gamma x^{\eta-\gamma-1} \delta(M_e x^{-\gamma}) dx \\ &= \frac{\gamma}{\gamma - \eta} \left[\delta(M_e) - \gamma M_e \int_1^\infty x^{\eta-2\gamma-1} \delta'(M_e x^{-\gamma}) dx \right]. \end{aligned} \tag{IA.25}$$

In addition, we have:

$$M_e \frac{dV^{(1)}}{dM_e} = \gamma M_e \int_1^\infty x^{\eta-2\gamma-1} \delta'(M_e x^{-\gamma}) dx. \tag{IA.26}$$

Recalling that $spill_{out} = M_e \frac{dV^{(1)}}{dM_e} / V^{(1)}$, we have the desired formula (IA.24) for the outcome-based spillover. ∎

B.2.2 Disagreement Asymptotics with Multiple Cutoffs

We now consider the generalization of δ to allow for multiple cutoffs. In particular, suppose we have cutoffs $\underline{a}_1 < ... < \underline{a}_K$, with $\underline{a}_k \equiv F^{-1}(1 - \frac{M_k}{M_e})$, and constants $\Delta_1, ..., \Delta_K$ so that

$$\delta(r) = \sum_{k=1}^{K} \Delta_k \mathbf{1} \{ r \leq M_k \}. \tag{IA.27}$$

Notice that this imples that $V^{(n)} = \sum_{k=1}^{K} \Delta_k V_k^{(n)}$, where $V_k^{(n)} \equiv \int_{\underline{a}_k}^{\infty} x^\eta dF_n(x)$, and

$$-M_e \frac{dV^{(n)}}{dM_e} = -\sum_{k=1}^{K} \left(\Delta_k \frac{M_k}{M_e} \cdot a^\eta \cdot \frac{F_n'}{F'}(\underline{a}_k) \right).$$

For convenience, we normalize the cost of producing blueprints so that $W(b) = f_e b^{\theta+1} M_K^{-\theta} / (\theta + 1)$.

Lemma B.2. *Holding M_e constant, the outcome-based spillover is larger than the market-based spillover.*

Proof. Apply the proof for Proposition 1 for each k. ∎

Theorem B.3 (Asymptotics for the market-based spillover with multiple cutoffs)**.** *With business-stealing of the form (IA.27), in the high-disagreement limit ($n \to \infty$), the market-based spillover converges to a finite limit.*

- *If $\gamma\theta < \eta$, then $spill_{mkt}(n) \to -(\gamma - \eta)/\gamma$.*
- *If $\gamma\theta > \eta$, then $spill_{mkt}(n) \to 0$.*

- *If $\gamma\theta = \eta$, then $spill_{mkt}(n) \to -\frac{1}{f_e}\sum_{k=1}^{K}\left[\Delta_k \left(\frac{M_K}{M_k}\right)^{\frac{\eta-\gamma}{\gamma}} \alpha_\infty \exp\left(-\frac{M_k}{M_K}\alpha_\infty\right)\right]$.*

Proof. Suppose $\gamma\theta < \eta$. As before, conjecture that we can write $\underline{a}_K = \alpha(n)n^{1/(\gamma(1+\theta)-\eta)}$. This yields

$$f_e \simeq \sum_{k=1}^{K} \Delta_k \left(\frac{M_k}{M_K}\right)^{\frac{\gamma-\eta}{\gamma}} \alpha^{\eta-\gamma(\theta+1)} \frac{\gamma}{\gamma-\eta}. \tag{IA.28}$$

Therefore, we have the asymptotics for firm entry:

$$\frac{M_e}{M_K} = \left[\frac{1}{f_e}\sum_{k=1}^{K} \Delta_k \left(\frac{M_k}{M_K}\right)^{\frac{\gamma-\eta}{\gamma}} \frac{\gamma}{\gamma-\eta}\cdot n\right]^{\frac{\gamma}{\gamma(\theta+1)-\eta}}. \tag{IA.29}$$

Substituting this into the formula for the market-based spillover, we have

$$spill_{mkt}(n) = -\frac{\sum_{k=1}^{K} \Delta_k \left(\frac{M_k}{M_e}\right)^{\frac{\gamma-\eta}{\gamma}} n\left(1-\frac{M_k}{M_e}\right)^{n-1}}{f_e\left(\frac{M_e}{M_K}\right)^{\theta}} \to -\frac{\gamma-\eta}{\gamma} \tag{IA.30}$$

as desired.

Now suppose $\gamma\theta > \eta$. Then we have

$$\begin{aligned} spill_{mkt}(n) &= -\frac{n\sum_{k=1}^{K} \underline{a}_k^{\eta-\gamma}\left(\underline{a}_k^{-\gamma}\right)^{n-1}}{f_e \underline{a}_K^{\gamma\theta}} \\ &= -\frac{n\sum_{k=1}^{K}\left(\frac{M_K}{M_k}\right)^{\frac{\eta-\gamma}{\gamma}} \underline{a}_K^{-\gamma}\left(1-\frac{M_k}{M_K}\underline{a}_K^{-\gamma}\right)^{n-1}}{f_e\underline{a}_K^{\gamma\theta-\eta}} \end{aligned} \tag{IA.31}$$

Suppose $\underline{a}_K \to \infty$. Then we can write the first-order condition for firm creation as:

$$\frac{f_e\underline{a}_K^{\gamma\theta-\eta}}{n\underline{a}_K^{-\gamma}} = \sum_{k=1}^{K} \Delta_k \left(\frac{M_K}{M_k}\right)^{\frac{\eta-\gamma}{\gamma}} \gamma \int_1^\infty t^{\eta-\gamma-1}\left(1-\underline{a}_k^{-\gamma}t^{-\gamma}\right)^{n-1} dt. \tag{IA.32}$$

Since the integral on the right-hand side is bounded from above by $\int_1^\infty t^{\eta-\gamma-1}dt$, we have that $n\underline{a}_K^{-\gamma} \to \infty$, which implies that we can use a similar approximation to the proof of Proposition 2 to show that:

$$spill_{mkt}(n) \simeq -\frac{n\sum_{k=1}^{K}\left(\frac{M_K}{M_k}\right)^{\frac{\eta-\gamma}{\gamma}} \underline{a}_K^{-\gamma}\exp\left(-n\frac{M_k}{M_K}\underline{a}_K^{-\gamma}\right)}{f_e\underline{a}_K^{\gamma\theta-\eta}} \to 0. \tag{IA.33}$$

Finally, suppose $\gamma\theta = \eta$. We then have

$$f_e = \sum_{k=1}^{K} \Delta_k\gamma n \left(\frac{M_K}{M_k}\right)^{\frac{\eta-\gamma}{\gamma}} \underline{a}_K^{-\gamma} \int_1^\infty t^{\eta-\gamma-1}\left(1-\frac{M_k}{M_K}\underline{a}_K^{-\gamma}t^{-\gamma}\right). \tag{IA.34}$$

As before, we conjecture that $\underline{a}_K = \alpha(n)^{-1/\gamma} n^{1/\gamma}$. Then

$$
\begin{aligned}
f_e &\simeq \sum_{k=1}^{K} \Delta_k \left(\frac{M_K}{M_k}\right)^{\frac{\eta-\gamma}{\gamma}} \gamma\alpha(n) \int_1^\infty t^{\eta-\gamma-1} \exp\left[-(n-1)\alpha(n)n^{-1}\frac{M_k}{M_K} t^{-\gamma}\right] dt \\
&\to \sum_{k=1}^{K} \Delta_k \left(\frac{M_K}{M_k}\right)^{\frac{\eta-\gamma}{\gamma}} \gamma\alpha_\infty \int_1^\infty t^{\eta-\gamma-1} \exp\left[-\frac{M_k}{M_K}\alpha_\infty t^{-\gamma}\right] dt. \qquad \text{(IA.35)}
\end{aligned}
$$

By analogous reasoning to the proof in Proposition 2, we can obtain a finite bound on α_∞. We therefore have the market-based spillover:

$$
\begin{aligned}
spill_{mkt}(n) &= -\frac{1}{f_e} \sum_{k=1}^{K} \left[\Delta_k n \left(\frac{M_K}{M_k}\right)^{\frac{\eta-\gamma}{\gamma}} \underline{a}_K^{-\gamma} \left(1 - \frac{M_k}{M_K}\underline{a}_K^{-\gamma}\right)\right] \\
&\to -\frac{1}{f_e} \sum_{k=1}^{K} \left[\Delta_k \left(\frac{M_K}{M_k}\right)^{\frac{\eta-\gamma}{\gamma}} \alpha_\infty \left(1 - \frac{M_k}{M_K}\alpha_\infty\right)\right] \qquad \text{(IA.36)}
\end{aligned}
$$

as desired. ∎

B.2.3 Disagreement Asymptotics with Continuous Business-Stealing

We now consider a continuous function for the business-stealing effect

$$
\delta(r) = \begin{cases} 1 & \text{if } r < 1 \\ r^{-\zeta} & \text{if } r \geq 1 \end{cases} \qquad \text{(IA.37)}
$$

so that ζ parameterizes the business-stealing effect for low-productivity firms with $r \geq 1$. Larger ζ implies that low-productivity firms have a lower probability of producing, with $\zeta = 0$ corresponding to the case with no business-stealing effect. With $\zeta \to \infty$, this converges to the benchmark step function business-stealing effect with $M = 1$.

We now normalize the cost of producing blueprints, so that $W(b) = f_e b^{\theta+1}/(\theta+1)$, and define $\underline{a} \equiv M_e^{\frac{1}{\gamma}}$ to be the cutoff above which $\delta(a, M_e) = 1$, i.e., firms produce with probability one.

It will be convenient to consider the decomposition $V^{(n)} = V_L^{(n)} + V_U^{(n)}$, where

$$
\begin{aligned}
V_L^{(n)} &\equiv \gamma n M_e^{-\zeta} \int_1^{\underline{a}} x^{\eta-\gamma(1-\zeta)-1}(1-x^{-\gamma})^{n-1} dx \\
V_U^{(n)} &\equiv \gamma n \int_{\underline{a}}^{\infty} x^{\eta-\gamma-1}(1-x^{-\gamma})^{n-1} dx
\end{aligned}
$$

capture the expected profit conditional on having productivity below and above $\underline{a}$ respectively. We can write

$$
V_L^{(n)} = \gamma n \underline{a}^{\eta-\gamma(\theta+1)} \int_{\underline{a}^{-1}}^{1} t^{\eta-\gamma(1-\zeta)-1}(1-\underline{a}^{-\gamma}t^{-\gamma})^{n-1} dt \qquad \text{(IA.38)}
$$

$$
V_U^{(n)} = \gamma n \underline{a}^{\eta-\gamma(\theta+1)} \int_{1}^{\underline{a}^{-1}} t^{\eta-\gamma-1}(1-\underline{a}^{-\gamma}t^{-\gamma})^{n-1} dt. \qquad \text{(IA.39)}
$$

Moreover, since

$$\begin{aligned}\frac{dV_L^{(n)}}{dM_e} &= -\zeta M_e^{-1} V_L^{(n)} + \gamma n M_e^{-\zeta} M_e^{\frac{\eta-\gamma(1-\zeta)-1}{\gamma}} \left(1 - M_e^{-1}\right)^{n-1} \\ &= -\zeta M_e^{-1} V_L^{(n)} - \frac{dV_U^{(n)}}{dM_e},\end{aligned}$$

we have that

$$-M_e \frac{dV^{(n)}}{dM_e} = \zeta V_L^{(n)}. \tag{IA.40}$$

Theorem B.4 (Asymptotics for the market-based spillover with continuous business-stealing)**.** *Suppose we have business stealing of the form (IA.37) and $\zeta > \frac{\gamma-\eta}{\gamma}$. In the high-disagreement limit ($n \to \infty$), the market-based spillover converges to a finite limit.*

- *If $\gamma\theta < \eta$, then $spill_{mkt}(n) \to -(\gamma - \eta)/\gamma$.*
- *If $\gamma\theta \geq \eta$, then $spill_{mkt}(n) \to 0$.*

Proof. Suppose $\gamma\theta < \eta$. Conjecture that $\underline{a} = \alpha(n) n^{1/(\gamma(1+\theta)-\eta)}$. We have from the proof of Proposition 2 that $V_U^{(n)} \to \alpha^{\eta-\gamma} \frac{\gamma}{\gamma-\eta}$. In addition, we have from (IA.38) that $V_U^{(n)} \to \alpha^{\eta-\gamma} \frac{\gamma}{\eta-\gamma(1-\zeta)}$. Therefore, we have

$$f_e = \left(\frac{\gamma}{\gamma - \eta} - \frac{\gamma}{\gamma(1-\zeta) - \eta} \right) \alpha^{\eta-\gamma(\theta+1)}, \tag{IA.41}$$

which verifies the conjecture. We thus have the asymptotic market-based spillover

$$spill_{mkt}(n) = -\zeta \frac{V_L^{(n)}}{V^{(n)}} \to -\frac{\gamma - \eta}{\gamma} \tag{IA.42}$$

as desired.

Suppose $\gamma\theta > \eta$. Suppose $\underline{a} \to \infty$. Then we can rewrite (10) as:

$$n\underline{a}^{-\gamma} = \frac{f_e \underline{a}^{\gamma\theta-\eta}/\gamma}{\int_{\underline{a}^{-1}}^{1} t^{\eta-\gamma(1-\zeta)-1}(1 - \underline{a}^{-\gamma} t^{-\gamma})^{n-1} dt + \int_1^\infty t^{\eta-\gamma-1}(1 - \underline{a}^{-\gamma} t^{-\gamma})^{n-1} dt}. \tag{IA.43}$$

The two terms in the denominator of the right-hand side are bounded from above by $\int_0^1 t^{\eta-\gamma(1-\zeta)-1} dt$ and $\int_1^\infty t^{\eta-\gamma-1} dt$, respectively, which implies that $n\underline{a}^{-\gamma} \to \infty$. Using the approximation $(1 - \underline{a}^{-\gamma})^{n-1} \simeq \exp(-n\underline{a}^{-\gamma})$, we have that

$$spill_{mkt}(n) = -\frac{\zeta}{f_e \underline{a}^{\gamma\theta}} V_L^{(n)} \to 0. \tag{IA.44}$$

If $\underline{a}$ has a finite limit, we can show that $V_L^{(n)} \to 0$ since $n(1 - \underline{a}^{-\gamma} t^{-\gamma})^{n-1} \to 0$ for $t \in (\underline{a}^{-1}, 1)$, which implies that $spill_{mkt}(n) \to 0$ as well.

Suppose $\gamma\theta = \eta$. Using an analogous proof to Lemma A.4, we can show that $\underline{a}_n = \alpha(n)^{-1/\gamma} n^{1/\gamma}$, where $\alpha(n)$ has a finite limit α_∞. Since we can bound $V_L^{(n)}$ from above by

$$\begin{aligned} V_L^{(n)} &= \gamma\alpha(n)\int_{\underline{a}^{-1}}^{1} t^{\eta-\gamma(1-\zeta)-1}(1-\underline{a}^{-\gamma}t^{-\gamma})^{n-1}dt \\ &\leq \gamma\alpha(n)\int_{\underline{a}^{-1}}^{1} t^{\eta-\gamma(1-\zeta)-1}dt \to \frac{\gamma\alpha_\infty}{\eta-\gamma(1-\zeta)}, \end{aligned}$$

we have that $spill_{mkt}(n) = -\frac{\zeta V_L^{(n)}}{f_e \underline{a}^{\gamma\theta}} \to 0$. ∎

B.3 Results with a Zero-Cutoff-Profit Condition

Our results are robust to an extension in which the marginal firm earns zero profits. Our baseline model specifies that the M most productive firms will be allowed to produce, which allows for tractability but results in the marginal firm earning positive profits, $\pi(\underline{a}) > 0$. We now augment the model with an intermediate stage where firms, after entering the market, compete to be among one of the M firms producing. The competition stage ensures that the business-stealing externality remains. We keep the belief and production structure of the model intact= and show that the main features of the spillovers remain unchanged despite the introduction of a zero-cutoff-profit (ZCP) condition for the marginal firm.

In the new intermediate decision stage, firms can use some of their production as advertisement to reach consumers, a deadweight loss. Only the M firms that spend the most on advertising produce in equilibrium. Formally, each firm chooses how much of its production to use on advertisement, $h_i \leq \pi(a_i)$. In doing so, firms take as given the equilibrium level $\underline{h}$ of advertising necessary to attract consumers. Their profit function is therefore $\pi(a_i)\mathbf{1}\{h_i \geq \underline{h}\} - h_i$. The optimal advertisement choice is $h_i = \underline{h}$ if $\pi(a_i) \geq \underline{h}$ and 0 otherwise. The equilibrium value of $\underline{h}$ is such that exactly M firms choose to spend on advertisement. Keeping the definition of the production cutoff $\underline{a}$ from earlier, this implies

$$\underline{h} = \pi(\underline{a}). \tag{IA.45}$$

Firms must spend the profits of the marginal firm to be able to produce, resulting in zero profits for the marginal firm.

B.3.1 General Derivations

Firm value in this model is modified to account for the cost of advertisement:

$$\widetilde{V}^{(n)}(M_e) = \int_{\underline{a}}^{\infty} (\pi(a) - \pi(\underline{a}))\, dF^n(a). \tag{IA.46}$$

We can define the corresponding integral $\widetilde{\mathcal{I}}_n$. With this new definition of firm value, the remainder of the competitive equilibrium and the planner problem are unchanged. In particular, the market-based spillover is $spill_{mkt} = \mathcal{E}_{\widetilde{\mathcal{I}}_n}$.

Decompose firms' valuations into the revenue (from (IA.46)) and advertising cost components:

$$V^{(n)}(M_e) = \int_{F^{-1}\left(1-\frac{M}{M_e}\right)}^{\infty} \pi(a)dF_n(a) - \left(\frac{M}{M_e}\right)^{1-\frac{\eta}{\gamma}} \cdot n\left(1-\frac{M}{M_e}\right)^{n-1}. \tag{IA.47}$$

The first derivative of $V^{(n)}$ is:

$$-M_e \cdot \frac{dV^{(n)}(M_e)}{dM_e} = \frac{\eta}{\gamma}\left(\frac{M_e}{M}\right)^{\frac{\eta}{\gamma}} \cdot \left[1-\left(1-\frac{M}{M_e}\right)^n\right].$$

Using the free-entry condition, $V^{(n)}(M_e) = W'(M_e)$, we have following formula for the market-based spillover:

$$spill_{mkt}(n; M_e) = \frac{\eta}{\gamma} \cdot \frac{1}{f_e} \cdot \left(\frac{M_e}{M}\right)^{\frac{\eta}{\gamma}-\theta} \cdot \left[1-\left(1-\frac{M}{M_e}\right)^n\right]. \tag{IA.48}$$

B.3.2 Spillovers and Firm Entry

Lemma B.5. *In the model with a ZCP condition, the outcome-based spillover is:*

$$spill_{out} = -\frac{\gamma-\eta}{\gamma}.$$

Proof. The free-entry condition with $n = 1$ gives us:

$$\left(\frac{M_e}{M}\right)^{\frac{\gamma(1+\theta)-\eta}{\gamma}} = \frac{1}{f_e} \cdot \frac{\eta}{\gamma-\eta}.$$

Given the derivation of the spillover in (IA.48), we have:

$$spill_{out}(M_e) = -\frac{\eta}{\gamma} \cdot \frac{1}{f_e} \cdot \left(\frac{M_e}{M}\right)^{\frac{\eta}{\gamma}-\theta} \cdot \frac{M}{M_e} = -\frac{\gamma-\eta}{\gamma}, \tag{IA.49}$$

where we have used our equilibrium solution for M_e/M. ∎

Lemma B.6. *In the high-disagreement limit ($n \to \infty$), the mass of entrants also increases and goes to infinity:* $\lim_{n\to\infty} M_e = \infty$.

Proof. We adapt the proof from Lemma A.3, again defining the sequence $\underline{a}_n = (M_e/M)^{1/\gamma}$ and showing that $\underline{a}_n \to \infty$. Equation (IA.47) implies the implicit definition of the sequence $(\underline{a}_n)_n$ in this case:

$$f_e \underline{a}_n^{\gamma(\theta+1)-\eta} = \gamma n \int_1^\infty t^{\eta-\gamma-1}\left(1-\underline{a}_n^{-\gamma}t^{-\gamma}\right)^{n-1} dt - n(1-\underline{a}_n^{-\gamma})^{n-1}.$$

Assume that $\underline{a}_n$ has a finite limit that is strictly larger than zero, $\underline{a}_\infty > 0$. Then there exists N large enough such that $\forall n > N, \underline{a}_n > A = \underline{a}_\infty - \epsilon > 0$. For any arbitrary threshold T_n, we have

$$I_n > n\left[\frac{\gamma}{\gamma-\eta} \cdot T_n^{\eta-\gamma}\left(1-A^{-\gamma}T_n^{-\gamma}\right)^{n-1} - 1\right].$$

As in Lemma A.3, we conclude by considering the threshold $T_n = n^{1/\gamma}$. ∎

Lemma B.7 (Asymptotics for firm creation)**.** *In the high-disagreement limit ($n \to \infty$), we have the following asymptotics for the mass of firms created M_e:*

- *If $\gamma\theta < \eta$, then* $\lim_{n\to\infty} M_e/M = \alpha_\infty^\gamma n^{\frac{\gamma}{\gamma(1+\theta)-\eta}}$.

- *If $\gamma\theta = \eta$, then $\lim_{n\to\infty} M_e/M = \alpha_\infty^{-1} n$.*

In each case, α_∞ is a constant defined below.

Proof. We adapt the proof from Lemma A.4. Starting from (10), and using $\underline{a}$:

$$f_e \simeq \gamma \underline{a}^{\eta-\gamma(\theta+1)} n \int_1^\infty \left(t^\eta - 1\right) t^{-\gamma-1} \exp\left(-(n-1)\underline{a}^{-\gamma} t^{-\gamma}\right) dt,$$

where we have used the fact that $\underline{a} \to \infty$ and $\log(1-x) = -x + \mathcal{O}(x^2)$. To find a solution, we guess that asymptotically $\underline{a} \simeq \alpha(n) n^{\frac{1}{\gamma(1+\theta)-\eta}}$ and show that $\alpha(n)$ converges to a finite limit α. The first-order condition becomes

$$f_e \simeq \gamma \alpha(n)^{\eta-\gamma(\theta+1)} \int_1^\infty \left(t^\eta - 1\right) t^{-\gamma-1} \exp\left(-\alpha(n)^{-\gamma} \frac{n-1}{n^{\frac{\gamma}{\gamma(1+\theta)-\eta}}} t^{-\gamma}\right) dt.$$

If $\gamma\theta < \eta$, then the exponential term converges to zero and we have:

$$\alpha_\infty = \left(\frac{1}{f_e} \cdot \frac{\eta}{\gamma - \eta}\right)^{\frac{1}{\gamma(1+\theta)-\eta}}. \tag{IA.50}$$

If $\gamma\theta = \eta$, then $\underline{a}$ is defined by:

$$f_e = \gamma \underline{a}_n^{-\gamma} n \int_1^\infty t^{\eta-\gamma-1} \left(1 - \underline{a}^{-\gamma} t^{-\gamma}\right)^{n-1} dt.$$

We guess and verify that $\underline{a}_n = \alpha(n)^{-1/\gamma} n^{1/\gamma}$, and $\alpha(n)$ has a finite limit α_∞:

$$f_e = \gamma \alpha_\infty \int_1^\infty \left(t^\eta - 1\right) t^{-\gamma-1} e^{-\alpha_\infty t^{-\gamma}} dt,$$

where we took the limit when $n \to \infty$. Moreover, we are able to bound the magnitude of the market-based spillover above using a bound on α_∞:

$$\frac{\alpha_\infty e^{-\alpha_\infty}}{f_e} < \frac{\gamma - \eta}{\eta}, \tag{IA.51}$$

which verifies that α_∞ is finite. ∎

We now show that, despite the presence of the ZCP, Proposition 2 holds.

Theorem B.8. *In the high-disagreement limit ($n \to \infty$), the market-based spillover converges to a finite limit.*

- *If $\gamma\theta < \eta$, then $spill_{mkt}(n) \to -(\gamma - \eta)/\gamma$.*
- *If $\gamma\theta > \eta$, then $spill_{mkt}(n) \to 0$.*
- *If $\gamma\theta = \eta$, then $spill_{mkt}(n) \to -\frac{\eta}{\gamma}\frac{1}{f_e} e^{-\alpha_\infty}$.*

Proof. If $\gamma\theta > \eta$, then given equation (IA.48), we use that $M_e \to \infty$ to conclude that $\lim_{n\to\infty} spill_{mkt} = 0$.

If $\gamma\theta < \eta$, then we can use the asymptotics from B.7 and the formula for the market-based spillover from (IA.48):

$$spill_{mkt}(n; M_e) \simeq -\frac{\eta}{\gamma}\frac{1}{f_e}\alpha_{\infty}^{\eta-\theta\gamma} \cdot n^{\frac{\eta-\theta\gamma}{\gamma(1+\theta)-\eta}} \cdot \left[1 - \left(1 - \alpha_{\infty}^{-\gamma} n^{\frac{-\gamma}{\gamma(1+\theta)-\eta}}\right)^{n}\right] \tag{IA.52}$$

$$\simeq -\frac{\eta}{\gamma}\frac{1}{f_e}\alpha_{\infty}^{\eta-\theta\gamma} \cdot n^{\frac{\eta-\theta\gamma}{\gamma(1+\theta)-\eta}} \cdot \left[1 - \exp\left(-\alpha_{\infty}^{-\gamma} n^{\frac{\gamma\theta-\eta}{\gamma(1+\theta)-\eta}}\right)\right] \tag{IA.53}$$

$$\simeq -\frac{\eta}{\gamma}\frac{1}{f_e}\alpha_{\infty}^{\eta-\theta\gamma} \cdot n^{\frac{\eta-\theta\gamma}{\gamma(1+\theta)-\eta}} \cdot \alpha_{\infty}^{-\gamma} n^{\frac{\gamma\theta-\eta}{\gamma(1+\theta)-\eta}} \to -\frac{\eta}{\gamma}\frac{1}{f_e}\alpha_{\infty}^{\eta-\gamma(1+\theta)}. \tag{IA.54}$$

Using the definition of α_∞ from the proof above, we conclude $\lim_{n\to\infty} spill_{mkt}(n; M_e) = -(\gamma-\eta)/\gamma$.

In the knife-edge case with $\gamma\theta = \eta$, we have

$$spill_{mkt}(n; M_e) \simeq -\frac{\eta}{\gamma}\frac{1}{f_e} \cdot \left[1 - \left(1 - \alpha_{\infty} n^{-1}\right)^{n}\right] \to -\frac{\eta}{\gamma}\frac{1}{f_e} \cdot e^{-\alpha_\infty}. \tag{IA.55}$$

We can bound the market-based spillover in the limit: $\lim_{n\to\infty} |spill_{mkt}(n; M_e)| < \alpha_{\infty}^{-1} \cdot (\gamma - \eta)/\gamma$. $\blacksquare$

Our conclusions are therefore robust to including competition to enter. Intuitively, marginal firms drive the externality in both settings. In our baseline, the externality operates at the extensive margin: more entry displaces the profits of excluded marginal firms. In this model, the externality is on the intensive margin: firm entry increases the productivity of the marginal firm and thus advertisement costs for all producing firms.

C Relation of the Model with Theoretical and Empirical Notions of Bubbles

Our framework yields equilibrium behavior consistent with features of bubble episodes related to the introduction of new technologies. Some well-documented examples include railroads, electricity, automobiles, radios, micro-electronics, personal computers, bio-technology, and the Internet. Scheinkman (2014) and Brunnermeier and Oehmke (2013) survey the field of speculation and bubbles; Janeway (2012) gives a first-person account of the relationship between innovation and speculation.

In the empirical analysis in Section 6, we use the abnormal price increase in the first phase of a boom to distinguish bubble periods, following Greenwood, Shleifer, and You (2018). While they also show that conditioning on a bust helps capture more features of bubbles, the ex-post nature of this conditioning would be an issue for our empirical tests.

A more formal definition of a bubble is a situation in which asset prices exceed an asset's fundamental value (see, for example, Brunnermeier (2016)). The drop in prices at date 1 is expected by all investors—they agree on aggregate outcomes—and supports this definition. How can all investors agree that the market portfolio is overpriced? Such a situation arises from households' heterogeneous beliefs. Different households view different firms as the most valuable and specialize their portfolios in those firms, which seem fairly priced to them. The short-sale constraint prevents each household from shorting the other firms, which it views as overpriced.[46] Chen, Hong, and Stein (2002), Diether, Malloy, and Scherbina (2002), and Yu (2011) establish empirically the link between dispersed beliefs and low future returns.[47]

Our model takes a static view of speculation, but in practice, investors' views change over time. In Appendix B.1, we study an extension of the model that entertains this possibility. A stronger form of overvaluation arises: the price of each firm exceeds the maximum valuation of its cash-flow by any specific investor in the economy. This difference comes from the fact that when investors change views, the current investor of a specific firm will typically not favor it anymore and sell it to somebody else. Hence, each time households trade firms signals a change in who values which firms the most, a mechanism similar to the models of Harrison and Kreps (1978) and Scheinkman and Xiong (2003). We show that this dynamic overvaluation is increasing in volume per period and the length of the bubble. Historically, abnormally high trading volume is seen as a hallmark of bubbles—see Scheinkman (2014) for a survey. For example, during the Roaring Twenties, daily records of share trading volume were reached ten times in 1928 and three times in 1929, with no new record set until 1968 (Hong and Stein, 2007). More recently, during the dot-com bubble, internet stocks had three times the turnover of otherwise similar stocks. Greenwood, Shleifer, and You (2018) also document that large stock price increases are more likely to end in a crash when they are accompanied by increased trading volume.

Finally, while our model does not provide an explicit premise for increases in disagreement, it is natural to expect disagreement during innovative episodes. As investors see these ideas and firms for

[46] Van den Steen (2004) describes how disagreement combined with optimal choice leads to overvaluation and Miller (1977) first pointed out the importance of short-sale constraints in financial markets.

[47] Using investor survey data to quantify disagreement, Diether, Malloy, and Scherbina (2002) find that stocks with dispersed analysts' forecasts experience low subsequent returns. Yu (2011) aggregates this measure to portfolios such as the market portfolio and finds a similar result. Using stock market positions to measure disagreement, Chen, Hong, and Stein (2002) construct the fraction of the mutual fund population investing in a given stock, a measure of the breadth of ownership for individual stocks. They find that this measure predicts low stock returns.

the first time, they must rely on their priors to evaluate them. In contrast, more mature industries are likely associated with more common information that investors might have accumulated over time, accompanied by stronger agreement about what makes a firm successful. Consistent with this view, Greenwood, Shleifer, and You (2018) find that when the price run-up in an industry occurs disproportionately among the younger firms, crashes and low future returns are more likely.

D General Equilibrium Model with Richer Spillovers

Competition is only one of the many ways through which the effect of an innovation are felt in the economy. When a firm innovates, it not only affects shareholders but also workers (see, e.g., Kogan et al. (2020) for recent evidence). Moreover, a new product alters consumers' choice over their entire consumption basket (Blanchard and Kiyotaki (1987)). Finally, others can learn from this innovation, as emphasized by Romer (1986). We incorporate these three prominent sources of spillovers in our theory.

Doing so is interesting for three reasons. First, we obtain new testable predictions of our theory on the interaction of speculation and innovation that can help discipline future empirical work. Second, by comparing across many different specifications, we obtain a more systematic typology of what drives the divergence between market-based and outcome-based measures arising from speculation. Finally, the results highlight the flexibility of our theoretical framework, which is reinforced in Appendix F through many more realistic extensions.[48] Derivations and proofs are presented in Appendix E.

D.1 Model with Richer Spillovers

In all the settings that follow, we maintain the same preferences, beliefs, firm-creation technology, and allocation of production slots as in the model of Section 3. However, we now endogenize how profits $\pi(a)$ are determined in equilibrium, which creates new sources of spillovers. These spillovers, while important, do not change qualitatively the aggregate behavior of the economy in response to speculation. Specifically, an increase in disagreement n always yields a bubble and increases the market-based private value of innovation (in absolute terms and relatively to the outcome-based measure). For this reason, we focus only on the novel predictions for spillovers below.

D.1.1 Labor

Workers supply the labor that is necessary to operate the firms and thus take advantage of blueprints. We formalize this in the model: households are endowed with a fixed quantity of labor L. Firms use labor to produce a homogeneous good according to a technology with decreasing returns to scale.[49] The production function for a given productivity level a is:

$$y(a) = a \cdot \frac{\sigma}{\sigma - 1} \ell^{\frac{\sigma-1}{\sigma}}, \tag{IA.56}$$

where y is firm output, ℓ is firm labor input, and the parameter $\sigma \in [1, \infty]$ controls the returns to scale in labor. In equilibrium (see Appendix E.1), labor trades at a competitive wage w, and the profit function of a firm with productivity a is:

$$\pi(a) = \frac{1}{\sigma - 1} \cdot w^{1-\sigma} a^{\sigma}. \tag{IA.57}$$

[48] In particular, we study the role of an elastic supply of labor input, a variable number of producing firms M, a setup in which firms compete to participate, and a setting where fixed costs determine the set of producing firms, as in Melitz (2003). For all these models, we obtain simple generalizations of the spillover formula of Proposition D.1 and show that the comparative statics of the spillovers remain valid.

[49] This perfectly competitive approach, introduced in Hellwig and Irmen (2001), differs from the most commonly used models with imperfect substitution and monopolistic competition. We study these models and the role of the demand complementarities they induce in Section D.1.2.

As in Section 3, profits are isoelastic with respect to productivity a.

The presence of workers gives rise to two new sources of spillovers. First, workers capture some of the surplus from better innovations through higher wages. Investors on financial markets do not take into account this value when deciding on new firm creation. This externality is commonly known as the *appropriability effect*. Second, the competition of firms for the same source of labor leads to an interaction between them beyond business-stealing. When a new firm enters, it pushes wages up. This *input price effect* makes labor more expensive for every other firm. For example, the entry of new technology firms such as Facebook creates new opportunities for software engineers (the appropriability effect), bidding their wages up and making it more difficult for other firms to hire (the input price effect). More generally, these spillovers also apply to other production inputs: ℓ could stand for intermediate goods in scarce supply.

Measuring the spillovers. We extend our measure of social value to account for the presence of labor. For the market-based social value of an extra firm, we compute the change in expected utility of households created by this new firm. This calculation includes both the market value of profits from investing in the firms and the income from working in these firms. In our model, it is a dollar amount because of the presence of a quasi-linear good at date 0. The outcome-based social value of an extra firm is still the change in total output in the economy. Importantly, both definitions coincide with the work in Section 3 in the absence of labor.

This overall measure sums the effect of each type of spillover. Here the sources are the appropriability, input price, and business-stealing effects. Each additional source of spillovers introduces extra terms. The separation of different types of spillovers in the overall measure maps naturally to estimation strategies from the empirical literature. For example, as described in Section 2, Bloom, Schankerman, and Van Reenen (2013) separate the business-stealing and knowledge spillovers. One could also imagine measuring the effect of firm entry on workers, the appropriability effect. Similarly, the response of firm value to innovation by other firms that compete for the same workers but operate in different product markets would identify the input price effect.[50]

Predictions. The business-stealing effect of the model in Section 3 is still present in this economy given the similar market structure. As before, this spillover, which arises because entrants displace marginal firms, has magnitude $\mathcal{E}_{\mathcal{I}_n}$. Hence, the predictions for this spillover we made in Section 4.2 still hold.

However, we now also have an appropriability effect. When new firms enter, aggregate output increases, with constant elasticity $\mathcal{E}_{\mathcal{C}} = 1/\gamma$. The production function implies that workers receive a constant fraction of aggregate output given by the labor share $(\sigma - 1)/\sigma$. Therefore, the social value of entry for workers is $\frac{\sigma-1}{\sigma}\mathcal{E}_{\mathcal{C}}\mathcal{C}/M_e$. Importantly, this quantity does not depend directly on the amount of disagreement: all firms offer the same wage in equilibrium, so beliefs are irrelevant for workers. However, the market-based private value of the firm does. This value is $\mathcal{I}_n/\mathcal{I}_1 \times \sigma^{-1}\mathcal{C}/M$: the relative expected output of a favorite firm to an average firm multiplied by average profits of firms. The spillover is the ratio of these two values,

$$\text{Appropriability Spillover} = (\sigma - 1)\ \mathcal{E}_{\mathcal{C}}\ \mathcal{I}_1/\mathcal{I}_n. \tag{IA.58}$$

When focusing on the outcome-based measure, we can just replace n with 1, and the spillover becomes $(\sigma - 1)\ \mathcal{E}_{\mathcal{C}}$. According to either metric, the appropriability effect is a positive spillover,

[50] For clarity, we do not include multiple sectors in the model. The additive property of total spillover with respect to each type of spillover allows us to isolate the different effects.

larger when workers capture more of total surplus—high σ—or when entry has a stronger impact on output—high $\mathcal{E}_{\mathcal{C}}$. Novel to our model, we see that disagreement does not affect the outcome-based spillover. In contrast, the market-based spillover decreases in n, disappearing altogether in the limit when $n \to \infty$. This is because the bubble inflates the market value of firms, but workers' acknowledge that their earnings are determined by the average producing firm and realize that not all firms will be winners.

Finally, the input price spillover comes from the effect of firm entry on wages. From equation (IA.57), we see that profits have an elasticity of $1 - \sigma$ relative to the wage. In addition, the wage grows as fast as aggregate output, $\mathcal{E}_{\mathcal{C}} = \mathcal{E}_w$, because of the constant labor share and labor supply. A change in wage affects all firms proportionally, irrespective of their productivity. Hence, disagreement does not impact the input price spillover. Rather, both market-based and outcome-based measures of the spillovers are constant and equal to:

$$\text{Input Price Spillover} = -(\sigma - 1)\mathcal{E}_{\mathcal{C}}. \tag{IA.59}$$

This negative externality is larger when firms rely more on labor—high σ—or when the economy responds more to entry—high $\mathcal{E}_{\mathcal{C}}$.[51]

D.1.2 Aggregate Demand

With goods that are not perfect substitutes, households prefer a consumption basket that is diversified. Higher productivity for any particular good thus increases aggregate demand. This implies not only more profit for the specific firm but also for other firms producing the rest of the consumption basket. To formalize the role of aggregate demand, we study an economy with differentiated goods, where firms operate under monopolistic competition at date 1 in the style of Dixit and Stiglitz (1977). Each firm produces a differentiated variety indexed by i, and household utility over the set of goods produced is:

$$\mathcal{C} = \left(\int_0^{M_e} \int_{F^{-1}\left(1 - \frac{M}{M_e}\right)}^{\infty} c\,(a,i)^{\frac{\sigma-1}{\sigma}}\, dF(a)di \right)^{\frac{\sigma}{\sigma-1}}. \tag{IA.60}$$

Firms operate a linear technology in labor, and output for a firm with productivity a is $y = a\ell$. We leave our other assumptions unaltered.

At the aggregate level, the economy behaves similarly to the previous model.[52] However, the microeconomics of firms' interactions is different and so are profits:

$$\pi(a) = \frac{1}{\sigma} \cdot \left(\frac{\sigma}{\sigma - 1} \right)^{1-\sigma} w^{1-\sigma} \cdot \mathcal{C} \cdot a^{\sigma-1}. \tag{IA.61}$$

The elasticity of profits to individual firm productivity is no longer σ but rather $\sigma - 1$. However, profits are now increasing in aggregate demand $\mathcal{C}$ because of imperfect substitution across goods.

[51] In the case of agreement, $n = 1$, the appropriability and input price spillovers exactly cancel out. It is a situation where pecuniary externalities cancel out even though the first welfare theorem does not hold because of business-stealing.

[52] The profit share is $1/\sigma$, the aggregate production function is homogeneous of degree one in the distribution of productivities, and the relative labor allocations are efficient. This result was first shown in Lerner (1934). It is the consequence of the homogeneous distortions at the firm level when markups are constant. The macroeconomic elasticities of aggregate consumption and wages to firm entry are therefore $\mathcal{E}_{\mathcal{C}} = \mathcal{E}_w = 1/\gamma$.

This role of aggregate demand gives rise to an additional source of spillovers: a demand externality as in Blanchard and Kiyotaki (1987). Similar to the role of the wage, aggregate demand affects all firms proportionally. Therefore the demand spillover is the product of the elasticity of aggregate output to entry $\mathcal{C}$ and the elasticity of profits to aggregate output:

$$\text{Demand Spillover} = \mathcal{E}_{\mathcal{C}}. \tag{IA.62}$$

Demand spillovers do not depend on disagreement and are identical whether measured using outcomes or market value.

D.1.3 Knowledge Spillovers

Firms also learn from each other's innovations. We capture the role of knowledge spillovers in the style of Romer (1990) by assuming that a firm's productivity combines its own type, a, and an aggregate of all the active firms' productivity, A. We assume the aggregator is homogeneous of degree one in the productivity distribution.[53] The production function extends (IA.56) and becomes:

$$y = \frac{\sigma}{\sigma - 1} a^{1-\alpha} A^{\alpha} \ell^{\frac{\sigma-1}{\sigma}}, \tag{IA.63}$$

where α is the intensity of knowledge spillovers. Again, the macroeconomic features of the simple economy with labor are preserved.[54] However, the microeconomics of firms' interactions differ. Profits are:

$$\pi(a) = \frac{1}{\sigma - 1} \cdot w^{1-\sigma} \cdot A^{\alpha\sigma} \cdot a^{(1-\alpha)\sigma}. \tag{IA.64}$$

As the role of knowledge increases—larger α—firm profits respond more to aggregate knowledge A instead of individual productivity a.

The role of aggregate knowledge for profits highlights how knowledge spillovers operate. Just like the previous two cases, the impact of knowledge on profits is the same irrespective of each individual firm's productivity. The knowledge spillover is therefore the product of the elasticity of profit to knowledge $\alpha\sigma$, and the elasticity of knowledge to entry $1/\gamma$[55]

$$\text{Knowledge Spillover} = \alpha(\sigma - 1)\mathcal{E}_{\mathcal{C}}. \tag{IA.65}$$

This expression does not depend on disagreement and is identical for market-based and outcome-based measures.

D.2 Social Value and Disagreement

The previous results provide useful predictions for how each channel through which innovation affects the economy varies with disagreement. We now turn to the behavior of social value overall, i.e., the total effect of an innovation, which combines all sources of spillover. This quantity is

---

[53]In Appendix E.3, we derive the case of Hölder mean of degree q, $A = \left(M_e/M \int_{\underline{a}}^{\infty} a^q dF(a)\right)^{1/q}$, where the parameter $q < \gamma$ controls how much aggregate knowledge comes from the top firms.

[54]The labor share is $(\sigma - 1)/\sigma$ and $\mathcal{E}_{\mathcal{C}} = \mathcal{E}_w = 1/\gamma$.

[55]Because both knowledge and output are determined by the distribution of firm productivity, they grow at the same pace with entry $\mathcal{E}_A = \mathcal{E}_{\mathcal{C}}$.

interesting in its own right, but also because it represents the optimal subsidy or tax on firm entry. The following proposition shows that the spillovers we have introduced so far can be organized in three categories, each with its own response to disagreement.

Proposition D.1. *For all the models of Section D, the market-based spillover is:*

$$spill_{mkt}(n) = \underbrace{\mathcal{E}_{\mathcal{I}_n}}_{bus.\ stealing} + \underbrace{\mathcal{E}_{\pi}}_{general\ equilibrium} + \underbrace{(\sigma-1)\mathcal{E}_{\mathcal{C}}\frac{\mathcal{I}_1}{\mathcal{I}_n}}_{appropriability\ effect}. \tag{IA.66}$$

The outcome-based spillover, which does not depend on disagreement, is:

$$spill_{out} = \mathcal{E}_{\mathcal{I}_1} + \mathcal{E}_{\pi} + (\sigma-1)\mathcal{E}_{\mathcal{C}}. \tag{IA.67}$$

This decomposition highlights how disagreement can matter for market-based measures of spillovers. While our theoretical exercise is not exhaustive, most spillovers considered in the innovation literature fit in one of our three categories.

The first category is business-stealing. As we have discussed before, disagreement dampens the effect of business-stealing. The risk of displacement is particularly acute for relatively less productive firms. However, with speculation, each investor places a relatively higher weight on her investments having high productivity. In the limit when n goes to infinity, this force can be so strong that the spillover disappears altogether.[56] Competitive interactions between firms of different productivities can take different forms than the displacement of our model. Regardless, the takeaway is that spillovers that are more bottom-heavy tend to be dissipated by disagreement.

This stands in contrast to the second category: general equilibrium effects. In our models, these are the effects of the wage, aggregate demand, and aggregate knowledge on firm profits. The common force across all these sources of spillovers is that they affect all firms proportionally, irrespective of their productivity. Therefore, they can be summarized by the elasticity of firm profits to firm entry, holding productivity constant, $\mathcal{E}_{\pi}$. Because the response to these general equilibrium forces does not interact with the productivity distribution, these spillovers do not depend on beliefs.

Finally, the third category of spillovers is appropriability effects. Not all spillovers affect firms. In our models, workers capture some of the surplus due to firm entry. Because the surplus of workers is determined in the spot market for labor, it does not depend on the relative positions of firms. Unlike firm valuations, wage expectations are not affected by speculation about the relative positions of firms beyond its direct impact on entry and overall labor demand. When disagreement increases, the market-based spillover to workers disappears. This insight is not specific to workers but rather affects all stakeholders of the innovation process. Other key stakeholders, which we could have similarly introduced in the model, include owners of production inputs in scarce supply other than labor or consumers who enjoy some of the surplus.

D.3 Three Illustrations of the Role of Disagreement

We draw three implications from Proposition D.1 that illustrate that disagreement fundamentally alters how to measure and interpret the value of innovation.

[56] In the model of Section 3, this occured when $\gamma\theta > \eta$, while now the condition is $\gamma\theta > 1$.

D.3.1 Macroeconomic versus Microeconomic Elasticities

Without disagreement, market-based and outcome-based measures of spillovers coincide because valuations are expected outcomes. In the economies we have considered, the result is even stronger. The spillover under agreement is the same across all specifications: with labor only, with aggregate demand, and with aggregate knowledge. It takes the value:

$$spill_{out} = spill_{mkt}(1) = \sigma \mathcal{E}_{\mathcal{C}} - 1. \tag{IA.68}$$

While we can derive this expression from equation (IA.67) separately for each model, a simple macroeconomic argument justifies the result. The total effect of entry is the response of aggregate output to entry $d\mathcal{C}/dM_e$. Ex ante, each firm contributes an equal fraction to total output, and the value of a firm is output times the profit share $1/\sigma$. Hence, the value of a firm is $\mathcal{C}/(M_e\sigma)$, and the spillover is given immediately by equation (IA.68).

Regardless of the nature of firm interactions, only two macroeconomic quantities are needed to evaluate the total spillover—the capital share and the elasticity of aggregate output to firm entry. In particular, all our specifications lead to the same values of these two quantities. Disagreement breaks this result. Because different spillovers respond differently to disagreement, the aggregate reasoning under agreement no longer works.

One particularly telling example is the limit of large n when the market-based spillover converges to the profit elasticity $\mathcal{E}_\pi$. This spillover measure is a microeconomic elasticity. It is the response of the profits of one specific firm (i.e., of given productivity) to overall entry. This implies that one needs firm-level data rather than aggregate data to estimate spillovers. Moreover, across our three model specifications, while the outcome-based spillover is identical, the market-based spillover for large disagreement takes different values:

$$spill_{mkt}(n \to \infty) = -\frac{\sigma - 1}{\gamma} \qquad \text{with labor only,} \tag{IA.69}$$

$$spill_{mkt}(n \to \infty) = -\frac{\sigma - 2}{\gamma} \qquad \text{with aggregate demand,} \tag{IA.70}$$

$$spill_{mkt}(n \to \infty) = -\frac{(1-\alpha)\sigma - 1}{\gamma} \qquad \text{with aggregate knowledge.} \tag{IA.71}$$

In other words, the nature of microeconomic interactions matters for market-based spillovers in the presence of disagreement.

D.3.2 Reversal of Comparative Statics

The divergence between market-based and outcome-based spillovers is not only quantitative but also qualitative. Key properties of the economy often have an opposite impact on the total spillover, depending on whether it is measured using outcomes or market values. The following proposition highlights one such reversal, for a parameter common to all of our specification, σ.

Proposition D.2. *For all models, the outcome-based spillover is increasing in the labor share. Conversely, with high disagreement ($n \to \infty$ and $\theta > 1/\gamma$), the market-based spillover is decreasing in the labor share.*

The outcome-based spillover is given by the macroeconomic formulation of equation (IA.68). An economy with a larger labor share has mechanically a lower capital share. Thus, the importance of social value relative to the value of one firm is larger. For the market-based spillover, the focus

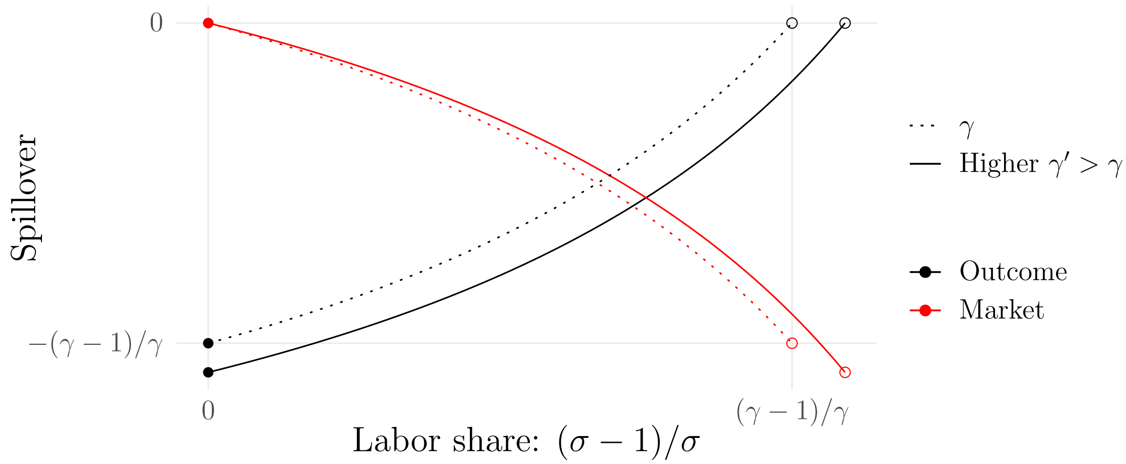

Figure IA.2
Market-based and outcome-based spillovers.
The figure reports the outcome-based (black lines) and market-based spillovers (red lines) as a function of the labor share for the model with labor only. Solid lines correspond to a larger value of γ than dotted lines.

is on the elasticity of individual firm profits to entry. A higher labor share implies higher reliance on labor and therefore stronger negative spillovers through the wage effect.

By examining our results, the reader can find more situations where reversals occur. In the model with labor, comparative statics with respect to the thickness of the tail of the productivity distribution γ are also reversed. Figure IA.2 illustrates these results. Appendix F has more examples.

D.3.3 Reversal of Sign of the Spillover

More strikingly, we also identify situations where the sign of the total spillover is reversed. These are cases where firm entry brings positive externalities according to market-based measures but negative externalities according to outcome-based measures or vice-versa.

Proposition D.3. *With demand externalities or knowledge spillovers, if the labor share is close to zero, the outcome-based spillover is positive and the market-based spillover is negative with large disagreement. The converse happens when the labor share is close to its upper bound.*

When the labor share is low, the labor surplus is relatively small, and the dominant force for the wedge is that firms do not internalize the aggregate decreasing returns to scale of the economy, leading to negative real spillovers. With disagreement however, since firms do not rely much on labor, the general equilibrium effect is small. Hence, the demand or knowledge externality dominates, leading to positive value spillovers. The sign reversal across measures of spillovers is not a knife-edge case. Reversals happen throughout the entire range of the labor share whenever $\gamma = 2$ with demand externalities or $\alpha = 1 - 1/\gamma$ with knowledge spillovers. The proposition also shows that the sign reversal can happen in both directions: a positive spillover becoming negative or a negative spillover becoming positive.

E Derivations for the General Equilibrium Model

Recall the definition of the average of a power function in productivity under measure $F^{(n)}$:

$$\mathcal{I}_n(M_e, \sigma) = \int_{\underline{a}}^{\infty} a^{\sigma} dF^n(a).$$

The integral with no disagreement is $\mathcal{I}_1$. We will use $\mathcal{I}_n$ when the dependence of the integral to M_e or σ is unambiguous. Under the Pareto distribution with parameter γ, we have the following result:

$$\mathcal{I}_1 = \frac{\gamma}{\gamma - \sigma} \cdot \left(\frac{M_e}{M} \right)^{\frac{\sigma}{\gamma} - 1}. \tag{IA.72}$$

E.1 Model with Decreasing Returns to Scale

E.1.1 Equilibrium

The firm-optimization problem given the production function and the competitive input price w is:

$$\max_{\ell(a)} \pi(a) = a \cdot \frac{\sigma}{\sigma - 1} \ell(a)^{\frac{\sigma-1}{\sigma}}.$$

The first-order condition leads to demand for labor at the firm level:

$$\ell(a) = \left(\frac{w}{a} \right)^{-\sigma}.$$

Output and profit at the firm level are:

$$y(a) = \frac{\sigma}{\sigma - 1} \cdot w^{1-\sigma} \cdot a^{\sigma}$$
$$\pi(a) = \frac{1}{\sigma - 1} \cdot w^{1-\sigma} \cdot a^{\sigma}.$$

Market clearing on the input market yields:

$$L = M_e \cdot w^{-\sigma} \int_{\underline{a}}^{\infty} a^{\sigma} dF(a) = M_e \cdot w^{-\sigma} \cdot \mathcal{I}_1, \tag{IA.73}$$

which, given (IA.72), leads to the following wage in equilibrium under a Pareto distribution for F:

$$w = \left(\frac{\gamma}{\gamma - \sigma} \right)^{\frac{1}{\sigma}} \cdot \left(\frac{M_e}{L} \right)^{\frac{1}{\sigma}} \cdot \left(\frac{M_e}{M} \right)^{\frac{1}{\gamma} - \frac{1}{\sigma}}.$$

Given the equilibrium quantities, we can decompose aggregate output into the profit and labor shares. First, observe that aggregate ouput is:

$$\mathcal{C} = M_e \cdot \int_{\underline{a}}^{\infty} y(a) dF(a) = M_e \cdot \frac{\sigma}{\sigma - 1} w^{1-\sigma} \mathcal{I}_1.$$

From this expression we immediately conclude that:

$$w^{1-\sigma} \cdot \mathcal{I}_1 = \frac{\sigma - 1}{\sigma} \cdot \frac{\mathcal{C}}{M_e},$$

and we are able to simplify the ex-ante valuation of firms:

$$\begin{aligned} V^{(n)}(M_e) &= \int_{\underline{a}}^{\infty} \pi(a) dF^n(a) = \frac{1}{\sigma - 1} \cdot w^{1-\sigma} \cdot \mathcal{I}_n(M_e) \\ &= \frac{1}{\sigma} \cdot \frac{\mathcal{C}}{M_e} \cdot \frac{\mathcal{I}_n(M_e)}{\mathcal{I}_1(M_e)}. \end{aligned}$$

Finally, we express the wage as a function of the equilibrium mass of firms:

$$w = \left(\frac{\gamma - \sigma}{\gamma} L \right)^{-\frac{1}{\sigma}} \cdot M^{\frac{\gamma - \sigma}{\gamma \sigma}} \cdot M_e^{\frac{1}{\gamma}}.$$

The equilibrium condition that determines entry in equilibrium is:

$$W'(M_e) = \frac{1}{\sigma} \cdot \frac{\mathcal{C}}{M_e} \cdot \frac{\mathcal{I}_n(M_e)}{\mathcal{I}_1(M_e)}. \tag{IA.74}$$

E.1.2 Spillovers

As before, the spillover is a ratio of the direct and indirect effect of firm entry. Consumption for household j is the product of labor income and profits from its investment:

$$\mathcal{C}_j = \underbrace{\frac{\sigma - 1}{\sigma} \cdot \mathcal{C}}_{\text{labor income: } wL} + \underbrace{\frac{1}{\sigma} \cdot \frac{\mathcal{I}_n}{\mathcal{I}_1} \cdot \mathcal{C}}_{\text{firm profits: } V^{(n)}}.$$

Hence the social value under market-based measures of entry can be written:

$$\frac{1}{\sigma} \cdot \frac{d\left(\mathcal{I}_n / \mathcal{I}_1 \cdot \mathcal{C}\right)}{dM_e} + \frac{\sigma - 1}{\sigma} \cdot \frac{d\mathcal{C}}{dM_e}. \tag{IA.75}$$

To find the market-based spillover, we take the ratio of the direct and indirect effect of firm entry:

$$1 - spill_{mkt}(n) = \frac{M_e}{\mathcal{C}} \frac{\mathcal{I}_1}{\mathcal{I}_n} \cdot \frac{d\left(\mathcal{I}_n / \mathcal{I}_1 \cdot \mathcal{C}\right)}{dM_e} + (\sigma - 1) \cdot \frac{M_e}{\mathcal{C}} \frac{\mathcal{I}_1}{\mathcal{I}_n} \cdot \frac{d\mathcal{C}}{dM_e}.$$

This leads us immediately to the general formula for the market-based spillover:

$$spill_{mkt}(n) = -\mathcal{E}_{\mathcal{I}_n} + (1 + \mathcal{E}_{\mathcal{I}_1} - \mathcal{E}_{\mathcal{C}}) - (\sigma - 1)\mathcal{E}_{C} \cdot \frac{\mathcal{I}_1}{\mathcal{I}_n}. \tag{IA.76}$$

The asymptotic environment is similar to that of Section 3. We start by studying the asymptotics of the business-stealing effect.

Lemma E.1 (Asymptotics for business-stealing effect)**.** *In the high-disagreement limit ($n \to \infty$), the business-stealing effect converges to a limit that depends on the marginal cost of firm creation θ:*

- *If* $\theta\gamma < 1$, *then* $\lim_{n\to\infty} \mathcal{E}_{\mathcal{I}_n} = \mathcal{E}_{\mathcal{I}_1} = \frac{\sigma}{\gamma} - 1$.

- *If* $\theta\gamma > 1$, *then* $\lim_{n\to\infty} \mathcal{E}_{\mathcal{I}_n} = 0$.
- *If* $\theta\gamma = 1$, *then* $\lim_{n\to\infty} \mathcal{E}_{\mathcal{I}_n} = \alpha_\infty e^{-\alpha_\infty}/f_e$.

Proof. The free-entry condition equation (IA.74) leads to:

$$(\sigma - 1)\left(\frac{\gamma - \sigma}{\gamma} L\right)^{\frac{1-\sigma}{\sigma}} \cdot f_e = M^{\theta + \frac{\sigma-\gamma}{\gamma}\frac{\sigma-1}{\sigma}} \cdot M_e^{\frac{1-\sigma}{\gamma} - \theta} \cdot \mathcal{I}_n.$$

We recast the free-entry condition using $\underline{a}$ to be able to use the asymptotic results from Lemma A.4

$$\text{constant} = \underline{a}^{1-\sigma-\gamma\theta} \int_{\underline{a}}^{\infty} x^\sigma dF_n(x).$$

Writing $\tilde{\theta} = \theta + (\sigma - 1)/\gamma$ and $\tilde{\eta} = \sigma$, we recognize the expression from Lemma A.4 and use Proposition 2. ∎

For the labor surplus term, we study the behavior of $\mathcal{I}_1/\mathcal{I}_n$.

Lemma E.2 (Asymptotics for labor surplus distortion)**.** *In the high-disagreement limit ($n \to \infty$), the labor surplus distortion disappears:*

$$\lim_{n\to\infty} (\sigma - 1)\mathcal{E}_{\mathcal{C}} \frac{\mathcal{I}_1}{\mathcal{I}_n} = 0$$

Proof. Since $\tilde{\theta} > 0$, Lemma A.3 gives $\lim_{n\to\infty} M_e = \infty$. The proof of Lemma A.3 implies $\lim_{n\to\infty} \mathcal{I}_n = \infty$. Finally, because $\sigma < \gamma$,

$$\mathcal{I}_1 = \frac{\gamma}{\gamma - \sigma}\left(\frac{M_e}{M}\right)^{\frac{\sigma-\gamma}{\gamma}} \to 0$$

as $n \to \infty$. Therefore, $\mathcal{I}_1/\mathcal{I}_n$ converges to 0. ∎

E.2 Differentiated Goods

E.2.1 Date 1 Economy

The introduction of differentiated goods in Section D.1.2 changes the production stage. We therefore focus on the equilibrium conditions at date 1.

Firms produce a mass M of differentiated goods, indexed by (a, i), where a is firm productivity and i indexes the firms. We drop the i index when unambiguous. Household utility aggregates consumption of these goods with constant elasticity of substitution σ across goods. At date 1, household j with total expenditure E_j solves:

$$\mathcal{C}(E_j) = \max_{\{c(a,i)\}} \left(\int_0^{M_e} \int_{F^{-1}\left(1-\frac{M}{M_e}\right)}^{\infty} c\,(a,i)^{\frac{\sigma-1}{\sigma}}\, dF(a)di\right)^{\frac{\sigma}{\sigma-1}}$$
$$\text{s.t.} \int_0^{M_e} \int_{F^{-1}\left(1-\frac{M}{M_e}\right)}^{\infty} p\,(a,i)\, c\,(a,i)\, dF(a)di \le E_j.$$

For reasons that will soon be clear, we denote by $1/\mathcal{P}$ the Lagrange multiplier on the budget constraint. Because the objective function is homogeneous of degree one in consumption and the budget constraint is linear, $\mathcal{C}(E_j)$ is linear in E_j. Thus, we have $\mathcal{C}(E_j) = E_j/\mathcal{P}$. Therefore, $\mathcal{P}$ is the price of one unit of the consumption basket. We use this consumption basket as the numeraire at date 1 by normalizing $\mathcal{P} = 1$. The linearity also implies that to aggregate individual demands, it is sufficient to know the aggregate expenditure in the economy and not the whole distribution of individual expenditures. The first-order condition in the problem above implies the demand curve:

$$c(p) = \mathcal{C}p^{-\sigma}.$$

Output for a firm with productivity a is $y = a\ell$. Firms face monopolistic competition. They maximize profits by setting prices, taking as given the demand curve from each household:

$$\max_{p(a)} \; p(a)y\left(p\left(a\right)\right) - \frac{wy\left(p\left(a\right)\right)}{a} = \mathcal{C}\left[p(a)^{1-\sigma} - \frac{w}{a}p(a)^{-\sigma}\right].$$

The optimal price is therefore

$$p(a) = \frac{\sigma}{\sigma-1}\frac{w}{a}.$$

Firms charge a markup $\sigma/(\sigma-1)$ over their marginal cost w/a.

We can then compute output y, revenue py, labor expenditure $w\ell$, and profits π as functions of productivity:

$$\begin{aligned}
y &= \mathcal{C}w^{-\sigma}a^{\sigma}\left(\frac{\sigma}{\sigma-1}\right)^{-\sigma} \\
py &= \mathcal{C}w^{1-\sigma}a^{\sigma-1}\left(\frac{\sigma}{\sigma-1}\right)^{1-\sigma} \\
w\ell &= \frac{\sigma-1}{\sigma}\mathcal{C}w^{1-\sigma}a^{\sigma-1}\left(\frac{\sigma}{\sigma-1}\right)^{1-\sigma} \\
\pi &= \frac{1}{\sigma}\mathcal{C}w^{1-\sigma}a^{\sigma-1}\left(\frac{\sigma}{\sigma-1}\right)^{1-\sigma}.
\end{aligned}$$

We see that labor expenditure is a fraction $(\sigma-1)/\sigma$ of revenues, and profits make up the remaining $1/\sigma$ share.

Labor market clearing gives $\mathcal{C}(\sigma-1)/\sigma = wL$. In equilibrium, aggregate expenditure is equal to aggregate consumption, so we have:

$$\begin{aligned}
\mathcal{C} &= \mathcal{C}\left(\frac{\sigma}{\sigma-1}w\right)^{1-\sigma} M_e\mathcal{I}_1(M_e,\sigma-1) \\
&= M_e^{\frac{1}{\sigma-1}}\left(\frac{\gamma}{\gamma-(\sigma-1)}\right)^{\frac{1}{\sigma-1}}\left(\frac{M_e}{M}\right)^{\frac{(\sigma-1)-\gamma}{(\sigma-1)\gamma}} \cdot L \\
&= \left(\frac{\gamma}{\gamma-(\sigma-1)}\right)^{\frac{1}{\sigma-1}} M^{\frac{1}{\sigma-1}-\frac{1}{\gamma}}M_e^{\frac{1}{\gamma}} \cdot L.
\end{aligned}$$

Therefore, we have $\mathcal{E}_{\mathcal{C}} = \mathcal{E}_w = 1/\gamma$. Alternatively, notice that the labor allocation is efficient with monopolistic competition and the aggregate production function is homogeneous of degree one in the distribution of productivity. Because an increase in M_e increases all productivities with an elasticity $1/\gamma$, this results in an elasticity of aggregate consumption of $1/\gamma$.

E.2.2 Spillovers

All arguments behind Proposition D.1 apply, so the proposition is still valid, but with $\mathcal{I}_1$ and $\mathcal{I}_n$ now evaluated with parameter $\sigma - 1$.

Because the aggregate consumption elasticity is unchanged, the output-based spillover (and market-based spillover under agreement) is unchanged: $spill_{out} = -(\gamma - \sigma)/\gamma$.

With speculation, the free-entry condition is:

$$\left(\frac{M_e}{M}\right)^{\theta} = \frac{1}{\sigma}\mathcal{C}\left(\frac{\mathcal{C}}{L}\right)^{1-\sigma}\mathcal{I}_n,$$

which we can rewrite as:

$$KM_e^{\theta-(1-(\sigma-1))/\gamma} = \mathcal{I}_n,$$

where K does not depend on M_e and n. This is again the same condition as the homogeneous goods model, with σ replaced by $\sigma - 1$. The condition for the convergence of $\mathcal{E}_{\mathcal{I}_n}$ from Lemma E.1 still applies as well. In the high-disagreement limit with $\theta > 1/\gamma$, the market-based spillover becomes:

$$spill_{mkt}(n \to \infty) = -1 - \mathcal{E}_{\mathcal{I}_1} + \mathcal{E}_{\mathcal{C}} = -\frac{\sigma - 2}{\gamma}. \quad \text{(IA.77)}$$

The upper panel of Figure IA.3 shows the sign reversal of the market-based spillover, as described in Proposition D.3.

E.3 Knowledge Externalities

E.3.1 Date 1 Economy

We again focus on the date 1 economy and return to a setting with decreasing return to scale.

Now firm productivity depends on the productivity of other firms producing. In particular, consider the production function:

$$y = \frac{\sigma}{\sigma - 1}a^{1-\alpha}A^{\alpha}\ell^{\frac{\sigma-1}{\sigma}},$$

where a is firm productivity and A is an aggregator of all producing firms' productivities. $\alpha > 0$ captures the intensity of knowledge spillovers. We use a Hölder mean of the productivity of all firms producing:

$$A = \left(\frac{M_e}{M}\int_{\left(\frac{M_e}{M}\right)^{\frac{1}{\gamma}}}^{\infty} a^q dF(a)\right)^{\frac{1}{q}}.$$

Imposing $q < \gamma$ so that the integral is well-defined, we have:

$$A = \left(\frac{\gamma}{\gamma - q}\right)^{\frac{1}{q}}\left(\frac{M_e}{M}\right)^{\frac{1}{\gamma}}.$$

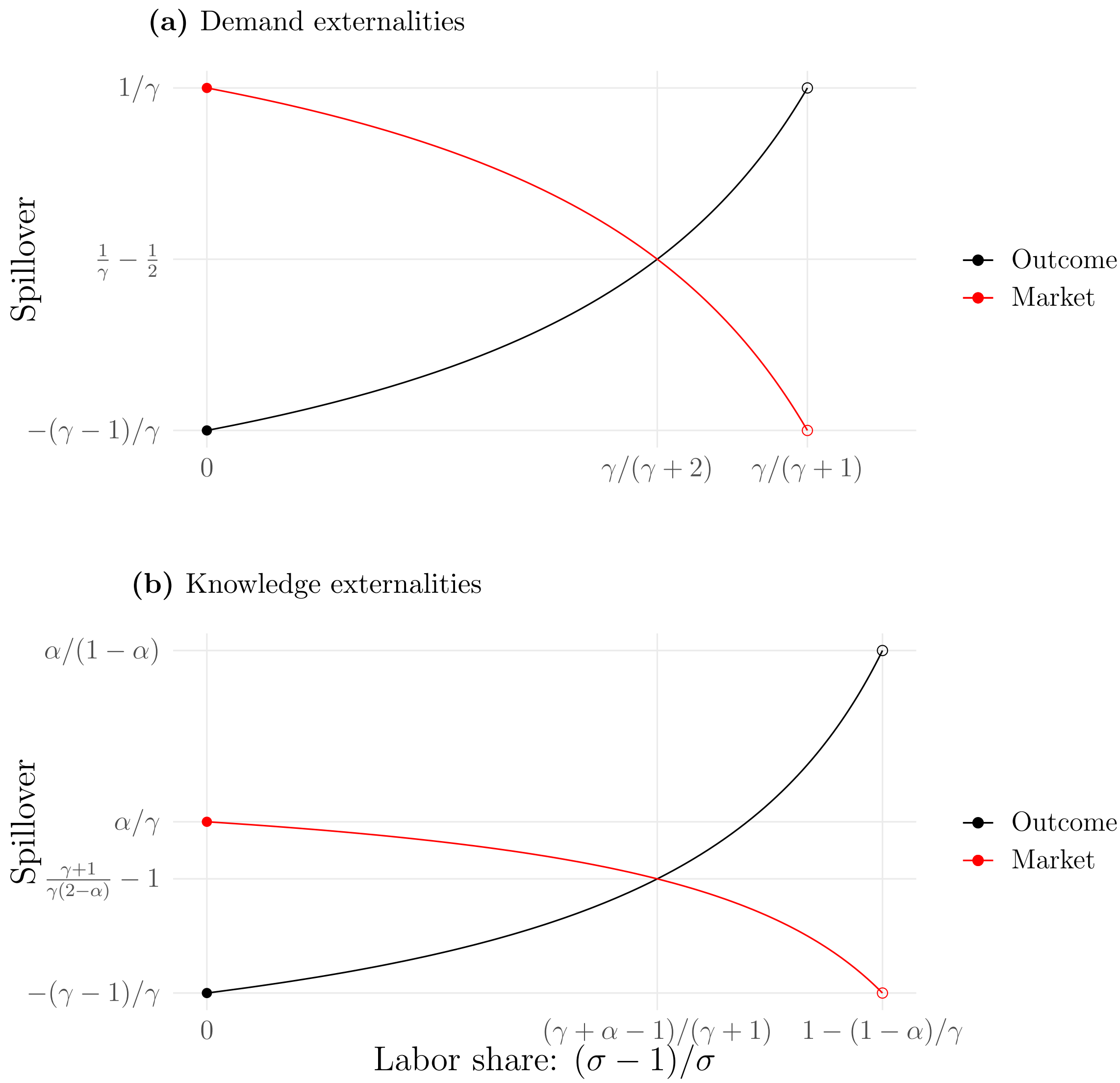

Figure IA.3
Market-based and outcome-based spillovers.

Our results generalize to any aggregator that is homogeneous of degree one in the productivity distribution of producing firms. Such aggregators similarly yield an elasticity $1/\gamma$ with respect to M_e.

Firms maximize their profits, taking the wage as given:

$$\max_{\ell} \frac{\sigma}{\sigma-1} a^{1-\alpha} A^{\alpha} \ell^{\frac{\sigma-1}{\sigma}} - w\ell.$$

The demand for labor is therefore

$$\ell = \left(\frac{w}{a^{1-\alpha}A^{\alpha}}\right)^{-\sigma},$$

and we have:

$$y(a) = \frac{\sigma}{\sigma - 1} \left(a^{1-\alpha} A^{\alpha}\right)^{\sigma} w^{1-\sigma}$$
$$w\ell(a) = \left(a^{1-\alpha} A^{\alpha}\right)^{\sigma} w^{1-\sigma} = \frac{\sigma - 1}{\sigma} y(a)$$
$$\pi(a) = \frac{1}{\sigma - 1} \left(a^{1-\alpha} A^{\alpha}\right)^{\sigma} w^{1-\sigma} = \frac{1}{\sigma} y(a).$$

The labor share is still $(\sigma - 1)/\sigma$.

The market-clearing condition for labor is:

$$\begin{aligned} L &= w^{-\sigma} A^{\alpha\sigma} M_e \mathcal{I}_1 \left(M_e, (1-\alpha)\sigma\right) \\ &= \left(\frac{\gamma}{\gamma - q}\right)^{\frac{\alpha\sigma}{q}} \left(\frac{M_e}{M}\right)^{\frac{\alpha\sigma}{\gamma}} M_e \frac{\gamma}{\gamma - (1-\alpha)\sigma} \left(\frac{M_e}{M}\right)^{\frac{(1-\alpha)\sigma}{\gamma} - 1} w^{-\sigma} \\ &= \left(\frac{\gamma}{\gamma - q}\right)^{\frac{\alpha\sigma}{q}} \frac{\gamma}{\gamma - (1-\alpha)\sigma} M \left(\frac{M_e}{M}\right)^{\frac{\sigma}{\gamma}} w^{-\sigma} \\ w &= \left(\frac{M}{L}\right)^{\frac{1}{\sigma}} \left(\frac{\gamma}{\gamma - q}\right)^{\frac{\alpha}{q}} \left(\frac{\gamma}{\gamma - (1-\alpha)\sigma}\right)^{\frac{1}{\sigma}} \left(\frac{M_e}{M}\right)^{\frac{1}{\gamma}}. \end{aligned}$$

We still have $(\sigma - 1)/\sigma \mathcal{C} = wL$, and the same elasticities: $\mathcal{E}_w = \mathcal{E}_{\mathcal{C}} = \mathcal{E}_A = 1/\gamma$.

E.3.2 Spillovers

Proposition D.1 and Lemma E.1 still apply, with $\mathcal{I}_1$ and $\mathcal{I}_n$ evaluated with parameter $(1-\alpha)\sigma$. The outcome-based spillover is unchanged: $spill_{out} = -(\gamma - \sigma)/\gamma$. The market-based spillover in the high-disagreement limit with $\theta > 1/\gamma$ becomes:

$$spill_{mkt}(n \to \infty) = -1 - \mathcal{E}_{\mathcal{I}_1} + \mathcal{E}_{\mathcal{C}} = -\frac{(1-\alpha)\,\sigma - 1}{\gamma}. \tag{IA.78}$$

The lower panel of Figure IA.3 shows the sign reversal of the market-based spillover, as described in Proposition D.3.

F Extensions to the General Equilibrium Model

F.1 Elastic Labor Supply

F.1.1 Setting and Equilibrium

We now consider the case of variable labor supply. Households can provide labor L by exerting an effort cost $S(L)$. We assume

$$S'(L) = f_l \left(\frac{L}{L_0}\right)^{1/\kappa},$$

where κ is the Frisch elasticity of labor supply. As κ converges to 0, the model converges to a constant labor supply L_0. The remainder of the model is unchanged.

In equilibrium, we have $S'(L) = w$, which implies that $\mathcal{E}_L = \kappa \mathcal{E}_w$. Noting that we still have a constant labor share $((\sigma - 1)/\sigma \mathcal{C} = wL)$, we also have $\mathcal{E}_C = \mathcal{E}_w + \mathcal{E}_L = (1 + \kappa)\mathcal{E}_w$.

Market clearing for labor yields:

$$L = M_e \cdot w^{-\sigma} \int_{\underline{a}}^{\infty} a^{-\sigma} dF(a) = M_e \cdot w^{-\sigma} \cdot \mathcal{I}_1,$$

which given the expression for $\mathcal{I}_1$ in (IA.72) under a Pareto leads to the following restriction:

$$wL^{1/\sigma} = \left(\frac{\gamma}{\gamma - \sigma}\right)^{\frac{1}{\sigma}} \cdot M_e^{\frac{1}{\sigma}} \cdot \left(\frac{M_e}{M}\right)^{\frac{1}{\gamma} - \frac{1}{\sigma}}.$$

Using the labor supply equation, we obtain

$$\mathcal{E}_w = \frac{1}{\gamma} \frac{\sigma}{\sigma + \kappa}$$
$$\mathcal{E}_{\mathcal{C}} = \frac{1}{\gamma} \frac{\sigma + \kappa\sigma}{\sigma + \kappa}.$$

As we increase the elasticity of labor supply, the wage becomes less elastic to firm entry and consumption becomes more elastic to firm entry as it becomes less costly to expand labor.

F.1.2 Spillovers

Asymptotics. To study the asymptotic behavior of the market-based spillover, recall the free-entry condition:

$$f_e \left(\frac{M_e}{M}\right)^{\theta} = \frac{1}{\sigma - 1} w^{1-\sigma} \mathcal{I}_n.$$

We define

$$\tilde{\theta} = \theta + \frac{\sigma - 1}{\gamma} \frac{\sigma}{\kappa + \sigma} \geq 0$$

and recognize the free-entry condition from the pure business-stealing model. This guarantees that $\lim_{n\to\infty} \mathcal{I}_1/\mathcal{I}_n = 0$. In addition, $\mathcal{E}_{\mathcal{I}_n}$ converges to 0 if:

$$\gamma\tilde{\theta} > \sigma \tag{IA.79}$$

$$\Leftrightarrow \gamma\theta > 1 + (\sigma - 1)\frac{\kappa}{\kappa + \sigma}. \tag{IA.80}$$

Behavior of the spillovers. The market-based social value is characterized by:

$$\begin{aligned} & \frac{1}{\sigma}\mathcal{C}\frac{\mathcal{I}_n}{\mathcal{I}_1} + \frac{\sigma - 1}{\sigma}\mathcal{C} - S(L) - W(M_e) \\ = \quad & \frac{1}{\sigma}\mathcal{C}\frac{\mathcal{I}_n}{\mathcal{I}_1}\frac{\mathcal{I}_n'}{\mathcal{I}_n} + \frac{1}{\sigma}\mathcal{C}'\frac{\mathcal{I}_n}{\mathcal{I}_1} - \frac{1}{\sigma}\mathcal{C}\frac{\mathcal{I}_n}{\mathcal{I}_1}\frac{\mathcal{I}_1'}{\mathcal{I}_1} + \frac{\sigma - 1}{\sigma}\mathcal{C}' - \underbrace{S'(L)L}_{\frac{\sigma-1}{\sigma}\mathcal{C}}\frac{1}{L}\frac{dL}{dM_e}. \end{aligned}$$

The market-based spillover is similar to Proposition D.1. However, the appropriability term now accounts for the utility cost of expanding the labor supply:

$$spill_{mkt}(n) = \mathcal{E}_{\mathcal{I}_n} - \mathcal{E}_{\mathcal{I}_1} - 1 + \mathcal{E}_{\mathcal{C}} + (\sigma - 1)\underbrace{(\mathcal{E}_{\mathcal{C}} - \mathcal{E}_L)}_{\mathcal{E}_w}\frac{\mathcal{I}_1}{\mathcal{I}_n}.$$

The outcome-based spillover is:

$$spill_{out} = -1 + \mathcal{E}_{\mathcal{C}} + (\sigma - 1)\mathcal{E}_w = -\frac{\gamma - \sigma}{\gamma}. \tag{IA.81}$$

With high speculation and large θ, we have:

$$spill_{mkt}(n \to \infty) = -(\sigma - 1)\mathcal{E}_w = -\frac{\sigma - 1}{\gamma}\frac{\sigma}{\kappa + \sigma}. \tag{IA.82}$$

The outcome-based spillover is unchanged from the baseline model. Thee market-based spillover with high disagreement is decreasing in σ and increasing in γ, as is the case in Proposition D.2. The elasticity of labor supply does not affect the outcome-based spillover, but under market-based measures, increasing κ increases the spillover. As labor supply becomes more elastic, the wage becomes less responsive to entry, and firms have less influence on each other through general equilibrium effects. With perfectly elastic labor supply, there are no general equilibrium effects and hence no market-based spillovers in the high-disagreement limit, i.e., $spill_{mkt}(n \to \infty) = 0$.

F.2 Variable Number of Participating Firms

F.2.1 Setting and Equilibrium

We study a model where the number of participating firms, M, responds to firm creation M_e, which can be interpreted as households' consumption bundles becoming more or less concentrated as more firms enter the economy. We assume that M varies exogenously with the level of firm entry M_e:

$$M = \frac{1}{M_0^{\chi-1}} \cdot M_e^{\chi},$$

where χ is the elasticity of firms producing to firms created and M_0 a normalization constant. We assume that $\chi \leq 1$ such that we always have $M \leq M_e$.

The cost of creating a firm only depends on M_0 through:

$$W'(M_e) = f_e \left(\frac{M_e}{M_0}\right)^{\theta}.$$

The productivity threshold to produce is now:

$$\underline{a} := F^{-1}\left(1 - \frac{M}{M_e}\right) = \left(\frac{M_e}{M_0}\right)^{\frac{1-\chi}{\gamma}}.$$

The model still features a constant labor share and firm profits are still isoelastic in the productivity:

$$\pi(a) = \frac{1}{\sigma - 1} \cdot w^{1-\sigma} \cdot a^{\sigma} = \frac{1}{\sigma}\frac{\mathcal{C}}{M_e} \cdot \frac{a^{\sigma}}{\mathcal{I}_1},$$

where we have redefined the integrals $\mathcal{I}_1$ and $\mathcal{I}_n$ to adjust for the new expressions for the productivity threshold $\underline{a}$:

$$\mathcal{I}_n(\chi) = \int_{\left(\frac{M_e}{M_0}\right)^{\frac{1-\chi}{\gamma}}}^{\infty} a^{\sigma} dF_n(a)$$
$$\mathcal{I}_1(\chi) = \frac{\gamma}{\gamma - \sigma} \cdot \left(\frac{M_e}{M_0}\right)^{(\chi-1)\frac{\gamma-\sigma}{\gamma}}.$$

The market-clearing condition $L = M_e w^{-\sigma} \mathcal{I}_1$ implies the equilibrium wage:

$$w = \left(\frac{\gamma}{\gamma - \sigma}\right)^{\frac{1}{\sigma}} \cdot L^{-\frac{1}{\sigma}} M_0^{(1-\chi)\left(\frac{1}{\sigma} - \frac{1}{\gamma}\right)} \cdot M_e^{\frac{\chi}{\sigma} + \frac{1-\chi}{\gamma}},$$

so that the labor elasticity is :

$$\mathcal{E}_w = \frac{1}{\gamma} + \chi \cdot \left(\frac{1}{\sigma} - \frac{1}{\gamma}\right).$$

We obtain aggregate consumption by aggregating individual output $\mathcal{C} = M_e\sigma/(\sigma-1)w^{1-\sigma}\mathcal{I}_1$, which yields equilibrium aggregate consumption and elasticity:

$$\mathcal{C} = \frac{\sigma}{\sigma - 1}\frac{\gamma}{\gamma - \sigma} \cdot L^{\frac{\sigma-1}{\sigma}} \cdot M_0^{(1-\chi)\left(\frac{1-\sigma}{\sigma} + \frac{\gamma-1}{\gamma}\right)} \cdot M_e^{\frac{1}{\gamma} + \chi \cdot \left(\frac{1}{\sigma} - \frac{1}{\gamma}\right)}$$
$$\mathcal{E}_{\mathcal{C}} = \mathcal{E}_w = \frac{1}{\gamma} + \chi \cdot \left(\frac{1}{\sigma} - \frac{1}{\gamma}\right)$$

F.2.2 Spillovers

Given the constant labor share and isoelastic profits, we can apply Proposition D.1 and obtain the market-based spillover:

$$spill_{mkt}(n) = \mathcal{E}_{\mathcal{I}_n(\chi)} - 1 - \mathcal{E}_{\mathcal{I}_1(\chi)} - \mathcal{E}_{\mathcal{C}} + (\sigma - 1)\mathcal{E}_{C} \cdot \frac{\mathcal{I}_1(\chi)}{\mathcal{I}_n(\chi)}. \quad \text{(IA.83)}$$

From the expression for $\mathcal{I}_n$ we have the following change in the elasticities:

$$\mathcal{E}_{\mathcal{I}_n(\chi)} = (1-\chi)\mathcal{E}_{\mathcal{I}_n(\chi=0)} = (1-\chi)\mathcal{E}_{\mathcal{I}_n} \tag{IA.84}$$

Asymptotics. We now turn to the high-disagreement limit. The first-order condition for firm creation is:

$$\begin{aligned} f_e \left(\frac{M_e}{M_0}\right)^{\theta} &= \frac{1}{\sigma-1} w^{1-\sigma} \mathcal{I}_n(\chi) \\ \iff \quad \text{constant} &= \underline{a}^{-\theta \frac{\gamma}{1-\chi} + (1-\sigma)\frac{\gamma}{1-\chi}\left(\frac{1}{\gamma} + \chi\left(\frac{1}{\sigma} - \frac{1}{\gamma}\right)\right)} \int_{\underline{a}}^{\infty} a^{\sigma} dF_n(a). \end{aligned}$$

We define:

$$\tilde{\theta} = \frac{1}{1-\chi}\left(\theta + \frac{\sigma-1}{\gamma} + \chi(\sigma-1)\left(\frac{1}{\sigma} - \frac{1}{\gamma}\right)\right),$$

and recognize the entry condition of the baseline model. We apply our previous results, changing the condition for $\mathcal{E}_{\mathcal{I}_n(\chi)} \to 0$ to $\gamma\tilde{\theta} > \sigma$, which reduces to:

$$\gamma(\theta + \chi) > 1 + \chi\left(\frac{\gamma}{\sigma} - 1\right). \tag{IA.85}$$

If this condition is satisfied, then $\lim_{n\to\infty} \mathcal{E}_{\mathcal{I}_n(\chi)} = 0$. When the inequality is reversed, $\lim_{n\to\infty} \mathcal{E}_{\mathcal{I}_n(\chi)} = \mathcal{E}_{\mathcal{I}_1(\chi)} = (1-\chi)(\sigma-\gamma)/\gamma$. With equality, the elasticity admits a finite limit between these two values.

Behavior of the spillovers. The outcome-based spillover is

$$spill_{out} = -1 + \sigma\mathcal{E}_{\mathcal{C}} = -\frac{\gamma-\sigma}{\gamma} + \chi\sigma\left(\frac{1}{\sigma} + \frac{1}{\gamma}\right). \tag{IA.86}$$

The market-based spillover with high disagreement, when θ is large enough, is:

$$spill_{mkt}(n\to\infty) = -1 - \mathcal{E}_{\mathcal{I}_1(\chi)} + \mathcal{E}_{\mathcal{C}} = -\frac{\sigma-1}{\gamma} - \chi(\sigma-1)\left(\frac{1}{\sigma} - \frac{1}{\gamma}\right) \tag{IA.87}$$

As long as $|\chi| < 1$, Proposition D.2 still holds with the generalized version of $\mathcal{I}_n$. A higher elasticity of firm participation with respect to firm entry leads to opposite results with and without disagreement. A large elasticity χ dampens the outcome-based spillovers because it diminishes business stealing. However it strengthens the market-based spillover with disagreement: in response to firm entry, labor demand responds at the intensive margin with more productive firms and at the extensive margin with more participating firms.

F.3 Advertising to Participate

We augment the previous model with an intermediate stage after market entry when firms compete to be one of M firms producing, as in Appendix B.3.

F.3.1 Setting and Equilibrium

In the new intermediate decision stage, firms choose to spend on advertisement to reach consumers. We assume that only the M firms that spend the most on advertising produce in equilibrium. Formally if a firm with productivity a_i spends h_i in advertising, its profit is: $\pi(a_i)\mathbf{1}\{h_i \geq \underline{h}\} - h_i$. Hence there is a threshold level of advertising, $\underline{h}$, below which firms cannot reach any consumers and above which firms do produce. Firms take the threshold as given and decide on their choice of advertising. Thus the advertising equilibrium is such that the threshold matches the profit of the marginal firm: $\underline{h} = \pi(\underline{a})$.

Profits are modified with respect to the standard model of Section E.1 to incorporate the advertisement payments:

$$\pi(a) = \frac{1}{\sigma} w^{1-\sigma} \left(a^\sigma - \underline{a}^\sigma\right),$$

The ex-ante firm valuation is therefore:

$$V^{(n)}(M_e) = \frac{1}{\sigma} \cdot \frac{\mathcal{C}}{M_e} \cdot \frac{\widetilde{\mathcal{I}}_n}{\mathcal{I}_1},$$

where we define the adjusted integral $\widetilde{\mathcal{I}}_n$ as

$$\widetilde{\mathcal{I}}_n(M_e) = \int_{\left(\frac{M_e}{M}\right)^{\frac{1}{\gamma}}}^{\infty} \left(a^\sigma - \left(\frac{M_e}{M}\right)^{\frac{\sigma}{\gamma}}\right) dF_n(a).$$

The entry condition in the competitive equilibrium is now:

$$W'(M_e) = \frac{1}{\sigma} \cdot \frac{\mathcal{C}}{M_e} \cdot \frac{\widetilde{\mathcal{I}}_n}{\mathcal{I}_1}.$$

F.3.2 Spillovers

The market-based social value is characterized by:

$$\frac{1}{\sigma}\mathcal{C}\frac{\widetilde{\mathcal{I}}_n}{\mathcal{I}_1}\frac{\widetilde{\mathcal{I}}'_n}{\widetilde{\mathcal{I}}_n} + \frac{1}{\sigma}\mathcal{C}'\frac{\widetilde{\mathcal{I}}_n}{\mathcal{I}_1} - \frac{1}{\sigma}\mathcal{C}\frac{\widetilde{\mathcal{I}}_n}{\mathcal{I}_1}\frac{\mathcal{I}'_1}{\mathcal{I}_1} + \frac{\sigma-1}{\sigma}\mathcal{C}'.$$

The market-based spillover is therefore:

$$spill_{mkt}(n) = \mathcal{E}_{\widetilde{\mathcal{I}}_n} - \mathcal{E}_{\mathcal{I}_1} - 1 + \mathcal{E}_{\mathcal{C}} + (\sigma-1)\mathcal{E}_{\mathcal{C}}\frac{\mathcal{I}_1}{\widetilde{\mathcal{I}}_n}. \tag{IA.88}$$

The outcome-based spillover (or market-based spillover under agreement) is:

$$spill_{out} = -1 + \mathcal{E}_{\mathcal{C}} + (\sigma-1)\mathcal{E}_{\mathcal{C}}\frac{\gamma}{\sigma} = -\frac{1}{\sigma} + \frac{1}{\gamma}, \tag{IA.89}$$

where we have used that, as in the baseline model, $\mathcal{E}_{\mathcal{C}} = \mathcal{E}_w = 1/\gamma$. However, the profit share is now lower because of advertisement costs. A fraction $(\sigma-1)/\sigma$ of output accrues to labor but only a fraction $1/\gamma$ ($< 1/\sigma$) is collected as profits. The larger importance of labor relative to profits gives rise to a smaller outcome-based spillover. As in the standard model, $|spill_{out}|$ is decreasing in σ and increasing in γ.

To derive the market-based spillover with high disagreement, notice that $\mathcal{I}_1/\widetilde{\mathcal{I}}_n \to 0$ and therefore, if $\theta > 1/\gamma$, then $spill_{mkt}(n \to \infty)$ is unchanged from the standard model:

$$spill_{mkt}(n \to \infty) = -\frac{\sigma - 1}{\gamma}. \tag{IA.90}$$

Therefore, Proposition D.2 still holds.

F.3.3 Advertising with Demand or Knowledge Spillovers.

Introducing advertisement costs to the aggregate demand and knowledge externalities models from Sections E.2 and E.3 yields the same formula for $spill_{mkt}(n)$ as in equation (IA.88), so that we have the limit with high disagreement $spill_{mkt}(n \to \infty) = -(\sigma - 1)/\gamma$.

The main difference between spillovers in the standard model and the models in Section E.2 and E.3 arises through the differences in the profit function, which affects the ratio $\mathcal{I}_1/\widetilde{\mathcal{I}}_n$. With aggregate demand externalities, the ratio is $\gamma/(\sigma - 1)$, and the outcome-based spillover is:

$$spill_{out}^{\mathrm{AD}} = \frac{1}{\gamma}. \tag{IA.91}$$

For the model with knowledge spillovers, the ratio is $\gamma/(1-\alpha)\sigma$, and the outcome-based spillover is:

$$spill_{out}^{\mathrm{KS}} = -1 + \frac{1}{\gamma} + \frac{\sigma - 1}{(1-\alpha)\sigma}. \tag{IA.92}$$

F.4 Participation Costs in the Baseline Model

Another way to ensure the marginal firm makes zero profit is to assume firms invest in infrastructure to produce. In particular, suppose that upon entry all firms can participate on the goods market, but firms must buy one unit of infrastructure to reach all of their customers. Households produce infrastructure competitively at a cost of effort Φ. In an equilibrium with M producing firms, the price of infrastructure is:

$$\Phi'(M) = \varphi(M) = \varphi_0 \cdot M^{\nu}$$

with $\nu > 0$, so that the cost of infrastructure is increasing in the mass of producing firms M.

F.4.1 Setting and Equilibrium

Participating firms. Given M_e and M, profits before the infrastructure costs are unchanged from the standard model with decreasing returns to scale:

$$\pi(a) = \frac{1}{\sigma - 1} \cdot w^{1-\sigma} \cdot a^{\sigma}.$$

The equilibrium wage is also unchanged:

$$w = \left(\frac{\gamma}{\gamma - \sigma}\right)^{\frac{1}{\sigma}} \cdot \left(\frac{M_e}{L}\right)^{\frac{1}{\sigma}} \cdot \left(\frac{M_e}{M}\right)^{\frac{1}{\gamma} - \frac{1}{\sigma}}.$$

The marginal firm has productivity $\underline{a}$ and spends all of its profit on infrastructure. Therefore, we have the zero-cutoff-profit condition $\Phi'(M) = \pi(\underline{a})$, which implies:

$$M^{\nu+\frac{1}{\gamma}+\frac{\sigma-1}{\sigma}} = \frac{1}{\varphi_0}\frac{1}{\sigma-1}\left(\frac{\gamma-\sigma}{\gamma}\right)^{\frac{\sigma-1}{\sigma}} L^{\frac{\sigma-1}{\sigma}} \cdot M_e^{\frac{1}{\gamma}},$$

where we use the fact that $\underline{a} = (M_e/M)^{1/\gamma}$. In Section F.2, we specified an exogenous set of producing firms $M = M_e^{\chi}/M_0^{\chi-1}$. This arises endogenously through our cost of infrastructure with

$$\chi = \frac{1}{\gamma}\left(\nu + \frac{1}{\gamma} + \frac{\sigma-1}{\sigma}\right)^{-1}$$

$$M_0^{1-\chi} = \left(\frac{1}{\varphi_0}\frac{1}{\sigma-1}\left(\frac{\gamma-\sigma}{\gamma}\right)^{\frac{\sigma-1}{\sigma}} L^{\frac{\sigma-1}{\sigma}}\right)^{\left(\nu+\frac{1}{\gamma}+\frac{\sigma-1}{\sigma}\right)^{-1}},$$

where the exponent satisfies $\chi \leq 1$.

We can also compute the elasticity $\mathcal{E}_{\mathcal{C}}$:

$$\mathcal{E}_{\mathcal{C}} = \frac{1}{\gamma} + \chi\left(\frac{1}{\sigma} - \frac{1}{\gamma}\right) = \frac{1}{\gamma} \cdot \frac{1+\nu}{1+\nu+1/\gamma-1/\sigma} = \chi \cdot (1+\nu).$$

Equilibrium. The equilibrium condition in the competitive equilibrium is:

$$W'(M_e) = \frac{1}{\sigma} \cdot \frac{\mathcal{C}}{M_e} \cdot \frac{\widetilde{\mathcal{I}}_n}{\mathcal{I}_1},$$

where we define the modified $\widetilde{\mathcal{I}}_n$ integral to account for the infrastructure expenditures of the firm:

$$\widetilde{\mathcal{I}}_n(M_e, \chi) = \int_{\left(\frac{M_e}{M_0}\right)^{\frac{1-\chi}{\gamma}}}^{\infty} \left(a^{\sigma} - \left(\frac{M_e}{M_0}\right)^{\sigma\frac{1-\chi}{\gamma}}\right) dF_n(a).$$

With $n = 1$, we have:

$$\widetilde{\mathcal{I}}_1(M_e, \chi) = \frac{\sigma}{\gamma-\sigma} \cdot \left(\frac{M_0}{M_e}\right)^{(1-\chi)\frac{\gamma-\sigma}{\gamma}} = \frac{\sigma}{\gamma} \cdot \mathcal{I}_1(M_e, \chi).$$

Aggregate profits therefore represent a fraction σ/γ of aggregate revenue after labor costs, while aggregate infrastructure costs account for the other $(\gamma-\sigma)/\gamma$. Therefore, aggregate profits represent a share $1/\gamma$ of consumption and aggregate infrastructure costs $1/\sigma - 1/\gamma$.

F.4.2 Spillovers

The market-based social value is now characterized by:

$$\frac{d}{dM_e}\left[\frac{1}{\sigma}\mathcal{C}\frac{\widetilde{\mathcal{I}}_n}{\mathcal{I}_1}+\frac{\sigma-1}{\sigma}\mathcal{C}+\underbrace{\left(\frac{1}{\sigma}-\frac{1}{\gamma}\right)\mathcal{C}}_{\substack{\text{consumption from}\\ \text{infrastructure}}}-\underbrace{\Phi(M)}_{\substack{\text{cost of}\\ \text{infrastructure}}}\right]$$

$$=\frac{1}{\sigma}\mathcal{C}\frac{\widetilde{\mathcal{I}}_n}{\mathcal{I}_1}\frac{\widetilde{\mathcal{I}}'_n}{\widetilde{\mathcal{I}}_n}+\frac{1}{\sigma}\mathcal{C}'\frac{\widetilde{\mathcal{I}}_n}{\mathcal{I}_1}-\frac{1}{\sigma}\mathcal{C}\frac{\widetilde{\mathcal{I}}_n}{\mathcal{I}_1}\frac{\mathcal{I}'_1}{\mathcal{I}_1}+\frac{\sigma-1}{\sigma}\mathcal{C}'+\left(\frac{1}{\sigma}-\frac{1}{\gamma}\right)\mathcal{C}'-\underbrace{\Phi'(M)M}_{\left(\frac{1}{\sigma}-\frac{1}{\gamma}\right)\mathcal{C}}\cdot\frac{1}{M}\frac{dM}{dM_e}.$$

The market-based spillover is therefore:

$$spill_{mkt}(n)=\mathcal{E}_{\widetilde{\mathcal{I}}_n}-\mathcal{E}_{\mathcal{I}_1}-1+\mathcal{E}_{\mathcal{C}}+(\sigma-1)\mathcal{E}_{\mathcal{C}}\cdot\frac{\mathcal{I}_1}{\widetilde{\mathcal{I}}_n}+\underbrace{\frac{\gamma-\sigma}{\gamma}(\mathcal{E}_{\mathcal{C}}-\mathcal{E}_M)\cdot\frac{\mathcal{I}_1}{\widetilde{\mathcal{I}}_n}}_{\substack{\text{surplus from}\\ \text{infrastructure costs}}},$$

where the last term accounts for the surplus from infrastructure creation.

The outcome-based spillover (and market-based spillover under agreement) is:

$$spill_{out}=-1+\mathcal{E}_{\mathcal{C}}+\left[(\sigma-1)\mathcal{E}_{\mathcal{C}}+\left(1-\frac{\sigma}{\gamma}\right)(\mathcal{E}_{\mathcal{C}}-\chi)\right]\frac{\gamma}{\sigma}.$$

Using the values of $\mathcal{E}_{\mathcal{C}}$ and χ, we obtain:

$$spill_{out}=-1+\chi\gamma\left(1+\nu-\frac{1}{\sigma}+\frac{1}{\gamma}\right)=0, \tag{IA.93}$$

given the formula above for χ. Participation is now a good traded on a competitive market. Hence the first welfare theorem applies, and there are no outcome-based spillovers.

Now we apply the reasoning from Appendix F.1 to find the condition for convergence when θ is large. The condition for convergence of $\mathcal{E}_{\widetilde{\mathcal{I}}_n}$ is the same as for $\mathcal{E}_{\mathcal{I}_n}$:

$$\gamma(\theta+\chi)>1+\chi\left(\frac{\gamma}{\sigma}-1\right) \tag{IA.94}$$

$$\iff\quad \gamma\theta>1+\frac{1}{\nu+\frac{1}{\gamma}+\frac{\sigma-1}{\sigma}}\left(\frac{1}{\sigma}-\frac{1}{\gamma}-1\right). \tag{IA.95}$$

As $n\to\infty$, we have that $\widetilde{\mathcal{I}}_n\to\infty$ and $\mathcal{I}_1\to 0$, and therefore, $\mathcal{I}_1/\widetilde{\mathcal{I}}_n\to 0$.

For the high-disagreement market-based spillover we have

$$spill_{mkt}(n\to\infty)=-(\sigma-1)\cdot\mathcal{E}_w=-\frac{\sigma-1}{\gamma}-(\sigma-1)\chi\left(\frac{1}{\sigma}-\frac{1}{\gamma}\right) \tag{IA.96}$$

$$=-\frac{\sigma-1}{\gamma}\cdot\left(\frac{1+\nu}{1+\nu+1/\gamma-1/\sigma}\right). \tag{IA.97}$$

Again, Proposition D.2 holds. Moreover, $|spill_{mkt}(n\to\infty)|$ is decreasing in ν since $1/\gamma<1/\sigma$. As the cost of producing infrastructure becomes steeper, the sensitivity of firm participation to firm creation is smaller, and the market-based spillover is less responsive. In the limit with $\nu \to \infty$, a fixed number of firms produces, and we are back to our baseline $spill_{mkt}(n \to \infty) = -(\sigma - 1)/\gamma$. Finally, $|spill_{mkt}(n \to \infty)|$ is increasing in σ.

F.5 Melitz (2003) Model: Participation Costs and Dixit-Stiglitz

We now introduce Dixit-Stiglitz preferences to the above model, as in Melitz (2003).

F.5.1 Setting and Equilibrium

Participating firms. Given M_e and M, profits before the infrastructure costs are unchanged from the standard model with decreasing returns to scale:

$$\pi(a) = \frac{1}{\sigma}\left(\frac{\sigma}{\sigma - 1}\right)^{1-\sigma} \cdot \mathcal{C} \cdot w^{1-\sigma} \cdot a^{\sigma-1}.$$

The equilibrium consumption is also unchanged:

$$\frac{\mathcal{C}}{L} = \left(\frac{\gamma}{\gamma - (\sigma - 1)}\right)^{\frac{1}{\sigma-1}} M^{\frac{1}{\sigma-1}-\frac{1}{\gamma}} M_e^{\frac{1}{\gamma}}.$$

The marginal firm has productivity $\underline{a}$ and spends all of its profit on infrastructure. Therefore, we have the zero-cutoff-profit condition $\Phi'(M) = \pi(\underline{a})$, which implies

$$M^{\nu+\frac{1}{\gamma}+\frac{\sigma-2}{\sigma-1}} = \frac{1}{\varphi_0}\frac{1}{\sigma}\left(\frac{\gamma - (\sigma - 1)}{\gamma}\right)^{\frac{\sigma-2}{\sigma-1}} L \cdot M_e^{\frac{1}{\gamma}},$$

where we use the fact that $\underline{a} = (M_e/M)^{1/\gamma}$. In Section F.2, we specified an exogenous set of producing firms $M = M_e^{\chi}/M_0^{\chi-1}$. This arises endogenously through our cost of infrastructure with

$$\chi = \frac{1}{\gamma}\left(\nu + \frac{1}{\gamma} + \frac{\sigma - 2}{\sigma - 1}\right)^{-1},$$

$$M_0^{1-\chi} = \left(\frac{1}{\varphi_0}\frac{1}{\sigma}\left(\frac{\gamma - (\sigma - 1)}{\gamma}\right)^{\frac{\sigma-2}{\sigma-1}} L\right)^{\left(\nu+\frac{1}{\gamma}+\frac{\sigma-2}{\sigma-1}\right)^{-1}},$$

where the exponent satisfies $\chi \leq 1$ if and only if $\nu + \frac{\sigma-2}{\sigma-1} \in (-\infty, -1/\gamma) \cup [0, \infty)$. Otherwise, all firms participate as M_e grows to infinity.

Finally, we derive the elasticity $\mathcal{E}_{\mathcal{C}}$:

$$\mathcal{E}_{\mathcal{C}} = \frac{1}{\gamma} + \chi\left(\frac{1}{\sigma - 1} - \frac{1}{\gamma}\right) = \frac{1}{\gamma} \cdot \frac{1 + \nu}{1 + \nu + 1/\gamma - 1/(\sigma - 1)} = \chi \cdot (1 + \nu).$$

Equilibrium. The equilibrium condition in the competitive equilibrium is:

$$W'(M_e) = \frac{1}{\sigma} \cdot \frac{\mathcal{C}}{M_e} \cdot \frac{\widetilde{\mathcal{I}}_n}{\mathcal{I}_1}.$$

Aggregate profits represent a fraction $(\sigma-1)/\gamma$ of aggregate revenue after labor costs, and aggregate infrastructure costs account for the other $(\gamma-(\sigma-1))/\gamma$. Therefore, aggregate profits represent a share $(\sigma-1)/(\sigma\gamma)$ of consumption and aggregate infrastructure costs $(\gamma-(\sigma-1))/(\sigma\gamma)$.

F.5.2 Spillovers

The market-based social value is:

$$\begin{aligned}
&\frac{d}{dM_e}\left[\frac{1}{\sigma}\mathcal{C}\frac{\widetilde{\mathcal{I}}_n}{\mathcal{I}_1}+\frac{\sigma-1}{\sigma}\mathcal{C}+\left(\frac{\gamma-(\sigma-1)}{\sigma\gamma}\right)\mathcal{C}-\Phi(M)\right] \\
=\; &\frac{1}{\sigma}\mathcal{C}\frac{\widetilde{\mathcal{I}}_n}{\mathcal{I}_1}\frac{\widetilde{\mathcal{I}}'_n}{\widetilde{\mathcal{I}}_n}+\frac{1}{\sigma}\mathcal{C}'\frac{\widetilde{\mathcal{I}}_n}{\mathcal{I}_1}-\frac{1}{\sigma}\mathcal{C}\frac{\widetilde{\mathcal{I}}_n}{\mathcal{I}_1}\frac{\mathcal{I}'_1}{\mathcal{I}_1}+\frac{\sigma-1}{\sigma}\mathcal{C}'+\left(\frac{\gamma-(\sigma-1)}{\sigma\gamma}\right)\mathcal{C}'-\Phi'(M)M\frac{1}{M}\frac{dM}{dM_e}.
\end{aligned}$$

The market-based spillover is therefore:

$$spill_{mkt}(n)=\mathcal{E}_{\widetilde{\mathcal{I}}_n}-\mathcal{E}_{\mathcal{I}_1}-1+\mathcal{E}_{\mathcal{C}}+\left[(\sigma-1)\mathcal{E}_{\mathcal{C}}+\left(1-\frac{\sigma-1}{\gamma}\right)(\mathcal{E}_{\mathcal{C}}-\chi)\right]\frac{\mathcal{I}_1}{\widetilde{\mathcal{I}}_n}. \tag{IA.98}$$

The outcome-based spillover (and market-based spillover under agreement) is:

$$\begin{aligned}
spill_{out} &= -1+\mathcal{E}_{\mathcal{C}}+\left[(\sigma-1)\mathcal{E}_{\mathcal{C}}+\left(1-\frac{\sigma-1}{\gamma}\right)(\mathcal{E}_{\mathcal{C}}-\chi)\right]\frac{\gamma}{\sigma-1} && \text{(IA.99)}\\
&= \frac{1}{\sigma-1}\cdot\frac{1+\nu}{1+\nu+1/\gamma-1/(\sigma-1)}. && \text{(IA.100)}
\end{aligned}$$

Now we apply the reasoning from Section F.1 to find the condition for convergence when θ is large. The condition for convergence of $\mathcal{E}_{\widetilde{\mathcal{I}}_n}$ is the same as for $\mathcal{E}_{\mathcal{I}_n}$:

$$\begin{aligned}
&\gamma(\theta+\chi)>1+\chi\left(\frac{\gamma}{\sigma-1}-1\right) && \text{(IA.101)}\\
\iff\quad &\gamma\theta>1+\frac{1}{\nu+\frac{1}{\gamma}+\frac{\sigma-2}{\sigma-1}}\left(\frac{1}{\sigma-1}-\frac{1}{\gamma}-1\right). && \text{(IA.102)}
\end{aligned}$$

As $n\to\infty$, we have $\widetilde{\mathcal{I}}_n\to\infty$ and $\mathcal{I}_1\to 0$, and therefore $\mathcal{I}_1/\widetilde{\mathcal{I}}_n\to 0$.

For the high-disagreement market-based spillover we have

$$spill_{mkt}(n\to\infty)=-(\sigma-1)\cdot\mathcal{E}_w+\mathcal{E}_{\mathcal{C}}=-\frac{\sigma-2}{\gamma}\cdot\left(\frac{1+\nu}{1+\nu+1/\gamma-1/(\sigma-1)}\right). \tag{IA.103}$$

When $\nu\to\infty$, there is a fixed supply of infrastructure and thus a fixed number of firms, which implies:

$$\begin{aligned}
spill_{out} &= \frac{1}{\sigma-1},\\
spill_{mkt}(n\to\infty) &= -\frac{\sigma-2}{\gamma}.
\end{aligned}$$

G Data Appendix

G.1 Data Construction Details

Bubbles. Following Greenwood, Shleifer, and You (2018), we identify bubbles as episodes in which stock prices of an industry have increased over 100% in terms of both raw and net-of-market returns over the previous two years, followed by a decrease in absolute terms of 40% or more. Industries are classified according to the Fama-French 49-industry scheme, and the data begin in 1928.

Value of Innovation. We use the stock market value of patents at the patent level and at the firm level directly from Kogan et al. (2017), as well as the number of citations that accrue to a patent.[57]

Compustat Segments. We merge the Compustat funda file with the Compustat segments file. We estimate the number of segments with different industry codes. The Compustat segments file provides both a six- and a four-digit industry code, which gives two measures of the number of different types of industries within a public firm.

Value of Spillovers. We obtain information on the quantity of competition spillovers (variable spillsic) as well as technological spillovers (variable spilltec) from the replication files in Bloom, Schankerman, and Van Reenen (2013). The exposure to spillovers from product market, *spillsic*, is defined as the correlation of the sales across two firms' Compustat segments. If we consider the vector of average sales share across each industry for a given firm i, $\mathbf{S}_i$, product market proximity between firm i and j is defined by the uncentered correlation: $\text{SIC}_{ij} = \mathbf{S}_i\mathbf{S}_j'/\left(\sqrt{\mathbf{S}_i\mathbf{S}_i'}\sqrt{\mathbf{S}_j\mathbf{S}_j'}\right)$. The product market spillover is the average stock of R&D that is in the product market proximity of firm i:

$$spillsic_i = \sum_{j\neq i} \text{SIC}_{ij} G_j,$$

where G_j is the stock of R&D for firm j. The exposure to knowledge spillovers is constructed the same way, where we define for firm i a vector of share of patents across technology classes from the USPTO as $\mathbf{T}_i$. The uncentered correlation of technology between firm i and j is: $\text{TECH}_{ij} = \mathbf{T}_i\mathbf{T}_j'/\left(\sqrt{\mathbf{T}_i\mathbf{T}_i'}\sqrt{\mathbf{T}_j\mathbf{T}_j'}\right)$. The product market spillover is the average stock of R&D that is in the product market proximity of firm i:

$$spilltech_i = \sum_{j\neq i} \text{TECH}_{ij} G_j.$$

To look at the effect of spillovers, we use sales item from Compustat funda file and Tobin's q (market-to-book ratio) from the CRSP-Compustat merged file.

[57] We thank Dimitris Papanikolaou for graciously sharing his data with us.

G.2 Supplementary Tables

Table IA.1

Summary Statistics

	N	Mean	Std. Dev.	25th pct.	Median	75th pct.
Bubble						
Bubble Periods Dummy	2,734	0.0271	0.162	0	0	0
Value of Innovation (KPSS)						
Patent Level Value						
Stock Market ($ Mn)	1,171,806	14	37.8	2.32	5.46	12.7
Citations (fwd. looking)	1,171,806	12	22.6	2	5	13
Firm Level Value						
Stock Market ($ Mn)	47,887	232	1880	0.519	3.06	24.5
Citations (fwd. looking)	47,887	52.9	236	2.88	7.8	26.7
Firm Level Statistics						
Mkt. Cap. ($ Mn)	47,887	2854	14667	47.2	200	949
Segments (# NAICS-4)	53,066	1.33	0.646	1	1	2
Segments (# NAICS-6)	53,066	1.41	0.729	1	1	2
Measuring Spillovers (BSvR)						
Firm Outcomes (real or market valued)						
Sales ($ Mn)	9,382	3563	12626	135	509	2037
Tobin's q	9,382	2.46	3.09	0.86	1.49	2.71
Measures of Spillovers (Jaffe)						
Technology	9,382	9.8	1.02	9.34	9.97	10.5
Competition	9,382	7.32	2.35	6.33	7.64	9.01
Measures of Spillover (Mahalonobis)						
Technology	9,382	11.4	0.821	10.9	11.5	11.9
Competition	9,382	8.53	1.73	7.87	8.77	9.74

Note: Table IA.1 presents summary statistics of the main variables included in the regression specifications. The bubble dummy corresponds to bubble detected across the Fama-French 49 industries, according to the methodology outlined in Greenwood, Shleifer, and You (2018). The value of innovation both at the firm and patent level is directly taken from Kogan et al. (2017). The stock market value of innovation at the patent level corresponds to the appreciation in the value of a firm issuing a patent around the patent-issuance date. The stock market value of innovation at the firm level corresponds to an annual aggregation of the total value of all patents issued by a firm in a given year. Both the patent- and firm-level citation value of a patent corresponds to its forward looking number of citations (until the end of the sample in 2010). Other firm-level statistics correspond to the CRSP-Compustat merged file (for market capitalization, sales, and Tobin's q) and to the Compustat segments file. Tobin's q is measured from Bloom, Schankerman, and Van Reenen (2013) as the market value of equity plus debt divided by the stock of fixed capital. We obtain measures of technological and competition spillovers from Bloom, Schankerman, and Van Reenen (2013), corresponding to the distance between the technological class of patents issued by a firm with other public firms and to the distance between the set of product market of a firm and other public competitors.

Table IA.2
Number of Patents in Times of Bubbles

	Patents (#)	Log Patents (#)			
	(1)	(2)	(3)	(4)	(5)
Bubble	1.385**	0.148***	0.154**	0.169***	0.178**
	(0.578)	(0.056)	(0.066)	(0.063)	(0.075)
Lagged Citations	0.982***				
	(0.026)				
Lagged Log Citations		0.824***	0.795***	0.827***	0.799***
		(0.008)	(0.008)	(0.007)	(0.008)
Fixed Effects	C	–	C	Y	C, Y
Observations	106,176	106,278	106,176	106,278	106,176
R^2	0.91	0.67	0.68	0.68	0.68

Note: Table IA.2 presents panel regressions of the quantity of innovation, measured by the number of patents issued at the USPTO three-digit class level, on a dummy from Greenwood, Shleifer, and You (2018) that captures whether the firm is in an industry that is in a bubble or not. We control for the lagged number of patents for column one and lagged logarithm for columns two to five. Depending on the specification, we include fixed effects for the patent class level C and patent grant-year Y. Standard errors clustered at the grant-year level are in parentheses. *, **, and *** denote significance at the 10%, 5%, and 1% levels, respectively.

Table IA.3

Social Value of Innovation in Times of Bubbles: Other Measures of Spillovers

	Market-based Spillovers			Outcome-based Spillovers		
	Jaffe (1)	Mahalanobis (2)	IV Jaffe (3)	Jaffe (4)	Mahalanobis (5)	IV Jaffe (6)
Bubble x Spill-SIC	0.146***	0.211***	0.172***	0.004	0.003	0.004***
	(0.028)	(0.036)	(0.038)	(0.009)	(0.014)	(0.001)
Spill-SIC	−0.086***	−0.223***	−0.335***	−0.023***	−0.015	−0.046
	(0.018)	(0.044)	(0.101)	(0.005)	(0.015)	(0.044)
Spill-Tech	0.267**	0.854***	1.063***	0.121***	0.159***	0.157**
	(0.114)	(0.148)	(0.148)	(0.022)	(0.040)	(0.063)
Fixed Effects	Y, F	Y, F	Y, F	Y, F	Y, F	Y, F
Observations	8,910	8,946	8,910	8,789	8,825	8,789
R^2	0.74	0.74	0.73	0.99	0.99	0.99

Note: Table IA.3 presents panel regressions of firm value (log of sales or Tobin's q) on a measure of competition from Bloom, Schankerman, and Van Reenen (2013) interacted with a bubble dummy, measured as in Greenwood, Shleifer, and You (2018) that captures whether the firm is an industry that is in a bubble state or not. We control for the technological spillover measure that corresponds to the public firms that issue patent in similar technological space. We use a measure of spillovers based on the Jaffe Covariance/Exposure Distance Metrics (see Table 8 of Bloom, Schankerman, and Van Reenen (2013)). We follow the specification from Table of 3 and 5 of Bloom, Schankerman, and Van Reenen (2013) and include the same controls. We use firm F and year Y fixed effects. Standard errors clustered at the year level are presented in parentheses. *, **, and *** denote significance at the 10%, 5%, and 1%, respectively.

Table IA.4

Private Value of Innovation in Bubbles Controlling for Industry Fixed Effects Interacted with Citations

	Patent Level			Firm Level		
	(1)	(2)	(3)	(4)	(5)	(6)
Bubble	0.317***	0.289***	0.277***	0.514***	0.429***	0.431***
	(0.094)	(0.090)	(0.083)	(0.114)	(0.123)	(0.080)
Log Market Cap			0.543***			0.625***
(lagged)			(0.026)			(0.020)
Fixed Effects	Y, F	Y, F	Y, F	Y, F	Y, F	Y, F
Interaction	NA	Ind x Cite	Ind x Cite	NA	Ind x Cite	Ind x Cite
Observations	1,171,806	1,118,675	1,116,740	47,886	47,886	47,484
R^2	0.68	0.69	0.74	0.89	0.94	0.96

Note: Table IA.4 presents panel regressions of the value of innovation, as measured in Kogan et al. (2017) at the patent firm levels, on a dummy from Greenwood, Shleifer, and You (2018) that captures whether the firm is in an industry that is in a bubble or not. We control for the forward-looking number of citations generated by a patent (or firm) from Kogan et al. (2017) and the lagged market capitalization of the firm. We include firm fixed effects F and patent grant year fixed effects Y. Depending on the specification, we also use industry fixed effects (from the Fama-French 49-industry classification) interacted with the log number of forward-looking citations to allow for different slopes in the relation between private valuation and the patent quality across industries. Standard errors clustered at the grant-year level are in parentheses. *, **, and *** denote significance at the 10%, 5%, and 1% levels, respectively.

Table IA.5

Diversity and Private Value of Innovation in Bubbles (NAICS 6 Digit Industries)

	Patent Level			Firm Level		
	(1)	(2)	(3)	(4)	(5)	(6)
Bubble x Segments	-0.562^{***}	-0.550^{***}	-0.488^{***}	-0.388^{**}	-0.370^{***}	-0.295^{***}
(NAICS 6 digits)	(0.178)	(0.175)	(0.164)	(0.155)	(0.094)	(0.072)
Bubble	1.456^{***}	1.425^{***}	1.329^{***}	1.459^{***}	1.389^{***}	1.167^{***}
	(0.232)	(0.227)	(0.235)	(0.317)	(0.342)	(0.289)
Segments	0.122	0.122	0.112	0.010	-0.031	-0.026
(NAICS 6 digits)	(0.096)	(0.095)	(0.101)	(0.044)	(0.048)	(0.041)
Log Citations		0.049^{***}	0.047^{***}		0.047^{***}	0.047^{***}
(forward looking)		(0.010)	(0.009)		(0.009)	(0.009)
Log Market Cap			0.156^{***}			0.287^{***}
(lagged)			(0.042)			(0.046)
Fixed Effects	Y, F	Y, F	Y, F	Y, F	Y, F	Y, F
Observations	180,636	180,636	177,911	10,426	10,426	10,256
R^2	0.71	0.71	0.72	0.88	0.93	0.94

Note: Table IA.5 presents panel regressions of the value of innovation, as measured in Kogan et al. (2017) at the patent and firm levels, on a bubble dummy interacted with the number of industries spanned by the different segments of the parent firm. The bubble dummy is from Greenwood, Shleifer, and You (2018) and captures whether the firm is in an industry that is in a bubble or not. Compustat segments are measured at the six-digit NAICS code level from the Compustat segments file. We control for the forward-looking number of citations generated by a patent (or firm) from Kogan et al. (2017) and the lagged market capitalization of the firm. We also include fixed effects for firm F and patent grant year Y. Standard errors clustered at the grant-year level are in parentheses. *, **, and *** denote significance at the 10%, 5%, and 1% levels, respectively.

Table IA.6

Spillovers During Bubbles with a Finer Classification of Bubbles Using Crashes

	Market-based Spillovers		
	Jaffe	Mahalanobis	IV Jaffe
	(1)	(2)	(3)
No-Crash x Spill-SIC	0.140**	0.153**	0.143***
	(0.057)	(0.066)	(0.049)
Crash x Spill-SIC	0.164***	0.282***	0.203***
	(0.021)	(0.033)	(0.069)
Spill-SIC	−0.089***	−0.103***	−0.314*
	(0.016)	(0.033)	(0.188)
Spill-Tech	0.407***	0.843***	1.209***
	(0.147)	(0.177)	(0.338)
Fixed Effects	Y, F	Y, F	Y, F
Observations	8,896	8,946	8,896
R^2	0.74	0.74	0.73

Note: Table IA.6 presents panel regressions of firm market value (Tobin's q) on a measure of competition from Bloom, Schankerman, and Van Reenen (2013) interacted with a bubble dummy, measured as in Greenwood, Shleifer, and You (2018) that captures whether the firm is an industry that is in a bubble state or not and whether the bubble crashes or not. We control for the technological spillover measure that corresponds to the public firms that issue patent in similar technological space. We follow the specification from Table of 3 and 5 of Bloom, Schankerman, and Van Reenen (2013) and include the same controls. We use firm F and year Y fixed effects. Standard errors clustered at the year level are presented in parentheses. *, **, and *** denote significance at the 10%, 5%, and 1%, respectively.