Creative Destruction, Inequality and Asset Prices*

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Abstract

We analyze the effect of technological innovation on asset prices in a tractable, general equilibrium framework with heterogeneous households and firms. The main feature of our model is incomplete markets. Financial market participants do not capture all the economic rents resulting from innovative activity, even when they own shares in innovating firms. We calibrate the parameters of our general equilibrium model using a minimum distance estimator. Our model reproduces key stylized facts about the cross-section of asset returns and the economy. We derive and test new predictions of our framework using a direct measure of innovation. The model's predictions are supported by the data.

*An earlier version of this paper circulated under the title "Technological Innovation: Winners and Losers." We thank Hengjie Ai, Jaroslav Borovička, Kent Daniel, Carola Frydman, Lars Hansen, Erik Loualiche, Deborah Lucas, Stavros Panageas, Jonathan Parker, Monika Piazzesi, Amit Seru, Costis Skiadas, Annette Vissing-Jorgensen, Amir Yaron, and seminar participants at Berkeley, Chicago Booth, Boston University, CITE, Columbia GSB, University of Indiana, Jackson Hole Finance Conference, LBS, LSE, MIT Sloan, NBER AP, Northwestern University, Society of Economic Dynamics, Universidad de San Andres, Washington University, and WFA for valuable discussions and comments. Dimitris Papanikolaou thanks the Zell Center for Risk and the Jerome Kenney Fund for financial support. Leonid Kogan thanks J.P. Morgan for financial support.

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