CSEF

Centre for Studies in Economics and Finance

ACTIVITY REPORT 2012

CENTRE FOR STUDIES IN ECONOMICS AND FINANCE
University of Naples "Federico II"
Department of Economics
Via Cintia, Monte S. Angelo
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University of Naples Federico I | University of Salerno | Bocconi University, Milan

Contents

What is CSEF?

The Centre for Studies in Economics and Finance (CSEF) is a joint venture of the University of Naples Federico II, the University of Salerno, and Bocconi University. It aims at performing and promoting research in economics and finance, and at linking up researchers in Naples, Salerno and Bocconi with international research via seminars, conferences, exchange of researchers and joint research projects.

CSEF premises are at the Department of Economics and Statistics of the University of Naples Federico II, where CSEF hosts researchers and doctoral students from other Italian and foreign universities. CSEF runs a weekly research seminar, open to faculty and doctoral students, and collaborates with the Master in Economics and Finance (MEF) at the University of Naples Federico II.

Besides strengthening the networking between its parent institutions, the Centre applies for research grants, organizes workshops and conferences, and runs research projects as an independent entity.

The Centre's administration is entrusted to **Maria Rosaria Esposito** and **Stefania Maddaluno**.

News

This has been a great year for CSEF, with researchers getting important academic recognitions and professional appointments or advancements.

Marco Pagano was awarded an Advanced ERC Grant for a project on "Labour and Finance". **Achille Basile, Gabriella Graziano, Tullio Jappelli** and **Marco Pagano**, with other CSEF researchers, were awarded three research grants by the Ministry of University (PRIN Projects). **Giacinta Cestone**, **Chiara Fumagalli** and **Giovanni Pica** an AXA Research Grant. **Francesco Drago** was one of the recipients of the research grant funded by EIEF for young Italian economists, and won the Distinguished Article Prize 2012 of the *American Law and Economics Review* for his article "Prison Conditions and Recidivism". **Marco Pagnozzi** received the FARO grant from the University of Naples Federico II and a small grant from IFREE. **Pierluigi Conzo**, a CSEF post-doctoral Fellow, was appointed assistant professor at the University of Turin.

Last year CSEF benefited from the presence of excellent researchers who carried out joint projects with CSEF Fellows and taught in the Master in Economics and Finance: **Rossella Argenziano** (University of Essex), **Dimitris Christelis** (Directorate General Research of the European Central Bank), **Andrew Ellul** (Kelley School of Business, Indiana University), and **Alex Frino** (University of Sydney).

How to contact us:

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Main research areas

Research activity at CSEF focuses on three main areas:

(i) Analysis of household choices (saving, portfolio and labor decisions), especially regarding saving, portfolio choice, retirement and labor supply.

(ii) Financial economics (banking, portfolio choice, corporate finance, market microstructure). Main areas of research include law and finance, corporate governance, and issues at the interface between finance and macroeconomics.

(iii) Economic theory, particularly economics of information, contract theory, design and enforcement of regulation, game theory and general equilibrium theory.

Funding

Research projects carried out at CSEF in 2012 were funded by research grants of the Compagnia di San Paolo, the Observatoire de l'Epargne Européenne (OEE), the European Research Council (ERC Advanced Grant on Labor and Finance), and the Italian Ministry of University and Research (PRIN projects).

Conferences

Workshop on *Fairness and Equity in Equilibrium Analysis*

Held at the Department of Economics of the University of Naples Federico II in January 2012, the workshop was organized by Achille Basile and Maria Gabriella Graziano (CSEF).

3rd Workshop ME@Ravello on *The Economics of Coordination and Communication: Theory and Empirics*

The ***Workshop on The Economics of Coordination and Communication: Theory and Empirics,*** held in Ravello on June 1-3 2012, was organized by CSEF Fellows Alberto Bennardo, Annamaria C. Menichini and Giuseppe Russo, Alessandro Bonatti (MIT), Eleonora Patacchini (University of Rome La Sapienza), Nicola Persico (Northwestern University). The workshop fostered interaction between economic theorists and empirical researchers on issues related to organizational design and choice between private and public institutions, and contributed to the training of Italian young researchers and graduate students in this area. The keynote speakers were Luigi Pistaferri (Stanford University) and Sanjeev Goyal (University of Cambridge).

8th Csef-Igier Symposium on Economics and Institutions

From 25 to 29 June 2012, CSEF and the Innocenzo Gasparini Institute for Economic Research (IGIER Bocconi) held their annual joint **Symposium on Economics and Institutions**, which was organized by CSEF Fellows Francesco Drago, Andrew Ellul, Anna Maria Cristina Menichini, Marco Pagnozzi, Nicola Pavoni e Giovanni Pica. As in past editions, the Symposium allowed for free, informal discussion, with seminars held in the mornings in three parallel sessions, afternoons being reserved to informal workshops and collaborative work. The conference program included papers in Applied Microeconomics, Finance, Applied Theory, Theory, Experiments and Macroeconomics. The invited speakers were **Hugo Hopenhayn**, Professor of Economics at University of California-Los Angeles (UCLA), **Dan Lavin,** Professor of Economics at Ohio-State University, **Daniele Terlizzese**, Director of the Einaudi Institute for Economics and Finance (EIEF), and **Luigi Zingales**, Professor of Entrepreneurship and Finance at the University of Chicago Booth School of Business.

Seminars

In 2012 CSEF hosted one or two research seminars per week. Papers were presented both by invited speakers and resident researchers.

January

Rossella Argenziano (University of Essex), *Strategic Information Acquisition and Transmission*

Alex Frino (University of Sydney), *Information Disclosure and Stock Liquidity: Evidence from Borsa Italiana* (with D. Gerace and R. Palumbo)

Sergei Kovbasyuk (EIEF), *Optimal Certification Design*

Gael Giraud (Centre National de la Recherche Scientifique), *Liquidity Trap versus Financial Crashes: the Dilemma of Monetary Policy*

Marco Frittelli (Università di Milano), *From Risk Measures to Research Measures* (with I. Peri)

February

Tommaso Frattini (Università di Milano), *Estimating the Effects of Emigration from Poland on Polish Wages*

Francesca Barigozzi (Università di Bologna), *Credit Markets with Ethical Banks and Motivated Borrowers* (con P. Tedeschi)

Balåzs Szentes (University of Chicago), *Spontaneous Discrimination* (with M. Peski)

March

Alessandro Bucciol (Università di Verona), *Household Portfolios and Risk Bearing over Age and Time* (with R. Miniaci)

April

Giovanni Walter Puopolo (Università Bocconi), *The Dynamics of Tobin's Q*

Marisa Ratto (Università Paris-Dauphine), *Behavioural Responses to Taxpayer Audit* (with N. Gemmell)

Antonio Guarino (UCL), Social Learning with Coarse Inference

May

Luigi Paciello (EIEF), *Monetary Shocks with Observation and Menu Costs* (with F. Alvarez e F. Lippi)

Andrew Ellul (Indiana University), *Is Historical Cost Accounting a Panacea? Market Stress, Incentive Distortions, and Gains Trading*

Danila Serra (Florida State University), *Participatory Accountability and Collective Action*

Veruska Oppedisano (UCL), *Fostering the Emancipation of Young People: Evidence from a Spanish Rental Subsidy* (with A. Aparicio)

Alessandra Voena (Harvard University), *Prenuptial Agreements and Household Welfare: Theory and Evidence from Italy*

Ruben Durante (Sciences Po Paris), *Influence for Sale: Evidence from the Italian Advertising Market* (with S. Della Vigna, B. Knight, E. La Ferrara)

Alessandro Bonatti (MIT Sloan School of Management), *Optimal Information Structures in Oligopoly* (with D. Bergemann)

September

Yeon-Koo Che (Columbia University), *Credit Dervatives and the Cost of Capital* (with R. Sethi)

Jean Charles Rochet (University of Zurich), *Capital Regulation and Credit Cycles* (with H. Gersbach)

Mauro Caselli (University of New South Wales, Australia), *Trade, Skill-biased Technical Change and Wages in Mexican Manufacturing*

October

Giuseppe Coco (Università di Bari), *Inequality of Credit Opportunities* (with G. Pignataro)

Agnese Leonello (LSE), *Credit Market Competition and Liquidity Crises* (with E. Carletti)

Francesco Caselli (LSE), *The Geography of Inter-State Resource Wars* (with D. Rohner and M. Morelli)

Laurence Lescourret (ESSEC Business School), *Non-fundamental Information and Market-makers' Behavior During the Nasdaq Preopening Session*

Botond Koszegi (University of California), *The Market for Deceptive Products* (with P. Heidhues and T. Murooka)

David Ettinger (Université Paris Dauphine), *Hiding Information through Jump Bids in Ascending Auctions*

November

Tommaso Oliviero (European University Institute), *Family Firms and the Agency Cost of Debt: The Role of Soft Information during a Crisis* (with L. D'Aurizio and L. Romano)

Andrea Mattozzi (European University Institute), *The Right Type of Legislator*

Nicola Pavoni (Università Bocconi), *Efficient Child Care Subsidies* (with C. Ho)

December

Maurizio Montone (Università di Cassino), *The Puzzling Countercyclicality of the Value Premium: Empirics and a Theory*

Efrem Castelnuovo (Università di Padova) *Monetary Policy Neutrality? Sign Restrictions Go to Monte Carlo*

Ouarda Merrouche (European University Institute), *The Manipulation of Basel Risk-weights: Evidence from 2007-2010* (with M. Mariathasan)

Marco di Maggio (MIT), *Market Turmoil and Destabilizing Speculation*

ANTONIO ACCONCIA is Associate Professor of Economics at the University of Naples Federico II. In 2012 he revised the papers "Mafia and Public Spending: Evidence on the Fiscal Multiplier from a Quasi-experiment" (with G. Corsetti and S. Simonelli) and "Underpricing and Firm's Distance from Financial Centre" (with A. Del Monte and L. Pennacchio). He is currently working on three new papers: "Fiscal Policy after a Disaster: Evidence from the 1980-81 Earthquake in the South of Italy" (with G. Corsetti and S. Simonelli), "The Effect R&D Tax Credit" (with Claudia Cantabene), and "The Effect of Fiscal Policy on Consumption".

CARLO ALTAVILLA is Associate Professor of Economics at the University of Naples Parthenope and Research Affiliate at CESifo (Munich). He received a Ph.D. in Economics from the Catholic University of Leuven. His research interests cover international monetary policy, applied time series and financial econometrics. In 2012 he visited the Department of Economics at University College London and ECARES at Universitè Libre de Bruxelless. He is currently working on the effects of non-standard monetary policies (with D. Giannone, ULB), yield curve modelling and forecasting (with R. Giacomini, UCL), and asset price and macroeconomic news (with D. Giannone and M. Modugno, ULB).

CIRO AVITABILE is an economist in the Social Protection and Health Division of the Inter-American Development Bank. He received a Ph.D. in Economics from the University College London. His paper "Does Information Improve the Health Behavior of Adults Targeted by a Conditional Transfer Program?" has been recently published in the *Journal of Human Resources*. He is currently studying the effect of conditional cash transfer programs on the school achievements of children in beneficiary households and the determinants of students' school choices in a centralized allocation system.

ACHILLE BASILE is Professor of Mathematics, Chairman of the Faculty of Economics at the University of Naples Federico II and President of AMASES, the Italian Association of Mathematics Applied to Economics and Social Sciences for 2011-13. His recent publications include "Core and Equilibria in Coalitional Asymmetric Information Economies" (with C. Donnini and M.G. Graziano), in the *Journal of Mathematical Economics*, and "Economies with Informational Asymmetries and Limited Vetoer Coalitions" (with C. Donnini and M.G. Graziano) in *Economic Theory*. Recent working papers include "On mixed markets with public goods" (with G. Graziano and M. Pesce); "A solution to the conflict between efficiency and envy freeness in differential information economies" (with G. Graziano and M. Pesce).

MATTEO BASSI is a CSEF Post-Doctoral Fellow. He received a Ph.D. in Economics from the Toulouse School of Economics, discussing a dissertation on *Behavioral Public Economics*. His current research deals with public economics, political economy, industrial organization and behavioral economics. In 2012 he started, with M. Pagnozzi and S. Piccolo, a project on the role of altruism and reciprocity on optimal contracting. He is currently working on optimal taxation problems with bounded rationality, on the political economy of social security with time inconsistent agents and on the economics of addiction.

LUIGI BENFRATELLO is Assistant Professor of Economics at the University of Naples Federico II. He previously worked at the Italian National Research Council (CNR) and the University of Turin. His research focuses on applied industrial organization (firms' location choices and export activities, regulation and privatization). In 2012 he worked on a paper (with A. Iozzi and M. Piacenza) on technology adoption by private and public owned firms. His paper "Spatial clustering and nonlinearities in the location of multinational firms" (with R. Basile and D. Castellani) is forthcoming in *Geographical Analysis*.

ALBERTO BENNARDO is Professor of Economics at the University of Salerno and CEPR Research Affiliate. His current research focuses on three themes: the effects of information sharing in credit markets with multi-bank lending; private and social incentives to gather information in perfectly and imperfectly competitive financial markets; managers second-best optimal compensation schemes in the presence of manipulation opportunities. Last year he revised the paper "Multiple-Bank Lending, Creditor Rights and Information Sharing", joint with M. Pagano and S. Piccolo, and produced a new paper on "Perks as Second Best Optimal Compensations", joint with P.A. Chiappori and J. Song.

SALVATORE CAPASSO is Professor of Economics at the University of Naples Parthenope. He holds a Ph.D. in Economics from the University of Manchester. His research focuses on economic growth, contract theory, monetary economics and theory of financial intermediation. His recent publications include "Tax Evasion, The Underground Economy and Financial Development", forthcoming in *Journal of Economic Behaviour and Organisation* (with K. Blackburn and N. Bose), and "Financial Development and the Underground Economy", forthcoming in *Journal of Development Economics* (with T. Jappelli). His latest research focuses on the relationship between criminal activity, corruption and growth and on the role of the underground economy in economic development.

CRISTINA CELLA is Assistant Professor of Finance at the Stockholm School of Economics. In 2012 she has worked on several projects. The paper "Investors' Horizons and the Amplification of Market Shocks", co-authored with A. Ellul (Indiana University) and M. Giannetti (Stockholm School of Economics), studies price dynamics during market stress induced by the trading horizon of institutional investors. In the paper "Is There Too Much Entry in the Entrepreneurial Activity?", co-authored with M. Giannetti, she investigates the relationship between entrepreneurs' social status and entrepreneurial activity and the impact on firm value and welfare. Finally, she has worked on the project titled "Earning Management and CEO's Compensation", co-authored with A. Ellul and N. Gupta (Indiana University) and on the project on "Mutual Funds Flow and Individuals' Holdings", co-authored with P. Sodini (Stockholm School of Economics) and Laurent Calvet (HEC).

GIOVANNI CESPA is a Reader at Cass Business School and a CEPR Research Affiliate. His research focuses on market microstructure theory and corporate governance. In the former field, he has investigated the effect of short term behaviour in financial markets, the properties of different trading mechanisms, and the relationship between the sale of financial market information and insider trading in a dynamic market. In the latter (with G. Cestone), he investigated the relationship between corporate social responsibility and corporate governance. His recent research focuses on the informational properties of asset prices and consensus opinion in markets with differential information. His paper "Dynamic Trading and Asset Prices: Keynes vs. Hayek (with X. Vives) is forthcoming in the *Review of Economic Studies*. With T. Foucault, he also investigates the market for the sale of price and quote information by focussing on its welfare properties (Insiders-Outsiders, Transparency, and the Value of the Ticker") and its implication for liquidity (Dealer Attention, Liquidity Spillovers, and Endogenous Market Segmentation).

GIACINTA CESTONE is a Senior Lecturer at Cass Business School and a Research Associate of the European Corporate Governance Institute (ECGI). Her research focuses on corporate finance, corporate governance and industrial organization. She is particularly interested in the interaction between corporate finance and product market competition. Her paper "The Deep Pocket Effect of Internal Capital Markets" (forthcoming in the *Journal of Financial Economics*) provides empirical evidence that affiliation with a cash-rich group represents a source of competitive strength for manufacturing firms. Giacinta is currently working on a research project (with C. Fumagalli, F. Kramarz and G. Pica) analyzing the interplay between internal capital markets and internal labor markets in business groups. She has also contributed to the literature on venture capital financing, and in ongoing work she analyzes how double-sided asymmetric information shapes venture capital syndication deals.

DIMITRIS CHRISTELIS is a Senior Economist at the Directorate General Research of the European Central Bank and a CSEF Research Fellow. He obtained his Ph.D. in Economics from the University of Pennsylvania in 2003. His research interests include household saving and portfolio choice, imputation of missing data, panel data estimation methods, and health economics. He is currently working on the estimation of panel discrete choice models (with R. Fonseca), on determining the effect of capital losses and unemployment on household spending in the US and Europe (with D. Georgarakos and T. Jappelli), on the influence of health insurance on portfolio choice (with D. Georgarakos and A. Sanz-de-Galdeano), on the influence of social activities on cognition (with L. I. Dobrescu), and on the impact of childhood cognition and socio-economic status on risky portfolio choice later in life (with L. I. Dobrescu and A. Motta).

PIERLUIGI CONZO is Assistant Professor of Economics at the University of Turin, Department of Economics "Cognetti de Martiis". His research interests are in the field of development economics, experimental economics, happiness and social preferences. He has carried out fieldworks in Argentina, Thailand, Kenya and Sri Lanka concerning the impact of microfinance or fair trade project on subjective and objective well-being as well as on other-regarding preferences. He is currently working on the effects of tsunami on altruism in Sri Lanka and on the impact of social other-regarding activities on aging Europeans' life satisfaction. Recent publications include: "Enhancing capabilities through credit access: Creditworthiness as a signal of trustworthiness under asymmetric information", *Journal of Public Economics*, 2011 (with L. Becchetti); "Virtuous Interactions in Removing Exclusion: The Link between Foreign Market Access and Access to Education", *Journal of Development Studies*, 2011 (with L. Becchetti and F. Pisani), “Calamity, Aid and Indirect Reciprocity: the Long Run Impact of Tsunami on Altruism”, 2012, with L. Becchetti and S. Castriota.

MARCELLO D’AMATO is Professor of Economic Policy at the University of Salerno. His current research focuses on the institutional design of Central Banks, the political economy of social security, education and social mobility, and managerial incentives. Recent publications include “On the determinants of Central Bank independence in open economies” (with B. Pistoresi and F. Salsano), in *International Journal of Finance and Economics*, and “Political Intergenerational Risk Sharing” (with V. Galasso) in the *Journal of Public Economics*.

GIUSEPPE DE MARCO is Assistant Professor of Mathematics at the University of Naples Parthenope. His current research focuses on ambiguous games, psychological game theory, moral hazard models, multicriteria games, networks and financial contagion. Recent publications include: “Altruistic Behavior and Correlated Equilibrium Selection” (with J. Morgan) in *International Game Theory Review* (2011), ”Beliefs Correspondences and Equilibria in Ambiguous Games” (with M. Romaniello) in *International Journal of Intelligent Systems* (2012), and ”Partnership, Reciprocity and Team Design” (with G. Immordino) in *Research in Economics* (2013).

ELENA L. DEL MERCATO is Maître de Conférences of Mathematics at University Paris 1 Panthéon-Sorbonne (Paris), and previously Assistant Professor at the University of Salerno (2004-08). Her research focuses on market failure as incomplete markets, externalities and public goods in microeconomic theory. Recently she published “Externalities, Consumption Constraints and Regular Economies” (with J.-M. Bonnisseau) in *Economic Theory*. Work in progress includes “Markets for Externalities à la Arrow-Laffont: Equilibrium and Optimality” and “Externalities in Production Economies and Competitive Equilibria: Existence and Regularity” (with V. Platino).

SERGIO DESTEFANIS is Professor of Economics at the University of Salerno, where he heads the Ph.D. Programme in Economics. He is President of the Italian Association of Labour Economics (AIEL). In 2012 he published in *Economics Letters* a paper with G. Mastromatteo on “Assessing the Reassessment. A Panel Analysis of the Lisbon Strategy”, and two reports about the Italian labour markets within the OECD-LEED *Skills for Competitiveness* and *Local Job Creation* projects. He was also involved in an Isfol-Istat research project on human capital measurement. His current research deals with the comparison of American and European labour markets (with R. Fonseca and R.

Warren), the macro-evaluation of labour market policies (with G. Mastromatteo), and the efficiency of small banks (with C. Barra and G. Lubrano Lavadera).

FRANCESCO DRAGO is Associate Professor at the University of Naples Federico II and a Research Affiliate at IZA, Bonn. His research interests are in the fields of labor economics, political economy and crime. Last year he was one of the recipients of the research grant funded by EIEF for young Italian economists. With his co-authors, he is the winner of the Distinguished Article Prize 2012 of the *American Law and Economics Review* for his article “Prison Conditions and Recidivism”. He is currently involved in a research project on network effects in illegal behavior with C. Traxler (University of Marburg) and F. Mengel (University of Essex) and in another research project with R. Galbiati (CNRS) and M. Belloc (Università di Roma La Sapienza) on institutional change and beliefs. Finally he has a paper joint with T. Nannicini (Boccono-Igier) and F. Sobbrio (EUI) on the effect of local news on political outcomes.

SARAH DRAUS is a CSEF Post-doctoral Fellow. She completed a Ph.D. in finance at the University of Paris-Dauphine in 2009, winning the Pirou/Aguirre-Basualdo prize for her doctoral dissertations, awarded by the Chancellerie des Universités de Paris. Her research combines finance with industrial organization and aims at understanding the stock market industry, in particular competition for trading volume, devices to regulate trading, and the role of information disclosure requirements. Currently she is involved in a research project on “circuit breakers” in securities markets. She is also studying the effects of fragmentation of trading volume on the listing requirements determined by stock markets, and the channels through which a listing decision certifies the quality of firms. In 2012 she visited the Rotterdam School of Management.

ANDREW ELLUL is Associate Professor of Finance and Fred T. Greene Distinguished Scholar at Indiana University's Kelley School of Business. His research interests focus on empirical corporate finance, institutional investors’ trading and market microstructure. He is a Research Associate of ECGI, CSEF and FMG, and serves as Associate Editor of the *Review of Finance* since 2010. In 2012 his paper titled “Stronger Risk Controls, Lower Risk: Evidence from U.S. Bank Holding Companies” (with Vijay Yerramilli) was accepted by the *Journal of Finance*. He has presented the working paper titled “Accounting Transparency, Tax Pressure, and Access to Finance” (with T. Jappelli, M. Pagano and F. Panunzi) at the American Finance Association’s Annual Meeting, NBER Corporate Finance Meeting and the CEPR Summer Symposium. He has also finished a new working paper titled “IPOs and Employment” (with Alexander Borisov and Merih Sevilir).

CARLO FAVERO holds the Deutsche Bank Chair in Quantitative Finance and Asset Pricing at Bocconi University and is a CEPR Research Fellow. His current research focuses on the interaction between theory and data for identification, specification and estimation of econometric models relevant for policy analysis and forecasting, and the interaction between demographics and financial markets. He has four forthcoming papers: “A Spectral Estimation of Tempered Stochastic Volatility Models and

Option Pricing" (with J. Li and F. Ortu) in *Computational Statistics and Data Analysis*, "Reconciling VAR based and Narrative Measures of the Tax Multiplier" (with F. Giavazzi) in the *American Economic Journal: Economic Policy*, "Term Structure Forecasting: No-arbitrage Restrictions Versus Large Information Set" (with L. Niu and L. Sala) in the *Journal of Forecasting*, and "Demographic Trends, the Dividend-Price Ratio and the Predictability of Long-Run Stock Market Returns (with A. Gozluklu and A. Tamoni) in the *Journal of Financial and Quantitative Analysis*.

CHIARA FUMAGALLI is Associate Professor of Economics at Bocconi University and a CEPR Research Affiliate. She is also special consultant of Compass Lexecon and Member of the Steering Committee of ACE (Association of Competition Economics). Her research focuses on industrial organization, in particular on competition policy issues. Part of her work deals with the interaction between firms financial decisions and competitive behaviour. On this topic, her paper "The Deep Pocket Effect of Internal Capital Markets" (joint with X. Boutin, G. Cestone, G. Pica and N. Serrano Velarde, forthcoming in the *Journal of Financial Economics*) provides empirical evidence that affiliation with a cash-rich group represents a source of competitive strength for manufacturing firms thereby affecting market entry. Chiara is also working on a research project with F. Kramarz and G. Pica, analyzing the interplay between internal capital markets and internal labor markets in business groups. In 2012 this project he has been awarded the AXA Research Grant for 3 years. Chiara also works on the economics of exclusionary practices. On this topic, the paper "Exclusive dealing: investment promotion may facilitate inefficient foreclosure" (with M. Motta and T. Ronde) is forthcoming in the *Journal of Industrial Economics,* and the paper "A simple theory of predation" (with M. Motta) is under revision for the *Journal of Law and Economics.* Finally, Chiara is writing a book with M. Motta, *Monopolization: A Theory of Exclusionary Practices,* in preparation for CUP.

VINCENZO GALASSO Vincenzo Galasso is Professor of Economics at Università della Svizzera Italiana (USI), Lugano (Switzerland), Director of the Center for Economic and Political Research on Aging at USI, CEPR Research Fellow and IGIER Research Fellow. He is also associate editor of the European Journal of Political Economy and member of the editorial board of the Journal of Pension Economics and Finance. His current research focuses on the interactions between fertility decisions and welfare state, on the selection of politicians and the political economy of structural reforms. In 2012 he has published "The role of political partisanship during economic crises" in *Public Choice*, "The Political Economy of Flexicurity" (with T. Boeri and J. I. Conde-Ruiz) in the *Journal of the European Economic Association* and "The role of income effects in early retirement" (with J.I. Conde-Ruiz and P. Profeta) forthcoming in the *Journal of Public Economics Theory*.

MARIA GABRIELLA GRAZIANO is Professor of Mathematics at the University of Naples Federico II. Her current research focuses on general equilibrium theory, infinite dimensional economies, economies with public goods, economies with uncertainty and asymmetric information. She has recently published the following papers: “Linear cost share equilibria and the veto power of the grand coalition” (with M. Romaniello), *Social Choice and Welfare* (2012); “Fuzzy cooperative behavior in response to market imperfections”, *International Journal of Intelligent Systems* (2012); “Core equivalences for equilibria supported by non-linear prices” (with A. Basile), *Positivity* (2012); “Coalitional fairness in interim differential information economies” (with C. Donnini and M. Pesce), *Journal of Economics* (2012). Recent working papers include “On mixed markets with public goods” (with A. Basile and M. Pesce); “Stable sets and public projects” (with M. Romaniello); “A solution to the conflict between efficiency and envy freeness in differential information economies” (with A. Basile and M. Pesce).

GIOVANNI IMMORDINO is Associate Professor of Economics at the University of Salerno and associate editor of the *International Review of Law and Economics.* He holds a Ph.D. in Economics from the University of Toulouse. In 2012 he has published the article “Corporate fraud governance and auditing”, (with M. Pagano), in the Inaugural Issue of *The Review of Corporate Financial Studies* and three papers of his have been accepted for publication: “Optimal prostitution policy”, (with F. Russo), forthcoming in the Handbook of the Economics of Prostitution, Oxford University Press; “Legal institutions, innovation and growth” (with L. Anderlini, L. Felli and A. Riboni), forthcoming in the *International Economic Review* and “Partnership, reciprocity and team design” (with G. De Marco), forthcoming in *Research in Economics.*

TULLIO JAPPELLI is Professor of Economics at the University of Naples Federico II, Research Fellow of CEPR and CFS (Center of Financial Studies) and International Fellow of Netspar (Tilburg). He is currently one of the Managing Editors of Economic Policy. In 2012 he published: “Financial advisors: A case of babysitters?” (with A. Hacketal and M. Haliassos), *Journal of Banking and Finance*; “Cognitive abilities, healthcare and screening tests” (with C. Avitabile and M. Padula), *Journal of Population Aging*; “Financial integration in Europe” (with M. Pagano), in *The Evidence and Impact of Financial Globalization*, edited by G. Caprio for Elsevier. The following papers have been accepted for publication: “Pension wealth uncertainty” (with L. Guiso and M. Padula) in the *Journal of Risk and Insurance*; “Transfer taxes and intergenerational transfers” (with M. Padula and G. Pica) in the *Journal of the European Economic Association*; “Financial development and the underground economy” (with S. Capasso) in the *Journal of Development Economics*; “The role of intuition and reasoning in driving aversion to risk and ambiguity” (with L. Guiso and J. Butler) in *Theory and Decisions.* Currently he is working on projects on financial literacy and portfolio choice (with M. Padula); the effect of wealth shocks on consumption in the U.S. and Europe (with D. Christelis and D. Georgarakos); heterogeneity of the marginal propensity to consume (with L. Pistaferri); firms' transparency, tax pressure and access to finance (with M. Pagano, A. Ellul and F. Panunzi); financial advice (with M. Haliassos and A. Hackethal), ambiguity aversion (with J. Butler and L. Guiso). With L. Pistaferri he is writing a book on consumption theories and applications.

RICCARDO MARTINA is Professor of Economics at the University of Naples Federico II. He received a Ph.D. in Economics from the University of Naples. His research interests are mainly in the areas of industrial organization and public economics. His recent research focuses on the relationship between corruption and tax evasion, on the "second mover advantage" in multi-stage games with sequential choices, and on tax evasion and incentive contracts in oligopolistic markets.

ANNAMARIA MENICHINI is Associate Professor of Economics at the University of Salerno. Her research interests focus on financial economics, contract theory and incomplete contracts. Her latest publications include "A Simple Impossibility result in Behavioral Contract Theory" (joint with G. Immordino and M.G. Romano), *Economics Letters,* and "Inter-firm Trade Finance in Times of Crisis," *The World Economy.* She has recently completed one paper with Daniela Fabbri on the optimal financial contract when investment in pledgeable assets is endogenous and unobservable to financiers and is currently working on two new research projects: one with P. Simmons on the design of optimal group lending contracts; one with D. Fabbri studying the impact of collateral value manipulation on debt renegotiation.

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Experimental Analysis of Entry and Speculation in Auctions” (with K. J. Saral).

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GIOVANNI PICA is Associate Professor of Economics at the University of Salerno. He specializes in labor and finance, international economics and macroeconomics. In 2012 he published “Finance and Employment” (with M. Pagano), *Economic Polic*. Three papers by him have been accepted for publication: “The deep-pocket effect of internal capital markets” (with X. Boutin, G. Cestone, C. Fumagalli and N. Serrano Velarde) in the *Journal of Financial Economics*; “Who Pays for It? The Heterogeneous Wage Effects of Employment Protection Legislation” (with M. Leonardi) in the *Economic Journal*; and “Do Transfer Taxes Reduce Intergenerational Transfers?” in the *Journal of the European Economic Association*. In 2012 he has been awarded the AXA Research Grant for a 3-year joint project with with Giacinta Cestone, Chiara Fumagalli and Francis Kramarz on "(Why) Are Business Groups Special? Internal Labor and Capital Markets in French Business Groups".

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SAVERIO SIMONELLI is Assistant Professor of Economics at the University of Naples Federico II. He holds a PhD in Economics from the University of Naples Federico II, and a Master in Economics from University Pompeu Fabra. His current research focuses on real business cycle, dynamic factor models and forecasting in real-time. Recently he published "International Comovements, Business Cycle and Inflation: a Historical Perspective" (with H. Mumtaz and P. Surico) in *Review of Economic Dynamics*. His recent papers include "Mafia and Public Spending: Evidence on the Fiscal Multiplier from a Quasi-experiment" (with A. Acconcia e G. Corsetti), "The Dunlop-Tarshis Observation Revisited" (with M. Ravn) and "Investment-Specific Technology Shocks in the US and European Business Cycle". He is currently working on the effect of fiscal policy on output and consumption (with A. Acconcia and G. Corsetti), and on systemic risk and home bias in the euro-area sovereign market (with N. Battistini and M. Pagano).

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302 G. Russo and L. Senatore, A Note on Contribution Games with Loss Functions

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303 A. Basile, M.G. Graziano and M. Pesce, *On Fairness of Equilibria in Economies with Differential Information*

The paper proposes a notion of fairness which overcomes the conflict arising between efficiency and the absence of envy in economies with uncertainty and asymmetrically informed agents. We do it in general economies which include, as particular cases, the main differential information economies studied in the literature. The analysis is further extended by allowing the presence of large traders, which may cause the lack of perfect competition.

304 G. Immordino and S. Piccolo, *Optimal Accomplice-Witnesses Regulation under Asymmetric Information*

We study the problem of a Legislator designing immunity for privately informed cooperating accomplices. Our objective is to highlight the positive (vertical) externality between expected returns from crime and the information rent that must be granted by the Legislator to whistleblowers in order to break their code of silence (omertà) and elicit truthful information revelation. We identify the accomplices' incentives to release distorted information and characterize the second-best policy limiting this behavior. The central finding is that this externality leads to a second-best policy that purposefully allows whistleblowers not to disclose part of their private information. We also show that accomplices must fulfill minimal information requirements to be admitted into the program (rationing), that a bonus must be awarded to accomplices providing more reliable information and that, under some conditions, rewarding a self-reporting `boss' can increase efficiency. These results are consistent with a number of widespread legislative provisions.

305 C. Avitabile, I. Clots-Figueras and P. Masella, *Citizenship, Fertility and Parental Investment*

Citizenship rights are associated with better economic opportunities for immigrants. This paper studies how in a country with a large fraction of temporary migrants the fertility decisions of foreign citizens respond to a change in the rules that regulate child legal status at birth. The introduction of birthright citizenship in Germany, following the introduction of the new German nationality law in 2000, represented a positive shock to the returns to investment in child human capital. Consistent with Becker's "quality-quantity" model of fertility, we find that birthright citizenship leads to a reduction in immigrant fertility and an improvement in health outcomes for the children affected by the reform.

306 G. Russo and L. Senatore, *Who Contributes? A Strategic Approach to a European Immigration Policy*

According to the Lisbon Treaty the increasing cost of enforcing the European border against immigration shall be shared among the EU members. Nonetheless, the Treaty is rather vague with respect to the "appropriate measures" to adopt in order to distribute the financial burden. Members who do not share their borders with source countries have an incentive to free ride on the other countries. We study a contribution game where a border country and a central country minimize a loss function with respect to their national immigration target. We consider both sequential and simultaneous decisions and we show that joint contribution occurs only if the immigration targets are not too different. Total contribution is higher when decisions are simultaneous, but the sequential framework achieves joint contribution under a wider difference in the national targets.

307 S. Nisticò, *Monetary Policy and Stock-Price Dynamics in a DSGE Framework*

This paper analyzes the role of stock prices in driving Monetary Policy for price stability in a Non-Ricardian DSGE model. It shows that the dynamics of the interest rate consistent with price stability requires a response to stock-price changes that depends on the shock driving them: a supply shock (e.g. productivity) does not require an additional, dedicated response relative to the standard Representative-Agent framework, while a demand shock does. Moreover, we show that implementing the exible-price allocation by means of an interest-rate rule that reacts to deviations of the stock-price level from the exible-price equilibrium incurs risks of endogenous instability that are the higher the less profitable on average equity shares. On the other hand, reacting to the stock-price growth rate is risk-free from the perspective of equilibrium determinacy, and can be beneficial from an overall real stability perspective.

308 G. Immordino and F. F. Russo, *Regulating Prostitution: Theory and Evidence from Italy*

We build an equilibrium model of prostitution where clients and sex workers choose to demand and supply sex under three legal regimes: prohibition, regulation and laissez-faire. The key feature is the endogenous evolution of the risk as a consequence of policy changes. We calibrate the model to empirical evidence from Italy and then compare the effect of different policies on the equilibrium quantity of prostitution and on the harm associated with it. A prohibition regime that makes it illegal to buy sex but not to sell it is more effective than the opposite regime in reducing quantity but less effective in reducing harm. Taxes are one inducement to go illegal and prevent some of the less risky individuals from joining the market, leaving it smaller but riskier. A licensing system that prevents some infected individuals from joining the legal market reduces the risk and is therefore associated with a sharp increase in quantity. While prohibition is preferable to minimize quantity, regulation is best to minimize harm.

309 Basile and M.G. Graziano, *Core Equivalences for Equilibria Supported by Non-linear Prices*

The goal of this paper is to provide some new cooperative characterizations and optimality properties of competitive equilibria supported by non-linear prices. The general framework is that of economies whose commodity space is an ordered topological vector space which need not be a vector lattice. The central notion of equilibrium is the one of personalized equilibrium introduced by Aliprantis, Tourky and Yannelis (2001). Following Herves-Beloso and Moreno-Garcia (2008), the veto power of the grand coalition is exploited in the original economy and in a suitable family of economies associated to the original one. The use of Aubin coalitions allows us to connect results with the arbitrage free condition due to non-linear supporting prices. The use of rational allocations allows us to dispense with Lyapunov convexity theorem. Applications are provided in connection with strategic market games and economies with asymmetric information.

310 A. Ellul, T. Jappelli, M. Pagano and F. Panunzi, *Transparency, Tax Pressure and Access to Finance*

In choosing transparency, firms must trade off the benefits from better access to finance against the cost of a greater tax burden. We study this trade-off in a model with distortionary taxes and endogenous rationing of external finance. The evidence from two different data sets, one formed only by listed firms and another mainly by unlisted firms, bears out the model's predictions: First, transparency is negatively correlated with tax pressure, particularly in sectors where firms are less dependent on external finance. Second, financial development enhances the positive effect of transparency on investment, and encourages transparency by financially dependent firms. Finally, investment and access to finance are positively correlated with firms' transparency, especially in firms that depend more on external finance, and are negatively correlated with tax pressure. JEL Classification: G31, G32, G38, H25, H26, M40.

311 M. D'Amato and D. Mookherjee, *Educational Signaling, Credit Constraints and Inequality Dynamics*

We present a dynamic OLG model of educational signaling, inequality and mobility with missing credit markets. Agents are characterized by two sources of unobserved heterogeneity: ability and parental income, consistent with empirical evidence on returns to schooling. Both quantity and quality of human capital evolve endogenously. The model generates a Kuznets inverted-U pattern in skill premia similar to historical US and UK experience. In the first (resp. later) phase the skill premium rises (falls), social returns to education exceed (falls below) private returns: under-investment owing to financial imperfections dominate (are dominated by) over-investment owing to signaling distortions. There always exist Pareto-improving policy interventions reallocating education between poor and rich children.

312 V. Acharya, M. Pagano and P. Volpin, *Seeking Alpha: Excess Risk Taking and Competition for Managerial Talent*

We present a model where managers are risk-averse, and firms compete for scarce managerial talent ("alpha"). When managers are not mobile across firms, firms provide efficient compensation, which allows for learning about managerial talent and insures low-quality managers. When instead managers can move across firms, firms cannot provide co-insurance among their employees. In anticipation, risk-averse managers may churn across firms before their true quality is learnt. The result is excessive risk-taking with pay for short-term performance and build up of long-term risks. We conclude with the analysis of policies to address the resulting inefficiency in firms' compensation.

313 S. Draus and M. Van Achter, *Circuit Breakers and Market Runs*

This paper analyzes whether the application of a "circuit breaker" to a financial market (i.e. a mechanism that interrupts trading for a predetermined period when the price moves beyond a predetermined level) reaches its intended goals of increased market stability and overall welfare. Our framework of analysis is a model in which investors can trade at several dates and might face a liquidity shock forcing them to sell immediately when the shock occurs. This setting potentially induces a "market run" where investors commonly sell merely out of fear other investors are selling and not because they have current liquidity needs. We show that the introduction of a sufficiently tightly-set circuit breaker within this setting successfully prevents this market run from occurring. Even more so, it could induce the socially optimal state (in which trading only takes place when it is motivated by liquidity needs) to arise. However, this desirable equilibrium can only be reached under particular economic conditions. When these conditions are not met, installing a circuit breaker might even lower social welfare as compared to a setting without a circuit breaker as it impedes socially desirable trades and stimulates socially undesirable trades.

314 G. De Marco and G. Immordino, *Reciprocity in the Principal Multiple Agent Model*

This paper studies how incentives are affected by intention-based reciprocity preferences when the principal hires many agents. Our results describe the agents' psychological attitudes required to sustain a given strategy profile. We also show that hiring reciprocal agents to implement a first or a second-best contract will always benefit the principal if the strategy profile is symmetric. When instead the profile (first or second-best) is asymmetric the principal's best interest might be better served by self-interested agents. We conclude the paper by clarifying when symmetric profiles are most likely to arise.

315 F. Magris and G. Russo, *Fiscal Revenues and Commitment in Immigration Amnesties*

Reasons to grant immigration amnesties include the intention to reduce the weight of the informal sector and the attempt to identify employers of undocumented workers. However, it is incontestable that potential fiscal gains are important: tax revenues are crucial in all kinds of amnesties. Nevertheless, over the last 30 years 24% of applications have been rejected. It is still unexplained why governments accept this loss of fiscal base. We argue that applying for amnesty is basically selfincrimination, and that immigration-averse governments have an incentive to exploit the applications to identify and expel illegal workers. In our Nash equilibrium only applicants with the highest income are granted amnesty, and the poorest immigrants do not apply. In addition, it is not possible to establish a reputation because the players are different every time the game is repeated. Thus, fiscal revenues are sub-optimal and amnesties are an inefficient way to make illegal workers come forward.

316 L. Becchetti, S. Castriota and P. Conzo, *Calamity, Aid and Indirect Reciprocity: the Long Run Impact of Tsunami on Altruism*

Natural disasters have been shown to produce effects on social capital, risk and time preferences of victims. We run experiments on altruistic preferences on a sample of Sri Lankan microfinance borrowers affected/unaffected by the tsunami shock in 2004 at a 7-year distance from the event (a distance longer than in most empirical studies). We find that people who suffered at least a damage from the event behave in dictator games less altruistically as senders (and expect less as receivers) than those who do not report any damage. Interestingly, among damaged, those who suffered also house damages or injuries send (expect) more than those reporting only losses to the economic activity. Since the former are shown to receive significantly more help than the latter we interpret this last finding as a form of indirect reciprocity.

317 M. Bassi, *Optimal Libertarian Sin Taxes*

This paper studies the optimal fiscal treatment of addictive goods (cigarettes, drugs, fatty foods, alcohol, gambling etc.). It shows that, when agents have private information about their productivity levels and their degree of rationality, the Atkinson and Stiglitz result of optimal uniform commodity taxation does not hold: addictive and non-addictive goods should be taxed at different rates. Depending on the direction of redistribution, the addictive good should be taxed more or less than the non-addictive good. Differential commodity taxation is not driven by the planner’s paternalism, but only by incentive considerations. A tax authority which fully respects consumers’ sovereignty taxes the consumption of addictive and non-addictive goods at different rates to improve screening of types and increase income redistribution.

318 Fabbri and A.C. Menichini, *The Commitment Problem of Secured Lending*

The paper investigates optimal financial contracts when investment in pledgeable assets is endogenous and not observable to financiers. In a setting with uncertainty, two inputs with different collateral value and investment unobservability, we show that a firm-bank secured credit contract is time-inconsistent: Once credit has been granted, the entrepreneur has an ex-post incentive to alter the input combination towards the input with low collateral value and higher productivity, thus jeopardizing total bank revenues. Anticipating the entrepreneur's opportunism, the bank offers a non-collateralized credit contract, thereby reducing the surplus of the venture. One way for the firm to commit to the contract terms is to purchase inputs on credit and pledge them to the supplier in case of default. Observing the input investment and having a stake in the bad state, the supplier acts as a guarantor that the input combination specified in the bank contract will be actually purchased and that the entrepreneur will stick to the contract terms. The paper concludes that: (1) Buying inputs on account facilitates the access to collateralized bank financing; (2) Firms using both trade credit and collateralized bank finance invest more in pledgeable assets than firms only using uncollateralized bank credit. Our results are robust to the possibility of collusion between entrepreneur and supplier.

319 G. De Marco and J. Morgan, *On Ordered Weighted Averaging Social Optima*

In this paper, we look at the classical problem of aggregating individual utilities and study social orderings which are based on the concept of Ordered Weighted Averaging (OWA) Aggregating Operator. In these social orderings, called OWA social welfare functions (swf), weights are assigned a priori to the positions in the social ranking and, for every possible alternative, the total welfare is calculated as a weighted sum in which the weight corresponding to the k-th position multiplies the utility in the k-th position. In the a–OWA swf, the utility in the k-th position is the k-th smallest value assumed by the utility functions, whereas, in the b–OWA swf, it is the utility of the k-th poorest individual. We emphasize the differences between the two concepts, analyze the continuity issue and provide maximum points existence results.

320 D. Christelis and L. I. Dobrescu, *The Impact of Social Activities on Cognitive Ageing: Evidence from Eleven European Countries*

Using micro data from eleven European countries, we investigate the impact of being socially active on cognition in older age. Cognitive abilities are measured through scores on numeracy, fluency and recall tests. We address the endogeneity of social activities through panel data and instrumental variable methods. We find that social activities have an important positive effect on cognition, with the results varying by gender. Fluency is positively affected only in females, while numeracy only in males. Finally, recall is affected in both sexes. We also show that social activities, through their effect on cognition, influence positively households' economic welfare.

321 M. B. Lignola and J. Morgan, *Approximating Values of MinSup Problems with Quasi-variational Inequality Constraints*

We consider a two-stage model where a leader, according to its risk-averse proneness, solves a MinSup problem with constraints corresponding to the reaction sets of a follower and defined by the solutions of a quasi-variational inequality (i.e. a variational inequality having constraint sets depending on its own solutions) which appear in concrete economic models such as social and economic networks, financial derivative models, transportation network congestion and traffic equilibrium. In general the infimal value of a MinSup (or the maximal value of a MaxInf) problem with quasi-variational inequality constraints is not stable under perturbations in the sense that the sequence of optimal values for the perturbed problems may not converge to the optimal value of the original problem even in presence of nice data. Thus, we introduce different types of approximate values for this problem, we investigate their asymptotical behavior under perturbations and we emphasized the results concerning MinSup problems with variational inequality constraints as well results holding under stronger assumptions that can be more easily employed in applications.

322 M. Pagnozzi and S. Piccolo, *Information Sharing between Vertical Hierarchies*

When do principals independently choose to share the information obtained from their privately informed agents? Information sharing affects contracting within competing organizations and induces agents' strategies to be correlated through the distortions imposed by principals to obtain information. We show that the incentives to share information depend on the nature of upstream externalities between principals and the correlation of agents' information. With small externalities, principals share information when externalities and correlation have opposite signs, and do not share information when externalities and correlation have the same sign. In this second case, principals face a prisoners' dilemma since they obtain higher profits by sharing information.

323 M. Di Maggio and M. Pagano, *Financial Disclosure and Market Transparency with Costly Information Processing*

We study a model where some investors ("hedgers") are bad at information processing, while others ("speculators") have superior information-processing ability and trade purely to exploit it. The disclosure of financial information induces a trade externality: if speculators refrain from trading, hedgers do the same, depressing the asset price. Market transparency reinforces this mechanism, by making speculators' trades more visible to hedgers. As a consequence, asset sellers will oppose both the disclosure of fundamentals and trading transparency. This is socially inefficient if a large fraction of market participants are speculators and hedgers have low processing costs. But in these circumstances, forbidding hedgers' access to the market may dominate mandatory disclosure.

324 L. Becchetti, S. Castriota and P. Conzo, *Bank Strategies in Catastrophe Settings: Empirical Evidence and Policy Suggestions*

The poor in developing countries are the most exposed to natural catastrophes and microfinance organizations may potentially ease their economic recovery. Yet, no evidence on MFIs strategies after natural disasters exists. We aim to fill this gap by building adataset which merges bank records of loans, issued before and after the 2004 Tsunami by a Sri Lankan MFI recapitalized by Western donors, with detailed survey data on the corresponding borrowers. Evidence of effective post-calamity intervention is supported since the defaults in the post-Tsunami years (2004-2006) do not imply smaller loans in the period following the recovery (2007-2011) while people hit by the calamity receive more money. Furthermore, a cross-subsidization mechanism is in place: clients with a long successful credit history and those not damaged by the calamity pay higher interest rates. All these features helped damaged people to recover and repay both new and previous loans. However, we also document an abnormal and significant increase in default rates of non victims suggesting the existence of contagion and/or strategic default problems. For this reason we suggest reconversion of donor aid into financial support to compulsory microinsurance schemes for borrowers.

325 T. Jappelli and L. Pistaferri, *Fiscal Policy and MPC Heterogeneity*

We use responses to survey questions in the 2010 Italian Survey of Household Income and Wealth that ask consumers how much of an unexpected transitory income change they would consume. We find that the marginal propensity to consume (MPC) is 48 percent on average, and that there is substantial heterogeneity in the distribution. We find that households with low cash-on-hand exhibit a much lower MPC than affluent households, which is in agreement with models with precautionary savings where income risk plays an important role. The results have important implications for the evaluation of fiscal policy, and for predicting household responses to tax reforms and redistributive policies. In particular, we find that a debt-financed increase in transfers of 1 percent of national disposable income targeted to the bottom decile of the cash-on-hand distribution would increase aggregate consumption by 0.82 percent. Furthermore, we find that redistributing 1% of national disposable from the top to the bottom decile of the income distribution would boost aggregate consumption by 0.1%.

326 M. Pagano, *Finance: Economic Lifeblood or Toxin?*

In the past two decades, academic research has produced massive evidence of the beneficial role of financial development for growth and the allocation of investment. Our current vision, however, is dominated by instances of dysfunctional behavior of financial markets associated with acute and widespread crises. This raises the issue of when and why finance ceases to be the “lifeblood” and turns into a “toxin” for real economic activity. This paper is a first step towards an answer. Its thesis is that the metamorphosis occurs when finance becomes “too large” relative to the underlying economy. At this point finance stops contributing to economic growth and comes to threaten the solvency of banks and systemic stability. A related question is why regulation is not designed so as to prevent the financial industry from growing above this threshold. I argue that the answer lies largely in the symbiosis between politicians and the finance industry.