The American Economic Review

ARTICLES

AVINASH DIXIT

Governance Institutions and Economic Activity

JUAN CARLOS CONESA, SAGIRI KITAO, AND DIRK KRUEGER
Taxing Capital? Not a Bad Idea After All!

WILLIAM ADAMS, LIRAN EINAV, AND JONATHAN LEVIN
Liquidity Constraints and Imperfect Information in Subprime Lending

MARCO CAGETTI AND MARIACRISTINA DE NARDI Estate Taxation, Entrepreneurship, and Wealth

ALEXANDRE MAS AND ENRICO MORETTI Peers at Work

LENA EDLUND AND WOJCIECH KOPCZUK
Women, Wealth, and Mobility

MIGUEL URQUIOLA AND ERIC VERHOOGEN

Class-Size Caps, Sorting, and the Regression-Discontinuity Design

PAUL BEAUDRY, CHARLES BLACKORBY, AND DEZSÖ SZALAY

Taxes and Employment Subsidies in Optimal Redistribution Programs

ROBERT J. BARRO

Rare Disasters, Asset Prices, and Welfare Costs

JEAN TIROLE Con

Cognition and Incomplete Contracts

SHAUN P. HARGREAVES HEAP AND DANIEL JOHN ZIZZO
The Value of Groups

CARLOS DOBKIN AND NANCY NICOSIA

The War on Drugs: Methamphetamine, Public Health, and Crime

JEAN BOIVIN, MARC P. GIANNONI, AND ILIAN MIHOV

Sticky Prices and Monetary Policy: Evidence from Disaggregated US Data

MARK J. MACHINA

Risk, Ambiguity, and the Rank-Dependence Axioms

KATHERINE HO

Insurer-Provider Networks in the Medical Care Market

YAN CHEN AND SHERRY XIN LI

Group Identity and Social Preferences

SHORTER PAPERS: S. F. Hamilton; J. Morgan and F. Várdy; M. Angelucci and G. De Giorgi; M. D. Makowsky and T. Stratmann; A. Spilimbergo; D. Ariely, A. Bracha, and S. Meier

MARCH 2009

THE AMERICAN ECONOMIC ASSOCIATION

Founded in 1885

EXECUTIVE COMMITTEE

Elected Officers and Members

President

ANGUS DEATON, Princeton University

President-elect

ROBERT E. HALL, Stanford University

Vice-Presidents

JAMES J. HECKMAN, University of Chicago

JAMES M. POTERBA, Massachusetts Institute of Technology and National Bureau of Economic Research

Members

ANNE C. CASE, Princeton University

DAVID H. ROMER, University of California at Berkeley

SUSAN C. ATHEY, Harvard University

JANICE C. EBERLY. Northwestern University

DARON ACEMOGLU, Massachusetts Institute of Technology

MARIANNE BERTRAND, University of Chicago

Ex Officio Members

THOMAS J. SARGENT, New York University AVINASH K. DIXIT, Princeton University

Appointed Members

Editor, The American Economic Review

ROBERT A. MOFFITT, Johns Hopkins University

Editor, The Journal of Economic Literature

ROGER H. GORDON, University of California at San Diego

Editor, The Journal of Economic Perspectives

DAVID H. AUTOR, Massachusetts Institute of Technology

Editor, American Economic Journal: Applied Economics ESTHER DUFLO, Massachusetts Institute of Technology

Editor, American Economic Journal: Economic Policy

ALAN J. AUERBACH, University of California at Berkeley

Editor, American Economic Journal: Macroeconomics

STEVEN J. DAVIS, University of Chicago

Editor, American Economic Journal: Microeconomics ANDREW POSTLEWAITE, University of Pennsylvania

Secretary-Treasurer

JOHN J. SIEGFRIED, Vanderbilt University

OTHER OFFICERS

Editor, Resources for Economists

WILLLIAM GOFFE, State University of New York at Oswego

Director of AEA Publication Services and

Managing Director of EconLit Production and Marketing DRUCILLA EKWURZEL. Pittsburgh

Managing Director of EconLit Product Design and Content STEVEN L. HUSTED, University of Pittsburgh

Executive Director

WILLIAM W. DAMON, Vanderbilt University

Counsel

TERRY CALVANI, Freshfields Bruckhaus Deringer LLP Washington, DC

ADMINISTRATORS

Administrative Director
REGINA H. MONTGOMERY
Convention Manager
MARLENE HIGHT

• Typeset by American Economic Association Publications, Pittsburgh, Pennsylvania, USA

 Printed at RR Donnelley Company, Eldridge, Iowa USA

• Registered in the US Patent and Trademark Office®

• Copyright © 1998, 1999, 2000, 2001, 2002. 2003. 2004, 2005, 2006, 2007, 2008, 2009 by the American Economic Association. Permission to make digital or hard copies of part or all of American Economic Association publications for personal or classroom use is granted without fee provided that copies are not distributed for profit or direct commercial advantage and that copies show this notice on the first page or initial screen of a display along with the full citation, including the name of the author. Copyrights for components of this work owned by others than AEA must be honored. Abstracting with credit is permitted. The author has the right to republish, post on servers, redistribute to lists and use any component of this work in other works. For others to do so requires prior specific permission and/or a fee. Permissions may be requested from the American Economic Association, 2014 Broadway, Suite 305, Nashville, TN 37203.

• No responsibility for the views expressed by authors in this *Review* is assumed by the editors or the publishers, The American Economic Association.

Correspondence relating to advertising, business matters, permissions to quote, back issues, subscriptions, and changes of address, should be sent to the American Economic Association, 2014 Broadway, Suite 305, Nashville, TN 37203. Change of address notice must be received at least six (6) weeks prior to the publication month. A membership or subscription paid twice is automatically extended for an additional year unless otherwise requested.

THE AMERICAN ECONOMIC REVIEW (ISSN 0002-8282), March 2009, Vol. 99, No. 1. The AER is published five times a year (March, May, June, September, December) by the American Economic Association, 2014 Broadway, Suite 305, Nashville, TN 37203. Annual fees for regular membership are: \$64.00, \$77.00, or \$90.00, depending on income. Further information on subscriptions and the American Economic Association can be found at www.vanderbilt.edu/AEA/. Periodical postage paid at Nashville, TN and at additional mailing offices. POSTMASTER: Send address changes to The American Economic Review, 2014 Broadway, Suite 305, Nashville, TN 37203. Printed in the USA.



THE AMERICAN ECONOMIC REVIEW

Editor ROBERT A. MOFFITT	March 2009	
Coeditors VINCENT CRAWFORD MARK GERTLER PINELOPI KOUJIANOU GOLDBERG DIRK KRUEGER ALESSANDRO LIZZERI RICHARD ROGERSON	volume 99 , number 1	
Managing Editor JANE EMILY VOROS		
Assistant Managing Editor STEVEN M. STELLING Board of Editors BRUCE BLONIGEN RALPH BRAID GARY CHARNESS STEPHEN COATE DORA COSTA MIGUEL COSTA-GOMES	Articles Governance Institutions and Economic Activity Avinash Dixit	5
	Taxing Capital? Not a Bad Idea After All! Juan Carlos Conesa, Sagiri Kitao, and Dirk Krueger	25
RACHEL CROSON MATTHIAS DOEPKE	Liquidity Constraints and Imperfect Information in Subprime Lending	
JANICE C. EBERLY HANMING FANG JESÚS FERNÁNDEZ- VILLAVERDE SIMON GILCHRIST DAVID GREEN CHRISTIAN HELLWIG IGAL HENDAL MING HUANG BOTOND KÖSZEGI JOHN LEAHY JONATHAN LEVIN JAMES LEVINSOHN JOHN A. LIST SYDNEY LUDVIGSON SHELLY LUNDBERG	William Adams, Liran Einav, and Jonathan Levin	49
	Estate Taxation, Entrepreneurship, and Wealth Marco Cagetti and Mariacristina De Nardi	85
	Peers at Work Alexandre Mas and Enrico Moretti	112
	Women, Wealth, and Mobility Lena Edlund and Wojciech Kopczuk	146
	Class-Size Caps, Sorting, and the Regression- Discontinuity Design	
KAIVAN MUNSHI ROHINI PANDE	Miguel Urquiola and Eric Verhoogen	179
NINA PAVCNIK RICARDO REIS ESTEBAN ROSSI-HANSBERG FRANK SCHORFHEIDE	Taxes and Employment Subsidies in Optimal Redistribution Programs Paul Beaudry, Charles Blackorby,	
HOLGER SIEG ANDRZEJ SKRZYPACZ	and Dezsö Szalay	216
LONES SMITH JOEL SOBEL CHRISTOPHER TIMMINS	Rare Disasters, Asset Prices, and Welfare Costs Robert J. Barro	243
PETRA TODD CHRISTOPHER UDRY	Cognition and Incomplete Contracts Jean Tirole	265
	The Value of Groups Shaun P. Hargreaves Heap and Daniel John Zizzo	295

Carlos Dobkin and Nancy N		324
Sticky Prices and Monetary Policy: Evidence from Disaggregated US Data Jean Boivin, Marc P. Giannoni, and Ilian Mihov		
Risk, Ambiguity, and the Rank-Dependence	Axioms Mark J. Machina	385
Insurer-Provider Networks in the Medical Ca	are Market Katherine Ho	393
Group Identity and Social Preferences Yan Chen and Sherry Xin		431
Shorter Papers		
Excise Taxes with Multiproduct Transactions	Stephen F. Hamilton	458
Diversity in the Workplace	John Morgan and Felix Várdy	472
Indirect Effects of an Aid Program: How Do Cash Transfers Affect Ineligibles	s' Consumption? Manuela Angelucci and Giacomo De Giorgi	486
Political Economy at Any Speed: What Deter	rmines Traffic Citations? Michael D. Makowsky and Thomas Stratmann	509
Democracy and Foreign Education	Antonio Spilimbergo	528
Doing Good or Doing Well? Image Motivation and Monetary Incentives in Behaving Prosocially Dan Ariely, Anat Bracha, and Stephan Meier		544

Information on how to submit a manuscript is available online: http://www.aeaweb.org/aer/submissions.html

It is the policy of *The American Economic Review* to publish papers only if the data used in the analysis are clearly and precisely documented and are readily available to any researcher for purposes of replication. Details of the computations sufficient to permit replication must be provided. The Editor should be notified at the time of submission if the data used in a paper are proprietary or if, for some other reason, the requirements above cannot be met.



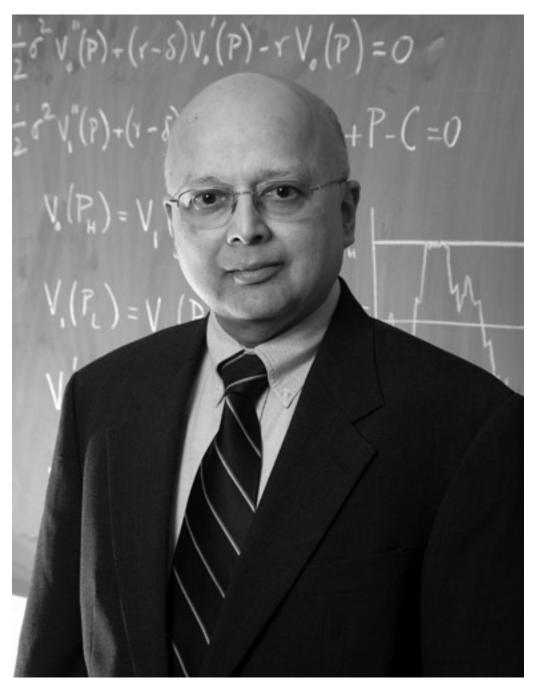


Photo by Steven Waskow, Princeton

Annal Dixit