

# **Predatory Short-Sales and Bailouts**

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Abstract: This paper extends the literature on predatory short selling and bailouts through a joint analysis of the two. We consider a model with informed short sales, as well as uninformed predatory short sales, which can trigger the inefficient liquidation of a firm. We obtain several novel results: A government commitment to bail out insolvent firms with positive probability can increase welfare because it selectively deters predatory short selling without hampering desirable informed short sales. Contrasting a common view, bailouts can be optimal ex-ante but undesirable ex-post. Furthermore, bailouts in our model are a better policy tool than short selling restrictions. Welfare gains from the bailout policy are unevenly distributed: shareholders gain while taxpayers lose. Bailout taxes allow ex-ante Pareto improvements.