



Cornell University  
College of Arts and Sciences

**Karl Shell**  
Thorne Professor of Economics  
ks22@cornell.edu  
www.karlshell.com  
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**Fall 2009**

## **Economics 7310: Monetary Economics**

Economics 7310 is an important course for graduate students specializing in macro and related fields. This course can be repeated.

The organizational meeting will be in 498 Uris Hall on Thursday, September 3 at 5pm. We must find a permanent room and time for the course.

Instructor: Karl Shell, [ks22@cornell.edu](mailto:ks22@cornell.edu); 255-5618; 402 Uris Hall;  
[www.karlshell.com](http://www.karlshell.com).

Professor Shell's office hours for Fall 2009: Thursdays 3-4pm in Uris Hall 402.

Office Assistants: Max Mihm and Yu Zhang, [shelloffice@cornell.edu](mailto:shelloffice@cornell.edu); 255-5618; 402 Uris Hall.

### **Conference on Financial Fragility**

Econ 7310 students are invited (and urged) to participate in this conference taking place at Cornell on the last weekend in September (9/26 – 9/27/2009). The speakers are Phil Dybvig (WUSL), Douglas Gale (NYU), John Geanakoplos (Yale), Chao Gu (Missouri), Marie Hoerova (ECB), Todd Keister (NY Fed), Koralai Kirabaeva (Bank of Canada), Ed Nosal (Chicago Fed), Julio Rotemberg (Harvard), Adam Slawski (Penn State), and Randy Wright (Wisconsin).

A tentative schedule for the conference is attached.

### **First Reading List**

From a Cornell computer, these can be read and downloaded at [www.karlshell.com](http://www.karlshell.com).

#### **A. Bank Runs**

Freixas, Xavier and Jean-Charles Rochet. *Microeconomics of Banking*, 2<sup>nd</sup> Edition. MIT Press, 2008.

Diamond, Douglas W., and Dybvig, Philip H. "[Bank Runs, Deposit Insurance, and Liquidity](#)," *Journal of Political Economy* 91 (June 1983): 401-19.

Green, Edward J., and Lin, Ping. "[Diamond and Dybvig's Classic Theory of Financial Intermediation: What's Missing?](#)" *Fed. Reserve Bank Minneapolis Q. Rev.* 24 (Winter 2000): 3-13.

Wallace, Neil. "[Another Attempt to Explain an Illiquid Banking System: The Diamond and Dybvig Model with Sequential Service Taken Seriously.](#)" *Fed. Reserve Bank Minneapolis Q. Rev.* 12 (Fall 1988): 3-16.

Wallace, Neil. "[A Banking Model in Which Partial Suspension is Best.](#)" *Fed. Reserve Bank Minneapolis Q. Rev.* 14 (Fall 1990): 11-23.

Peck, James, and Shell, Karl. "[Bank Portfolio Restrictions and Equilibrium Bank Runs.](#)" *Working Paper no. 99-07.* Ithaca, NY.: Cornell Univ., Center Analytic Econ., July 1999.

Peck, James, and Shell, Karl. "[Equilibrium Bank Runs.](#)" *Journal of Political Economy*, Vol. 111, No. 1, February 2003, 103-123.

## **B. Sunspots**

Karl Shell, "[Sunspot Equilibrium](#)," forthcoming in *The New Palgrave: A Dictionary of Economics*, L. Blume and S. Durlauf (eds), Macmillan.

Karl Shell, "[Sunspot Equilibrium](#)," in *The New Palgrave: A Dictionary of Economics* (J. Eatwell, M. Milgate, and P. Newman, eds.), Vol. 4, New York: Macmillan, 1987, 549-551.

Karl Shell and Bruce Smith, "[Sunspot Equilibrium](#)," in *The New Palgrave Dictionary of Money and Finance* (J. Eatwell, M. Milgate, and P. Newman, eds.), Vol. 3, London: Macmillan, 601-605.

Karl Shell, "[Monnaie et Allocation Intertemporelle](#)," [title and abstract in French, text in English] mimeo, Séminaire d'Econométrie Roy-Malinvaut, Centre National de la Recherche Scientifique, Paris, November 21, 1977. (Forthcoming in *Macroeconomic Dynamics*.)

David Cass and Karl Shell, "[Do Sunspots Matter?](#)" *Journal of Political Economy*, Vol. 91(2), April 1983, 193-227.

Costas Azariadis, "[Self-Fulfilling Prophecies](#)," *Journal of Economic Theory*, Vol. 25(3), December 1981, 380-396.

Costas Azariadis and Roger Guesnerie, "[Sunspots and Cycles](#)", *Review of Economic Studies*, Vol. 53(5), October 1986, 725-738.

Yves Balasko, "[Extrinsic Uncertainty Revisited](#)," *Journal of Economic Theory*, Vol. 31(2), December 1983, 203-210.

James Peck, "[On the Existence of Sunspot Equilibria in an Overlapping Generations Model](#)," *Journal of Economic Theory*, Vol. 44(1), February 1988, 19-42.

James Peck and Karl Shell, "[Market Uncertainty: Correlated and Sunspot Equilibria in Imperfectly Competitive Economies](#)," *The Review of Economic Studies*, Vol. 58(5), October 1991, 1011-1019.

Karl Shell and Randall Wright, "[Indivisibilities, Lotteries and Sunspot Equilibria](#)," *Economic Theory*, Vol. 3(1), January 1993, 1-17.

David Cass and Karl Shell, "[Sunspot Equilibrium in an Overlapping-Generations Economy with an Idealized Contingent-Commodities Market](#)," Part 1, Chapter 1 in *Economic Complexity: Chaos, Sunspots, Bubbles, and Nonlinearity* (W. Barnett, J. Geweke, and K. Shell, eds.), New York: Cambridge University Press, 1989, 3-20.

Edward Prescott and Robert Townsend, "[Pareto Optima and Competitive Equilibria with Adverse Selection and Moral Hazard](#)," *Econometrica*, Vol. 52(1), January 1984, 21-45.

Edward Prescott and Robert Townsend, "[General Competitive Analysis in an Economy with Private Information](#)," *International Economic Review*, Vol. 25(1), February 1984, 1-20.

Rod Garratt, Todd Keister, Cheng-Zhon Qin, and Karl Shell, "[Equilibrium Prices when the Sunspot Variable is Continuous](#)," *Journal of Economic Theory*, Vol. 107(1), November 2002, 11-38. doi:10.1006/jeth.1999.2634

Aditya Goenka and Karl Shell, "[When Sunspots Don't Matter](#)," *Economic Theory*, Vol. 9(1), January 1997, 169-178.

Aditya Goenka and Karl Shell, "[Robustness of Sunspot Equilibria](#)," *Economic Theory*, Vol. 10(1), July 1997, 79-98.

James Peck and Karl Shell, "[Bank Portfolio Restrictions and Equilibrium Bank Runs](#)," Working Paper 99-07, *Center for Analytical Economics*, Cornell University, Ithaca, July 1999.

Timothy J. Kehoe, David K. Levine, Edward C. Prescott, "[Lotteries, Sunspots, and Incentive Constraints](#)," *Journal of Economic Theory*, Vol. 107(1), November 2002, 39-69. doi:10.1006/jeth.2001.2792.

Rod Garratt, Todd Keister, and Karl Shell, "[Comparing Sunspot Equilibrium and Lottery Equilibrium Allocations: The Finite Case](#)," *Incomplete Markets Workshop*, SUNY Stony Brook, July 2001.

### **C. Money, Securities and Taxes: Background**

K. J. Arrow, "[The Role of Securities in the Optimal Allocation of Risk-Bearing](#)," *Review of Economic Studies*, April 1964, 91-96.

Yves Balasko and Karl Shell, "[Lump-Sum Taxation: The Static Economy](#)," in *General Equilibrium, Growth, and Trade: The Legacy of Lionel McKenzie, II*. (R. Becker, M. Boldrin, R. Jones and W. Thomson, eds.) New York: Academic Press, 1993, 168-180.

James Peck, "[Non-Connectedness of the Set of Equilibrium Money Prices: The Static Economy](#)," *Journal of Economic Theory*, Vol. 43(2), December 1987, 348-354.

Rod Garratt, "[The Connectedness of the Set of Equilibrium Money Prices Depends on the Choice of the Numeraire](#)," *Journal of Economic Theory*, Vol. 56(1), February 1992, 206-217.

#### **D. Overlapping Generations and Money**

Karl Shell and Bruce Smith, "[Overlapping-Generations Model and Monetary Economics](#)," in the *New Palgrave Dictionary of Money and Finance* (J. Eatwell, M. Milgate, and P. Newman, eds.), Vol. 3, London: Macmillan, 1992, 104-109.

Paul A. Samuelson, "[An Exact Consumption-Loan Model of Interest with or without the Social Contrivance of Money](#)," *Journal of Political Economy*, December 1958, 467-482.

Peter A. Diamond, "[National Debt in a Neoclassical Growth Model](#)," *American Economic Review*, Vol. 55(5), December 1965, 1126-1150.

Karl Shell, "[Notes on the Economics of Infinity](#)," *Journal of Political Economy*, Vol. 79(5), September/October 1971, 1002-1011. (Appears in Spanish as "Notas sobre las economías del infinito" (translation by M. Santos), *Cuadernos Economicos de I.C.E.*, Vol. 35(1), 1987, 31-39.)

David Gale, "[Pure Exchange Equilibrium of Dynamic Economic Models](#)," *Journal of Economic Theory*, Vol. 6(1), February 1973, 12-36.

David Cass, Masahiro Okuno and Itzhak Zilcha, "[The Role of Money in Supporting the Pareto Optimality of Competitive Equilibrium in Consumption-Loan Type Models](#)," *Journal of Economic Theory*, Vol. 20(1), February 1979, 41-80.

Yves Balasko and Karl Shell, "[The Overlapping-Generations Model, I: The Case of Pure Exchange without Money](#)," *Journal of Economic Theory*, Vol. 23(3), December 1980, 281-306.

Yves Balasko and Karl Shell, "[The Overlapping-Generations Model, II: The Case of Pure Exchange with Money](#)," *Journal of Economic Theory*, Vol. 24(1), February

1981, 112-142. See also "Erratum," *Journal of Economic Theory*, Vol. 25(3), December 1981, 471.

Yves Balasko and Karl Shell, "[Lump-Sum Taxes and Transfers: Public Debt in the Overlapping-Generations Model](#)," in *Essays in Honor of Kenneth J. Arrow*, Vol. II: Equilibrium Analysis (W. Heller, R. Starr, and D. Starrett, eds.), New York: Cambridge University Press, 1986, Chapter 5, 121-153.

Karl Shell, "[Monnaie et Allocation Intertemporelle](#)," [title and abstract in French, text in English] mimeo, Séminaire d'Econométrie Roy-Malinvaut, Centre National de la Recherche Scientifique, Paris, November 21, 1977. (Forthcoming in *Macroeconomic Dynamics*.)

Costas Azariadis, "[Self-Fulfilling Prophecies](#)," *Journal of Economic Theory*, Vol. 25(3), December 1981, 380-396.

## E. Growth

R. M. Solow, "[A Contribution to the Theory of Economic Growth](#)," *Quarterly Journal of Economics*, February 1956, 65-94.

D. Cass, "[Optimum Growth in an Aggregative Model of Capital Accumulation](#)," *Review of Economic Studies*, July 1965, 233-240.

K. Shell, "[Toward a Theory of Inventive Activity and Capital Accumulation](#)," *American Economic Review*, May 1966, 62-68.

K. Shell, "[Inventive Activity, Industrial Organization and Economic Growth](#)," in *Models of Economic Growth*, (J. Mirrlees and N. Stern, eds.) Macmillan and Halsted, 1973, 77-100.

P. Romer, "[Increasing Returns and Long-Run Growth](#)," *Journal of Political Economy*, October 1986, 1002-1037.

P. Romer, "[Endogenous Technological Change](#)," *Journal of Political Economy*, October 1990, S71-S102.

K. Shell, "[Applications of Pontryagin's Maximum Principle in Economics](#)" in *Mathematical Systems and Economics*, I (H. W. Kuhn and G. P. Szego, eds.), Berlin: Springer Verlag, 1969, 241-292. (The "Varenna Lectures.")

K. Shell and J. Stiglitz, "[The Allocation of Investment in a Dynamic Economy](#)," *Quarterly Journal of Economics*, Vol. 81(325), November 1967, 592-609.

K. Shell, M. Sidrauski, and J. Stiglitz, "[Capital Gains, Income, and Saving](#)," *The Review of Economic Studies*, Vol. 36(1), No. 105, January 1969, 15-26.

8/31/2009

## **Conference on Financial Fragility: Tentative Schedule**

**Organizers:** Karl Shell (Cornell) and Neil Wallace (Penn State)

Supported by the following at Cornell: The Center for Analytic Economics, the Department of Economics, the Office of the Deputy Provost for the Social Sciences, and the Thorne Research Fund.

**Conference administrators:** Amy Moesch (alg5@cornell.edu), Koralai Kirabaeva (607-280-1759), Max Mihm (607-339-6037), Judit Temesvary (607-592-5875), Yu Zhang (607-220-4025)

**Saturday (9/26/2009), G01 Biotech Building, Cornell University, Ithaca, NY**

8:00 am – 8:45 am      Continental breakfast

8:45 am – 9:00 am      Karl Shell (Cornell), Introduction to Financial Fragility

Morning session chair: Jim Peck (OSU)

9:00 am – 9:50 am      John Geanakoplos (Yale), “Leverage Cycles and the Anxious Economy”

9:50 am – 10:40 am      Todd Keister (NY Fed), “Bailouts and Bank Runs” or “Commitment and Equilibrium Bank Runs”

10:40 am – 11:00 am      Coffee break

11:00 am – 11:50 am      Ed Nosal (Chicago Fed), “Optimal Information Revelation in the Diamond-Dybvig Model: A comment on some recent literature”

Lunch: 11:50am – 1:10 pm

Afternoon session chair: Todd Keister (NY Fed)

1:10 pm – 2:00 pm Phil Dybvig (WUSL), TBA

2:00 pm – 2:50 pm Koralai Kirabaeva (Bank of Canada), TBA

2:50 pm – 3:05 pm Coffee break

3:05 pm – 3:55 pm Julio Rotemberg (Harvard), “Liquidity Needs in Economies with Interconnected Financial Obligations”

3:55 pm – 4:45pm Marie Hoerova (ECB), “Liquidity, Hoarding and Interbank Market Spreads”

7:00 pm Dinner, Ramin Parlor Room, Sage Hall, Cornell University, Ithaca

**Sunday (9/27/2009), G01 Biotech Building, Cornell University, Ithaca, NY**

8:00 am – 9:00 am Continental breakfast

Morning session chair: Marie Hoerova (ECB)

9:00 am – 9:50am Chao Gu (Missouri), “Production, Hidden Actions, and the Payment System”

9:50 am – 10:40 am Randy Wright (Wisconsin), “Information, Liquidity, Asset Prices and Monetary Policy”

10:40 am – 10:55 am Coffee break

10:55am – 11:45am Douglas Gale (NYU), “Rollover Risk and Market Freezes”

11:45 am – 12:35 pm Adam Slawski (Penn State), “Heterogeneous beliefs, learning, and speculative trade in a hidden Markov environment with short sale constraints”

12:35 pm – 2:00pm Box lunch