

Professor Karl Shell
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Economics 732: Monetary Economics II

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Problem Set # 6

Equilibrium Bank Runs

Consider the 2-consumer i.i.d. example from Peck and Shell.

If the propensity to run is $s = 0$ and $y = 3$ trees are deposited, *ex ante* welfare is 0.27396.

What is *ex ante* welfare if $s = 0.005$ and $y = 3$? Assuming $s = 0.005$, how many trees y must be deposited for *ex ante* welfare to be 0.27396?

Let $s = 0.5$. What is *ex ante* welfare? What is the value of y that yields *ex ante* welfare of 0.27396?

y (the quantity of trees) is a nonnegative scalar (not necessarily an integer).

Bank Runs

Write a brief, critical essay on the Diamond-Dybvig-Wallace modelling of financial intermediation.