

Economics 8107

N. R. Kocherlakota
Office: Heller 1160
Phone: 5-3810 or 612-204-5484
e-mail: nkocher@econ.umn.edu
webpage: <http://www.econ.umn.edu/~nkocher/econ8107.htm>

University of Minnesota
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Class Hours: T Th 2:30-3:45
Office Hours: W 1:30-3:30

DESCRIPTION AND REQUIREMENTS

This course is divided into two sections. The first section is an introduction to the theory of asset pricing. In the second part of the course, we study the optimal financing of a given stream of public expenditures, assuming that the government can commit itself a priori to a possibly nonlinear taxation plan.

There is no textbook for the class. However, the relevant sections of Ljungqvist and Sargent, *Recursive Macroeconomic Theory (2nd Edition)* (MIT Press, 2004) (labeled LS below), provide good background.

Throughout the course, I will hand out five problem sets. These will be worth half of your grade. The final exam will account for the rest of your grade. The exam is closed book, closed notes; it will be written on March 7 from 2:30-4:30 pm. You will not be allowed to work with others on the final exam. Problem sets can be done in groups of up to three people.

You should do as many problems as you possibly can - it is the best way to learn the relevant material. I will provide a sample final and (at the end of the course) three sample comp questions. I encourage you to try these under actual test conditions (i.e. alone, with time constraints, and before looking at the answers). The syllabus includes exercises from LS that relate to the material. They are not required, but they are recommended. Sketches of the solutions to the problems from LS are on Thomas Sargent's webpage at <http://homepages.nyu.edu/~ts43/TEACHING/teachingframe.htm>.

The Teaching Assistant for the course is Anderson Schneider.

SYLLABUS

ASSET PRICING

Week 1: Basics of Asset Pricing

L. Hansen and S. Richard, "The Role of Conditioning Information in Deducing Testable Restrictions Implied by Dynamic Asset Pricing Models," *Econometrica* 55, 587-614, 1987.

J. Cochrane and L. Hansen, "Asset Pricing Explorations for Macroeconomics," NBER working paper 4088, 1993.

Weeks 2-3: Asset Pricing in an Arrow-Debreu Economy

LS, Chapters 8, 13

D. Krueger's notes on *Macroeconomic Theory*, pages 14-18,
<http://www.econ.upenn.edu/~dkrueger/PhdLecture.pdf>

T. Gorman, "Community Preference Fields," *Econometrica*, 1953.

G. Constantinides, "Intertemporal Asset Pricing with Heterogeneous Consumers and without Demand Aggregation," *Journal of Business* 55, 253-67, 1982.

LS Exercises: 8.1, 8.2, 8.3, 8.4, 8.5, 8.8, 8.9, 8.10, 13.1, 13.2, 13.3, 13.4

Week 3: Production-Based Asset Pricing

F. Hayashi, "Tobin's Marginal and Average q : A Neoclassical Interpretation," *Econometrica* 50, 213-224, 1982.

R. Hall, "The Stock Market and Capital Accumulation," *American Economic Review* 91, 1185-1202, 2001.

E. McGrattan and E. Prescott, "Is the Stock Market Overvalued?" *Federal Reserve Bank of Minneapolis Quarterly Review*, 2000 (especially Appendix B).

Week 4: Incomplete Markets

N. Gregory Mankiw, "The Equity Premium and the Concentration of Aggregate Shocks," *Journal of Financial Economics* 17, 211-19, 1986.

G. Constantinides and D. Duffie, "Asset Pricing with Heterogeneous Consumers," *Journal of Political Economy* 104, 219-240, 1996.

N. Kocherlakota, "The Equity Premium: It's Still a Puzzle," *Journal of Economic Literature*, 1996.

LS, Chapters 16, 17

LS Exercises: 16.1, 16.2, 16.4, 16.5

DYNAMIC OPTIMAL TAXATION: NONLINEAR TAXES

Week 5: Simple Static Mirrlees Economy

Weeks 6-7: Capital Taxes in a Dynamic Mirrlees Economy

N. Kocherlakota, "Wedges and Taxes," *American Economic Review Papers and Proceedings*, 109-113, 2004.

N. Kocherlakota, "Zero Expected Wealth Taxes: A Mirrlees Approach to Dynamic Optimal Taxation," *Econometrica* 73, 2005.