

DISSERTATION PROPOSAL

Essays on Asset Pricing and the Macroeconomy with Limited Stock Market Participation

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The first essay examines the role of personal and corporate income taxation on asset prices in a general equilibrium model featuring limited stock market participation. Taxes are realistically modeled to redistribute income from stockholders to non-stockholders. An increase in either type of tax raises the Sharpe ratio and equity premium while lowering the risk-free rate. The higher risk premium is due to a general equilibrium mechanism that amplifies stockholder's consumption growth volatility, causing them to demand a higher premium to hold the risky stock.

The second essay (joint with Nam Jong Kim) studies international risk sharing and asset prices in a general equilibrium two-country macroeconomic model that features limited stock market participation, non-traded goods, as well as distribution cost. In contrast to traditional models of the equity premium, our model is consistent with smooth exchange rates while also making substantial progress towards explaining the empirically observed low consumption growth correlation between countries. We argue that both, financial and goods market frictions, are necessary for the model to generate a low correlation of consumption growth between countries. Our results offer insights into the degree of international risk sharing. We find that while international risk sharing seems low as measured by aggregate consumption growth correlations, the model predicts that risk sharing is higher among stock market participants than among non-participants.