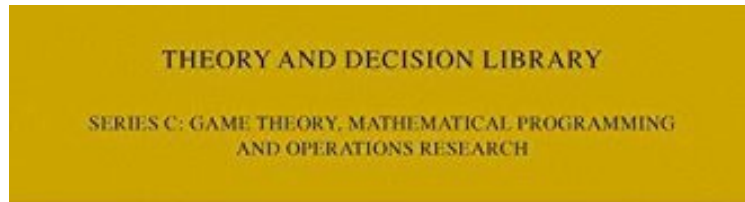


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# General Equilibrium Foundations of Finance: Structure of Incomplete Markets Models (Theory and Decision Library C)

*Thorsten Hens, Beate Pilgrim*  
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THORSTEN HENS AND BEATE PILGRIM  
**GENERAL EQUILIBRIUM  
FOUNDATIONS OF  
FINANCE**

*Structure of Incomplete Markets Models*



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The purpose of this book is to give a sound economic foundation of finance. Finance is a coherent branch of applied economics that is designed to understand financial markets in order to give advice for practical financial decisions. This book argues that for a sound economic foundation of finance the famous general equilibrium model which in its modern form emphasizes the incompleteness of financial markets is well suited. The aim of the book is to demonstrate that financial markets can be meaningfully embedded into a more general system of markets including, for example, commodity markets. The interaction of these markets can be described via the well known notion of a competitive equilibrium. We argue that for a sound foundation this competitive equilibrium should be unique. In a first step we demonstrate that this essential goal cannot be achieved based only on the rationality principle, i. e. on the assumption utility maximization of some utility function subject to the budget constraint. In particular we show that this important lack of structure is disturbing as well for the case of mean-variance utility functions which are the basis of the Capital Asset Pricing Model, one of the cornerstones of finance. The final goal of our book is to give reasonable restrictions on the agents' utility functions which lead to a well determined financial markets model.

About the Author Thorsten Hens, Ph.D. University of Bonn, is professor for financial economics at the institute for empirical research in economics at the University of Zurich. He has held positions in Bielefeld, Paris and Stanford and is currently also an adjunct professor at the Finance Department of the Norwegian Business School, NHH, in Bergen. Beate Pilgrim, Ph.D. University of Bielefeld, is currently working for Reuters AG, Frankfurt.