



**FIRM SIZE  
FINANCIAL  
INTERMEDIATION  
AND  
BUSINESS CYCLES**

**Rajeev Dhawan**

This book is the outcome of a doctoral dissertation program at the University of California, Los Angeles. Its two noteworthy features are, first, the extension of the real business cycle paradigm to incomplete market economies and, second, the use of panel data techniques to estimate parameters of macroeconomic interest. Its focus is on the implications of introducing private information into a real business cycle framework. The analysis has been carried out with the help of a computable stochastic general equilibrium model. The model is calibrated so as to provide precise answers to two issues. One is to assess the welfare costs of credit market imperfection. The other is the study of its effects on the business cycle properties of the model.

Analysis of a large panel of publicly traded U.S. firms for the period 1970-89 reveals the positive role of internal funds on their investment behavior, especially for smaller sized firms. Additionally, the book finds evidence to the fact that small firms outperform large firms with respect to their productivity, profitability and growth, but are also riskier with a higher probability of failure. A striking prediction of the model is that even small credit market frictions have large welfare implications for the economy as a whole. Finally, the model is capable of reproducing the cyclical fluctuations at the aggregate level, especially the *characteristic* of the labor market, namely, the low correlation between real wages and hours worked.

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\$29.95

ISBN 81-7169-373-3

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