

Public Abstract

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The nature and characteristics of changes in economic variables have interested economists for long. This paper is based on the findings of the real business cycle literature. Amongst much regularity observed is the fact that least developed countries experience more drastic changes in their measures of economic activity than developed countries. This study aims to provide an explanation of this phenomenon in the hope that a better understanding of this process can help policymakers to reduce its effects on least developed economies.

This paper describes stylized facts about economic fluctuations at the country level and for all states that compose the United States. Based on the findings it then proposes a model that formalizes the idea that, in the absence of perfect information about government's policies, firms might define production and investment plans that increase output volatility.

The model successfully predicts an increase in volatility in countries in which there is uncertainty about government's policies. The model used is a standard asymmetric information model in which the firm does not know the size of the transfer that it will be required to pay to the government. This lack of information induces the firm to increase the gap between two possible production choices. However, this is only a one period model and this idea should be tested in a model that considers many periods.

The potential of this line of research is significant. If the hypothesis proposed in this paper is correct, then the governments of least developed countries have an opportunity to correct their policies and reduce the impact of excessive economic fluctuations.