

Imperfect Competition, Controls on Capital Inflows, and the Phillips

Curve: Experiences from Taiwan and Brazil

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Abstract

Based on a two-country model, incorporating imperfect competition, country sizes, and controls on capital inflow, this research investigates the trade-off between inflation and unemployment rates. We find that the slope of the Phillips curve increases with the degrees of substitution between goods, the intensity of capital controls but decreases with the country size of domestic country. Especially, when domestic economy is absolutely large, controls on capital inflow might bring stagflation. Based on country experiences of Taiwan and Brazil, from 1989 to 2000, the empirical evidence lends support to our analytical results. With the constructed capital control index, we estimate the effects of capital control intensity on the slope of the Phillips curve over time. Regression results further establish the robustness of our theoretical validity. In that sense, this work provides a new insight into the effects of controls on capital inflows on macroeconomic performance in the context of the Phillips curve

Keywords: Imperfect competition, Controls on capital inflows, Country sizes, the Phillips curve.

JEL classification: F32, F41

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