

ANIMAL SPIRITS, CAPITAL
REPATRIATION AND INVESTMENT

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Abstract In the aftermath of the debt crisis, developing countries are endeavoring to repatriate flight capital and to resume domestic private investment. Yet investment and the associated capital inflows continue to be disappointing and highly uneven over time in many cases. This paper provides a model of investment and capital movements in and out of such countries. Central to the paper is the introduction of fiscal increasing returns to domestic capital into a standard dynamic optimizing model. The resulting system may display multiple steady states and surprising dynamic behavior. A limit cycle may occur around one of the welfare-inferior equilibria. Along that cycle, capital stocks and relative prices display endogenous fluctuations. Moreover, initial conditions and expectations both matter in selecting the equilibrium on which the economy converges. For some initial conditions, "animal spirits" can determine the course of investment and capital flows.

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