

Term Paper Assignment

The term paper assignment requires the submission of a 10-page paper (10 pages pertains to *text* of paper, does not include graphs/tables/references), due by 5PM, Tuesday, December 15th, delivered electronically (in PDF, or if necessary Word format). You can choose among several different topics discussed below, or you may select an alternative if there is a specific issue-area of the crisis that you wish to investigate further. Such topics, however, should be discussed with me before proceeding.

You should structure the paper as a formal academic paper, with introduction, statement of problem, analysis of causes (and remedies if you wish), and conclusion. In addition, a cover page, with name, paper title, abstract, and contact relevant information (not included in the page count) should be included.

If the paper is empirically focused, then cases studies or empirical analyses should be used to buttress your arguments. Use tables and graphs where necessary. *Do not cut and paste these tables and graphs from other sources; generate your own graphs and tables. Proper citation of source materials must be made.* In addition, you should feel free to conduct your own statistical analyses, if you believe that would be helpful in supporting your case.

You should feel free to *consult* certain weblogs (Econbrowser, *WSJ* RealTime Economics, CBO Blog, Calculated Risk), and op-eds to get ideas and links to documents, **but do not cite weblog posts as references.** Also, do not cite lecture notes. I would encourage use the usual policy organization sources (including IMF, OECD, BIS, Federal Reserve Board working papers), and NBER working papers.

The evaluation of the paper will be based upon the following:

1. How well is the paper organized, and how clear it is in terms of exposition.
2. How well persuasive your arguments are, including the use of models to analyze the situation.
3. How well your discussion of remedies fit in with the analysis you present (if you propose such remedies).

Topic 1: The Expectations Hypothesis of the Term Structure and the Business Cycle

The expectations hypothesis of the term structure (both narrowly defined and including the liquidity premium) is a key concept in finance. Your paper should examine some or several of the following questions:

- What is the empirical evidence regarding the usefulness of the expectations hypothesis of the term structure (EHTS) for explaining future spot interest rates?
- Has the decrease in long term interest rates been due primarily to low expected future short term rates, or a decrease in the term premium?
- How well does the EHTS explain future recessions in the United States and/or across countries?

A suggested background paper/source: http://www.ssc.wisc.edu/~mchinn/Chinn_Kucko_IF2015.pdf This paper topic is amenable to empirical work.

Topic 2: Why Are Interest Rates So Low?

With the United States economy recovering, and the Fed planning its exit strategy from quantitative/credit easing, the big surprise over the past year has been the sustained low nominal and real interest rates. In your analysis,

- Document trends in interest rates
- Explain the competing theories for the determination of interest rates
- And use data and/or econometric analyses to explain what your preferred explanation.

A suggested background paper/source: Kitchen and Chinn (*Int'l Finance*, 2012), and IMF *World Economic Outlook* (April 2014). See also Teulings and Baldwin, *Secular Stagnation* (2014), http://www.voxeu.org/sites/default/files/Vox_secular_stagnation.pdf

Topic 3: Causes of the Asset Boom and Bust of the 2000's

There are several different interpretations of the asset boom that preceded the current recession. They include monetary (lax Fed policy propagated to the rest-of-the-world), excess saving flow from East Asia and oil exporters, and lax regulation/financial innovation. Your paper should examine one or both of the following questions:

- What are the theoretical models underpinning each explanation?
- What is the empirical evidence on each competing view?

In your analysis, use of data, and support from econometric studies, will be essential. In-depth studies from the Bank for International Settlements, the IMF *WEO* and *GFSR*, as well as working papers, will be useful. Some references are also included in Chinn and Frieden, *Lost Decades*.

Additional suggested background papers/sources:

http://www.ssc.wisc.edu/~mchinn/imbalance_paper.pdf ;

http://www.stanford.edu/~johntayl/2010_pdfs/Origins_and_Policy_Implications_of_the_Crisis.pdf ;

Topic 4: Post-Crisis Financial Regulation

Discuss the rationale for the various components of the Dodd-Frank financial regulation legislation, as well as the Basel III accords. Your paper should examine one or several of the following questions:

- What are the major components of the legislation?
- What aspects of the regulatory framework still need to be implemented?
- Will the measures “work” to reduce the incidence and costs of financial crises?
- Will there be any negative consequences of the legislation and/or Basel III accords?

Suggested background papers/sources:

<http://www.princeton.edu/~markus/research/papers/Geneva11.pdf>

<http://www.voxeu.org/content/dodd-frank-one-year>
<http://pubs.aeaweb.org/doi/pdfplus/10.1257/jep.27.4.45>

Some additional references are also included in Chinn and Frieden, *Lost Decades*.

Topic 5: Exiting Unconventional Monetary Policies

Discuss the potential challenges involved in exiting unconventional monetary policies, either in one country (the United States), or the set of countries (US, Euro area, UK):

- What measures have been implemented? And what has been the likely effect?
- What should determine the timing of the exit?
- Should the exit involve slow or rapid reduction in the central bank(s) balance sheet(s)?
- What is the role for extended guidance?
- In the case of the US, what should be the policy rate or rates going forward?

Suggested background papers/sources:

<http://research.stlouisfed.org/publications/review/13/01/Fawley.pdf>
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1576596
http://www.ssc.wisc.edu/~mchinn/monetarypolicy_postcrisis_JEP2015.pdf

Also see various publications in the Federal Reserve System.

Topic 6: Should Monetary Policy Target Asset Booms?

From the mid-1980s until the financial crisis of 2007, most central banks in industrial countries have followed some version of the Taylor rule, wherein the policy interest rate (in the US, the Fed funds rate) is response to changes in inflation and the output gaps. Should this approach be amended? In your paper, you might wish to discuss:

- What are the variants of the Taylor rule?
- Did deviation from the Taylor rule cause the housing boom in the United States?
- Would modification of the Taylor rule to incorporate an asset price address the problem of financial crises? If so, what asset price should be targeted, and how?

Suggested background papers/sources:

<http://onlinelibrary.wiley.com/doi/10.1111/1468-2362.00092/pdf>
<http://fic.wharton.upenn.edu/fic/papers/11/11-39.pdf>

Topic 7: Are Recoveries from Balance Sheet/Financial Crises-Induced Recessions Different

The financial crisis of 2007-08, and ensuing recession, differed from most US recessions in that it involved a systemic crisis in the financial system and a housing bust. Some economists have asserted that recoveries from such events are usually slower than those accompanying monetary-induced recessions. In your paper, discuss:

- What are the characteristics of balance sheet-financial crises?
- Are recoveries from such crises/recessions slower than those of a standard recession?
- Does the crisis of 2007-08 conform to this description?

Why are recoveries from such crises/recession typically slower; i.e., what are the economic mechanisms that explain this outcome?

Suggested background papers/sources:

Carmen Reinhart and Kenneth Rogoff, *This Time Is Different: Eight Centuries of Financial Folly* (Princeton University Press, 2009). (Much of the material can be found in NBER Working Papers, authored by Reinhart and Rogoff).

<http://www.frbsf.org/publications/economics/papers/2011/wp11-27bk.pdf>

<http://www.nber.org/papers/w18194> . This paper topic is amenable to empirical work.