Public Affairs 854
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University of Wisconsin-Madison

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Social Sciences 7418

Term Paper Assignment

The term paper assignment requires the submission of a 15-page paper, due by 5PM, Tuesday, December 15th, electronically (in PDF or, if necessary, Word format). You can choose among three different topics discussed below, or you may select an alternative if there is a specific area of international macroeconomics that you wish to investigate further. However, the risk of choosing an alternative topic is that you will not have the benefit of the explicit guidelines and suggestions that I outline below.

It might be helpful in structuring this paper to pretend that you are a senior economist at the U.S. Treasury Department (topic 1 or 2) or the Ministry of Finance (topic 3) of a given country, and you are writing this as a memo to the Assistant Secretary of Treasury for International Affairs (or equivalent) to give him/her background on one of the topics outlined below.

The memo should be structured as follows:
1. Brief introduction and current situation
2. Analysis
3. Policy options (with analysis of likely outcomes) and recommendations

The memo should also incorporate informational graphs (with data) and tables **if useful**. Analytical graphs (such as supply and demand figures) are not typically used in memos.

Since it is not usually standard practice to "cut and paste" tables and graphs from other documents into official memos, you should strive to generate your own graphs and tables. Data sources are located on the course website (including FRED), as well as on campus (Data and Information Services Center in the Social Sciences Building, http://www.disc.wisc.edu/ http://www.disc.wisc.edu/).

In addition, follow the usually conventions: include page numbers, label sources for tables and graphs, and list references.

You should feel free to consult certain weblogs (Econbrowser, *WSJ* RealTime Economics, CBO Blog, Economists View blog), to get ideas and links to documents, **but do not cite weblog posts as references.** Also, do not cite lecture notes.

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 the situation is summarized (including the use of statistics and graphs).
3. How well models are used to analyze the situation.
4. How well your policy recommendations fit in with the analysis you present.

<u>Topic 1: External Influences on the US Economy</u>

Given the tentative nature of the economic recovery, and the threat from growth deceleration in China and Europe, discuss the options that face U.S. policymakers.

The paper should address the following questions:
1. What is the current state of the US economy
2. What are the implications of a Fed rate rise for economic growth?

3. What policies should we encourage our economic partners to pursue?
4. Be sure to address the implications of your policy recommendations for output, unemployment, interest rates, as well as inflation and the trade balance.

There are many sources for this topic. I suggest you consult the links on the course website. In addition, there are materials on the IMF, the Federal Reserve Board (and the Federal Reserve Banks), the OECD and CBO websites, among others.

Topic 2: The Yuan

The Chinese exchange rate (called the "yuan", or sometimes the "Renminbi") has been a contentious issue over the past several years, especially against the context of a wide bilateral trade deficit with the US. However, over the past year, the Chinese trade balance has shrunk considerably as a share of Chinese GDP, Chinese reserves have declined, and financial capital outflows have increased.

In your memo, you should discuss the following issues:

1. The effect of the current value, and trajectory, of the *Yuan* on the US and world economies.

2. The theoretical arguments for changes to the Chinese exchange rate regime, including accelerated revaluation and/or allowing a free float, given the currently fragile nature of the Chinese economy.

3. The implications for the US economy of such changes. What will happen to the value of the dollar against the yuan if China goes on a free float? What would be the implications for the ability of the U.S. government to borrow?

4. The possible consequences for the Chinese economy, and the other economies in the region (Japan, Korea, Thailand).

Topic 3: Emerging Market Responses to Capital Outflows

The two speed world economy that dominated after the global financial crisis -- emerging market economy growth far outpacing advanced economy - (US, Japan, Eurozone) growth – is reversing. Now, the US seems to be the only consistent source of world growth, and with US interest rates likely to rise. This combination has led to a reversal of the surge of financial capital to the emerging markets (the "taper tantrum" is an example of this), and the problems of the "Fragile Five".

Your main readings for this paper should be Chapter 16 of our textbook (Chapter 24 of Caves, Frankel and Jones), as well as various readings from the IMF's *World Economic Outlook.*

Your paper should try to address these questions (perhaps selecting a given country, preferably one such as Brazil, Russia, India, or South Africa):

1. How should an emerging market economy respond to capital outflows (if they should at all) with monetary, fiscal and exchange rate policies?
2. Are capital controls a useful adjunct to conventional policies in stemming capital outflows?

3. How do measures in the advanced economies (the reversal of unconventional monetary policies, austerity or stimulus) complicate the economic management of an emerging market economy?

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