

### **Term Paper Assignment**

The term paper assignment requires the submission of a 15-page paper, due by 5PM, Friday, May 11, in my mailbox, or (preferably) electronically (in PDF, or if necessary Word). 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 staff member at the U.S. Treasury Department, and you are writing this as a memo to the Assistant Secretary of Treasury for International Affairs to give him 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, as well as on campus (Data and Information Services Center in the Social Sciences Building).

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

#### **Topic 1: U.S. Macroeconomic Policy and “Global Rebalancing”**

Many have argued that in recent years, the trade deficit is “too large”, and that part of the reason for this large trade deficit has been an “overvalued” dollar. This means the price of foreign currency is too low.

This paper should address the following questions:

1. What are the implications of chronic US current account deficits? How is this question linked to the issue of “sustainability”?
2. Should policy be used to attempt to lower the value of the dollar (raise the dollar exchange rate)?
3. Should monetary policy be devoted toward that task, or should it be attempted through “sterilized intervention”?
4. What are the implications for the rest of the world’s major economies, most importantly the Euro area and Japan? What will be the effect upon the less developed countries?

In addition to our textbook, the readings in the following text should provide you with all the information you need. A warning, though: this is somewhat difficult material.

- Bergsten, C. Fred, and John Williamson, eds., 2004, *Dollar Adjustment: How Far? Against What?* Special Report 17 (Washington, DC: Institute for International Economics). Available for purchase from <http://www.iie.com> .
- Chinn, Menzie, 2005, "Getting Serious about the Twin Deficits," *Council Special Report* No. 10 (New York: Council on Foreign Relations, September).  
[http://www.cfr.org/content/publications/attachments/Twin\\_DeficitsTF.pdf](http://www.cfr.org/content/publications/attachments/Twin_DeficitsTF.pdf)

There is also some policy related literature on the UW/WAGE current account sustainability website, at <http://currentaccount.lafollette.wisc.edu> .

### **Topic 2: RMB "Misalignment"**

The exchange rate of the RMB has been a contentious issue over the past several years, especially against the context of a wide bilateral trade deficit.

In your memo, you should discuss the following issues:

1. The effect of the current value of the *Renminbi* (Rmb) on the US and world economy.
2. The theoretical arguments for changes to the Chinese exchange rate regime, including revaluation and allowing a free float.
3. The implications for the US economy. Will a change in a bilateral exchange rate necessarily change the overall US trade deficit? Will the dollar necessarily weaken against the yuan?
4. The possible consequences for the Chinese economy, and the other economies in the region (Japan, Korea, Thailand).
5. The ability of the U.S. government to influence the Chinese government's stance on this issue.

Your main readings for this are to be found on the following website:

<http://www.ssc.wisc.edu/~mchinn/RMB.html>

See also the sections in the 2004 and 2006 *Economic Report of the President* on this topic.

### **Topic 3: The IMF and Emerging Market Crises**

(Note: This is a difficult topic, which will require you to read – and cover -- lots of material. On the other hand, the memo will be somewhat less quantitative in nature, due to the topic.) The emerging market crises, including the East Asian crises of 1997-98, the Russian Crisis of 1998, and the Argentine experience, have provoked a lot of thought and research. Here I want you to focus on what we have learned from these crises about the role of the IMF:

Was the response by the International Monetary Fund appropriate? What lessons can the IMF learn for how to respond to crises in the future? Is there a case for diminishing the role of the IMF and building some sort of new international financial architecture to deal with crises?

Your main readings for this paper should be Chapter 24 of our textbook as well as Blustein, Paul, 2001, *The Chastening* (Public Affairs) as well as his 2005 *And the Money Kept Rolling In (and Out): Wall Street, the IMF, and the Bankrupting of Argentina* (Public Affairs).

Your paper should try to address these questions:

1. How was the IMF response to the crises in Korea, Russia, and Argentina different in each case? How did the IMF adjust its policy recommendations as it learned from its mistakes?
2. What policies were most successful? What policies were successful but at a high cost? What policies were unsuccessful?
3. How might the crisis have played out if there were no IMF or global financial institution? Would there even have been a crisis?
4. Within its existing framework, what could the IMF do better?

Here are some suggestions for further reading:

- “IMF-Supported Programs in Indonesia, Korea and Thailand,” *IMF Occasional Paper No. 178* (1999).
- Cooper, Richard N., 2002, “Chapter 11 for Countries?” *Foreign Affairs* 81(4): 90-103.
- Kenneth Kletzer, 2004, “Resolving Sovereign Debt Crises with Collective Action Clauses,” *FRBSF Economic Letter* 2004-06 (February 20).
- Stiglitz, Joseph E., 2002, *Globalization and Its Discontents*, (W.W. Norton).

More exhaustive analyses:

- Roubini, Nouriel and Brad Setser, *Bailouts or Bail-ins? Responding to Financial Crises in Emerging Economies* (Washington, DC: Institute for International Economics, 2004).
- Peter Isard, *Globalization and the International Financial System: What’s Wrong and What Can Be Done* (Cambridge, Cambridge University Press, 2005).
- Reports of the Independent Evaluation Office of the IMF:  
<http://www.imf.org/external/np/ieo/index.htm> .