

**Question 5**

- a) Describe the two main schools of thought in the literature about the role of fiscal policy in the economy. **(10 marks)**
- b) Delineate the Ricardian Equivalence proposition. **(5 marks)**
- c) Describe how coordination between fiscal and monetary policies is implemented in Swaziland. In your opinion, is this coordination important? Explain. **(10 marks)**

**Question 1 (Compulsory) Total marks 40**

- a) Various steps are followed in determining of a monetary policy framework. Outline these steps. **(10 marks)**
- b) Outline two main arguments in favour of a discretionary monetary policy regime. **(5 marks)**
- c) Independence, accountability and transparency are important institutional arrangements necessary for proper operation of the Central Bank of Swaziland (CBS). Define each of these concepts as they relate to the CBS. Explain their importance as well. **(10 marks)**
- d) Presented here is Theil's Social welfare function:  $Z = b(U - U^*)^2 + (\pi - \pi^*)^2$ .
  - i) Define all the variables in the equation above. **(5 marks)**
  - ii) Explain what the function shows and indicate the main conclusions derived from this function. **(10 marks)**

**Question 2**

- a) Discuss the three main causes of financial instability. **(10 marks)**
- b) Why is the maintenance of financial stability crucial for the CBS? **(5 marks)**
- c) Differentiate between the gold standard and the gold exchange standard. What led to the collapse of each of these international monetary systems? **(10 marks)**

**Question 3**

- a) Outline the main features of the Mundell-Fleming model. State all relevant equations. **(10 marks)**
- b) What were the main causes of the collapse of the Bretton Woods International monetary system? **(5 marks)**
- c) The equation for the Taylor rule can be stated as follows:

$$i_t = \pi_{t-1} + (i_t - \pi_t)^* + \alpha(\pi - \pi^*)_{t-1} + \beta \frac{Y - Y^*}{Y^*_{t-1}}$$

Define each of the variables and where applicable state the sizes of some of these variables. Explain what this equation represents. Outline the criticism levelled against this rule. **(10 marks)**

**Question 4**

- a) Using a graph, show and explain the effect of an expansionary monetary policy in a flexible exchange rate regime with imperfect capital mobility. **(12.5 marks)**
- b) Repeat part a) above assuming that capital is perfectly mobile. **(12.5 marks)**

**UNIVERSITY OF SWAZILAND  
FACULTY OF SOCIAL SCIENCE  
DEPARTMENT OF ECONOMICS**

**MAIN EXAMINATION**

**MAY 2014**

TITLE OF PAPER: MONETARY POLICY

COURSE CODE: ECON 404

TIME ALLOWED: THREE (3) HOURS

INSTRUCTION: ANSWER QUESTION **ONE (COMPULSORY)**  
AND ANY OTHER **THREE** QUESTIONS.

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