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Question 14 (Answer: **B**)

- The quantity theory is $MV = PQ$.
- Assuming velocity and real output are constant, a change in the money supply changes the price level proportionately.
- So it predicts that monetary growth causes inflation – it is about M and P, not about liquidity preference.

Question 15 (Answer: **A**)

- Keynes argued that at very low interest rates people hold money rather than bonds – the liquidity trap.
- Monetary policy then cannot lower rates any further, so it becomes ineffective.
- Markets always clearing, and full employment as the norm, are *classical* propositions instead.

Question 21 (Answer: **C**)

- Lower investment means lower aggregate demand and so lower output.
- That reduces incomes and tax revenue while raising benefit payments.
- So the budget deficit worsens, and less investment also reduces future productive capacity.

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Question 13 (Answer: **B**)

- The money supply falls when banks lend less or when money is withdrawn from circulation.
- Holding money as *idle* balances rather than spending it reduces the money actually circulating.
- A *lower* required liquidity ratio would let banks lend more, which increases the money supply.

Question 19 (Answer: **A**)

- The active (transactions) demand for money depends on the value and frequency of transactions.
- Being paid more often means less needs to be held between pay days, so demand falls.
- A higher price level would raise the money needed for the same real transactions, shifting demand right.

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Question 14 (Answer: **A**)

- An increase in the money supply lowers the interest rate along the liquidity preference curve.
- But in a liquidity trap the LP curve is horizontal, so the rate cannot fall further.
- Monetary policy is then ineffective, however much money is added.

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Question 20 (Answer: **B**)

- The liquidity preference curve shifts when the demand for money changes at every interest rate.
- A higher price level or higher national income raises the transactions demand for money.
- So the curve shifts right; a change in the interest rate alone just moves along it.

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Question 22 (Answer: **D**)

- Indirect taxes are collected when goods and services are bought and sold.
- So the policy works best when transactions are recorded and pass through formal markets.
- Bartering and an informal economy both hide transactions, which would *reduce* the revenue collected.