**Economic and Environmental Policy:**

**Contributing to Prosperity**

**Multiple Choice**

1. In *The Wealth of Nations* (1776), Adam Smith made all of the following arguments for *laissez-faire* capitalism except

a. the desire for profit is the invisible hand that guides a capitalist system.

b. the government should not be allowed any role whatsoever in the economy.

c. private firms should be left alone to make their production and distribution decisions.

d. when demand for a good increases, producers will respond by increasing production; when demand for a good falls, producers will cut back on its production.

1. certain areas of the economy were better-run by government agencies.

Answer: b

2. Which of the following statements best describes the relationship today between government and the economy in the United States?

a. The economy is largely self-regulating.

b. The government subsidizes economic interests but otherwise leaves them to operate as they please.

c. The government is the driving force in the U.S. economy; business has a secondary role.

d. The government has an important role in regulating and maintaining the U.S. economy.

1. The government owns most of the means of production in the United States.

Answer: d

3. The six stages of interactions between political actors that lead to the emergence and resolution of public policy issues is called

a. the fiscal-policy process.

b. the monetary-policy process.

c. the budgetary process.

d. the public-policy process.

1. the governmental process.

Answer: d

4. Economic efficiency requires

a. that the free market not be regulated by government.

b. firms to fulfill as many of society’s needs by using as few of its resources as possible.

c. the economy to be organized around large firms.

d. economic transactions to be fair to each party.

1. economic transactions to be equal to each party.

Answer: b

5. Regulation of the economy by the government for reasons of efficiency is justified when

a. there is restraint of trade or monopoly.

b. impure food or drugs are being sold.

c. business bankruptcies hurt investors and consumers.

d. there are disruptive labor strikes.

1. All of the answers are correct.

Answer: a

6. The term externality refers to

a. regulations imposed on a firm by government.

b. a nation that is a trading partner of another nation.

c. unpaid costs of production which are incurred by society.

d. tariffs imposed on American goods exported to other countries.

1. None of the answers are correct.

Answer: c

7. The key issue of regulatory policy is

a. the great amount of paperwork (red tape).

b. whether the costs imposed by regulation on business outweigh its potential benefits.

c. whether corporate and consumer interests are equally represented on regulatory commissions.

d. whether it has bipartisan support in Congress.

1. whether the commissioners’ opinion about a policy is unanimous.

Answer: b

8. The Enron bankruptcy case of 2001 is evidence that

a. the free-market principle has its limits.

b. under-regulation can result in harmful business practices.

c. some top executives engage in unethical practices.

d. workers are vulnerable to unscrupulous executives.

1. All of the answers are correct.

Answer: e

9. A ruling by the Food and Drug Administration that a drug is dangerous to use and therefore cannot be marketed is an example of regulation for the purpose of

a. supply-side safety.

b. demand-side safety.

c. equity.

d. efficiency.

1. profit.

Answer: c

10. The era of New Social Regulation, which addressed issues such as the environment and worker safety, differed from the previous two eras of regulatory reform in that

a. the Republican party took the lead in placing additional regulations on business.

b. the aim was to regulate activities of firms of many types, not just those in a particular industry.

c. the regulatory agencies were established in a way that prevented the president from having a role in their operations.

d. the guiding principle was self-regulation—business was given wide leeway in deciding how it would comply with the new requirement.

1. the guiding principle was overregulation—business would be allowed almost no leeway in deciding how it would comply with new regulations.

Answer: b

11. Government benefits for business include all of the following except

a. low-interest loans and government-guaranteed loans.

b. corporate tax breaks.

c. a national transportation system.

d. minimum-wage laws.

1. corporate tax cuts.

Answer: d

12. Judged in the context of the full range of public policies, the government in the United States has been

a. equally hostile to the interests of business and labor.

b. equally supportive of the interests of business and labor.

c. substantially more supportive of business than labor.

d. substantially more supportive of labor than business.

1. substantially more supportive of left-wing radicals than conservatives.

Answer: c

13. Government support for agriculture in the form of price supports and income subsidies is designed primarily to

a. increase farm production in order to meet the nation’s food needs.

b. stabilize farm income, which would otherwise fluctuate greatly due to market and weather conditions.

c. promote farm conservation so as to preserve the productive capacity of U.S. agriculture.

d. encourage rural development.

1. encourage urban development.

Answer: b

14. Fiscal policy is a mechanism which the government employs to influence the economy. Fiscal policy is based on

a. the idea that a balanced budget is the key to a healthy economy.

b. the money supply.

c. the government’s taxing and spending decisions.

d. the importance of maintaining a 12-month (fiscal year) economic cycle.

1. the projections of the Federal Reserve Board.

Answer: c

15. In John Maynard Keynes’ demand-side economic theory, an economic recession can be shortened through

a. government spending programs.

b. the natural workings of the free-market system.

c. a lowering of tariffs in the global economy.

d. a determination on the part of government not to spend any more than it receives in taxes.

1. tax cuts for the wealthy.

Answer: a

16. Supply-side economics during the Ronald Reagan and George W. Bush presidencies included

a. the supply component of the supply-demand equation.

b. stressing the importance of tax cuts for businesses.

c. stressing the importance of tax cuts for the wealthy.

d. an increase in the size of the national debt.

1. All of the answers are correct.

Answer: e

17. A fiscal-policy solution to inflation would be to

a. increase government spending.

b. lower tariffs and other barriers to trade.

c. increase the tax rate.

d. raise the discount rate.

1. decrease the tax rate.

Answer: c

19. The stages of the public policy process normally develop in a particular order. Which of the following sequences has three of those stages in their usual chronological order?

a. problem recognition, policy implementation, policy adoption.

b. political transformation, policy adoption, policy evaluation.

c. policy formulation, policy evaluation, policy adoption.

d. political transformation, policy evaluation, problem recognition.

1. problem recognition, policy evaluation, political transformation.

Answer: c

20. In a recent global survey, the United States ranked ahead of \_\_\_\_\_\_\_\_ in economic growth competitiveness.

a. Great Britain

b. Canada

c. Germany

d. Japan

1. All of the answers are correct.

Answer: e

21. Monetary policy includes all of the following assumptions except

a. control of the money supply is the key to sustaining a healthy economy.

b. too little money in circulation contributes to inflation.

c. too little money in circulation contributes to a slowdown in consumer buying.

d. too little money in circulation contributes to a slowdown in production.

1. too little money in circulation contributes to a slowdown in borrowing.

Answer: b

22. The Federal Reserve controls the money supply through the following action:

a. buying or selling surplus agricultural goods.

b. lowering or raising interest rates.

c. lowering or raising tax rates.

d. lowering or raising tariffs.

e. lowering or raising government spending.

Answer: b

23. Monetary policy differs from fiscal policy in all respects except

a. the decision-making process through which policy is made.

b. the speed with which policy can be implemented.

c. the extent to which the policymakers are subject to political pressure and accountability.

d. the broad economic goals the policy is expected to promote.

1. None of the answers are correct.

Answer: d

24. \_\_\_\_\_\_\_\_ wrote *Silent Spring* in 1962.

a. Al Gore

b. George W. Bush

c. Greenpeace

d. Rachel Carson

1. The Sierra Club

Answer: d

25. A major controversy surrounding the Federal Reserve’s role in economic policy is

a. the Fed’s political accountability.

b. whether the president should be able to veto the Fed’s decisions.

c. the issue of competence.

d. whether Congress should be able to reject the Fed’s decisions.

1. None of the answers are correct.

Answer: a

26. Advocates of deregulation are primarily concerned with

a. efficiency.

b. equity.

c. externalities.

d. public safety.

1. political expediency.

Answer: a

27. Which of the following is true about the Kyoto Agreement?

a. The United States is the largest single producer of greenhouse emissions in the world.

b. President George W. Bush refused to sign the accord.

c. It established targets that countries would meet to help reduce carbon emissions.

d. Senator John McCain supported it.

1. All of the answers are correct.

Answer: e

28. President Franklin Roosevelt’s methods of restoring the economy’s health after the Depression were closest to the economic position of

a. Adam Smith.

b. John Maynard Keynes.

c. Karl Marx.

d. Alan Greenspan.

1. Milton Friedman.

Answer: b

29. Why did the federal surplus disappear after 2001?

a. economic downturn

b. costs associated with the war on terrorism

c. cut in federal taxes

d. All of the answers are correct.

1. None of the answers are correct.

Answer: d

30. If the economic problem is low productivity and high unemployment, the fiscal policy action on the demand side would be to

a. increase taxes.

b. cut business taxes.

c. increase spending.

d. decrease spending.

1. None of the answers are correct.

Answer: c

31. Historically, a first step taken by the government toward the regulation of business trusts was the

a. Taft-Hartley Act.

b. Sherman Anti-Trust Act.

c. Environmental Protection Act.

d. Mann-Elkins Act.

1. Homestead Act.

Answer: b

32. In terms of the contribution of individual income taxes and corporate income taxes to the federal government’s revenues, it is accurate to say

a. at one time, corporate income taxes and personal income taxes contributed almost equally to government revenues.

b. today, corporate income taxes contribute substantially more to government revenues than individual income taxes do.

c. today, individual income taxes contribute substantially more to government revenues than corporate income taxes do.

d. at one time, corporate income taxes and personal income taxes contributed almost equally to government revenues; today, corporate income taxes contribute substantially more to government revenues than individual income taxes do.

e. at one time, corporate income taxes and personal income taxes contributed almost equally to government revenues; today, individual income taxes contribute substantially more to government revenues than corporate income taxes do.

Answer: e

33. \_\_\_\_\_\_\_\_ assists the president in creating the annual budgetary proposal to Congress.

a. The U.S. Treasury Department

b. The Federal Reserve Board

c. The Congressional Budget Office

d. The Council of Economic Advisers

1. The Office of Management and Budget

Answer: e

34. Democrats in Washington have usually responded to high levels of unemployment with

a. reduced government spending.

b. increased government spending.

c. increased government taxes.

d. decreased government taxes.

1. decreased government regulation.

Answer: b

35. Which is true regarding the nation’s environmental policy?

a. The first major steps by the national government to clean up the environment began in the early 1900s.

b. A majority of the public is sympathetic with the goals of environmentalism.

c. The modern environmental movement gained impetus with the publication of *Armageddon* in 1949.

d. In the 1960s, the government began a policy of land conservation through the creation of national parks.

1. Residents of most neighborhoods are eager to have waste dumps and other such facilities in their neighborhoods because of the high-paying jobs that accompanying these facilities.

Answer: b

36. Which of the following is correct about environmental policy?

a. The national parks are subject to a dual-use policy of preservation and the extraction of timber, oil, and other natural resources.

b. The Environmental Protection Agency was elevated to cabinet status in 1998 by President Clinton and the Republican Congress.

c. Environmental regulation has done little to improve air and water quality.

d. Policymakers always give more consideration to environmental protection than to economic development when the two conflict.

1. None of the answers are correct.

Answer: a

37. The \_\_\_\_\_\_\_\_ established minimum wages, maximum working hours, and constraints on the use of child labor.

a. Securities and Exchange Act of 1934

b. Banking Act of 1934

c. Airlines Deregulation Act of 1977

d. Fair Labor Standards Act of 1938

1. Homestead Act of 1862

Answer: d

38. The Fed is a preeminent example of \_\_\_\_\_\_\_\_ politics at work.

a. pluralist

b. elitist

c. majoritarian

d. Republican

1. Democratic

Answer: b

39. What effect have environmental regulations had on the quality of the environment?

a. The environment is no better than it was during the 1960s.

b. The environment is actually worse than it was during the 1960s.

c. The environment is much cleaner now than it was during the 1960s.

d. The environment is now so free of pollution that further regulatory activity would not be cost-effective.

1. None of the answers are correct.

Answer: c

40. In general, the rate of inflation during the past two decades has

a. been high enough that it has continually hurt economic growth.

b. been quite high, but not so high as to cripple the economy.

c. stayed at about the level that policymakers want it to be.

d. been so low that policymakers have worried that an economic depression could occur.

1. been so low that capital markets have suffered substantially.

Answer: c

41. The Federal Reserve System

a. is run by the Office of Management and Budget.

b. is run by the Congressional Budget Office.

c. regulates only national banks.

d. was created specifically to conduct fiscal policy.

1. None of the answers are correct.

Answer: e

42. Earth Day was the brainchild of Senator

a. Ted Kennedy.

b. Robert Byrd.

c. Mike Mansfield.

d. Ted Stevens.

1. Gaylord Nelson

Answer: e

43. Keynesian economics emphasizes \_\_\_\_\_\_\_\_ as a means of stimulating the economy in order to bring about the end of an economic recession or depression.

a. reduced taxes

b. increased government spending

c. decreased regulation

d. decreased inflation

1. increased taxes

Answer: b

44. Supply-side economics is based primarily on

a. stimulation of the business (supply) component.

b. government stimulation of consumer demands.

c. a repudiation of trickle-down theory.

d. increases in taxation.

1. increases in government regulation.

Answer: a

45. The Federal Reserve is most directly charged with establishing \_\_\_\_\_\_\_\_ policy.

a. monetary

b. military

c. fiscal

d. budgetary

1. security

Answer: a

46. Which country produces the largest proportion of the world’s greenhouse gas emissions, which are a cause of global warming?

a. Brazil

b. Russia

c. China

d. United States

1. India

Answer: d

47. The first national park was created at \_\_\_\_\_\_\_\_ in 1872.

a. Acadia

b. Yellowstone

c. Yosemite

d. Mammoth Cave

1. the Grand Canyon

Answer: b

48. The tax cut signed by President George W. Bush in 2001 was premised largely on

a. demand-side economics.

b. supply-side economics.

c. fiscal policy.

d. monetary policy.

1. Keynesian economics.

Answer: b

**Essay/Short Answer**

1. Describe the major differences between the *laissez-faire* and collectivist models of economics.

Answer: *Laissez-faire* capitalism holds that private individuals and firms should be left alone to make their own production and distribution decisions. As argued by Adam Smith in *The Wealth of Nations* (1776), demand for a good or service will result in it being provided by the private sector, while a decline in demand will result in a cutback in supply. The incentive that drives this process is profit. According to Smith, the desire for profit is the invisible hand that guides the private economic system toward the greatest wealth for all. Karl Marx wrote *Das Kapital* in 1867 and in it advocated a collectivist economy. Marx believed that the capitalist system is exploitive because producers, through their control of production and markets, can compel workers to labor at a wage below the value they add to production. To end the exploitation of labor (the proletariat) by the capitalist producers (or bourgeoisie), the workers needed to own and control the means of production. In theory, Marxism would have the effect of ensuring that the economy functioned in the interest of all citizens equally. No country today has either a pure free-market economy or a pure collectivist economy, although countries vary substantially in their mix. The United States tends strongly toward the private side.

2. Explain the difference between economic efficiency and economic equity as principles that justify government regulation of the economy.

Answer: An economy is a system of production and consumption of goods and services allocated through exchange. Economic efficiency requires firms to fulfill as many of society’s needs as possible by using as few of its resources as possible. Economic equity occurs when an economic transaction is fair to each party. A transaction can be considered fair if each party enters into it freely and is not unknowingly at a disadvantage. These principles can be the basis of government regulation. Government should intervene when necessary to enhance efficiency, as in the case of monopolistic competition in which a firm’s domination of the market enables it to produce and sell goods inefficiently. Government should also intervene to enhance equity. For example, in the case of a prescription drug company where the consumer is not in a position to determine whether a firm’s claims about the drug’s safety are valid, society must therefore rely upon government regulations. Laws that prevent monopolistic practices or impose drug-safety standards on pharmaceutical firms are examples of regulation for purposes of efficiency and equity respectively.

3. Define the term fiscal policy and explain how fiscal policy can be used in response to economic conditions.

Answer: The government’s efforts to maintain a stable economy are made mainly through its taxing and spending decisions, which together are referred to as its fiscal policy. The main school of thought associated with fiscal policy is demand-side economics, which originated in the theories of economist John Maynard Keynes. In different forms, demand-side economics has influenced government policy since the New Deal programs of Franklin D. Roosevelt in the 1930s. When there is an economic downturn, government can increase its spending or cut individual taxes as a means of stimulating consumer (demand-side) spending. When the economy is inflationary, the opposite actions can be taken as a way of dampening consumer demand. Fiscal policy can also take a supply-side form, as it did in part during the Reagan years. Supply-side emphasizes business production and investment. The economy can be stimulated through a reduction in taxes on firms and high-income individuals.

4. Define the term monetary policy, and describe two ways the Fed implements monetary policy.

Answer: Monetary policy is based on manipulation of the amount of money in circulation. Monetarists believe in tightening or loosening the money supply as a way of slowing or invigorating the economy. Economist Milton Friedman is a proponent of monetarism. Control of the money supply rests with the Federal Reserve System, or the Fed for short. The Fed can influence monetary policy by lowering or raising the interest charged when member banks borrow money from their regional Federal Reserve Bank and by raising or lowering the cash reserve that member banks are required to deposit with the regional Federal Reserve banks.

1. Define the public-policy process and identify and discuss the six stages in that process.

Answer: The public-policy processconsists of the interactions of political actors that leads to the emergence and resolution of public policy issues. Scholars have identified six stages in the process; the first two stages relate to the emergence of issues and the last four to their resolution. During the problem recognition phase, a particular condition comes to be seen as a public problem. An example is obesity, which was seen as strictly a personal issue until recently. Political transformation is the second stage in the policy process. It is the stage at which a policy problem becomes a political issue. As issues arise in the policy process, politicians and policy analysts bring forward ideas and proposals for how to handle them; this is the policy formulation stage. Even a well-formulated policy proposal is not assured of emerging successfully from the policy adoption stage. After a policy is adopted, the policy process enters the policy implementation stage. Bureaucrats and judges are the key actors at this stage. They decide how policy will be administered and interpreted. The final stage of the policy process—the policy evaluation stage—is when the effort is made to determine how well a program is working. Policy problems do not in every case progress stepwise through the six stages outlined here. But each stage is a relatively distinct component of the public-policy process.