

3. The government budget of the country of Geeland is currently balanced. The government budget is composed of tax revenues (T), transfer payments (TR), and government spending (G).
- (a) Assume the economy moves into a recession and there is no discretionary policy action.
- (i) Will the government budget move into a deficit or a surplus in the short run? Explain using the appropriate components of the government budget identified above.
 - (ii) Based on your answer to part (a)(i), what will happen to the government debt?
- (b) Based on your answer to part (a)(i), identify one specific fiscal policy action that will balance the budget.
- (c) How will the fiscal policy action from part (b) affect the actual unemployment rate in the short run? Explain.
- (d) Did the government efforts to maintain a balanced budget make Geeland's recession more severe or less severe in the short run? Explain.

Begin your response to this question at the top of a new page in the separate Free Response booklet and fill in the appropriate circle at the top of each page to indicate the question number.

Question 3: Short**5 points**

(a) (i)	State that the government budget will move into deficit in the short run and explain that tax revenues (T) will decrease and transfer payments (TR) will increase.	1 point
(ii)	State that the government debt will increase.	1 point
		Total for part (a) 2 points
(b)	Identify an increase in taxes or a decrease in government spending.	1 point
(c)	State that the actual unemployment rate will increase in the short run and explain that aggregate demand will decrease, which will decrease real output.	1 point
(d)	State that the government's efforts to maintain a balanced budget made Geeland's recession more severe in the short run and explain that in order to maintain a balanced budget, the government had to implement contractionary fiscal policy during a recession. (It is also acceptable to explain that the government's efforts to maintain a balanced budget will decrease real output or aggregate demand and that unemployment will increase.)	1 point
		Total for question 3 5 points