

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.

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**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**
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- 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**
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**Total for question 3** **5 points**