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.

STOP

END OF EXAM