

Corrections

This is a correction of the Section D lecture note at 2/13 (as you see, this note is understandable only for those who attend the class).

Twin Deficit

In talking the twin deficit ($S_{pvt}^d = I^d - S_{gvt} + CA$), I mentioned the following.

When the increase in fiscal deficit ($-S_{gvt}$) is caused by increase in government expenditure (G), S^d declines and I^d unchanged and hence CA has to fall: this is the twin deficit.

The italics sentence is valid only at the small open economy. In the large open economy, the conclusion is still true but the derivation is a little bit different. The following is true in the large open economy (and the above statement holds true at the small open economy).

Rewrite the basic equation to $S_{pvt}^d - I^d = -S_{gvt} + CA$. When the increase in fiscal deficit ($-S_{gvt}$) is caused by increase in government expenditure (G), $S_{pvt}^d - I^d$ declines and hence CA has to fall: this is the twin deficit.

See (**) and (***) marked in the note.

Desirable Saving

In deriving S^d (desirable amount of saving) in the numerical example done in the class (question 3 of the handout), I wrote:

$$S^d = Y - C^d - G \text{ (closed economy)}$$

The italics sentence should be (*when NFP=0*). This is an assumption which we made at p.152. See equations (2.8), (5.3) and (5.4).