

the burden of repayment of the rising debt shifts to future generations. But those longer-term problems will not come home to roost for the current Administration or even (not unimportantly for Administration political strategists) for the next Administration. There was, thus, in the view of some observers, a strong sense presently of "free lunches" in Washington.

The real test will come, it was argued, if interest rates get high enough to cause pain. But, it was pointed out by others, interest rates have not become a problem even with questions being raised about the Administration's seriousness on budget consolidation after it added US\$80 billion to defence spending a week after releasing the 2005-2006 budget. And, as long as that remains the case, there will be no macroeconomic problem deriving from the budget deficit, or by extension from the external deficit.

...but might global imbalances pose risks to trade?

Even if one takes a benign view of the macroeconomic consequences of global imbalances (which many observers worldwide do not⁶), there are potential risks for the trade system from the external deficit. If there is no change in policy, current trends imply a continued widening of deficits.⁷

⁶ As one observer put it, there are no precedents for the current situation; a gut-wrenching adjustment cannot be excluded. A detailed exposition of this view is provided by Lawrence H. Summers, "The U.S. Current Account Deficit and the Global Economy", *The Per Jacobsson Lecture*, October 3, 2004; <http://www.perjacobsson.org/2004/100304.pdf>.

⁷ Conventional private sector macroeconomic projections have tended to show the US current account deficit flattening out in absolute terms and gradually declining as a share of GDP. For example, Global Insight projected the deficit growing from US\$666 billion in 2004 to the US\$700 billion range in 2005 and remaining essentially flat in absolute terms thereafter, while declining as a share of GDP from the 5.7 percent range in 2004 to the 5 percent range in 2007-2008. See Global Insight, *Quarterly Review and Outlook*, Fourth Quarter 2004. The continued widening of the deficit has substantially exceeded these expectations; in the first half of 2005, the deficit was close to US\$800 billion at annual rates.