

Deficits and the Chinese Challenge

By Zachary Karabell

The dollar's sharp drop over the past few weeks has led to considerable anxiety about the status of the United States as the dominant force in the global economy. Closely related to this fear is constant worry about the rise of China and the evermore complicated relationship between Beijing and Washington.

Most people are now aware that China is the largest creditor to a heavily indebted U.S. government. It holds close to a trillion dollars of U.S. Treasuries and has invested hundreds of billions more in private enterprises in America. Even though these facts are plainly acknowledged, policy makers and experts continue to underestimate the full ramifications of this relationship.

Consider what happened in 1946, when a cash-strapped Great Britain turned to the U.S. for a loan. For 30 years or more, the British had been consumed by the threat of a rising Germany. Two wars had been fought, millions of lives had been lost, and the British treasury was dramatically depleted in the process. Britain survived, but the costs were substantial.

In spite of its global empire, a powerful military, and an enviable position at the center of world-wide commerce, in early 1946 the British government faced a serious risk of defaulting on its financial obligations. So it did what it had done at various points over the previous decade and turned to its closest ally for assistance. It asked the U.S. for a loan of \$5 billion at zero-interest repayable over 50 years. As generous as those terms seem today, such financing had been almost routine in years prior. To the surprise and shock of the British, Washington refused.

Unable to take no for answer, Britain explained that unless it received funds the government would be insolvent. The Americans came back with a series of conditions. They would lend Britain \$3.7 bil-

lion at 2% interest, and the British government would have to abide by the 1944 Bretton Woods plan, which made the dollar rather than the pound sterling the reference point for global exchange rates and required Britain to make the pound freely convertible. Even more significantly, Britain had to end its system of imperial preferences, which meant no more tariffs and duties on goods to and from colonies such as India. These were not mere financial penalties: Taken together, they meant the end of the British Empire.

Within two years, Britain had left India and was on its way to decolonizing throughout Asia and Africa. Unable to compete with the U.S. economically and no longer able to reap the benefits of colonial trade, Britain's military shrank and its commerce contracted. It quickly receded from its dominant global position and entered several decades of economic malaise. In the 1980s, Britain finally emerged as a prosperous country, but it was a shadow of what it had been in its heyday.

The U.S. replaced Britain as the guardian of the West. As one British official, Evelyn Shuckburgh, remarked in the late 1940s, "it was impossible not to be conscious that we were playing second fiddle." And that was precisely what the U.S. desired. Having supported the British for decades and become its banker and manufacturer during two wars, at the end of World War II the U.S. fully intended to supplant the British Em-

pire. The loan request provided the pretext, but by then the balance had already shifted and Britain could have done little to reverse the tide.

By 2030—if not sooner—China is likely to surpass the U.S. in the size of its economy, though it will remain on a per capita basis a much poorer society for many years after that. Trajectories can change, but the recent implosion of the American financial system has only accelerated China's rise.

Given the lesson of the British Empire's demise, it would be foolish to base current policy on the assumption that China will hit a fatal speed-bump before it is able to supplant the U.S. And while the level of current indebtedness is manageable for the U.S.—and in fact tethers the Chinese closely to the U.S. economy in ways that

treated as junior partners. As tension festered, the British were consumed with the more immediate threat of Germany. But in the end it was the U.S. that delivered the knockout blow.

The Americans have not had to deal with a true economic rival since the British more than half a century ago. America today is as unaccustomed to global economic competition as the British were at their apex. The U.S. often seems lumbering and ill-suited to the demands of economic rivalry.

The only way to avoid Britain's fate and meet the challenge of China is to reinvigorate economic life. This is a multiyear endeavor that must be done primarily through innovation, not legislation. America needs to retool its domestic economy to build on the global success of many U.S.

companies. It must focus on inventing new products and generating new ideas, rather than defending the rusty industries of yesterday. Fights over health care and climate change are the cultural equivalent of fiddling while Rome burns.

China thrives because it is hungry, dynamic, scared of failure and convinced that it should be a leading force in the world. That is why America thrived a century ago. Today, such hunger and dynamism seem less evident in American life than petulance that the world is not cooperating.

The U.S. is in danger of assuming that because it has been a dominant nation on the world stage, it must continue to be so. That is a recipe for becoming Britain.

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David Goehard

are arguably beneficial for both countries—the fact that these economies are currently bound together does not mean that their interests will always be in sync.

Here, too, the British analogy is sobering. For decades, the relationship between Britain and the U.S. was mutually beneficial, though the Americans resented being

Pakistan's Partial War on Terror

By C. Christine Fair

The past week's spate of suicide bombings in Pakistan and the siege of its military headquarters are again casting the spotlight on that country's war on terror. Attention will—and should—focus in particular on Islamabad's many failures to control militants on its own soil. Pakistan is now paying the heavy price for its earlier attempts to use terrorist groups as strategic tools.

Islamabad has viewed and used terrorist groups as assets to be cultivated. Before the Soviet invasion, Pakistan used Islamist militants for operations in India and Afghanistan. Today, Pakistan aids the Afghan Taliban mainly in the belief that if U.S. and international commitment to Afghanistan wanes, it would be better to be friendly with a group like the Taliban that can keep Indian influence in the country at bay—the same logic behind Pakistan's pre-2001 support for the Taliban.

At home, Pakistan has tolerated a raft of terrorist groups ostensibly linked to Kashmir, such as Lashkar-e-Taiba and Jaish-e-Mohammad. Lashkar-e-Taiba, the group responsible for last year's Mumbai massacre, continues to operate under various names. Its leadership roams free and its offices remain open. Jaish-e-Mohammad, responsible for several attacks in India and against international and domestic targets within Pakistan, is similarly unconstrained. Pakistan's track record against so-called anti-Shi'a militias, such as the Lashkar-e-Jhangvi and Sipha-e-Sahaba-e-Pakistan, has been equally lackluster despite vicious attacks against Shi'a who are perhaps one-fourth of Pakistan's population. These varied groups are ensconced not in the unruly tribal areas, but in Paki-

stan's most populous and militarized province: the Punjab.

Islamabad has long believed it could exploit these groups for strategic aims while preventing them from causing too much "unapproved" trouble. The government would have likely come to some modus vivendi with the Pakistan Taliban, had its leaders agreed to focus upon Afghanistan rather than Pakistan. Islamabad cracked down militarily on the Pakistani Taliban earlier this year only after it was clear that deal-making had failed. With respect to the so-called Kashmiri groups, Pakistan only sought to moderate their activities to prevent serious Indo-Pakistan crises and international pressure while maintaining their basic operational readiness.

Now it's possible to see exactly how shortsighted and dangerous Pakistan's strategy has been. First, all these groups are more interconnected than at first might appear, and in ways that make them hard to control. Lashkar-e-Jhangvi shares membership and resources with Jaish-e-Mohammad and the Pakistan Taliban. Both Lashkar-e-Jhangvi and Jaish-e-Mohammad facilitate the movement of persons outside of Pakistan into the terrorist sanctuaries in the tribal areas, provide suicide bombers to the Pakistan Taliban, and facilitate high-value operations throughout Pakistan. With the exception of Lashkar-e-Taiba, all support the Afghan Taliban and all are close to al Qaeda. They all share connections with Pakistan's intelligence agencies and some civilian leaders.

Some of these groups have now bitten the hand that once fed them. They are

vexed by Pakistan's support of the U.S. fight against al Qaeda, provision of logistical support for the Afghan war to undermine the Taliban, the state's complicity in Washington's use of drones in the tribal areas and Pakistan's own military operations in the Pashtun belt.

It is unlikely the recent attack on the Army headquarters, perpetrated by Lashkar-e-Jhangvi, will focus some minds in Pakistan on this complex problem. Pakistanis prefer to attribute their terrorism problem to blowback from the U.S.- and Saudi-sponsored anti-Soviet jihad, or to blame India for domestic attacks. Polls I have conducted suggest Pakistanis are unaware of both the activities of Pakistani militant groups operating on their soil and the long-standing ties between these groups and their security and intelligence agencies.

Washington has largely failed to understand the problem of Pakistan's militant landscape and forge appropriate policy. Since September 11, the U.S. has worked to secure Pakistan's sustained fight against al Qaeda, yet demanded Pakistani action against the Afghan Taliban only from 2007 onward. The delay happened in part because the Taliban was believed to have been vanquished. Even when the Taliban re-emerged in 2005, Washington was slow to prompt Pakistan to act for fear of compromising its cooperation against al Qaeda. Similarly, Washington has pressured Pakistan to act against the so-called Kashmiri groups only episodically, and only when their actions have sparked near-war crises between India and Pakistan. And Washington has tended to see anti-Shi'a groups as

The deadly results of cooperation with terrorists.

a domestic problem rather than the threat to regional security they really are.

During this period, the U.S. disbursed more than \$13 billion to compensate or reward Pakistan for its cooperation in the war on terror even while it undermined the goals of the same. Congress is improving on this record. Late last month, the legislature proposed tying \$7.5 billion of aid over five years to the strengthening of Pakistan's civilian governance. The bill also proposes binding security assistance to Pakistan's efforts to eliminate militant groups that have previously been viewed as state assets. The Pakistani army balked at these conditions because they would limit its ability to use terrorists strategically. But precisely for that reason, it's a good move.

Pakistan's efforts to fight the bad terrorists while protecting the good militants cannot be sustained. The latest string of attacks and bombings shows the high cost this policy is inflicting on Pakistan itself. Nor can the lackadaisical international response to Pakistan's action and inaction in the backdrop of enormous financial largess be justified. Despite army balking, Washington should insist that Islamabad act against terrorism comprehensively as a condition for further security assistance. In the end, Pakistanis may benefit most from such steadfast commitment.

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