

The Necessity for Smart Power: How a SWIFT Kick Hurts

by

Commander Jeremy Matthew Roberts
United States Navy



United States Army War College
Class of 2013

DISTRIBUTION STATEMENT: A

Approved for Public Release
Distribution is Unlimited

This manuscript is submitted in partial fulfillment of the requirements of the Master of Strategic Studies Degree. The views expressed in this student academic research paper are those of the author and do not reflect the official policy or position of the Department of the Army, Department of Defense, or the U.S. Government.

The U.S. Army War College is accredited by the Commission on Higher Education of the Middle States Association of Colleges and Schools, 3624 Market Street, Philadelphia, PA 19104, (215) 662-5606. The Commission on Higher Education is an institutional accrediting agency recognized by the U.S. Secretary of Education and the Council for Higher Education Accreditation.

REPORT DOCUMENTATION PAGE				Form Approved OMB No. 0704-0188	
The public reporting burden for this collection of information is estimated to average 1 hour per response, including the time for reviewing instructions, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing the burden, to Department of Defense, Washington Headquarters Services, Directorate for Information Operations and Reports (0704-0188), 1215 Jefferson Davis Highway, Suite 1204, Arlington, VA 22202-4302. Respondents should be aware that notwithstanding any other provision of law, no person shall be subject to any penalty for failing to comply with a collection of information if it does not display a currently valid OMB control number. PLEASE DO NOT RETURN YOUR FORM TO THE ABOVE ADDRESS.					
1. REPORT DATE (DD-MM-YYYY) xx-03-2013		2. REPORT TYPE STRATEGY RESEARCH PROJECT		3. DATES COVERED (From - To)	
4. TITLE AND SUBTITLE The Necessity for Smart Power: How a SWIFT Kick Hurts				5a. CONTRACT NUMBER	
				5b. GRANT NUMBER	
				5c. PROGRAM ELEMENT NUMBER	
6. AUTHOR(S) Commander Jeremy Matthew Roberts United States Navy				5d. PROJECT NUMBER	
				5e. TASK NUMBER	
				5f. WORK UNIT NUMBER	
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) Mr. Richard C. Coplen Peacekeeping and Stability Operations Institute				8. PERFORMING ORGANIZATION REPORT NUMBER	
9. SPONSORING/MONITORING AGENCY NAME(S) AND ADDRESS(ES) U.S. Army War College 122 Forbes Avenue Carlisle, PA 17013				10. SPONSOR/MONITOR'S ACRONYM(S)	
				11. SPONSOR/MONITOR'S REPORT NUMBER(S)	
12. DISTRIBUTION / AVAILABILITY STATEMENT Distribution A: Approved for Public Release. Distribution is Unlimited.					
13. SUPPLEMENTARY NOTES Word Count: 6,452					
14. ABSTRACT Examination of the complexities of the 21st Century through the prism of the United States' military, economic, and soft power bases alerts one to the new dynamics of employing power. The effects of the recent decision to remove Iranian banks from the Society for Worldwide Interbank Financial Telecommunication system demonstrates these complexities and the need for our future leaders to learn how to effectively employ smart power.					
15. SUBJECT TERMS power bases, complexity, decision making, Iranian sanctions					
16. SECURITY CLASSIFICATION OF:			17. LIMITATION OF ABSTRACT UU	18. NUMBER OF PAGES 34	19a. NAME OF RESPONSIBLE PERSON
a. REPORT UU	b. ABSTRACT UU	c. THIS PAGE UU			19b. TELEPHONE NUMBER (Include area code)

USAWC STRATEGY RESEARCH PROJECT

**The Necessity for Smart Power:
How a SWIFT Kick Hurts**

by

Commander Jeremy Matthew Roberts
United States Navy

Mr. Richard C. Coplen
Peacekeeping and Stability Operations Institute
Project Adviser

This manuscript is submitted in partial fulfillment of the requirements of the Master of Strategic Studies Degree. The U.S. Army War College is accredited by the Commission on Higher Education of the Middle States Association of Colleges and Schools, 3624 Market Street, Philadelphia, PA 19104, (215) 662-5606. The Commission on Higher Education is an institutional accrediting agency recognized by the U.S. Secretary of Education and the Council for Higher Education Accreditation.

The views expressed in this student academic research paper are those of the author and do not reflect the official policy or position of the Department of the Army, Department of Defense, or the U.S. Government.

U.S. Army War College
CARLISLE BARRACKS, PENNSYLVANIA 17013

Abstract

Title: The Necessity for Smart Power:
How a SWIFT Kick Hurts

Report Date: March 2013

Page Count: 34

Word Count: 6,452

Key Terms: power bases, complexity, decision making, Iranian sanctions

Classification: Unclassified

Examination of the complexities of the 21st Century through the prism of the United States' military, economic, and soft power bases alerts one to the new dynamics of employing power. The effects of the recent decision to remove Iranian banks from the Society for Worldwide Interbank Financial Telecommunication system demonstrates these complexities and the need for our future leaders to learn how to effectively employ smart power.

The Necessity for Smart Power: How a SWIFT Kick Hurts

The world is becoming more complex, and our jobs become so, too. We have to adjust how we develop leaders. We want to broaden their aperture. They can't just understand the "military art" anymore. They have to understand the underlying socioeconomic factors that impact the world.

—General Odierno, August 2012

The United States draws its strategic power from three foundational bases: economic, military, and soft power. These are the nation's center of gravity that enables the defense of the nation and the ability to influence others abroad. Traditionally, these three bases of power were considered distinct from one another and their management relatively straightforward. However, given the growing influence of the information revolution, technology advances, globalization, and the rise of transnational organizations, the complexity of our world has grown exponentially in the 21st Century. As with most complex systems, changing one part of the system directly and indirectly affects many others parts of the system. The new reality is that the three power bases are tightly intertwined; therefore, affecting one influences the others and can have broad effects on strategic outcomes.

This increasingly complex environment will require future strategic decision and policy makers to gain a greater understanding of each power base and how to effectively use smart power. The smart power approach highlights the need to synchronize our military, economic, and soft power bases. Smart power emphasizes not only the need for a strong military, but also the need to rely on governmental, nongovernmental, and military alliances at all levels in order to manage American

influence and legitimacy of action.¹ In this paper an analysis of the Congressional act of removing the Iranian banks from the Society for Worldwide Interbank Financial Telecommunication (SWIFT) system will demonstrate the intricate interconnection of each power base and the need for the U.S. to develop leaders that are capable of employing smart power.

Background

The removal of Iran from the SWIFT system was designed to halt Iran's ability to conduct international trade, thus pressuring Iran to halt efforts to obtain nuclear weapons. The United Nations (U.N.) began sanctions in 2006 against Iran, demanding that it suspend all uranium enrichment and processing activities.² In 2012 the United States organized an effort to prohibit Iranian banks from using the SWIFT system. This was in addition to the U.N. sanctions. Specifically, the United States wrote into law that any financial entity that does business with Iran will not be allowed to do business inside the United States. Effectively the U.S. used economic power over non-U.S. entities, forcing them to choose between trading with either the U.S. or Iran.

So what is the SWIFT system? It is the system whose sole purpose is "to transport data securely, reliably and confidentially between the financial institutions and corporations connected to its private messaging infrastructure."³ In the 1960's international banking transactions were becoming too cumbersome to handle manually and several computer based transaction systems began to appear. But each of the systems was unique and they were often incompatible with one another. To help improve efficiency, 239 banks from 15 countries created the SWIFT cooperative in 1973 to build a common system. The system was launched in 1977 and today has over 9,000 users in 203 countries. The SWIFT system now completes over 15 million transactions

each day. The SWIFT system is owned by its' users and is overseen by the G-10 central banks because of the importance to the international finance and banking systems. This system must comply with the laws of the countries where it operates. The SWIFT system describes itself as independent and apolitical.⁴

Economic Power Base – The 20th Century

The strategic economic power gained by a nation is mostly derived from the size of its economy, especially its exports and imports as these represent resource interdependence. However there are many other aspects that drive the economic power base of a nation. These include natural and human resources, technology, political stability, legal institutions, trade, finance and competition.⁵ Economic power is also influenced by a state's tariffs, quotas, rules that control access to their markets, legal sanctions, manipulation of exchange rates, and aid for the development of others. An important underlying dimension of economic power behavior is to make others more dependent on you than you are on them.⁶

At the end of the 20th century the United States represented 31.8% of the world's Gross Domestic Product (GDP).⁷ Given this relative U.S. economic strength for several previous decades, most believed it likely to continue for the foreseeable future. The dependency of other nations on the U.S. economy was significant and the U.S. wielded this power with seemingly minimal risk. The U.S. arguably had the most control of any nation over global financial systems, banking systems and markets. Since the end of World War II, the United States also wielded the power of having the world's reserve currency. With the removal of the U.S. dollar from the gold standard in 1971, the U.S. was free to produce as many dollars as necessary to benefit its economy with seemingly few little negative repercussions.

Economic Power Base – Part of the 21st Century Reality

The U.S. economic power base and influence has evolved significantly in the 21st century. Additionally, removing Iran from the SWIFT system had a sizable impact on the international banking system. The highly regulated bank transactions that are primarily controlled and monitored by the SWIFT system are only one part of the complex equation. In addition to this highly transparent aspect of the international banking system, there exists a shadow banking system which is highly unregulated and unmonitored. Recent reports from the Financial Stability Board estimate that this banking system grew from \$26 trillion in 2002 to \$67 trillion in 2012.⁸ It is now roughly equal in size to the regulated banking system. The system is arguably necessary in modern finance and banking because it provides services like money market funds and credit default swaps that traditional banks do not provide. The shadow banking system is often criticized for contributing to the 2008 financial crisis because of a unique feature of the system. Unlike the SWIFT system which ensures that the balance sheet of each participant is always positive, the shadow banking system does not. A financial institution may have large outstanding liabilities inside of this system, but unless they are self-reported to regulators and share holders, no other entity will know.

Another unregulated type of banking is the Informal Value Transfer System (IVTS), often referred to as the underground banking system. The methods employed in this system are many and vary in complexity. Though there is no certainty in the amount of transfers occurring across these systems due to no or limited record keeping, a U.S. Department of Justice report estimates they facilitate trillions of dollars in transfers each year.⁹ Some of these systems of banking are the oldest in existence, dating back to

5000 B.C. and are often based on trust among the participants. Most of these systems are legal and provide services to many people around the globe that do not have access to traditional banking facilities. The oldest form of an IVTS is called Hawala and is based in Islamic law. It can be found in the Middle East, North Africa and the Indian subcontinent. The system works for the users much like Western Union services work, but at a personal level based upon membership in the exchange. Other common and easily understood IVTS include transfers between brokerage accounts, stored value transfers such as phone cards or pre-paid debit cards, courier services, bank guarantees, and internet based transfer systems.

Since 2000 this fragmentation of the banking industry has created a more complex economic environment. Adding to the complexity and difficulty for U.S. is the reduction of the United States' influence. From 2000 to 2011 the percent of world GDP the United States represents shrank from 31.8% to 21.6%.¹⁰ During the same timeframe Brazil, Russia, India, and China increased their share of world GDP to nearly 25%.¹¹ Collectively, these nations are now larger than the U.S. as a percent of world GDP.

Economic Power Base – The SWIFT Sanction Effects

In 2000 there were few alternatives to using the SWIFT system for conducting international trade, especially on a large scale. However, with the growth of the shadow banking system and Informal Value Transfer Systems, Iran now has more options and a much better probability of finding alternatives to the SWIFT system. In today's complex environment, not only will the SWIFT sanction be less effective but at least four additional negative effects are likely.

First, not only will Iran attempt to find ways to conduct international trade inside the shadow or underground banking systems but others will also move into these less

regulated banking systems. To ensure Iranian banks and their agents can't use the SWIFT system, regulations increased. As noted by International Monetary Fund, a 1% increase in regulation leads to a 10% increase in the shadow economy. The negative effects will include the "alienation of large segments of the population which would otherwise be helpful in counter-terror coalitions and shifts to lesser known informal value transfer methods, prompting less transparency and traceability of transactions[.]"¹²

A second potential effect could be more detrimental to the future of consolidating financial transactions to provide good oversight, regulations and effective monitoring. In the spring of 2012, the BRIC nations took notice that the U.S. was using her economic power base to expel Iran from the SWIFT system. Recognizing the U.S. could employ this same action against them, they began to consider creating an alternative to the SWIFT system. An Indian news articles captures their thinking:

While the SWIFT settlement system is a Belgian-based international banking settlement agency, the U.S. influence over it was sufficient to halt all Iranian interbank transfers. It is not the system that is faulty but the influence of the U.S. over it that is the danger to the BRIC nations. The BRICs discussed the use of the SWIFT system of international settlements as a 'weapon' against Iran. With China and India as two of Iran's clients, they found that the U.S. could hurt them considerably with this action. The question that the BRIC nations asked was, "Must we be subject to the financial will of the U.S.?" The question has long-term implications that could affect the BRIC nations' freedom of financial activity. The question demands to see just how powerful the U.S. really is. It is very clear to these emerging nations that if they are to keep growing, unfettered by the U.S. will, they must set up a system that is not vulnerable to U.S. influence and to reduce the influence of the dollar itself.¹³

If the BRIC nations do create an alternative to the SWIFT system, it could greatly fracture international banking and financing. As the size of these nations' economies grows, more of the world's financial transactions would move to their system and leave

the U.S. and the West with less influence. Their ability to influence others, ensure fair trade, and track illegal activities would also be decreased.

A third negative effect could occur in global finance. We already see the BRIC nations using financing as a means of gaining power over others. In Africa and Latin America, China is providing significant financing to corporations for resource development and the building of infrastructure and communication systems. As Douglas Schaffer from The Institute of Land Warfare points out in his article titled, "Linking Latin America and the Pacific: A Strategy for the Long Term," the Chinese are buying influence in South America. Among other investments, the Chinese are providing subsidized financing to the telecommunication company Huawei, "an opaque organization that has been linked to government/military espionage activities."¹⁴ If the BRIC nations act on their concern over the undue influence the U.S. is exerting, they may soon conduct trade and finance completely in their own currencies outside the SWIFT system. This would make "connecting the dots" more difficult, if not impossible, for the U.S. and her allies.

A fourth negative effect could involve China's decision to trade oil contracts outside the existing oil market and to not settle the contracts in U.S. dollars. In November of 2012, The Wall Street Journal printed an article announcing that China had stated they would soon begin selling oil futures contracts.¹⁵ This is significant because since the 1970's all oil trades have settled in U.S. dollars on either the New York or London Stock exchange. In the near future the world will be able to trade oil in Yuans on a Chinese exchange. The article states China is making these efforts to help establish the Yuan as an accepted reserve currency in part to replace the U.S. dollar

and the U.S. influence over international oil prices. Others have speculated that China opening up a market to trade oil is more about foreign nations developing the ability to trade outside the SWIFT system and U.S. influence.¹⁶ In support of these claims is a quote from a Chinese foreign minister in response to a question concerning if China would consider continuing the purchase of oil from Iran after the SWIFT sanctions began:

China has always been against unilateral sanctions, based on domestic laws, imposed by any one country on another. We especially do not accept unilateral sanctions that are forcibly imposed on a third-party country.¹⁷

These types of concerns about the U.S. losing its reserve currency status seems overly alarming to most in government. But only 20% of our Chief Executive Officers, our economic leaders who deal in international trade daily, believe the U.S. dollar will still be the reserve currency in 2025.¹⁸

Military Power Base – The 20th Century

The military power base is usually considered to be the number of aircraft carriers, tanks, or battalions a nation possesses. However, it also includes how effective the forces are and how they are employed. Employing one's military forces to aid allies or assist friends can increase the power base of a nation's military.

The large economic power base the United States has enjoyed for most of the 20th Century has allowed it to build a large military power base. The United States represents nearly 40% of world military spending. The U.S. has created the largest military power base of any nation through the acquisition of military hardware, training, support to our allies, and by creating a foreign dependence on our military to defend

other countries and the commons. The United States' dominant conventional force has had no real competition since the fall of the Soviet Union.

Military Power Base – Part of the 21st Century Reality

Beginning with September 11th, the United States' understanding of warfare has significantly changed. Since 2001 the term “asymmetric warfare” is more prevalent and arguably more relevant to war fighters. Though the term began to gain popularity after Andrew Mack's 1975 article “Why Big Nations Lose Small Wars,” the term is still used differently among military personnel and members of academia. It is most often associated with terrorism, counterterrorism, insurgency, counterinsurgency, guerilla warfare, or innovative tactics. According to some Chinese military personnel, the new reality is that “financial warfare” should be put on this list as a common form of asymmetric warfare.¹⁹

Since the fall of the Soviet Union and the U.S. becoming the only superpower, the term “asymmetric warfare” has become closely associated with state and non-state terrorist organizations that are far inferior.²⁰ This perception of only terrorist organizations using asymmetric warfare may be wrong. As Russell Howard pointed out in a 2009 briefing to the Asymmetric Warfare group, asymmetric warfare is not a chess match, it is a poker game. It appears that, “for years, our military has been sitting at an empty chess table while our enemies play poker with our shadows. The difference? Their ability to bluff and more importantly, to “cheat.””²¹ Is it possible that while our military sits at our chess table the Chinese military has already engaged us in a game of poker? As we ponder what will happen if and when the Chinese have the conventional power to become a threat, they are engaging us in war. Not conventionally or with our understanding of asymmetric warfare, but with a new form of asymmetric warfare,

financial warfare. A clear insight into Chinese thinking on financial warfare is found in an essay entitled “The War God’s Face Has Become Indistinct,” included in a book on unrestricted warfare written in 1999 by Colonels Qiao Liang and Wang Xiangsui of the People’s Liberation Army:

Financial warfare has now officially come to war’s center stage-a stage that for thousands of years has been occupied only by soldiers and weapons... We believe that before long, “financial warfare” will undoubtedly be an entry in the... dictionaries of official military jargon. Moreover, when people revise the history books on the twentieth century warfare...the section on financial warfare will command the reader’s utmost attention...Today, when nuclear weapons have already become frightening mantelpiece decorations that are losing their real operational value...financial war has become a “hyper strategic” weapon that is attracting the attention of the world. This is because financial war is easily manipulated and allows for concealed actions, and is highly destructive.²²

This was written in 1999 and the Colonel’s conclusion is that 20th century warfare will be known for financial warfare, not the invention of nuclear arms as most American military personnel would assume. Since the beginning of Chinese economic reforms in 1978 their economy has grown from inflation adjusted terms of \$148B to \$1,198B in 2000. This represents an 800% growth in the last 32 years of the twentieth century, and the growth has not slowed since 2000. Perhaps by 2025 when China is predicted to overtake our economy we will have concluded they have been playing financial asymmetric warfare against the United States for nearly 50 years.

In 2008 the Department of Defense visibly began to consider that economic warfare may be a form of asymmetric warfare. The thought that this could be a possibility seems to have come from a Wall Street expert who has aided the U.S. National Security Community and the U.S. Department of Defense since 2001, James Rickards.²³

In 2006 James Rickards attended a STRATCOM strategy forum where he shared with the Department of Defense market intelligence techniques he and his partner developed. He shared with those in attendance techniques “to identify potential terrorist attacks in advance and to gain early warning of attacks on the U.S. dollar.”²⁴

Those in attendance took in interest in the concept that the dollar could be attacked. Rickards was contacted in 2008 and was asked to participate in a war game sponsored by the Office of the Secretary of Defense and hosted by the Applied Physics Laboratory (APL). The war game was non-kinetic and was based on currency and capital markets.

Rickards assisted APL by giving two training lectures. His first lecture explained how Sovereign Wealth Funds can create false fronts that can be “used to exercise malign influence over target companies in order to steal technology, sabotage new projects, stifle competition, engage in bid rigging, recruit agents or manipulate markets.”²⁵ His second lecture explained how the leveraged instruments of futures and derivatives could be used to manipulate their underlying markets including those is strategic commodities. He explained how the Commodity Futures Modernization Act signed by Clinton in 2000 made regulating these illegal and how they had grown exponentially since 2000 inside the shadow banking system. They were now hidden in the off balance sheets of the banking industry and nearly impossible to monitor. He finished “with a picture of how cutouts, sovereign wealth funds and derivatives leverage could be combined to launch a financial Pearl Harbor for which the United States was completely unprepared.”²⁶

Once the Department of Defense had put together the teams that would run and participate in the exercise, Rickards noted that none of them had any Wall Street experience. The experts were from academia, think tanks, Peterson Institute, Rand Corporation, other labs, and senior military officers from the Joint Chiefs of Staff. None of them had any practical experience with “front running, inside information, rumors, painting the tape with misleading quotes, short squeezes and the rest of the tricks in which Wall Street thrives.”²⁷ Rickards recruited two fellow Wall Street veterans and conducted the war game in 2009.

So what can we learn from studying asymmetric warfare and James Rickards’ insights about warfare in the 21st century? Clearly the Chinese military may not only be playing chess with us but also poker. While our military is concerned about locking our network’s back doors against cyber attack, the Chinese military has been using Sovereign Wealth Funds and fronts they have set up in the financial markets to walk in the front door as business owners.

Military Power Base – The SWIFT Sanctions’ Effects

The impact on our military power base is not immediate or direct as with most repercussions in a complex system. But understanding and appreciating the interconnection among our power bases is important. To make this point the interaction between the SWIFT sanctions and Indian military sales will demonstrate how just one of the nodes of our military power base has been affected.

U.S. foreign military sales to India represent over 15% of our global foreign military sales, totaling well over 4 billion dollars.²⁸ Foreign military sales of our military equipment are important because it keeps our military industrial base strong, strengthens our economy, and lowers the cost of each piece of equipment for both the

U.S. and our allies.²⁹ However, the relationship between India and the U.S. has issues. Following the 1998 Indian nuclear weapons test, the U.S. imposed sanctions on India which terminated foreign military sales and revoked their commercial license for purchasing U.S. munitions.³⁰ This incident, not forgotten by Indian decision makers, resulted in a “trust deficit” that still negatively impacts the U.S.-India military relationship.³¹

In July 2012 U.S. Deputy Secretary of Defense Ashton Carter went to New Delhi and stated India was the “linchpin” to the U.S. re-balancing our military in South East Asia.³² The focus was on increasing military sales that have included Apache helicopters and possibly F-35s. As the cost of F-35s has risen, increasing the sales to foreign nations has gained importance to the U.S. military to help lower our cost.

Will India want to buy F-35s? Looking at just the increasing ties between our two militaries and the fact our Deputy Secretary of Defense made a special trip to underscore our trust and their importance to the U.S., a person can say there is hope. But odds are they will not, when you consider just a month prior their Prime Minister was in discussion with the other BRIC nations determining how they could “set up a system that is not vulnerable to U.S. influence”³³ in reaction to the SWIFT sanctions.

Soft Power Base – The 20th Century

Early in the 20th century Soft Power was described as the power over opinion. Joseph S. Nye in his 2011 publication “The Future of Power” explains that this form of power depends upon credibility, and can be possessed by celebrities, nongovernmental organizations, corporations, and even terrorist networks. Governments gain their soft power through politics, culture, perceived values, and foreign policies. Even a strong military can contribute to having a strong soft power base. People are attracted to

strong nations more often than to weak nations. Nye goes on to explain that governments find difficulty in using this form of power because of three problems. First, unlike military or economic power, the outcome is controlled significantly by the target. Second, the outcome is often not immediate which can cause frustration and the delayed results may not be acceptable to either the politicians or the public they represent. The third problem is “it is often hard to use, easy to lose, and costly to reestablish.”³⁴

Arguably the United States was the greatest soft power nation of the 20th century. Our culture of openness, ingenuity and individual freedom attracted more of the world’s population than it repelled. Our political values expressed in our democratic procedures were revered and worked towards by a majority of the world population. Lastly, our foreign policy of alliances, assistance, and defense of our allies gained us the respect of most.

In the 20th century there were relatively few channels of communication. The vast majority of communication was done via radio, newspapers and television. All three were controlled by managers (editors, producers, etc.) and to varying degrees, governments. Most communication concerned local issues and most populations were not acutely aware of world affairs. Immigrants and foreign students within the United States accounted for a significant amount of the overseas awareness of American culture and ideals. These relatively few channels of communication allowed the management of a consistent message, the ability to limit opposing groups from getting their message out, and the capability to monitor the messaging of those who did oppose our ideals.

Soft Power Base – Part of the 21st Century Reality

One of the most important and manageable aspects of soft power is public diplomacy and government actions. Since 2000 our Soft Power Base has declined internationally, partly due to our actions in Iraq and Afghanistan. The Congressional Research Service wrote in 2009 that “the worldwide perception of the United States has declined considerably in recent years with the United States often being considered among the most distrusted and dangerous countries in the world.”³⁵ Attributed to this decline was the recent proliferation of the internet and information technology. These new forms of communication have greatly increased the number of global and regional broadcasters and “has diversified and complicated the shaping of attitudes of foreign populations.”³⁶ It is in this new environment in the 21st century that United States finds itself competing for attention and credibility.

Credibility is important. Credibility is the cornerstone of Soft Power. Under Secretary of State for Public Diplomacy and Public Affairs Judith McHale, summarizes the importance of maintaining this power base:

Governments inclined to support the U.S. policies will back away if their populations do not trust us. But if we do this right, if we develop relationships with people around the world, if they trust us as a partner, this dynamic will be reversed. Less cooperative regimes will be forced to moderate their positions under popular pressure. To the extent that we succeed, threats we face today will diminish and new partnerships will be possible.³⁷

These sentiments are not lost on American leadership. Beginning in 2009 Congress mandated the President to begin submitting an annual report on our interagency strategy for public diplomacy and strategic communication so they better understand what is being done to address this loss of Soft Power.

In a recent report the administration wrote that we must do a better job of understanding the concerns, attitudes, and how our actions are perceived by all others, not just those of the elites. The report also recognizes that our deeds and words must be synchronized to have credibility.³⁸

The Chinese also recognize the importance of soft power. In a 2007 speech to the Communist Party of China, President Jintao stated they must “enhance culture as part of the soft power of our country...a factor of growing significance in the competition in overall national strength.”³⁹

As noted earlier, soft power is not an “us versus them” game. Mass communication has allowed nongovernmental organizations, companies, celebrities, and even regional governments to take the same playing field as nations. They have an equal footing on the field to compete for the attention of people and to earn their trust and credibility. Therefore, in the 21st century alliances, coalitions, and associations will be so important in maintaining soft power. The more actors who come together in the modern age the higher the probability their message will be heard and accepted as credible. Also, the ability for others to attack one’s credibility will be more difficult because they will have to attack and de-legitimize all the other members who have supported the action or message.

Soft Power Base – The SWIFT Sanctions Effects

Effectively, our sanctions have strengthened the Iranian government’s soft power over its’ people and weakened our soft power base among the Iranians and others. History shows this is the most common effect of an embargo or sanctions against a population inside a country. Jay Gordon of the Social Science Research Center has written extensively on this topic. He clearly demonstrates that sanctions have a failure

rate of up to 95% and they most often create a rally-round-the-flag effect within the targeted population. The citizens react to the sanctions as a type of attack and they respond with increased nationalism, blaming the nation(s) imposing the sanctions.⁴⁰

Governments and militaries are rarely affected by these actions. Typically they simply use a higher percentage of the available limited resources. This appears to be the case with Iran. With limited resources, the Iranian government removed all subsidies on food and medical goods imported into the country, thus creating higher prices for the population. The Western press included quotes of Iranians and their reaction to this currency crisis. All of the quoted Iranians blamed the higher prices and lack of medical supplies on the American sanctions – they never once mentioned their own government's implementation of subsidy reform. The soft power base of the U.S. over the citizens of Iran and those who identify with them has clearly been weakened.

U.S. soft power appears to be eroding vis-à-vis other nations. Meanwhile, although the U.S. consistently espouses multilateral solutions and the importance of using regional or international organizations in settling disputes, the SWIFT sanctions are seen by many as a unilateral action.⁴¹ Iran petitioned the United Nations, stating the U.S. actions were illegal and inhumane and requesting review of these actions.⁴² The Iranians also filed cases in the European Union (E.U.) courts stating these actions were illegal. As of February 2013, the first two cases were decided in favor of Iran and the sanctions were deemed illegal by the E.U. courts.⁴³

Many perceived the U.S. as the bully and rogue nation in this case, believing that it acted illegally and unilaterally to pursue its own narrow interests. This reduced U.S.

credibility and thus U.S. soft power, suggesting that these types of actions must be avoided in the future if the U.S. wants to remain a significant player in world affairs.

Recommendations and Conclusion

Senior U.S. policymakers face an increasingly complex foreign policy environment, shifting relative power bases, and an uncertain future. As a result, assumptions of continued status quo are dangerous. There will be winners and losers as the global environment shifts. The U.S. can remain a winner without maintaining a dominant role in every power base; however, future U.S. strategic leaders must be more capable of operating in a complex environment and better trained to coordinate the respective power bases to achieve their objectives. Future U.S. leaders must be able to manage smart power effectively.

To manage smart power effectively, U.S. strategic leaders must broaden their conceptualization of the foreign policy environment and develop three essential skills. To attain a broad conceptualization of the foreign policy environment, they must fully understand the three power bases and develop a perspective that sees international relations as a complex network. They must understand that the many nodes in each power base are interrelated. Once the world is better understood through this paradigm shift of power being diffused through an interrelated network of actors, future leaders must develop and refine three critical skills: the ability to recognize relationships among nodes, to facilitate effects across the networks, and to make sound decisions in a complex environment.

Changing Our View of the Foreign Policy Environment

The U.S. operated in a bipolar world during the Cold War, thinking primarily in terms of an “us versus them” paradigm. In recent years, operating in a unipolar world,

U.S. strategic policymakers thought in terms of “how do we lead or influence them to implement our solution.” The U.S. is entering a multi-polar world. The policymakers now need to ask “who do we need to bring to the table to find the right solution.” Layered on top of this paradigm shift are advancements in technology, communication, and globalization. Further complicating the environment is the rise of transnational organizations, terrorist networks, and non-government actors gaining power at the local, regional, national, and international levels. Future leaders must recognize, accept, and embrace this high level of complexity.

The complex environment will force effective leaders to widen their aperture when looking at global issues. The future global environment will not focus on relative military or economic strengths amongst nations, but instead on the ability to effectively wield smart power.

Skill Sets for Future Leaders

Future U.S. strategic leaders operating in an evolving and complex environment will need certain skill sets to be successful. First, they must conceptualize international relations as a complex network and they must recognize relationships amongst the network’s key nodes. This type of network thinking will better enable them to pursue indirect paths to policy objectives. To limit thinking about a problem or how to solve it strictly in a linear path will disadvantage our leaders. For instance, the U.S. military is currently attempting to directly engage the Chinese military to begin Mil-to-Mil exercises. This may be more difficult than engaging them indirectly through South Korea. The Chinese accept Western ideals more easily when delivered by South Korea because they have a similar cultural background.⁴⁴ Perhaps we should be spending our time and efforts arranging joint training between South Korea and China to reach our objectives.

Future U.S. strategic leaders will also need the skill set of being able to facilitate solutions amongst multiple global actors. Whole of government approaches will not be sufficient to solve future problems. Governments alone will not possess enough knowledge to find good solutions or enough power across the power bases to implement the solution. Problems will need to be solved by a “community of interest,” thus requiring our leaders to engage private industries, small business owners, financial institutions, banks, religious leaders, NGOs, local leaders, and others.

The Department of Defense’s attempt to conduct a currency war simulation is a good example of the need to change how we view our role. Without the insistence of the one outside expert, we would have conducted the war game only with DOD military, academics, and think tank personnel. By including people who actually perform these trading tasks for a living, the outcome was changed and the correct lessons learned.

The final skill set is decision making in a complex environment. Though the study into this is relatively new, one constant appears to be that the leader must make decisions without all available information. Analysis similar to the PMESII approach is beneficial, but in a complex environment all the information and nodes of the system cannot be fully modeled and explored. Ultimately, decision makers and leaders must rely on some level of instinct and judgment. Decision makers must also learn to keep in focus overriding priorities to help simplify their day-to-day decisions.⁴⁵ For U.S. decision makers the recommended priority is to “export opportunity and hope, not fear.” Decision making in a complex environment is difficult and the training of our future leaders must begin today.

The first step is to create a less rigid decision-making environment and process. We must begin to encourage imaginative and creative solutions among our junior leaders. They must be challenged to consider not only their agencies' or department's tools, but also how their actions will be viewed and reacted to by all the actors affected.

Senior leaders need to increase the diversity of their workforce, recruiting and hiring accordingly. Meanwhile, junior leaders need to immediately open their aperture. To push this requirement we must force them to work and train with outside activities to include the private sector, NGOs, and other agencies and departments of our government. The goal is not to develop experts in other fields; the goal is to develop future leaders that have enough understanding of the environment that they can see the connections among all the nodes and how they affect each other. Future leaders need to be able to quickly identify the relevant "community of interest" and be able to ask the right questions of each when they are facilitating a solution to a problem.

An example of how the military could accomplish this is through leveraging their Reserve Forces. Creating functional experts for each Combatant Commander Area of Responsibility that aligns with the PMESII analytic model could be easily accomplished. The units would be manned with personnel that have similar expertise gained from their civilian careers. The military would have bankers, finance managers and small business owners studying how the economy of each AOR functions. Annual Training days would be used to either gain additional expertise through engagement with other government of civilian entities or in assisting Combatant Commanders in reviewing their existing or contingency plans to identify potential secondary effects of our actions. In times of

crisis, these units could be leveraged by a Joint Task Force Commander in doing the PMESII analysis.

The one certainty about the future is complexity and the necessity for future leaders to synchronize our military, economic, and soft power bases. By using the smart power approach our future leaders can ensure America is one of the winners in our new world. To ensure our future leaders will have the ability and necessary skills to be successful in this environment we must begin to train them today.

Endnotes

¹ Center for Strategic and International Studies, "CSIS Commission on Smart Power: A Smarter, More Secure America," 2007, CSIS homepage, pdf file, http://csis.org/files/media/csis/pubs/071106_csissmartpowerreport.pdf (accessed March 11, 2013).

² Toni Johnson and Greg Bruno, "The Lengthening List of Iran Sanctions," *Council on Foreign Relations*, 31 July 2012. <http://www.cfr.org/iran/lengthening-list-iran-sanctions/p20258> (accessed March 11, 2013).

³ SWIFT Press Office, "Facts about SWIFT for the Media," July 2010, SWIFT homepage, pdf file. http://www.swift.com/assets/swift_com/documents/about_swift/media_fact_sheet.pdf (accessed February 20, 2013).

⁴ Ibid.

⁵ Joseph S. Nye, *The Future Of Power* (Philadelphia, PA: Perseus Books, 2011), 52.

⁶ Ibid., 54.

⁷ Tyler Durden, "The Cost of Kidding Yourself," ZeroHedge, November 28, 2012. <http://www.zerohedge.com/news/2012-11-28/cost-kidding-yourself> (accessed March 10, 2013).

⁸ John Grgurich, "Shadow Banking: The \$67 Trillion Threat to the U.S. Economy online," *Daily Finance*, November 20, 2012. <http://www.dailyfinance.com/2012/11/20/shadow-banking-67-trillion-threat-economy> (accessed March 10, 2013).

⁹ Nikos Passas, *Informal Value Transfer Systems, Terrorism and Money Laundering* (Washington, DC: US Department of Justice, January 2005), 7.

¹⁰ Tyler Durden, "The Cost of Kidding Yourself online," ZeroHedge, November 28, 2012. <http://www.zerohedge.com/news/2012-11-28/cost-kidding-yourself> (accessed March 10, 2013).

¹¹Simon Kennedy, "O'Neill's BRICs Risk Hitting Wall Threatening G-20 Growth online," *Bloomberg*, June 14, 2012, <http://www.bloomberg.com/news/2012-06-14/o-neill-s-brics-risk-hitting-wall-threatening-g-20-growth.html> (accessed March 10, 2013).

¹²Tad Edward Thompson, "The War On Terror (IST Financing)," September 01, 2012, University of North Carolina Law School, publication, <http://www.law.unc.edu/documents/journals/ncbank/balancesheet/thewaronterroristfinancing3.pdf> (accessed March 10, 2013).

¹³Lovejeet Alex, "Dollar's Authority RIP?," *Halabol*, April 03, 2012. <http://voices.halabol.com/2012/04/02/dollar%E2%80%99s-authority-rip> (accessed March 11, 2013).

¹⁴Malcolm Maiden, "Huawei a Security Risk By Any Gauge," *Sydney Morning Herald*, March 28, 2012, <http://www.smh.com.au/business/huawei-a-security-risk-by-any-gauge-20120327-1vwnu.html> (accessed March 11, 2013).

¹⁵Kenneth Schortgen, "Dollar No Longer Primary Oil Currency as China Begins to Sell Oil Using Yuan," *Examiner*, September 12, 2012, <http://www.examiner.com/article/dollar-no-longer-primary-oil-currency-as-china-begins-to-sell-oil-using-yuan> (accessed March 11, 2013).

¹⁶King World News, "An Interview with Jim Sinclair," March 27, 2012, King World News broadcast, audio file, http://www.kingworldnews.com/kingworldnews/Broadcast/Entries/2012/3/27_Jim_Sinclair.html (accessed March 01, 2013).

¹⁷Indira Lakshmanan and Pratish Narayanan, "U.S. Wants Iran Oil Buyers to Pledge Cuts or Risk Sanctions," *Bloomberg*, March 23, 2012. <http://www.bloomberg.com/news/2012-03-23/u-s-wants-iran-oil-buyers-to-pledge-cuts-or-risk-sanctions-1-.html> (accessed March 06, 2013).

¹⁸Richard Dobbs and David Skilling, "Dollar as Reserve Currency: Mixed Signals," *Bloomberg*, January 22, 2010, http://www.businessweek.com/globalbiz/content/jan2010/qb20100122_964613.htm (accessed March 11, 2013).

¹⁹James Rickards, *Currency Wars: The Making of the Next Global Crisis* (New York: Penguin Group, 2012), 160.

²⁰Jesse G. Chace, "Defining Asymmetric Warfare: A Losing Proposition," *Joint Forces Quarterly*, no. 61 (2nd Quarter 2011), 125.

²¹*Ibid.*, 125.

²²James Rickards, *Currency Wars: The Making of the Next Global Crisis* (New York: Penguin Group, 2012), 160.

²³James Rickards, "Omnis Board of Directors online," No date given <http://www.omnisinc.com/directors.php#Rickards> (accessed March 11, 2013).

²⁴James Rickards, *Currency Wars: The Making of the Next Global Crisis* (New York: Penguin Group, 2012), 5.

²⁵*Ibid.*, 8.

²⁶*Ibid.*, 9.

²⁷*Ibid.*

²⁸Financial Policy and Analysis Business Operations, DSCA, "Foreign Military Sales, Foreign Military Construction Sales and Other Security Cooperation Historical Facts," September 30, 2011, DSCA Publication, PDF file, <http://www.dsca.mil/programs/biz-ops/factsbook/Historical%20Facts%20Book%20-%2030%20September%202011.pdf> (accessed March 01, 2013).

²⁹C. Todd Lopez, "Foreign Military Sales Make Partnerships Strong and Production Lines Hot," April 25, 2012, linked from *The United States Army Home Page* at "News Archives," http://www.army.mil/article/78614/Foreign_military_sales_make_partnerships_strong_keep_production_lines_hot/ (accessed March 10, 2012).

³⁰Robert Metzger and Sanjay Mullick, "A 'Work In Progress'-The Evolving U.S.-India Defense Supply Relationship," *India Law News* 2, issue 3 (Summer 2011): 11, http://www.pillsburylaw.com/sitefiles/publications/bylinedarticle_work_in_progress_the_evolution_us_india_defense_supply_relationship_summer_2011.pdf (accessed March 11, 2013).

³¹*Ibid.*

³²Rajat Pandit, "US Raises Arms Sales Pitch to India to Contain China," *The Times of India*, July 24, 2012, http://articles.timesofindia.indiatimes.com/2012-07-24/india/32826569_1_defence-supplier-ballistic-missile-defence-defence-technology (accessed March 11, 2012).

³³Lovejeet Alex, "Dollar's Authority RIP?," *Halabol*, April 03, 2012, <http://voices.halabol.com/2012/04/02/dollar%E2%80%99s-authority-rip> (accessed March 11, 2013).

³⁴Joseph S. Nye, *The Future Of Power* (Philadelphia, PA: Perseus Books, 2011), 83.

³⁵Kenneth H. Nakamura and Matthew C. Weed, *U.S. Public Diplomacy: Background and Current Issues* (Washington DC: U.S. Library of Congress, Congressional Research Service, December 18, 2009), 4.

³⁶*Ibid.*, 2.

³⁷Under Secretary of State for Public Diplomacy and Public Affairs, Judith A. McHale, "Public Diplomacy: A National Security Imperative," Address at the Center for a New American Security, Washington, June 11, 2009.

³⁸The Honorable Joseph R. Biden, *National Framework for Strategic Communication: Annual Report to Congress* (Washington, DC: Office of the President of the Senate, 2010), 3.

³⁹Rosecrance and Gu Guolang, eds., "The Rise of China's Soft Power and Its Implications for the United States," *Power and Restraint: A Shared vision for the U.S.-China Relationship* (New York: Public Affairs, 2009), 28.

⁴⁰Jay Gordon, "When Economic Sanctions Become Weapons of Mass Destruction," March 26, 2004, linked from *Social Science Research Council Contemporary Conflicts Home Page* at "Archives," <http://conconflicts.ssrc.org/archives/iraq/gordon/> (accessed March 11, 2013).

⁴¹Indira Lakshmanan and Pratish Narayanan, "U.S. Wants Iran Oil Buyers to Pledge Cuts or Risk Sanctions," *Bloomberg*, March 23, 2012. <http://www.bloomberg.com/news/2012-03-23/u-s-wants-iran-oil-buyers-to-pledge-cuts-or-risk-sanctions-1-.html> (accessed March 06, 2013).

⁴²Marcus George and Zahra Hosseinian, "Sanctions, Government Blamed for Iran's Drug Shortage," *Reuters*, December 05, 2012. <http://www.reuters.com/article/2012/12/05/us-iran-medicine-idUSBRE8B40NM20121205> (accessed March 09, 2013).

⁴³Jon Matonis, "EU Court Strikes Down Swift's Blockade Against Iranian Banks," *Forbes*, February 08, 2013. <http://www.forbes.com/sites/jonmatonis/2013/02/08/eu-court-strikes-down-swifts-blockade-against-iranian-banks> (accessed March 06, 2013).

⁴⁴Joseph S. Nye, *The Future Of Power* (Philadelphia, PA: Perseus Books, 2011), 85.

⁴⁵F. Burstein and C.W. Holsapple, eds., *Handbook on Decision Support Systems* (New York: Springer-Verlag, 2008), 6.

