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# Applied History in Practice

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Foreword by Graham Allison

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HARVARD Kennedy School

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*Applied History Project*



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# **Applied History in Practice**



# Foreword

*Graham Allison*

Ten years ago, my colleague Niall Ferguson and I published the Applied History Manifesto and launched the Applied History Project at Harvard Kennedy School's Belfer Center. Defining Applied History as the explicit attempt to illuminate current challenges and choices by analyzing historical precedents and analogues, we called for "revitalizing" its practice in the academy and promoting its use in government. The Manifesto notes the marked "history deficit" in policymaking today. The past decade has seen a healthy revival of Applied History around the world.

One core node in today's Applied History network is the Centre for Statecraft and National Security, formerly the Centre for Grand Strategy, at King's College London. Our colleagues there have energetically taken up the task set out in the Manifesto. Their *Case Study in Applied History: Commissioning Historical Papers for the UK's National Security Secretariat* is the result of their collaboration with the UK government to inject historical perspective into its Integrated Review of Security, Defence, Development and Foreign Policy. As a model example of Applied History, this project demonstrates how history, rigorously applied, can illuminate today's headline choices and challenges.

As the authors explain in their preface, the Centre assembled carefully researched and clearly communicated case studies, produced rapid-response memos on questions posed directly by policy officials, and embedded doctoral researchers inside the UK Cabinet Office. The Centre drew inspiration from an analogous effort undertaken by esteemed historians during the world wars to write a number of "handbooks" for policymakers.

Historians working in policy must be alert to live debates and make their expertise useful and accessible to busy policymakers. *A Case Study in Applied History* offers a clarifying example of how historians can rise to these challenges and meaningfully contribute to better policymaking. It offers valuable reading both for those aspiring to practice Applied History and for policymakers committed to effective statecraft.

# A Case Study in Applied History: Commissioning Historical Papers for the UK's National Security Secretariat

*By Andrew Ehrhardt, Maeve Ryan and Oliver Yule-Smith*

In 2019, the UK government under Boris Johnson announced that it would carry out an Integrated Review (IR) of security, defence, development, and foreign policy. It had been four years since the publication of the last major strategic defence review, and the announcement of the IR reflected an awareness of a deteriorating strategic outlook and sharpening systemic competition, in which the openness of the international system – so vital to UK prosperity and interests – was under direct challenge. The UK's closest ally had shifted to a more confrontational stance with its announcement of the return of great-power competition, and Britain, since its departure from the European Union, seemed adrift in a world that was in a state of systemic transformation. Within months, a global pandemic threw the world even further into disarray, with compounding and cascading geopolitical, economic, and strategic implications.

Observers of UK foreign policy and strategy had long bemoaned the dearth of serious strategic thinking in the system and stressed the need for a shared comprehension of the key national interests that should be at the heart of a grand strategy for the twenty-first century. Fundamental, then, to the project of the IR was an intent to achieve a modern 'grand strategic reset'. The core purpose of the IR would be to identify core national interests, and to establish clear and ambitious grand strategic handrails to guide the strategic reset.

As historians working at the Centre for Grand Strategy (now the Centre for Statecraft and National Security) at King's College London, we looked to history to see what precedents existed for the strategic challenge the UK government had set itself – and what cautionary tales officials might learn from. Established in 2016 with Applied History at its core, the central mission of our centre is to bring a greater degree of historical and strategic expertise to statecraft, diplomacy and foreign policy, particularly in the UK. Our community has built deep connections with the wider Applied History network, including Harvard, Stanford, Johns Hopkins SAIS, the University of Texas at Austin, the University of Cambridge, the Stockholm School of Economics, and more. Through the Engelsberg Applied History Programme, we had set up a programme of teaching and research that embodied this spirit of bringing historical knowledge to bear on the most pressing challenges of our time. We took the opportunity of the IR as a moment to do something new: to innovate, test, and refine different models of injecting deep historical expertise and targeted insights into the government strategy process. This was completely novel in the UK context. Unlike in the US, where there are deep connections and almost a revolving door between academia and the policy world, this needed to be built from scratch here.

We set to work building relationships with the National Security Secretariat, and over a period of months we learned from officials about the barriers to effective engagement. These include an aversion to talking shops, a perception that academics will come in and waffle (especially historians who might share examples that are either abstract, irrelevant, or too detailed as to be unclear), and a general sense that it would be hard to find and apply insights. It was a process beset with anxiety on the part of officials around the candid sharing of information.

With this in mind, we began designing our approach. Even at the very beginning, our entire endeavour would be shaped by historical precedent, namely, of the way that British historians were brought into a close working relationship with the British Foreign Office during the First World War. These academics, among them

Arnold Toynbee, Alfred Zimmern, and Charles Webster, produced 'political handbooks' – short historical pieces of 10-15 pages on subjects such as 'The History of the Danzig Corridor' and 'The Congress of Vienna, 1814-1815' – which provided policymakers and negotiators at the Paris Peace Conference with a historical grounding for their work. Two decades later, at the outbreak of the Second World War, many of these same historians were brought into similar advisory roles. Charles Webster, then on leave from his position as Chair of International History at the London School of Economics, was the shining example from these years. He was considered the foremost expert on both armistices and international organisation, due to his extensive scholarship on the Congress of Vienna, the nineteenth century 'Concert of Europe', and more recently, the League of Nations. Papers he produced in the first months of 1943 included: 'The Political and Procedural Problems of the Armistices of 1918', 'The Maintenance of Order in Europe 1918-19', and 'The Causes of the Failures of the League of Nations.' As the Foreign Office began to focus more on post-war planning, Webster became one of its most influential minds working to establish the United Nations Organization.

With these historical precedents in mind, we designed a range of approaches and methods of policy engagement, but the most effective were:

## Historical case studies

Inspired by Webster's approach outlined above, we proposed commissioning concise, focused, policy-oriented historical case studies on themes directly relevant to the strategy-making challenges the National Security Secretariat was facing. The first round of case studies would be focused on 'strategic resets' in foreign policy. The reception from government officials to these proposals was at first mixed. Some saw the benefit of past historical precedents for their work, while others were sceptical. Just how much could stories from past experience really illuminate and inform modern policy challenges? Hadn't the world changed too much, say, from the 1940s and 1970s, for case studies from these periods to be of any relevance? This scepticism was understandable, but we continually stressed that the purpose of looking to historical precedents was not to find easy answers but to glean insights that could help shape a more general strategic outlook.

We cast a wide net, both geographically and historically. We invited Professor Rana Mitter, then at Oxford University, to write about Chinese strategic resets in 1945 and 1972. Three scholars from King's College London – Ramon Pacheco Pardo, Rudra Chaudhuri, and Alessio Patalano – wrote about strategic recalibrations in South Korea, India, and Japan, respectively; while Gill Bennett (a former Foreign Office historian herself), Oliver Yule-Smith and Andrew Ehrhardt wrote about specific approaches to British and American strategic resets from earlier in the twentieth century. As for 'findings', we resisted the urge to construct any kind of larger generalisations from these different cases and instead worked to highlight certain insights that cropped up from specific studies. For example, Rana Mitter described how the cases of Chinese strategic resets in the 1940s and 1970s pointed to the fact that often, strategic realignments do not proceed in a smooth linear trajectory, and costs and benefits can accrue over time.

These papers were ultimately well-received among officials and they led to another round of work. The purpose of the next iteration of reports was to understand how, once a new national strategy has been decided, governments can best implement it. For this series of papers, we brought together a range of analysts and historians, including Georgina Wright, David Morgan-Owen, William James, and Kori Schake. Far from an exercise in ordering national strategy's greatest hits, these contributors used case studies to discern sources of procedural tensions and organisational harmonies right at the heart of a government's policy machinery. To name a few findings, contributors argued for the importance of so called 'agents of change', the necessity of bipartisanship for a durable strategy and that – much as we might want to think otherwise – budget

documents were essentially strategy documents. Kori Schake in her contribution chose to drill down into the implementation of national security policy under President Dwight D. Eisenhower, showing the value of a bespoke bureaucratic structure in which the US president had an outsized influence and how he was able to advance his strategy by 'structuring circumstances', fostering coalitions, and treating the budget as a powerful lever of control.

This was followed by a third and final series of papers related to the Integrated Review (IR). One of the initiatives from the government review was to design a Strategy Unit that could sit within the Cabinet Office and be concerned with the coordination of long-distance planning across various government departments. In line with this objective, we set out to commission papers looking at the 'mechanics of strategy-making', and in particular, best practices in designing certain structures and functions of dedicated strategy units within and across governments. Authors including Louise Kettle, Philip Zelikow, and Sir Lawrence Freedman described a range of precedents in designing strategy units and coordinating high-level foreign policy. Select findings from this report include the importance of ensuring strategic thinking – both within and between departments – benefits from a two-way conversation, with an opportunity to feed assessments, ideas, and recommendations up and down the hierarchy; the necessity of protecting institutional memory to avoid a disconnect between governments or administrations; and, the value of officials recognising and assessing a wide range of contingencies at each stage of the policy process.

## **Rapid-response deep dives**

Balancing the need to be responsive to specific topics that officials were grappling with, we also felt there was an important place for rapid-response 'think pieces' that pointed to questions or ideas that deserve special attention. These were often conceptual, regional and issue-led. They emphasised important concepts or ways of thinking that lay in the hinterlands of what officials were already thinking about. For example, during the course of a meeting with an official about US-China competition, there was a brief, offhand mention of a 'Cold War 2.0'. Given the range of interpretations and various meanings that that term carries, we thought it was important that officials had a firm grasp of the term's deeper intellectual tributaries. Similarly, in the course of a conversation about international order, there seemed to be some confusion about the difference between an 'international order', a 'world order', and a 'rules-based international order.' There was also a question about the utility of thinking in terms of 'regional orders'. Once again, we felt that it was important that there was a common understanding of these terms, which we believed would contribute to these officials' wider strategic fluency. These rapid-response 'think pieces' continue to be an important element of our approach.

## **Mutual capacity-building**

One of the most unique developments to come out of this academic collaboration with the National Security Secretariat was a pilot project whereby several doctoral students working on historical subjects were embedded within the Cabinet Office, tasked with investigating how officials engaged with the Integrated Review (IR) thought about the development of national strategy, the optimal structures and systems to underpin national strategy, and the state of international order. The embedded doctoral students interviewed officials at every level of the IR and from across Whitehall, ranging from highly specialised desk officers to pen holders of the review charged with pulling together the written document. The findings of these interviews were compiled into an internal report. The doctoral students were invited to extend the period in which they were embedded

to help with the next phase of translating the published IR into reality, playing an important role in the conceptual development of IR sub-strategies and implementation approaches. The value of this was recognised in a personal note of thanks that each participant received from the Deputy National Security Advisor.

This potted history of the early years of our work, trying to find our Applied History ‘method’, is the basis of a working relationship with government that continues to this day. In the wake of the election of the first Labour government since 2010 and in the shadow of the first Strategic Defence Review since 1998, our work continued. We produced papers on subjects like European security architecture and policy planning and the machinery of government, but we also continued to fine-tune the centrepiece of our approach: the Forum on Future Strategy. For these forums, we decide on a specific brief and get a set of orienting questions from officials, before identifying and commissioning contributors to write papers, which are then presented before they are discussed with senior officials. We have run these types of forums on subjects like the future of multilateralism, the war in Ukraine and the development of national strategy. As far as possible, we aim to create the conditions for frank and open discussions between officials and experts.

As these forums have become more agile and efficient, we have not lost sight of the fact that the indispensable ingredient for all of this is trust: trust that when hard-working senior officials in a perennial time deficit sign-up to attend these sessions, their time will not be wasted – that they will be able to have conversations that engage them, that challenge them or even inspire them to seek fresh approaches.

## **Our general approach**

The Centre for Grand Strategy, now Centre for Statecraft and National Security, approach can best be summarised as:

1. Drawing insights from past precedents.
2. Grasping the longer historical roots of modern phenomena by critically engaging with a creative and expansive range of comparative examples.
3. Working closely with academics, pushing hard for very concise, targeted, usable insights, carefully distilled and expressed as leanly and directly as possible, which include policy recommendations or options where appropriate.
4. Understanding older approaches and traditions in strategic policymaking to help shape institutional memory.
5. Anticipating barriers to policy delivery by identifying historical and bureaucratic path dependencies.
6. Red-teaming policy papers and proposals.
7. Making sense of the historical moment we are in.
8. Convening open conversations between officials and experts on high-level topics where existing policy engagement structures are inadequate.

## Lessons learned

Much as we might want to say this approach was quickly conceived and seamlessly deployed from day-one, the reality is that we adapted and improvised, based on feedback from government officials.

1. To be most policy relevant, prompts or questions should come from officials. On occasion, academics should provide prompts in the form of papers to help officials find fundamental first-order questions.
2. An editor is important. Knowledge often needs to be edited in line with what policymakers are looking for and willing to read.
3. The Applied Historian must have a foot in both history and policy, without becoming unmoored from either. Staying up-to-date with government personnel changes is as important as staying up-to-date with new historical research.
4. Flexibility, an ability to anticipate areas of governmental interest and the capacity to exploit opportunities are amongst the Applied Historian's most valuable virtues. When the winds change in government, the research must move with it to avoid being lost in the system.
5. The most impactful projects tend to have a strong bedrock of trust that has built up between the Applied Historian and official.
6. There are only so many projects that you can participate in at once. The key is to understand where you can add real value.

## What did we achieve?

The reason that this collaboration has lasted as long as it has is not only because we offered something unique within the constellation of governmental thinking, but because we delivered knowledge and insights that were of direct relevance to officials. These results were:

1. We demonstrated to the system the value of historical insights and ways of thinking.
2. We influenced policy and thinking, notably on areas related to the creation of systems for effective national strategy.
3. We gained firsthand experience of how to influence governmental thinking from inside the system. This was experience, not to mention a cross-government network, that we could continue to draw on for future projects.

## What did we learn about Applied History in practice?

1. The challenges of pinning down effective case study insights that can be applied in practice. These case studies had to simultaneously work as standalone pieces of history (which is to say they were academically rigorous and would hold up to academic scrutiny) and they had to be useful for policymakers.
2. Good ideas do not always lead to good outcomes. There are a multitude of cultural, practical, economic, bureaucratic and political barriers that can impede the conceptualisation, writing and/or

delivering of a national strategy. Academic policy engagement is ultimately subject to those same forces.

3. When it worked smoothly our contributions were integrated into the policy process, but our contributions were also used to help fight internal cross-departmental debates, which – when managed carefully – can be just as valuable.

## Editorial note

Reproduced in the following pages is the first historical case study report that was produced for British officials involved in the Integrated Review (IR) by the then Centre for Grand Strategy in 2020. Aside from some formatting changes to make these reports cohere as a single volume, none of the material presented herein has been amended from what was originally submitted to the UK government.

We would like to thank everyone who contributed the excellent case studies that made these reports so impactful. We particularly thank Rana Mitter, Ramon Pacheco Pardo, Rudra Chaudhuri, Alessio Patalano, Hillary Briffa, Gill Bennett, William Reynolds, James Barr, Benedict Wilkinson and Matthew R. H. Uttley for their permission to reproduce their original contributions below. Thank you to Ivana Tú Nhi Hoàng Giang, Aristotle Vainikos and members of the Belfer Center for their assistance in adapting this report for publication. We would also like to thank the Engelsberg Applied History Programme who funded all three of our reports and without whose support this ambitious project would not have been possible.

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## Historical Case Studies for the Integrated Review, Part I

### ‘Strategic Resets’

In coordination with the Cabinet Office, the Centre for Grand Strategy has commissioned a series of papers to help inform the planning and delivery of the United Kingdom’s forthcoming Integrated Review. The purpose of these reports is to understand how major strategic ‘resets’—i.e. significant redirections and realignments of foreign policy—have been conceived and implemented across a range of historical and contemporary contexts. By examining specific instances in which countries, including the United Kingdom, have undertaken strategic realignments, the papers offer valuable insights for policymakers currently developing the Integrated Review.

### Select findings included:

- Strategic resets must take account of existing political realities, particularly a country’s diplomatic, military and economic commitments to other countries as well as regional and international institutions. When these realities are ignored—or worse, incorrectly viewed as malleable—a strategic reset can result in failure.
- Strategic resets are rare, in part because they are difficult to initiate successfully. They often run up against bureaucratic inertia, a host of ingrained and implied values, images of national identity and subsequent choices about the future of war, force structure and weapons acquisition.
- Realignments require the buy-in of key stakeholders, but first and foremost the national public. Policymakers must thus have the ability to (1) gauge the direction and intensity of public opinion and (2) persuade citizens of the benefits of a particular strategic realignment.
- The mechanics of strategy-making are dependent on existing bureaucratic structures, but personalities and personal relationships matter. Closely related is that the major policy initiatives tend to be dependent upon the buy-in of various departments across government, a measure of support which is often secured in the early planning stages.
- Both from an intra-and inter-governmental perspective, those who take the strategic initiative often shape the political, economic or military agenda.
- External events, especially ones outside of the control of a national government, can doom a strategic reset from the start. The odds of a successful realignment further decline when policymakers misread—or worse, ignore—certain emergent forces within international politics.

- Strategic resets should begin with a sober reassessment of first-order assumptions and first-order principles. These can include: the nature and pace of change within the international system; the benefits and dangers of allies and adversaries; the sources of national influence; and the contours of national interest.
- Futures thinking and horizon scanning, while a necessary function, often suffer from inherent limitations.
- Strategic realignments do not usually proceed in smooth, linear trajectories. Benefits can arrive years, even decades later; while more negative ramifications can be experienced long after the reset was implemented. Moreover, future leaders can attempt to alter the narratives around perceived historical resets.
- Historical narratives of past 'strategic resets' can, at times, be exaggerated—a misuse of history which can exercise significant influences on contemporary approaches.

# Summaries of Reports

## 1. Chinese Strategic Resets in 1945 and 1972

*Professor Rana Mitter*

Part I of this paper first dissects China's unprecedented and anomalous position at the 'winner's table' after the Second World War, a moment which provided Chinese leader Chiang Kai-Shek an opportunity for a major strategic reset. The study sketches how the objectives of economic and political reconstruction at home, coupled with a newfound desire to become a global (non-western) leader, was crushed under the weight of the emergent Cold War. Part II of this paper turns to the 1972 rapprochement between China and the United States, an initiative which had profound implications for China as well as the global balance of power. Among a number of points put forward in this report is the importance of domestic economic strength and stability as well as the fact that strategic resets do not often proceed in a smooth linear trajectory, with benefits—as well as costs—possibly accruing over time.

## 2. South Korea's Strategic Reset under Roh Tae-woo: *Nordpolitik*

*Dr Ramon Pacheco Pardo*

This study explores the strategic and intellectual framework around which President Roh Tae-woo crafted his grand strategy of *Nordpolitik* in the late 1980s. Inspired by West Germany's *Ostpolitik*, this successful strategic realignment had economic and political components, including the promotion of trade and the improvement of relations with North Korea, the Soviet Union and China. Having buy-in from both the public and the 'elites' from the outset provided a strong foundation from which to begin seeking internal reforms and new external economic relationships, particularly with China. Though he was constrained by a single five-year premiership, Roh's initiatives built a transgenerational consensus and allowed his strategic realignment to survive across successive governments.

## 3. India's Strategic Resets in the 1990s and 2014

*Dr Rudra Chaudhuri*

Part I of this study on recent Indian strategic realignments begins in the 1990s, when the country's near-bankruptcy forced policymakers to alter economic and foreign policy priorities. The government of Narasimha Rao first enacted reforms to liberalise finance and trade, and then, sensing the changing international dynamics brought about by the end of Cold War, set about to improve relations with the United States and China. Key characteristics of Rao's approach included a determined political will, the absorption of expert advice and the circumvention of protocol to enact swift and decisive changes. Part II of this study turns to the government of Narendra Modi, who, upon entering office in 2014, spoke of delivering 'India's Century' by resetting India's relations with countries across the world. While significant reforms—such as reorienting supply chains back to India, or in agriculture and industry—were undertaken, these are yet to achieve fruition. The rise of China and its effects in South Asia have made the task of strategic reset harder to achieve.

## **4. Japan's Strategic Reset under Abe, 2012-2020: The Rise of the Kantei**

*Dr Alessio Patalano*

This paper discusses the strategic reset implemented by Prime Minister Shinzo Abe during his second tenure as a Prime Minister. Abe's success in re-engineering Japan's international profile and influence was the result of three core initiatives: he centralised the Japanese decision-making system around the Prime Minister's office (Kantei); he expanded the realm of the 'politically possible' in foreign and security affairs; and he injected Japanese foreign and security policy with a worldview focused on the Indo-Pacific region. In particular, the paper explores how the importance of Abe's centralisation of power cannot be disentangled from the fundamental ideational and behavioural changes implied in the second and third initiatives. Abe took power to the Prime Minister's office and used it to shake the bureaucracy out of established patterns of behaviour and offered a vision which made new policy—a reset—possible.

## **5. Malta's Strategic Reset: Becoming 'Blockchain Island'**

*Dr Hillary Briffa*

This report examines Malta's recent effort to adopt Blockchain technology as a fundamental pillar of its future economic, political and diplomatic strategy. Though it has been considered an unsuccessful realignment, Malta's effort to reconstitute itself as 'Blockchain Island' contains a number of important insights. First, it highlights the way in which the online space enables states of all sizes, with varying material resources, to become more economically competitive. Next, it displays the importance of aligning values with strategic efforts, especially when such initiatives engage with novel, unregulated technologies. Finally, the study underscores how the best ideas will still falter if the national reputation of the country does not foster credibility and public trust.

## **6. 'Substituting Bullets for Dollars': William Taft and Dollar Diplomacy 1909-1913**

*Oliver Yule-Smith*

This paper comprises the oldest historical study of the series, and examines an unsuccessful strategic reset initiated by American President William Taft in 1909. This mercantilist strategy, known as 'Dollar Diplomacy', prioritised financial and economic tools of statecraft, including the use of generous loans and the promotion of stronger commercial ties with foreign populations. The paper presents a cautionary tale that demonstrates the importance of striking a balance between different tools of statecraft, the dangers of mismanaging regional pivots, and the costs associated with undertaking a reset without broad domestic support. In Taft's case, the mismanagement of the political economy of a pivot towards another region, undertaken without the support of Congress and public opinion, proved to be a folly.

## **7. British Strategic Resets in the 1940s: The UN and NATO**

*Andrew Ehrhardt*

This paper examines certain elements of the British diplomatic planning efforts during and after the Second World War. It focuses on two moments in particular—the creation of the United Nations Organization in 1945

and the creation of the North Atlantic Treaty Organization in 1949—and highlights certain key takeaways. First, officials in the period not only valued but prioritised long-term planning, seeing it as a way to be ‘the master, and not the victim, of events.’ Next, first-order principles and first-order assumptions, assessed in the context of pressing contemporary challenges, often served as the conceptual starting point for strategy. Finally, there was an underlying approach to British grand strategy which held that the country’s interests—as well as its regional and international influence—rest in its ability to lead through larger political, economic and military institutions.

## **8. The United Kingdom after Suez: A Strategic Reset?**

*Gill Bennett MA, OBE, FRHistS*

This detailed study re-examines the popular narratives concerning British policy after the Suez Crisis, arguing that there was no strategic reset after the events of 1956. Though the government had long recognised the need for a reprioritisation of defence—based on dire post-war economic realities and a series of geopolitical ‘shocks’ which faced Britain in the years after 1945—there was little serious consideration of Britain reducing global obligations. Even after a more concerted effort to review British defence and security policy in the early 1950s, the ministerial views of Britain’s global role remained largely unchanged—a reality which lasted through the period of the Suez Crisis. Indeed, it was not until 1968 and the decision to withdraw British forces from the east of Suez and the Persian Gulf that a more radical strategic reset was implemented.

## **9. The UK’s attempted Strategic Reset under Edward Heath: EEC Membership**

*William Reynolds*

This study examines the unsuccessful strategic reset undertaken by the Edward Heath administration between 1970 to 1974, and in particular, Heath’s effort to harness national power through Britain’s accession to the European Economic Community (EEC). With both the Commonwealth and the ‘Special Relationship’ dwindling, EEC membership became the visionary foil for attaining the timeless tasks of ‘finding a role’, and ‘showing leadership.’ While willing to question first order assumptions and to capitalise on the end of Charles de Gaulle’s tenure (during which the French President had vetoed British accession twice), Heath struggled to sell the EEC to the public and ended up alienating his own party. Certain external events—including the American decision to end the Bretton Woods system and to undertake military action in Southeast Asia—served to fracture American-European relations, which remained a key aspect of Heath’s strategy.

## **10. New LIFFE: A Strategic Reset in the City**

*James Barr*

This paper examines the strategic reset initiated by the London International Financial Futures and Options Exchange (LIFFE), an institution with certain structural similarities to government. The exchange underwent a commercial strategic reset in 1998, sixteen years after its founding, in reaction to a competitor’s (Deutsche Termin Börse) entry into the market. LIFFE was initially unable to confront the threat because its governance structure required buy-in for radical change, namely from people who would be profoundly affected by that change and were able to block it because they owned stakes in the business. It was not until these

stakeholders reconciled themselves to the fall in the value of their investment in the business—and the prospect that it could soon be worthless if they continued to oppose change—that action became possible. New leadership was appointed that offered clear vision, and the realignment focused on the ways by which the market was made available to customers.

## 11. The Challenge of Strategic Resets

*Dr Benedict Wilkinson and Professor Matthew R. H. Uttley*

This report serves as a warning to those policymakers wishing to undertake a strategic reset. The authors examine the concept of a strategic reset through the prism of the future of conflict. For all the futures thinking which takes place in defence ministries, these exercises very rarely bring about major policy change, let alone strategic resets. One of the main reasons is that strategic resets butt up against a host of ingrained and implied values, images of national identity and subsequent choices about the future of war, force structure and weapons acquisition. For the United Kingdom, in particular, ideas about the type of role on the international stage that Britain ought to occupy are deeply embedded and challenging those will not just be about finding clever military solutions—it will also be about changing and shifting a set of perceptions about national identity. The best course of action may perhaps be to act fast to shift ingrained self-perceptions about Britain's role on the global stage.

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8 September 2020

# 1. Chinese Strategic Resets in 1945 and 1972

(1) This report examines two case studies of Chinese foreign policy in the post-1945 world. The first concerns the unsuccessful strategic reset undertaken in 1945 in the aftermath of World War II, and the second focuses on the successful realignment in 1972 when Mao Zedong met Richard Nixon.

(2) Examining cases based on the post-1945 history of China has a very particular value for British decision-makers. Because China has been such a definitively different polity from Britain in modern history, the comparisons and contrasts provide a control sample for other comparisons that are more similar. Comparisons with France, postwar Germany, or even Japan are, in the end, comparisons with countries that share certain basic commonalities, in particular a belief in democratic governance and the experience of full inclusion in the international system since 1945. Neither of the observations is true for China. Therefore, the observations from the two cases below provide a useful point of contrast with more familiar resets in foreign policy in the liberal world.

(3) There are some general observations from the two cases:

1. Grand strategy is important, but it needs economic and political strength and stability to operate in practice: even detailed aspiration is not enough without economic and strategic forward planning.
2. The success of a strategic reset is dependent on one's credibility with other key actors.
3. Long-term verdicts are sometimes different from short-term ones; but the "short" term can last decades.
4. Resets do not always proceed in a neat linear trajectory.
5. Domestic support is very important to achieve a sustainable reset.

## Part I: China takes a leading role in international society, 1945

(4) In August 1945, China found itself in a historically unprecedented and anomalous position. It was simultaneously stronger and weaker than it had been for a century. China, the US and the British Empire had formed the Allies in the Asian theatre of World War II. During the last years of the war, and the immediate postwar period, China's international position was greatly boosted, in particular because of American keenness to bolster the Chinese position. There was personal animosity between the then Chinese leader, Chiang Kai-shek and the administration of Franklin D. Roosevelt, but the Americans were also keen to make sure that the post-1945 settlement was not dominated by the European empires of Britain and France, and to encourage the end of those empires. Moves such as the installation of China as the only non-western permanent member of the UN Security Council served this purpose.

(5) However, China itself was not a passive recipient of these changes. Chiang, and the Chinese Nationalist party's leaders more broadly, saw the end of the war against Japan as a moment for a major strategic reset in China's relations with the world; from being a country constrained by various treaties it had been coerced into signing by foreign powers to one which itself could control the geopolitical weather in its own region, and which would be an exemplar for a reconstructed Asia.

(6) Geopolitical thinkers within Nationalist China proposed a range of important ideas about what a postwar China would look like, and how it would shape its region and the world:

- Reconstruction of the economy at home to create a modernized industrial sector and revive the agricultural sector which had been destroyed by the war, allowing an export-driven economy to develop
- Strong support for anti-imperialist movements in countries still under British, French and Dutch rule
- Development of political norms that would suit both Chinese circumstances and international demands, i.e. limited multi-party democracy
- Creation of new alliances; in particular, a bold proposal quickly to forgive Japan for its invasion of China and instead turn Japan into an ally on China's regional ambitions
- Active and leading roles in international organizations including the international legal system (war crimes trials, etc)

(7) China swiftly rose in status in the non-western world in the years immediately after 1945. Independence movements in countries that were still colonized sent petitions to Chinese ministers asking for their support (for instance, Sukarno in Indonesia). Its first ambassador to the UN, Jiang Tingfu, became a prominent figure in the organization, and was also heavily involved in emergent international organizations such as ECAFE (the Economic Commission for Asia and the Far East). China was still not taken very seriously by the western world, including by an increasingly hostile Truman administration. But among emergent states and liberation movements in Asia, China's new status was regarded as an important turning point for the non-western world.

(8) The Nationalist government's strategic reset also took place within a different context over which it had much less control or agency: the emergent Cold War. Chiang's immediate concern on this front was domestic: to control the Communist insurgency at home by crushing it militarily (and then, if necessary, coming to a domestic political compromise). On the international front, Chiang tried at first to balance between the great powers. He received considerable attention from the US, which naturally considered that a postwar China would provide support for the new US-defined global order. However, Chiang also moved in early 1945 to sign a Soviet-Chinese agreement which would ensure that the USSR would not intervene on behalf of the Chinese Communists in exchange for essentially rights of control in the crucial region of Manchuria.

(9) This clever national-level balancing, however, proved vulnerable to international forces beyond Chiang's control. The Soviets started to violate the agreement within a few months, giving arms and strategic support to the Chinese Communists in breach of the agreement; while the US made it clear that their support for Nationalist China would be limited. The domestic situation worsened. The war had destroyed China's economy and created a massive domestic refugee crisis which even \$600 million of United Nations relief could not solve. Domestic problems meant that Chiang's international status also weakened, ultimately irrecoverably, as the Nationalists lost the civil war and were forced to flee to Taiwan in 1949.

(10) POSITIVE: At the time, the civil war devoured almost all the attention of the Nationalist Government, and any attempts to focus on other aspects of the government's performance seemed almost irrelevant. Over the very long term (i.e. from the early 2000s), however, China's strategic reset in 1945 has become a source of enormous rhetorical power in contemporary China, particularly as the PRC seeks to portray itself as a citizen of—rather than a challenger to—the dominant order. Today, considerable attention is paid within the PRC to the attempts in the 1945–49 period by the Nationalist government to redraw maritime boundaries, establish a firm Chinese position in international organizations, and to portray itself as a leader in the Global South, all of which have clear parallels today. The post-1945 foreign policy reset is being selectively, and powerfully used by today's regime.

(11) **NEGATIVE:** China's plans were rooted in an ideological vision that was in many ways very suited to the time. The growth in anti-colonial sentiment in 1945 meant that there was room for a powerful non-western actor to take a leadership role in international society. There was also a certain skill in arguing that the new international circumstances (including the establishment of post-1945 international organizations) could provide a new framework for a sovereign China to operate. However, two major issues brought the plans to grief. China's regional and global aspirations were near-impossible when the country's economy was in dire straits. In addition, the National Government had insufficient understanding of the profound divisions within its own society. It failed to understand that the Communist-Nationalist divide was not merely a product of ideological "false consciousness" but reflective of genuine differences of view about the shape of China. This lack of understanding would undermine Nationalist China at home and destroy its genuine attempts to reset its position internationally.

## **Part II: The opening to America, 1972**

(12) In February 1972, US President Richard Nixon met Mao Zedong in Beijing, marking the beginning of the end of the diplomatic freeze between the two countries which had lasted since the Communists' rise to power in 1949. This event marked one of the most important strategic resets of the post-1945 era, and there is a direct line of connection to the present-day US-China relationship. The encounter has become one of the most famous diplomatic realignments in history, even being commemorated musically in John Adams's opera *Nixon in China*.

(13) However, at the time, it was significantly contested within the Chinese leadership itself. A lack of historical sources makes the precise details murky, but there is evidence that significant figures within the leadership, such as Defence Minister Lin Biao, did not want to open up to the US, whereas Premier Zhou Enlai was enthusiastic. The debate centred on the ideological significance of the meeting: would compromise with the old enemy, the US, mean ideological contamination of a pure, radical socialism as expressed in the Cultural Revolution, which was raging at the time?

(14) For both the US and China, there were significant advantages in choosing a reset at that moment. In both cases, they were under severe domestic and international pressure. For the US, an oil crisis and high inflation were on the way, and the Vietnam War showed no signs of ending. For China, the Cultural Revolution had plunged the country into chaos, and it had alienated all its overseas partners including the USSR, leaving only Albania as an ally. Each side could see that the talks might provide a genuine opportunity for their counterparts.

(15) Yet in 1972, despite the Cultural Revolution, China was not in a state of fundamental collapse as it was in 1945. Mao, Zhou and others saw that a reset could be implemented because domestic politics was (just) stable enough to allow a new arrangement to stick. They could see many advantages:

- A tacit partnership with the US protecting China against the USSR, which they considered a much greater threat
- Economic assistance for the incipient economic reforms (which in contrast with conventional wisdom did not begin in 1978 but were already under way under Zhou Enlai in the early 1970s)
- A new narrative about China's engagement with the world

(16) Yet in retrospect, one key lesson from the Mao-Nixon encounter was that strategic resets do not proceed in a smooth, linear fashion. It was another seven years (and under a different US president, Jimmy Carter) that China and the US finally established full diplomatic relations.

(17) POSITIVE: The general consensus over half a century has been that the reestablishment of links between China and the US was a long-overdue step that created a more stable and globalized world. Between the 1970s and the late 1980s, China was, in essence, a tacit ally of the US, allowing the Reagan administration more space to confront the USSR in the final phase of the Cold War. Meanwhile, China's move to a market economy, combined with US willingness to become a debtor nation, fuelled a global economic boom. None of this would have been possible without the opening to China in 1972.

(18) NEGATIVE: However, in 2019-20, the Trump administration has defined China as the major strategic challenge of the era. Noting egregious violations by China of international norms (on UNCLOS, human rights, agreements on Hong Kong), in a speech in July 2020, Secretary of State Mike Pompeo declared that the 1972 Nixon-Mao meeting had ultimately been a failure, because it created a China that was now a threat to the western order. It is still too early to tell whether this reinterpretation of the event will be widely accepted; few actors other than the US have declared that western engagement with China was, in principle, unwise.

## Conclusion

(19) The UK shares almost no social or political characteristics with either the weak Nationalist China of 1945 or the stronger PRC of 1972. Nonetheless, certain aspects of these two historical resets are universal, in that they apply to any power seeking to rethink its foreign policy. Very broadly speaking, China's attempt to reconstitute itself as a power that could reshape Asia and have global influence in 1945 was a failure; China's engagement with the US in 1972 was a success.

Both resets illustrated some important basic principles:

(20) Grand strategy is important, but it needs economic and political strength and stability to operate. China in 1945 was in an ironic situation, different from any other belligerent power in the Second World War. It was a victor, so it could not rely on the dubious privilege of being occupied and reconstructed like Japan or Germany. Yet it was, by a wide margin, the most impoverished and internally riven Allied power. Thus, when the Roosevelt administration charged it to take a globally leading role, China chose to take up the role of a strategic power at a time when it could not guarantee stability in its cities or sufficient food supplies for its population. Its aspirations and responsibilities heavily outweighed its capacity; yet its geopolitical situation prevented it from gaining further assistance.

(21) Credibility is also important. Nationalist China in 1945 had more credibility among its Asian peers than is sometimes realized, because it was seen as an Asian power that had fought essentially alone against an imperialist invader (Japan). Yet the domestic crisis in China prevented it building on that genuine goodwill. The PRC in 1972 had destroyed much of the credibility it had built up in the 1960s as a Third World leader. Yet it had also understood that successive US administrations were trying to reach out to it, and was aware that a deal with China was of sufficient value to Nixon that it was worth taking the trouble to create a credible, if fractious, relationship between the two.

(22) Long-term verdicts are sometimes different from short-term ones; but the "short" term can last decades. Today, the record of the Nationalist government in China in 1945 is taken quite seriously by PRC leaders, with Xi Jinping, Wang Yi and other leaders frequently referring to China as the first country to sign the UN Charter, something never mentioned under Mao while China was out of the organization. However, it took over half a century for that revisionist view to become mainstream in China. It is possible that the 1972 meeting, regarded for half a century as a great diplomatic triumph, may instead be criticised as a diplomatic failure in the future. Of course, it is a fool's errand to try to predict opinions decades into the future. But it is worth remembering

that long-term effects do matter and it is best to avoid projecting wishful thinking about what may happen. Much of the disappointment over contemporary China, at least in the Western world, is based on the idea that China failed to become a democracy after its rapprochement with the United States. Since a democratic system was never the Communist Party's intention, it might have made more sense for Western governments to understand what China thought it was doing, rather than anticipate what the West hoped China would do.

(23) Strategic resets do not necessarily follow a linear trajectory. The 1972 Nixon-Mao meeting has become the stuff of legend. Fewer people remember that the following seven years were marked by setbacks, reversals and difficulties on both sides, exacerbated by the change of leadership in both countries (Mao to Hua Guofeng to Deng Xiaoping; Nixon to Gerald Ford to Jimmy Carter). Americans involved in Track 2 discussions in the mid-1970s recall multiple frustrations on the way to what now seems an inevitable diplomatic rapprochement.

(24) Domestic stability and support are also crucial. In 1945, the Nationalists' genuinely ambitious and innovative plans in many areas—most notably a new role for China in international organizations—were destroyed in part by domestic instability and a lack of popular support. In contrast, in the early 1970s, the prospect of the Communist Party being destroyed either from within or outside was relatively low, and this gave more heft to the policy of closeness with the US.

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## 2. South Korea's strategic reset under Roh Tae-woo: *Nordpolitik*

(1) This report focuses on the strategic realignment undertaken by the government of South Korean president Roh Tae-woo in the late 1980s. Known as *Nordpolitik* or Northern Policy, the strategic reset was successful for three reasons: (1) South Korea was able to establish and improve relations with the Soviet Union, China, and European (post-)communist countries, (2) South Korea reduced tensions with North Korea, and (3) South Korea opened up new markets for its export-oriented firms.

(2) Roh Tae-woo won South Korea's first free election since the 1960s in December 1987. The election came at a crucial point in time in South Korean history. It put an end to almost three decades of dictatorship, which was possible thanks to recurring protests by ordinary South Koreans over the previous years. The election also came barely nine months before the Seoul 1988 Olympics, which symbolized that South Korea was 'winning' the competition for international recognition against North Korea. Furthermore, the election was held barely three weeks after North Korea blew up a Korean Air flight, killing all 115 people on board.

(3) It was in this context that newly-elected President Roh announced his *Nordpolitik* in July 1988. This was a major realignment of foreign policy that, to a large extent, has informed South Korean foreign policy through 2020. Both conservative and liberal administrations in power after President Roh left office in 1993 have implemented some version of this policy. Whether explicitly or implicitly, successive South Korean governments have followed its key tenets. *Nordpolitik* thus stands out as a successful case of a major and long-lasting 'strategic reset.'

(4) *Nordpolitik* had several core elements that revolutionized the character of South Korea's foreign policy strategy: promotion of trade, exchanges of visits at all levels, and humanitarian contacts between the two Koreas; the dropping of opposition to South Korea's allies engaging in non-military trade with North Korea; cooperation with North Korea in its efforts to normalize relations with the United States and Japan; and improvement in relations with the Soviet Union, China, and other communist countries. In short, South Korea would abandon its antagonistic relationship with North Korea, strengthen links with the communist bloc including the Soviet Union and China, and support engagement between North Korea and South Korean allies.

(5) The results of *Nordpolitik* during Roh's tenure were stark. South Korea normalized diplomatic relations with the Soviet Union in 1990 and with China in 1992; both Koreas were simultaneously admitted to the United Nations in 1991; the two Koreas also signed the Agreement on Reconciliation, Non-Aggression, and Exchanges and Cooperation between South and North Korea, or Basic Agreement, in December 1991, followed by the South-North Joint Declaration on the Denuclearization of the Korean Peninsula in January 1992; and the United States removed its tactical nuclear weapons from South Korea, partly as a result of *Nordpolitik* and the subsequent inter-Korean Korean Peninsula denuclearization agreement.

### Why did the Roh government introduce *Nordpolitik*?

(6) There were three main factors why the Roh government introduced *Nordpolitik*. Firstly, the changing domestic environment in South Korea allowed for a less antagonistic approach towards North Korea. South Korea had just become a democracy, with the associated freedoms that come with it; differently, North Korea continued to be a dictatorship. South Korea's economic development was translating into a more liberal

society; in contrast, North Korea's economy had almost stalled since the 1970s – and South Koreans were increasingly aware of this. The upcoming Seoul Olympics were making South Korea and South Koreans more confident in the world stage. In this environment, it was possible for President Roh to make a bold move, pushing beyond the boundaries that South Korean foreign policy had set for itself in the previous years and decades.

(7) Secondly, there was domestic 'elite' consensus regarding a new, more open, and less antagonistic foreign policy strategy. Some opposition politicians criticized *Nordpolitik* because they thought that it would imply the de facto division of Korea into South and North. But their voices did not carry much weight, due to the above-mentioned domestic factors and the successes of the policy – particularly the normalization of relations with the Soviet Union and China. Some media outlets warned that better relations with the Soviet Union could weaken relations with the United States. But President George H. W. Bush himself publicly supported *Nordpolitik*, thus rendering this criticism meaningless. South Korean businesses, on the other hand, welcomed *Nordpolitik* because it opened new markets and, in the case of China, also a potential production base. Diplomats and most of the media, for their part, were also supportive of *Nordpolitik*, which they saw as an opportunity to raise South Korea's profile and reduce tensions on the Korean Peninsula and with the communist bloc. As for the military, it supported *Nordpolitik* as a way to reduce inter-Korean tensions and foreign threats to South Korea more generally. In any case, the military was in a weak position to challenge a democratically elected president following the fall of the military dictatorship led by General Chun Doo-hwan. Last, but not least, many opposition politicians implicitly or explicitly supported *Nordpolitik* due to the potential benefits for South Korea that the policy carried.

(8) Thirdly, the changing international environment created the conditions for *Nordpolitik* to thrive. Mikhail Gorbachev in the Soviet Union and Deng Xiaoping – and later Jiang Zemin – in China were pursuing policies of more openness, both economically and in terms of foreign policy. Even though the announcement of *Nordpolitik* preceded the fall of the Berlin Wall in 1989 and German reunification in 1990, these events seemed to vindicate President Roh's policy – which was actually named after West Germany's *Ostpolitik*. The dissolution of the Soviet Union and the end of communism in Europe and across other parts of the world further reinforced *Nordpolitik*, which was in tune with improving relations between the US-led Western bloc and now post-communist countries.

## **What were the critical success factors behind Nordpolitik?**

(9) There were several critical success factors behind President Roh's new strategic approach to foreign policy. Consensus among 'elite' groups, mentioned above, was one of them. Buy-in from a society that was becoming more liberal and wealthier, also implied above, was another one. Four other critical success factors were as follows: the holistic nature of *Nordpolitik*, its tangible benefits, its partial modelling on the tried-and-tested *Ostpolitik* of West Germany, and South Korea's coordination with its allies – particularly the United States.

(10) With regards to the holistic nature of *Nordpolitik*, President Roh emphasized that the policy had both security and economic components. The security component included better relations between the two Koreas, and between South Korea on the one hand and the Soviet Union and China on the other. Coming in the aftermath of the Korean Air bombing and other North Korean violent actions earlier in the decade, this approach made sense and was welcomed by South Koreans who wanted an end to the threat coming from their northern neighbour. As for the economic component, it included opening up potentially lucrative markets and the potential for outsourcing to China. This was welcomed by South Korean firms that were moving

up the value added chain and were starting to produce consumer goods. And as South Korean labour was becoming more expensive, firms were also searching for new potential production bases. Nearby China made sense in this respect. *Nordpolitik*, therefore, encompassed security and economic elements that broadened its appeal across different groups.

(11) As for the tangible benefits of the new strategic foreign policy direction, they were obvious from the beginning. The Soviet Union, China, and almost all communist bloc countries participated in the Seoul Olympics, which was held only two months after *Nordpolitik* was announced. Their participation was not assured, following their boycott of the Los Angeles 1984 Olympics and North Korean calls for a boycott of the Seoul Olympics. This very tangible diplomatic benefit provided strong impetus to *Nordpolitik*. In the months and years after, (post-)communist bloc markets opened up to South Korean firms and diplomatic relations were established with the Soviet Union, China, and Europe's post-communist countries in the 1990s. Thus, the economic and diplomatic benefits were clear. They were complemented by South Korea's accession to the United Nations and the two agreements with North Korea – other important tangible outcomes of *Nordpolitik*.

(12) Regarding *Nordpolitik*'s partial modelling on the existing *Ostpolitik*, President Roh was attracted to two aspects of West Germany's policy towards East Germany since 1969: the emphasis on rapprochement and its survival across different German governments. The key aspect of *Ostpolitik* was engagement at different levels: economic, political, and societal. *Nordpolitik* replicated this approach, even if political contacts were prioritized in the early years of its implementation. As for the survival of the policy across government, South Korea's single five-year presidential term means that presidents do not have the opportunity to implement their policies over the long-term themselves. Thus, for any policy to survive, it must appeal to a broad range of actors – including future presidential candidates. President Roh designed *Nordpolitik* in a way that it would have been very difficult for any subsequent South Korean president to oppose its general goals and policies. Indeed, this has, for the most part, been the case through to the present day, as stated above.

(13) Last but not least, President Roh made sure to coordinate with South Korea's crucial ally – the United States – as much as possible. Thankfully for South Korea, the announcement and implementation of *Nordpolitik* coincided with a period in which US-Soviet tensions were de-escalating. Furthermore, the United States had supported South Korea's transition to democracy and was willing to provide the necessary diplomatic and political backing to make the new democratic system successful. Nonetheless, the Roh government coordinated closely with the administrations of Ronald Reagan and George H. W. Bush, keeping the Americans informed of the reasons behind their new foreign policy strategy and its next steps. Most notably, President Bush delivered a speech to the South Korean National Assembly in February 1989 – very shortly after his inauguration – which showed that the United States supported better links between South Korea and the communist bloc. South Korea also informed Japan of the main elements of *Nordpolitik*, even if this was a very secondary consideration compared to coordination with the United States. In any case, South Korea's approach showed a willingness to coordinate in advance with an important regional ally.

## **What were the key geopolitical issues informing Nordpolitik?**

(14) There were three main geopolitical issues that led President Roh to formulate *Nordpolitik*. To begin with, as discussed above, *Nordpolitik* came in the context of decreasing Cold War tensions, including an opening up process by both the Soviet Union and China. This environment was conducive towards a more diplomatic approach from South Korea. If either Moscow or Beijing had been more confrontational—or if North Korea had continued its terrorism campaign—President Roh would have found it more difficult to pursue *Nordpolitik*. But the three communist countries were receptive to President Roh's new foreign policy strategy.

Furthermore, and as just-described, the United States explicitly supported *Nordpolitik*. The backing of its main ally allowed President Roh to fend off any domestic criticism that South Korea was ‘abandoning’ the United States in favour of closer ties with the Soviet Union, China and North Korea. In addition, the support from the United States also allowed the Roh government to show to the three communist countries that the policy would not be reversed. From the perspective of the Soviet Union, China and North Korea, US support for any South Korean policy proved that Seoul could sustain it. Had the Reagan or Bush governments openly opposed *Nordpolitik*, President Roh would most probably have been forced to water it down or even abandon it.

(15) The other key geopolitical issue informing South Korea’s approach was the country’s geographical location. South Korea borders North Korea, and China and the Soviet Union are the two only countries bordering the Korean Peninsula. Proximity with China and the Soviet Union – never mind North Korea – was not going to change. From the perspective of the Roh government, the country had to be realistic and improve relations with its three closest neighbours. It could not afford to continue to live under the potential threat of an invasion from North Korea or a strike – however unlikely – from the Soviet Union or China, which South Korea would only be able to repel with the help of the United States. Following this logic, it made sense for President Roh to try out *Nordpolitik* as a means to improve South Korean security. And from an economic point of view, South Korea could be considered an island insofar as it did not have direct land access to the rest of the Eurasian landmass, since North Korea did not allow this. Therefore, *Nordpolitik* was also an attempt to connect the South Korean economy to East Asia’s and Eurasia’s by land.

## **What was the government culture underpinning Nordpolitik?**

(16) President Roh’s was arguably South Korea’s first-ever fully democratic government. President Roh himself had served in the South Korean army until 1981, and had then held several government roles during Chun’s dictatorial regime. Thus, there were some fears that his style of government would be authoritarian. However, President Roh understood that South Korean society had changed and that there was no way back from the newly democratic regime. Thus, his government emphasized openness, transparency, and consultation. Certainly, these minimum requirements of any democratic government were still underdeveloped in the nascent South Korean democracy. But it is generally acknowledged that the culture of the Roh government displayed these hallmarks.

(17) Thus, *Nordpolitik* was a strategic reset based on domestic support and allied consultation both before its announcement and during its implementation. Furthermore, President Roh sought to explain the rationale and benefits of the policy to the South Korean population. This inclusive approach helps to explain why South Korean foreign policy today continues to reflect the goals and policies inherent to *Nordpolitik*. By making use of consultation and openness, President Roh was able to convince South Korean ‘elites’ and the general population alike of the benefits of diplomatic and economic engagement with countries that hitherto had been considered enemies of South Korea.

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### 3. India's Strategic Resets in the 1990s and 2014

(1) This report examines two strategic resets undertaken by India since the end of the Cold War. In the early 1990s, as India struggled to come to terms with a post-Soviet world, its leaders reset India's priorities in a way that fundamentally changed India's economic and foreign policy objectives. Partly through encouraging high growth rates in the early part of the twenty-first century, policymakers freed India from the shackles of bi-polarity and paved the way for deeper relationships within Asia and with the West, most importantly with the United States. It gave Indian decision-makers a degree of confidence in re-organizing the terms of India's relationship with China, with whom India shares a 3,488-kilometer-long and contested land border.

(2) In more recent times, under the leadership of Prime Minister Narendra Modi, India has attempted something of a second reset. Indian experts refer to this era as the ushering of a 'third Republic'—the first being the period until the fall of the Soviet Union, and the second lasting until Modi's arrival. Whether or not the present Republic has delivered on the promise of a fundamental retuning of India's priorities and actions, is discussed below.

(3) This essay is divided into two parts. In the first, I analyze the motivations, processes and outcomes of the reset in the early 1990s. In the second, I offer my thoughts on what the Modi-led government has sought to transform, and whether or not, to date, it has succeeded. This note arrives at two sets of conclusions: first, the level of determination on the part of the political leadership is crucial to a successful reset. Second, without this determination, domestic political concerns can easily rob the will to take difficult but necessary decisions for the future.

#### Part I: Resetting to Survive (1990s)

##### Background

(4) As the Berlin wall collapsed, Indian decision-makers were fixated with a current account deficit in its balance of payments. The world was changing fast, and India was broke. Iraq's invasion of Kuwait in August 1990 doubled the price of crude oil. India then, as now, was a major importer of crude oil; and as prices rose, 150,000 Indians found themselves out of work and trapped in the Middle East. In November, the government of Prime Minister V. P. Singh lost the house's confidence. His successor, Prime Minister Chandra Shekhar Singh entered office just as India ran out of its foreign exchange reserves. An economic charter for growth, drawn-up in 1977, had long passed its sell-by date.

(5) In June 1991, India held its tenth general elections with Narasimha Rao becoming the Prime Minister. The internal and external scenario was more than tragic for this seventy-year-old non-Hindi speaking prime minister. The scion of the Congress Party, Rajiv Gandhi, had been assassinated by the Tamil Tigers just before the elections. Further afield, the collapse of the Soviet Union meant that India lost not only a key strategic trading partner but also its key defense supplier. From a domestic standpoint, communal politics was on the rise. A raging insurgency was tearing apart the Indian state of Jammu and Kashmir. The issue of reservations in public jobs—as a result of what is known as the Mandal Commission report – led to street protests and university campuses being set on fire. To top it all off, India was close to defaulting on its loans.

(6) A combination of structural changes in international relations, domestic strife, and most importantly near-bankruptcy, swiftly shifted the focus of the government. Rao and Manmohan Singh—the far-sighted, Oxbridge trained Indian Finance Minister—were quick to grasp that the need of the hour was a systemic and transformational reset.

## Enforcing Change

(7) Rao, Singh, and a select group of bureaucrats set-upon a reform-minded agenda based on financial and trade liberalisation. They devalued the rupee, reduced tariffs and encouraged foreign investments. The government also introduced financial sector reforms, including the creation of a statutory body to oversee trades in the stock market and to license private sector banks. Essentially, in three years, these reforms moved India from a past that was dotted with controls and checks, to a future designed for open markets and trade. In 1995, India joined the World Trade Organization. No doubt, the liberalization of trade played a crucial role in nearly doubling India's GDP growth rate in the second decade of the next century.

(8) The Rao government also understood that opening the markets was only the first step. An equal effort needed to be made to energize new international partners. A reset would require reforming foreign policy in tandem. Three sets of imperatives were exercised, with the view to make the best of the so-called 'unipolar moment' in post-Cold War international affairs.

(9) First, Rao, and his Foreign Minister Pranab Mukherjee, reached out to the United States. Though relations with the United States had changed for the better in the 1980s—and more so during Rajiv Gandhi's term as prime minister (1984-1989)—India's decision to test a nuclear weapon became a major sticking point between the two countries. In 1998, when India did test its weapon, the Clinton administration, somewhat ironically, came to the ultimate conclusion that greater engagement with India was a prudent policy. The shift in thinking in the United States was a direct result of India's fast and visibly changing approach to the economy.

(10) Second, Rao realized that stabilizing relations with China was equally important. China was a growing economic power, and capitalizing on its economic fortunes and benefitting from the same meant normalizing relations. Rajiv Gandhi had set the tone for a new relationship with China following a visit to Beijing in December 1988—the first by an Indian leader since a war between the two Asian giants in 1962. Rao capitalized on the moment. India signed two milestone agreements with China in 1993 and 1996. These were dramatic changes in Indian foreign policy, providing it with options in times of changing geopolitics. Third, Rao focused his government's attention eastward. Believing Asia to be central to India's economic fortunes, Rao encouraged what became known as the 'Act East' policy, with ASEAN at its center.

(11) By the mid 1990s, India had recovered from the economic crisis. The Rao government imagined, and then initiated, a strategic reset. The Rao administration exhibited determined political will, which included appointing doers rather than sheer administrators in key bureaucratic positions. Rao and his advisors listened to experts rather than shunning their advice. Indian leaders, at times, circumvented protocol with the view to enforce change. No one in the early 1990s stood on ceremony—they acted swiftly and effectively because they had the full backing of a prime minister intent on changing India, no matter the domestic political cost of these actions.

(12) The reset in the 1990s turned India into an attractive location for investments, making it easier to convince the United States and Asian powers of India's strategic value. India's growing market economy led the George H. W. Bush administration to focus on the partnership with India. Decades later, in 2008, the two countries signed a nuclear deal. Though India is the only country in the world that has not signed the non-proliferation treaty, it continues to stockpile fissile material and can trade with members of the Nuclear Supplier's Group for its civil nuclear needs. Elsewhere, India has joined the G20 as a member of the Finance Minister's Forum in 1999; and in 2008, following the global financial crisis, India played a crucial role working with leaders in the US, the UK and Europe. In short, the strategic reset in the early 1990s put India on the global map. It's foreign policy imperatives, including its centrality in the Indo-Pacific in more recent times, would be difficult to imagine had Rao and Singh not forced a set of measures that liberalized India in every sense of the word.

## Part II: Resetting as an Ambition (2014)

### Background

(13) In May 2014, Narendra Modi became the 14<sup>th</sup> prime minister of India. Aged 63, Modi came to power with the ambition to transform India and made clear that he was intent on delivering a ‘shining India.’ The twenty-first century, he told the world during his victory speech, would be ‘India’s century.’ It is this determination that prompted analysts to dub Modi’s India as the beginning of the ‘third republic.’ After all, for the years between 2011 and 2014, growth in the Indian economy had slowed. Corruption scams and well-organized protests against the government occupied the attention of Manmohan Singh’s Congress-led alliance, twice elected in 2004 and 2009. The Barack Obama administration lost faith in an India that was no longer performing economically. The bet on a free, democratic and economically booming India was called into question in London, Brussels, Paris, and most importantly, Washington.

(14) Further, relations with Pakistan soured. The lack of attention to foreign policy imperatives in 2013 witnessed a rise in cross-border attacks (between Indian and Pakistani administered Kashmir) for the first time since 2010. China’s assertive position in global politics—and especially Xi Jinping’s ambition to actively engage South Asian states and India’s immediate neighbors—was lost on Singh’s government. It remained in survival mode till the ‘Modi-wave’ paved the way for a new beginning.

### Enforcing Change

(15) Once elected, Modi sought to reset relations with countries across the world and to stimulate domestic economic growth. In his first year in power, Modi made nineteen state visits, including to countries like Mongolia and Seychelles. By the end of 2019, he had visited 106 countries, including Pakistan—a first for an Indian prime minister in more than a decade. Many argued that these trips were marketing ventures, designed to return the enthusiasm the world had for India in the earlier part of the twenty-first century. This was much more than about marketing India. It was about returning international trust in India, and it succeeded. During most of these trips, Modi held round tables with CEO’s and industry leaders. ‘Make in India’ became the bumper sticker of a regime determined to revive manufacturing and stimulate growth. Trade was important, of course, but a more important aim was the relocation of supply chains to India. With this end in mind, the government initiated a range of reforms. A goods and services tax under examination for years (before Modi leap-frogged into national politics) was passed by parliament. Reforms in the banking sector were mooted, and a partial bankruptcy law was introduced. All of these initiatives were, generally speaking, excellent news. At the beginning of 2016, it genuinely looked and felt as though Modi’s government was on the cusp of second-generation reforms.

(16) Modi cared little for bureaucratic lethargy, and when he entered office, he appointed those who he wanted in key positions. Seeking to centralize decision-making, Modi oversaw a small group of advisors which effectively ran the government. Yet, by 2016, certain cracks in the design were evident.

(17) In November 2016, the government took the decision to ‘demonetize’ the majority of Indian currency notes and replace them with new denominations. A variety of reasons were offered for this adventure, including curtailing the spread of ‘black’ money and terrorist financing. There is little doubt that the government had the right intentions. Yet, in the end, the decision led to the severe shortage of cash in the economy and contributed to an economic slowdown. Modi’s reset was under threat.

(19) Moreover, state-capital relations soured, as Indian billionaires began to invest their fortunes abroad. The trust deficit between money power and political authority was evident to any onlooker. The result was dipping

growth rates. This notwithstanding, on the other hand, Modi's promise for reform came alive with the passage of a range of changes in the agricultural sector—through what is known as the 'farm bills'—at the end of 2020. These were unpopular decisions and have led to widespread protests, but reforms were necessary. Much like Rao in the early 1990's, Modi's government demonstrated the ability to take hard decisions, and force a reset in economic growth. The fruits of this change will only be realized many years down the line.

(20) Further, these domestic changes took place at a time when the neighborhood was anything but stable. Relations with India's neighbors deteriorated, largely for reasons which had little to do with India. Pakistan returned to exercising support for violence in Jammu and Kashmir, while Xi's China made it its mantra to extend the Belt and Road Initiative to South Asia. Further, the Chinese People's Liberation Army (PLA) transgressed into territory claimed by India provoking an armed stand-off. In the first quarter of 2021, the Modi government successfully ended the stalemate and forced a 'disengagement' of troops. At the same time, it reaffirmed a ceasefire agreement with Pakistan. Despite the odds, and the trouble on two contested frontiers (with China and Pakistan), the Modi government, through patient diplomacy and the exercise of military force—that blocked the PLA from further incursions—demonstrated the effects of strong and uncompromising leadership. A new strategic reset with China is clearly in the making, defined more by coercion rather than accommodation.

(21) On the economic front, to an extent, the pandemic-hit economy provides the rationale to see the ambition of a 'shining India' come to life. Whether this occurs, however, is dependent on the political leadership being able to force further reforms, re-imagine trade and invest in public infrastructure.

(22) Since the outbreak of the pandemic, the Modi government has announced a variety of reforms. Many of these are designed to tide-over the current emergency. Yet, if India is indeed to make the best of both the changing nature of global economics as a result of the pandemic as well as the decoupling of Sino-American relations, it will need to project itself as a promising investment location. Supply chains will be diverted to India only if it's made more convenient for foreign firms to do business in India. This is not yet the case. This will require a greater dose of political intervention.

## Conclusion

(24) Both the case studies presented in this report underline the importance of political will and determination. In the case of the 1990's, Rao was willing to take hard calls despite the push-back from domestic quarters. He and Singh were clear that India needed a reset, no matter the domestic political cost. In the case of Modi, there is a clear desire for a reset but an absence of the will necessary to exercise options that are seen to be politically unviable. Rao took risks. Though the reset he put into action might well have failed, he was, more than anything, determined to follow a path designed by he, the finance minister and other experts. Perhaps more important was the fact that, once the decision for a reset was taken, there was no looking back. The current pandemic-induced emergency might well force a similar process in Modi's India. From what can be gleaned from the passage of the Farm Bills to stabilizing two highly militarized borders, there is a theory of change that drives the Modi government. The key will be to find an equitable balance between domestic pressures and the need for economic growth, making India *the* investment location for the twenty-first century.

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## 4. Japan's Strategic Reset under Abe, 2012-2020: The Rise of the Kantei

(1) This paper discusses the strategic reset implemented by Prime Minister Shinzo Abe during his second tenure as a Prime Minister (2012-20). It argues that Abe's success in re-engineering Japan's international profile and influence was the result of three core initiatives: he centralised the Japanese decision-making system around the Prime Minister's office (Kantei); he expanded the realm of the 'politically possible' in foreign and security affairs; and he injected Japanese foreign and security policy with a worldview focused on the Indo-Pacific region. In particular, the paper explores how the importance of Abe's centralisation of power cannot be disentangled from the fundamental ideational and behavioural changes implied in the second and third initiatives. Abe took power to the Prime Minister's office and used it to shake the bureaucracy out of established patterns of behaviour and offered a vision which made new policy—a reset—possible.

### Introduction: Man on a Mission

(2) On Friday 28 August 2020, Japan's longest serving Prime Minister, Abe Shinzo, announced that due to deteriorating health conditions he had to step down. During his tenure, Abe has conducted the most significant strategic reset since the 1950s. This paper reviews how Abe brought about such changes and why these matter to the United Kingdom's forthcoming Integrated Review. The paper engages with the specific material and ideational reforms that Abe introduced, which empowered the Japanese government with more effective tools for the practice of statecraft. When Abe came to power in 2012, Sino-Japanese relations had just entered an all-time low, while Japan was suffering from a sluggish economy and a weakened international reputation. Committed to rebooting the country's international standing, Abe implemented a series of interlocked reforms across different areas of government that were intended to create a more seamless, cohesive, and indeed integrated foreign and security policy.

(3) The paper argues that Abe achieved this result in three steps: he centralised the Japanese decision-making system around the Prime Minister's office (Kantei); he expanded the realm of the 'politically possible' in foreign and security affairs; and he injected Japanese foreign and security policy with a worldview focused on the Indo-Pacific region. These pillars were symbiotically connected. The first was instrumental for the other two to work; yet, no centralisation of power would have produced successful policies without the ideational and behavioural changes implied in the second and third pillars. Abe took power to the Prime Minister's office and used it to shake the bureaucracy out of established patterns of behaviour.

### Step 1 – Centralising Power: Abe's Kantei

(4) Under Abe, the Kantei became the command centre for the design of, and influence on, foreign and security policy. The Prime Minister did so by exercising top-down leadership that replaced the traditional consensus-based policy process linking political, bureaucratic, and business elites. Politically, Chief Cabinet Secretary (CCS) Suga Yoshihide, a close associate of Abe's, delivered the government's grasp on the ruling party. He manoeuvred the government into a position of control by making the most of the combined effect of media appealing initiatives (Abe maintained high approval rates throughout the majority of his second tenure) and appropriately timed snap elections. This granted the government a high degree of control over the political platforms of both the Liberal Democratic Party (LDP) and, crucially, its coalition partner, Komeito.

(5) Abe also formalised the subordination of civil service to the government's leadership in policy-making. In 2014, he created the Cabinet Bureau of Personnel Affairs, with the Deputy CCS Kato Katsunobu, another close aide, serving as its director general. This new body was tasked to oversee the appointment of about 600 elite bureaucrats at ministries and government agencies, including vice ministers and director generals. This reform ensured that key government policies and directives percolated through the rank and file of the Japanese bureaucracy and were implemented accordingly. The effect of this reform was amplified by the fact that key government advisors like Abe's Chief Executive Secretary Imai Takaya remained in power for long periods of time.

(6) Kantei reforms were conducted alongside the seizing of the narrative of Japan's economic direction of travel in two ways. First, Abe linked economic policy to foreign and security policies—establishing the need for these to be closely coordinated in the service of national security. His trademark economic strategy known as 'Abenomics' drew in fact upon an ideological resonance with the Meiji era slogan 'rich country, strong army'. Second, Abenomics proposed an ambitious 'come back' through the 'three arrows' of a generous monetary easing from the Bank of Japan, a significant fiscal stimulus through government spending, and structural reforms. The goal was to present Japan as a dynamic economic counterweight to China and partly reduce reliance on the United States for security. The first two arrows started to be implemented in the first weeks of government. Abenomics initial effects on the sluggish Japanese economy became a tool the government mobilised to maintain popular support for its wider foreign policy agendas.

(7) This centralisation of economic and national security narratives gave the Abe government the possibility to adjust to fast-evolving geopolitical circumstances. In September 2012, Sino-Japanese relations had taken a negative turn as a result of the dispute over the Japanese controlled-Senkaku islands, claimed by China under the name Diaoyu. The implementation of the first two arrows had the effect to partly insulate the Japanese economy from excessive dependency on Chinese markets and the retaliatory behaviour of the government in Beijing. This, in turn, established the Kantei's reputation as a key power player vis-à-vis the business community, traditionally more inclined towards a conciliatory China policy.

## **Step 2 – Expanding the Politically Possible: The National Security Secretariat**

(8) For Japan to regain prominence in international affairs, Abe needed to transform how elites conceived the realm of the politically possible in foreign and security policy. He achieved that by establishing Japan's first National Security Secretariat (NSS) and by fostering deeper synergies between the Ministry of Foreign Affairs (MOFA) and the Ministry of Defence (JMoD). Inaugurated in 2013, the NSS embodied Abe's aspiration to achieve a 'whole-of-government' approach to policy action as well as crisis management. The NSS was designed to be the laboratory for the ideas informing Japan's mid- and long-term strategic planning as well as the driving force behind policy action. It defined both the terms of Kantei's powers (through the national security strategy) and through the ways in which the government would act and respond (through the National Security Council) to international affairs.

(9) Greater MOFA-JMoD synergy was achieved by a renewed defence engagement agenda for JMoD which served to enhance diplomacy. This became particularly evident in light of the positive effect created by the Japanese participation to the disaster relief operations in the aftermath of the 2013 earthquake in the Philippines. The 2014 National Defense Programme Guidelines (NDPG) set out a robust defence engagement programme aimed at enhancing presence, building primarily on longstanding naval diplomatic initiatives

across Southeast Asia and the Indian Ocean. Abe's decision to focus on engagement in the troubled waters of the South China Sea to support and reassure local state actors, and to enhance its leadership role in the counter-piracy operation in the Indian Ocean—with the Japanese navy taking command of CTF-151 in 2015—represented a tailored way to underwrite Japan's commitment to Indo-Pacific security and international order.

(10) By prioritising the main efforts of defence engagement, the Abe government expanded the realm of the politically possible. The expansion of Chinese military might—especially its capacity to project power at sea in the Indian and Pacific oceans—was raising wider regional awareness over the centrality of sea-lanes and sea cables to regional stability, connectivity, and prosperity. This trend, combined with the emergence of maritime disputes and challenges to the established US-led maritime 'order', prompted the Abe government to centre the bulk of its efforts on naval activities. These directly fed into the image that Japan wanted to project: an engaging and pro-active security actor seeking to maintain the international status quo. Port calls, regular visits and exercises represented the building blocks to establish new—or reinforce existing—partnerships, with notable examples in Vietnam, the Philippines, and Australia. Capacity building programmes with countries like Sri Lanka, on the other hand, helped to build influence with key emerging states. Crucially, Japanese activities were pursued in coordination with close allies—notably the United States—which empowered Japan with a convening power that further enhanced the country's influence.

### **Step 3 – The Making of a Worldview: The Free and Open Indo-Pacific Initiative**

(11) These structural reforms were coupled by, and reinforced through, the development of a worldview that explained Japan's role in international affairs. Formally announced in 2016, Tokyo's 'Free and Open Indo-Pacific' (FOIP) initiative represented the ultimate manifestation of a political project that started in 2006. FOIP included elements of geopolitical anxiety vis-à-vis the need to propose alternative visions to China's Belt and Road Initiative. Yet, it was an attempt to propose a specific worldview that Abe developed over time, and that he distilled in three key speeches: the 2007 'Confluence of the Two Seas' which he delivered in India; the 2013 'The Bounty of the Open Seas' intervention which he delivered in Jakarta, and his keynote at TICAD in 2016.

(12) Abe's FOIP was a powerful statement about how Japan sees the world. In it, the future rested on Africa and Asia combining their forces to shape economic and social development. FOIP has three pillars, the first being about 'connectivity.' This was understood both as physical connectivity, promoting infrastructural projects—including ports, roads, and railways—and as ideational connectivity, facilitating people-to-people exchanges and institutional and cross-border links. FOIP's second and third pillars unfolded from the first. The second pillar was about security. Prosperity depends on security, and security in the Indo-Pacific related to the stability resulting from capacity and capability building, as well as by enhanced coordination in preventing and addressing disaster relief. The third pillar was about values—in particular, the respect of the existing maritime order (including the values of freedom of navigation and over flight) and of 'rule of law', the normative frameworks governing both the management of the oceans and approaches to disputes resolution.

(13) FOIP's ideational construct propelled and guided changes in a more markedly strategic direction of Japan's very significant foreign aid program. The ideological framework behind FOIP was informed by the logic of power politics (including the need to provide an alternative to growing Chinese economic influence) but it also embodied the prime minister's belief that Japan needed to empower emerging actors—such as India—which were to play a central role in the future of the Indo-Pacific region. The changing ideational

construct behind FOIP has been accompanied by a series of initiatives, from the 2015 revision of Japan's ODA charter to support "national interests", to the adoption of a Partnership in High Quality Infrastructure—to emphasise high quality projects—and increased support for the Asian Development Bank. Within this context, Japan's engagement with Sri Lanka provides an excellent window into the multi-faceted opportunities created by the ideas enshrined in FOIP. In 2018, Tokyo offered de-commissioned coast guard patrol vessels and infrastructure assistance for developing the Colombo and Trincomalee ports, striking a very different position to China's appropriation of the Hambantota port.

(14) FOIP enabled Abe's Japan to engage in a realm of international politics previously underexplored and underutilised: strategic communications. Abe's Japan has been quite successful at understanding the importance of a vision, a set of ideas, to enhance the country's communication power with international and domestic audiences. It also dedicated specific resources to it. For example, the government's budget for information activities more than tripled in 2015 to favour the understanding of Japan through initiatives like the establishment of Japan Chairs at important think tanks like the Hudson Institute and IISS. The appeal of FOIP's ideals provides a tangible measure of Japan's successes: its positive, prosperity-focused narrative and geographic contextualisation have gained currency among research specialists, journalists, and policymakers alike. In FOIP, Abe's Japan had the ideas of a regional order that enabled policy to produce effect.

## **Conclusions: The ideologue mugged by reality?**

(15) When he ascended to the helm of the Japanese government for a second time in 2012, many international observers regarded Abe Shinzo as an ideologue with revisionist views about history. Yet, his ideology, whilst driving an ambition to bring Japan back from a marginal role in international affairs, did not prevent him from enacting a pragmatic strategic reset that placed Japan at the centre of the Indo-Pacific dynamics. He achieved that in three ways. He re-centred the sources of Japanese political power around the *Kantei*; he created a command centre in the NSS to deliver to the primary levers of power clear instructions and a strong sense of priorities. Last but by no means least, he implemented these reforms in light of a clear worldview which he articulated in the FOIP initiative. This worldview took practical shape in a series of tailored public diplomacy and security initiatives that maximised visibility and presence throughout the Indo-Pacific.

(16) Abe took into account the geopolitical circumstances of the time, shaped in East Asia's case by a fast-rising China. This meant that the ideational elements of Abe's reforms had to be pursued in a strategic fashion. His personal views as a conservative politician, in particular, did not prevent the FOIP from presenting a coherent and positive aspirational worldview that placed Japan at the centre of narratives about the international order and regional stability and prosperity. In this regard, Abe's maritime focus became the point where themes about connectivity, stability, and values intersected. Abe's success was due in part to the fact that, as his reforms were implemented, he became an ideologue mugged by reality to the benefit of his country's international profile and influence.

(17) The case of realpolitik Japan under Abe matters to the UK because it offers a map towards what the building blocks of a successful Integrated Review may look like. In this regard, Japanese reforms—taken collectively—highlight four important lessons. First, a strong worldview, in which values and ambitions are grounded in the geopolitical realities of the time, is essential to set priorities and allocate resources to meet them. Second, clear government guidance—and adequate means to deliver it—needs to be matched by ways to coordinate across departments to ensure that policy implementation is mobilized to maximum effect. Third, both soft and hard power need to inform diplomatic action. The balance between the two may differ depending on specific political and geographic circumstances, but they work symbiotically to inform credibility and

produce influence. This is especially true in a geopolitical contest of state on state competition, one in which there is no replacement for the credibility delivered by hard capabilities. Lastly, the Japanese case suggests that a continuous form of presence—especially if designed to work with partners and allies and if aptly applied to substantiate a specific worldview—is the most effective way to amplify the wider effects of foreign policy.

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## 5. Malta's Strategic Reset: Becoming 'Blockchain Island'

(1) This report examines Malta's recent effort to adopt blockchain as a fundamental pillar of its economic, political and diplomatic vision. Though it has been considered an unsuccessful realignment, the case of Malta's effort to become 'Blockchain Island' includes some relevant insights for the United Kingdom's ongoing strategic reset. First, it demonstrates the visionary opportunities afforded by the adoption of emerging technologies; second, it highlights the pressing need to regulate grey digital spaces; and finally, it underscores how the best ideas will still falter if the national reputation of the country does not foster credibility and public trust.

### Becoming the 'Blockchain Island'

(2) In 2018, the future was looking bright for tiny, innovative Malta, enjoying the fruits of a remarkable 6.7% growth in GDP that made it the fastest growing economy in the EU.<sup>1</sup> This consistent economic growth was underpinned by a strategy of identifying emerging sectors with high growth potential, and enacting policies to enable them to flourish on the Mediterranean island. Although small in size and lacking in physical resources, diversification efforts turned to the virtual space and regulatory services. At a meeting of the United Nations General Assembly in September 2018, Maltese Prime Minister Joseph Muscat affirmed that 'those who will be able to bear the digital economy with a new state – the digital state – will be best poised to have a future proof society.'<sup>2</sup>

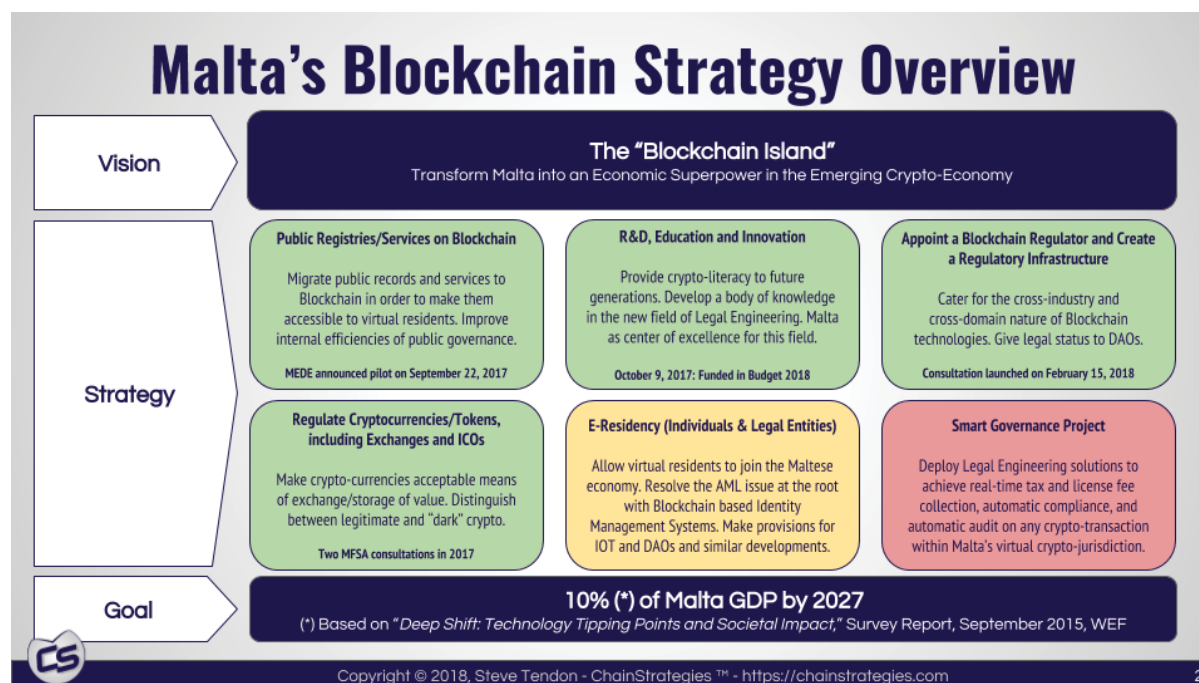
(3) In this UN address, Muscat introduced Malta's deliberate strategic effort to reposition Malta as the 'Blockchain Island.' Blockchain refers to technologies which allow for transactions to be carried out between people without interference or control by third parties. Individuals pay cryptocurrency directly to their peers, and assets are exchanged using blockchain technology, removing the need to interact with an intermediary such as a teller at a bank or post office (in person or online) and securing the immutability of these assets. There are many advantages to the use of this technology, ranging from the fact that property ownership registered on the blockchain can never be taken away from an owner if a deed is lost, to the potential to provide a digital identity and to store health records or degree certificates that can never be lost if a records building is destroyed in conflict-zones.

(4) Malta recognised that the virtual environment could enable the small country to eschew its physical constraints to gain strategic advantage. By taking a leading role in the blockchain industry at a time when most other countries remain wary of the utility and safety of the technology, Malta could acquire first mover advantage and establish strong brand recognition, similar to the way in which Estonia is famed for its e-governance. Encouraging blockchain companies to relocate to Malta, and generating an associated demand for professional services, was also seen as a potential boon for the economy and cross-sectoral job creation, ranging from legal and marketing services to real-estate providers. With these driving motivations, in 2016, Steve Tendon – a senior executive management consultant specialising in the transition to blockchain technologies – was brought in as the strategic adviser for the Ministry of Economy, Investment and Small Business, in order

1 The European Commission. 2019. "Malta." Summer Economic Forecast. 2019. [https://ec.europa.eu/info/sites/info/files/economy-finance/ecfin\\_forecast\\_summer\\_10\\_07\\_19\\_mt\\_en.pdf](https://ec.europa.eu/info/sites/info/files/economy-finance/ecfin_forecast_summer_10_07_19_mt_en.pdf).

2 Muscat, Joseph. 2018. "PM Address to UN General Assembly." *TVM*, September 27, 2018. <https://www.tvm.com.mt/en/news/segwi-d-diskors-tal-pm-lill-assemblea-general-tan-nazzjonijiet-magħquda-fuq-tvmi-u-tvm2/>.

to design Malta's National Blockchain Strategy. The overarching mission of this new grand strategy was to 'Transform Malta into an Economic Superpower in the Emerging Crypto-Economy.'<sup>3</sup>



(5) In April 2017, the Maltese Cabinet of Ministers unanimously approved the strategy, which would make Malta one of the first European countries to introduce blockchain into state programmes (e.g. the Land Register and National Health Registries), and a Blockchain Task Force was instituted to advise on its execution. The national Budget agreed for 2018 allocated funds for the promotion of blockchain technologies, including the establishment of a Blockchain Laboratory and a Blockchain Startup Hub under the auspices of the Malta Information Technology Agency.

(6) Despite Malta's support of blockchain technology, there remained global uncertainty, especially among national governments, about its legal and economic implications. The proliferation of blockchain is not just an issue of technology, but a paradigm shift involving the removal of central authorities. Hence, the means of regulating the cryptocurrency space necessitates serious attention. Significantly, despite the global uncertainty in relation to blockchain, in July 2018 the Maltese parliament became the first world jurisdiction to provide legal certainty to the crypto space by passing three bills that set a regulatory framework intended to drive innovation in blockchain and similar technologies. They included the Technology Arrangement and Services Bill (TAS), defining and identifying blockchain technologies legally and enabling service providers to register and acquire certification; the Virtual Currencies Bill (VS), seeking to regulate cryptocurrencies and Initial Coin Offerings; and the Malta Digital Innovation Authority Bill (MDIA), providing for the establishment of the Malta Digital Innovation Authority, to be responsible for exercising regulatory functions regarding ledger technologies and related services.

(7) This regulatory framework, combined with the operational infrastructure (of legal firms and associated services) and strong ICT, created favourable conditions for crypto start-ups to operate in Malta. Malta is

3 Tendon, Steve. 2018. "Malta's National Blockchain Strategy: The Big Picture." *ChainStrategies*, February 18, 2018. <https://chainstrategies.com/2018/02/18/maltas-national-blockchain-strategy-the-big-picture/>.

already attractive to investors due to its skilled workers, notoriously low tax rates (the lowest corporate tax rate for international companies in the EU, combined with generous Tax Incentives that offset operational costs), its geographical location connecting Africa and Europe (with proximity to European financial hubs), its small size facilitating communication between companies and regulators, its mild climate and leisure opportunities favourable to worker relocation, and its English speaking population. However, the legal framework gave a significant boost to investor confidence, and after passing the bills, Malta saw an influx of technology entrepreneurs. Industry giants such as Binance cryptocurrency exchange company (the world's largest bitcoin exchange operators) relocated their headquarters, and Exante (a blockchain company brokering the greatest number of markets in Europe) opened a head office in Malta. Malta was foremost globally regarding cryptocurrency exchange volume by the end of 2018.

(8) Concurrently, on the European stage Prime Minister Muscat urged European regulators to innovate and implement policies to harness the potential of cryptocurrencies, promoting the idea of Europe becoming the 'Bitcoin continent.' Building on this, in December 2018 Malta and six other EU countries signed a declaration seeking the promotion of distributed ledger technology in Southern Europe, intended to help these 'countries transform their economies and society into truly digital ones and become a leading region in this sector.'<sup>4</sup> Altogether, therefore, the national strategy initially enjoyed tremendous hype and a great deal of momentum, however once the new legislation came into force in Malta in November 2018, the execution soon proved more troubling than anticipated.

## From Big Dreams to a Bad Nightmare

(9) There are three main reasons why the strategy began to unravel: Maltese regulatory inefficiency; stifling international regulations; and Malta's deteriorating reputation. Regarding the first, the problem was that slow regulations are inconducive to a fast market. Controversially, companies were invited to launch in Malta and to operate until 2020 without having to abide by anti-money laundering laws during the year-long transition period. This proved highly attractive, hence the initial influx to Malta; yet to combat organised crime, local banks refused to open accounts for crypto and blockchain companies until they obtain licenses from the Malta Financial Services Authority. In addition to the delays, the cost of the license, at an eye-watering €10,000 for the pre-application process, is being viewed as prohibitive.

(10) Subsequently, around 70% of the firms that initially signed up to the scheme have not completed their licensing applications after the end of the transition period, including the flagship company Binance.<sup>5</sup> Unlicensed companies are unregulated and therefore unattractive to investors. Having failed to issue a single license, Malta has already lost its first mover advantage and been overtaken by Estonia, Germany, Finland, Austria, and Switzerland — all of which have sought to capitalise on the Blockchain revolution.<sup>6</sup> The lack of efficient licensing processes is thus preventing the 'Blockchain Island' dream of gaining legitimacy and credibility.

(11) International legislation has also stymied the proceedings. In January 2020 the European Union's 5<sup>th</sup> Anti-Money Laundering Directive (5AMLD) came into effect in a bid to counter money laundering and terrorist

4 Ministry of Economic Development - Italy. 2018. "Southern European Countries Ministerial Declaration on Distributed Ledger Technologies." 2018. [https://www.mise.gov.it/images/stories/documenti/Dichiarazione\\_MED7\\_versione\\_in\\_inglese.pdf](https://www.mise.gov.it/images/stories/documenti/Dichiarazione_MED7_versione_in_inglese.pdf).

5 Vella, Matthew. 2020. "Malta's Cryptocurrency Flop: 70% of Firms Have given up on Getting Licensed." *Malta Today*, April 24, 2020. [https://www.maltatoday.com.mt/news/national/101920/maltas\\_blockchain\\_flop\\_70\\_of\\_crypto\\_firms\\_have\\_given\\_up#.XOKjx36SIPa](https://www.maltatoday.com.mt/news/national/101920/maltas_blockchain_flop_70_of_crypto_firms_have_given_up#.XOKjx36SIPa).

6 Hamacher, Adriana. 2020. "Is This the End of Malta's Reign as Blockchain Island?" *Decrypt*, January 19, 2020. <https://decrypt.co/17024/is-this-the-end-of-maltas-reign-as-blockchain-island>.

financing. For the first time, this directive incorporated crypto services to engender more transparency in crypto transactions. However, many European companies have struggled to become compliant with these stringent new regulations, particularly the amount of personal data they require from prospective customers. Having been lured to Malta with the expectation of accessibility, the combination of rigorous regulations and complacency in issuing licenses has led companies to accuse the Maltese government of prioritising primacy to market ahead of operational readiness. Consequently, companies have begun exiting the Mediterranean island in droves. Despite the criticism, the Malta Financial Services Authority has defended the stringent regulations on the grounds of ensuring the highest standards of compliance and governance, among serious fintech operators who are properly regulated. A laxer regulatory framework could attract bad investors.

(12) This is a rational approach, given that the second set of problems troubling Malta relate to its deteriorating reputation. In 2017, Malta's foremost investigative journalist, Daphne Caruana Galizia – whose blog, 'Running Commentary' was the most read news source in Malta – was assassinated by a car bomb. In the months preceding her death, she levelled serious allegations of corruption at the Maltese government. These included articles on money laundering and fraud allegations levelled at Pilatus Bank, run by Ali Sadr Hasheminejad, who is now facing criminal prosecution in the United States. Caruana Galizia argued that cryptocurrencies would advantage organised crime, and that the blockchain dream in the hands of a corrupt elite would result in Malta becoming the Bitcoin money-laundering capital of the world.<sup>7</sup>

(13) A strategy must align with the values that a country communicates. Blockchain technology is premised on increasing trust by removing intermediaries. Yet Malta's advocacy for trust was entirely at odds with its international image. Caruana Galizia's assassination led to an international outcry across the EU, raising serious questions about Malta's democratic standards. Of particular concern is Malta's so-called 'Golden Visa' programme, whereby a permanent residency visa is issued to individuals who invest a required sum into the country. Pointedly, in September 2018, *Bloomberg Businessweek* journalist Monte Reel asked: 'to supercharge its financial-services sector, did the smallest country in the European Union sell its soul?'<sup>8</sup> This is because such programmes may be abused by tax evaders, money launderers and perpetrators of organised crime, particularly since Malta is part of the Schengen Area of countries which have abolished passport and border controls. A Maltese passport therefore provides freedom of movement across twenty-six European states and visa-free access to the European Union and its institutions, including banks, courts, and cultural and financial centres. Caruana Galizia was particularly vocal about the programme's lack of transparency and public consultation.

(14) After the assassination, a political crisis ensued and Prime Minister Muscat stepped down in December 2019, passing the reins to fellow Labour Party member Robert Abela. By this stage, however, the corruption allegations had cast a dark cloud over the small island, reducing investors' willingness to partner with the country and undermining the confidence-building integral to the regulation of ledger technologies. The blockchain strategy was overhyped, in part to detract from the notorious murder investigation, yet the image of a highly stable political and economic environment, touted to attract industry players intending to relocate to Malta, was at odds with mass protests and a reputation of government impunity. There are no quick fixes to remedy such troubles.

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7 Caruana Galizia, Daphne. 2017. "Muscat Says Europe Should Become a 'Bitcoin Continent', as the EU Fights against the Rise of Money-Laundering and Terrorism Financing through Bitcoins." *Running Commentary*, March 1, 2017. <https://daphnecaruanagalizia.com/2017/03/90555/>.

8 Reel, Monte. 2018. "Why the EU Is Furious With Malta." *Bloomberg Businessweek*, September 11, 2018. <https://www.bloomberg.com/news/features/2018-09-11/why-the-eu-is-furious-with-malta>.

## Lessons from an Unsuccessful Reset

(15) ‘Blockchain Island’ was a big, ambitious strategic initiative undertaken by Maltese policymakers who, thinking they could foresee the trajectory of the digital future, sought to gain first mover advantage and acquire international influence in the niche of emerging technology. The effort struggled to reap the intended rewards, owing to stifling national and international regulatory frameworks, operational delays, and a loss of strategic credibility because of the deteriorating Maltese reputation. This case study, even with its limited success, reveals both challenges and opportunities for policymakers looking to the future.

(16) First, it highlights the way in which the online space enables states of all sizes, with varying material resources, to become more economically competitive. Small states, like Malta, demonstrate the advantages of an agile and forward-thinking approach to new technologies, and the importance of regulatory frameworks to safeguard security. Yet the success of innovative approaches to national strategy is indivisible from domestic structures. A stable economy is attractive to investors, but there must also be conditions conducive to growth—a balance which can be difficult to strike. The stringent regulatory framework for blockchain in Malta was intended to restore credibility and legitimacy to Malta’s reputation; yet it is having the adverse effect of driving initially interested companies into the arms of international competitors (ranging from Lithuania to Singapore), who are increasingly recognising and adapting to the opportunities afforded by the digital future.

(17) The crisis of the Maltese reputation concurrently reveals the importance of aligning values with strategic efforts. Whilst the initial furore has died down, there is still an opportunity for Malta to leverage its booming economy and technical expertise in the area of cryptocurrency to remain a leading player in the industry. It is essential for policymakers to resolve operational failings, such as licensing delays, and to sustain company interest. More pressing is the need for Malta’s new leadership to demonstrate its renewed commitment to upholding the values of good governance enshrined in the Charter of Fundamental Rights of the European Union. The Maltese case demonstrates how no great vision can overcome domestic failures regarding the rule of law. These must be addressed, and robust trust building measures implemented to restore confidence in any democratic country whose strategy rests on the need to foster credibility and sustain public support.

(18) Crucially, blockchain and other distributed ledger technologies still hold tremendous promise as a means of preserving citizens’ digital identities. The utility of such technology extends beyond ICOs and cryptocurrency, to the multifaceted advantages of smart contracts and decentralized transactions. These can be applied to sectors spanning education (e.g. preventing fake University certificates), health (e.g. preventing the loss of NHS records), shipping, land and company registry, banking, and more. Despite Malta’s operational failings, when reflecting on his original vision for ‘Blockchain Island’, Steve Tendon noted that ‘It wasn’t just about the local and global economy, but also about social responsibility and even changing the very fabric of society with a deep concern about sustainability issues, social justice and distribution of wealth.’<sup>9</sup> These remain essential goals for all countries to pursue.

(19) One indisputable outcome of the turbulence of the 2020 COVID-19 pandemic is that it has been a catalyst for digital transformation. In this respect, the small island, embracing cutting-edge technology, was ahead of the curve. Since its launch in 2018, the Malta Digital Innovation Authority has not limited its attention to blockchain but has been working to position Malta as a leading country in the area of emerging technologies. Countries should be following the Maltese lead in seeking to regulate the grey digital domain, and in putting

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9 Tendon, Steve. 2019. “Will the Real Blockchain Island Please Stand Up!?” *ChainStrategies*, September 30, 2019. <https://chainstrategies.com/2019/09/30/will-the-real-blockchain-island-please-stand-up/>.

in place the necessary infrastructure to support innovation. Just as we seek to future-proof our physical borders, to truly safeguard citizens it is clear that we must future-proof our digital spaces as well.

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## 6. Substituting Bullets for Dollars: William Taft and Dollar Diplomacy 1909-1913

(1) This report focuses on the administration of American President William Taft and specifically its attempt to construct a new grand strategy for the United States beginning in 1909. This new strategy, known as ‘Dollar Diplomacy’, relied on financial and economic tools, like the guaranteeing of generous loans to governments and the building of commercial ties, to increase American influence in the world. In the words of Taft’s Secretary of State Philander Knox, “not only was the goal of diplomacy to improve financial opportunities, but also to use private capital to further US interests overseas”.<sup>10</sup>

(2) This was a mercantilist policy in the sense that it internalised economic power as the primary tool of statecraft, but crucially, it rejected the zero-sum component of *European* mercantilism. This economic statecraft would have benefits for the US but *also* benefit the countries who interacted with the US. Policymakers believed that this policy would be a major realignment of global power as it would challenge the very premise upon which European empires were founded: that of a prosperous core and an exploited periphery. This case study demonstrates the importance of balancing tools of statecraft, the dangers of mismanaging regional pivots and the cost of a lack of buy-in.

### Overview

(3) The reset undertaken by the Taft administration deliberately repudiated his predecessor’s, Theodore Roosevelt’s, own grand strategic reset. Roosevelt built on the work of the previous president William McKinley and ended American isolationism by crafting a truly global role for the United States in the early 20<sup>th</sup> century. Roosevelt married persuasive diplomacy and the use of force when necessary; and in so doing, created an overseas empire that included the Philippines and Puerto Rico, removed European influence from Latin American, mediated peace between Russia and Japan in 1904 and built the US Navy into the largest in the world. Though Roosevelt was seen as a successful foreign policy practitioner, Taft privately doubted the extent of Roosevelt’s accomplishments and sought a new approach.

(4) Despite Taft and Roosevelt’s differences in the conduct of foreign policy they, and their successors, shared the same first order assumptions about America’s role in the world. For them, the fundamental basis of American foreign policy was two-fold: that international law could form a basis of a legalist international order and that realpolitik and European balance of power politics were inherently destabilising. In this regard, Taft was no exception. What differed. However, was the *means by which* he sought to pursue these first order principles.

(5) Taft’s Dollar Diplomacy had three core elements: extrication from European affairs, an end to Spheres of Influence in Far East, and the defence of the Monroe Doctrine—a policy which, since the 1820s, had sought to exclude European interference in Central and Southern America. These elements were built on sound logic. By extricating the United States from Europe, it could avoid involvement in what Taft’s administration viewed as a diplomatic cul-de-sac, and thus, policymakers could focus finite resources on other regions. East Asia, American officials believed, not only represented a significant opportunity for Dollar Diplomacy but it could also ensure stability in the Far East and thus protect America’s Western approaches. Similarly, defending the country’s Southern approaches by cultivating good relations with its Latin American neighbours and

<sup>10</sup> Office of the Historian, United States Department of State, ‘Dollar Diplomacy, 1909-1913’ <https://history.state.gov/milestones/1899-1913/dollar-diplo>

excluding European interference improved the country's security. The final two cases also benefitted the American capitalist, industrialist and mercantile classes with increased economic opportunities.

(6) The grand strategy of Dollar Diplomacy, however, would ultimately fail in its goal of increasing American influence through economic tools. First and foremost, the strategy was insufficient to the task of affecting significant geopolitical change in the international system. Moreover, Taft's failed grand strategic reset reveals the perils of mismanaging a major pivot from one region to another. In this case, a pivot to Asia and extrication from European power politics was undermined by the fact that European powers still held significant sway in East Asia and could collaborate to exclude American overtures to the region. More fundamental, however, was Taft's failure to convincingly communicate his foreign policy vision to Congress and the American public more broadly. Without broad buy-in, this ambitious grand strategic reset was destined to fail. The following sections will discuss this in detail.

## Europe

(7) In the first decade of the twentieth century, Europe was a continent home to growing suspicion among rising and insecure powers. In Germany, Kaiser Wilhelm II's populism fuelled a *Weltpolitik* (global) policy which was supported by continued naval armaments. David Lloyd George, as Britain's Chancellor of the Exchequer, had pushed the United Kingdom to respond to this German naval build up with its own significant naval construction. This dynamic exacerbated the existing alliance structures. Austria-Hungary and Germany had established the Dual Alliance in 1879, with Italy joining three years later. In response France and Russia allied in 1894, with Britain joining informally in 1904. These competing blocs bred mutual suspicions on the continent, and as a result, instigated a massive armament construction by all European Great Powers.

(8) Taft contrasted sharply with his predecessor's policy towards Europe. Where Roosevelt had taken an interest in the region, Taft sought to distance the United States from the continent and redirect attention and resources to East Asia. Even as US State Department officials implored the Taft administration to take an interest in the Balkans and Near East—where the Agadir crisis in 1911, the Italo-Turkish War from 1911-12 and the Second Balkan War in 1913 threatened to destabilise the region—the administration thought it preferable to avoid the European quagmire entirely. Ultimately, staying out of European affairs and pivoting away from the region might well have been a sensible move and completely proportional with the means that the United States possessed at the time, but as will be evident, not cultivating *any* serious ties with European states was a move that had repercussions for other theatres of American grand strategy.

## East Asia

(9) Policy towards East Asia had, by this period, become a foreign policy priority. Though Taft agreed with Roosevelt that the domination of Far Eastern approaches to the United States by a foreign power represented an existential threat to the continental United States, their strategies were strikingly different. Where Roosevelt believed that a sizeable navy was the solution, Taft was confident the United States could leverage financial and economic assistance to increase its influence in the region and mitigate threats to its Western shores. Japan in Manchuria represented a particularly acute threat as policymakers believed that Japan's Northern sphere of influence could quickly be leveraged to make gains across China. However, the administration was confident that by breaking the European and Japanese financial stranglehold on China, they might weaken their political control.

(10) Towards this end, the Taft administration allowed for an extraordinary mix between American business and official diplomacy. Willard Straight, the head of the State Department's Far Eastern Division, was seconded to J P Morgan and became the representative for the American Banking Group—then the primary vehicle through which European powers invested in China. That this was allowed, and even encouraged, by the administration shows the deep level of integration of foreign policy with American big business. The plan of the American Banking Group was two-pronged. First, it would arrange loans for China to buy back the Chinese Eastern Railroad from Russia and the Southern Manchurian Railroad from Japan; and second, American bankers would simultaneously provide loans to the Chinese government to build its own railroad. Such a move, it was estimated, would allow China to reclaim some sovereignty in Manchuria from Japan and Russia as well as providing enormous financial opportunities to American corporations.<sup>11</sup>

(11) The scheme was doomed from the start. Russia and Japan refused to sell the railroads and, suspicious of American intentions, these powers effectively shut the United States out of the region by dividing Manchuria into Japanese and Russian spheres of influence. When Secretary of State Knox turned to France and Britain to intercede on the Americans behalf, he found the countries unwilling to intervene. France had been allied to Russia since 1894, an agreement that had a precedent for respecting Russian gains in Manchuria, and Britain was allied with Japan since 1902, which respected Japanese spheres of influence in northern China and Korea. Under British and French pressure, the United States was forced to admit Russia and Japan into their railroad consortium, thereby establishing a financially collaborative approach vis-à-vis China.

(12) The more egregious mistake for American grand strategy and Dollar Diplomacy in this region was to focus on China rather than Japan. In 1912, three years into Taft's term, the Qing Dynasty collapsed, throwing American economic interests in China into disarray. Yet, policymakers sentimentally clutched to China for its *potential* opportunities rather than its proven benefits. American exports to Japan were worth \$53 million—double that of China—and similarly, investment to and from Japan far outstripped that of China.<sup>12</sup> Tellingly, Chinese trade, and the absolute value of Asian trade, actually *declined* under Taft—a development which bred significant discontent from California traders, and by extension, politicians. Importantly, though, his administration genuinely believed that economic diplomacy could affect strategic gains whilst simultaneously promoting American business. This calculation, however, was fatally undermined by the administration's unwillingness to push the more traditional means of diplomacy. Relationships matter, and dollar diplomacy proved insufficient.

## Central and South America

(13) America's southern periphery was another important focus for the Taft administration's foreign policy. Officials wanted to reverse the years of intervention under Roosevelt and instead promote economic interdependence within the region—a move which they believed would help to stabilise the region and increase dependence on American capital. Prioritising American business interests, however, meant that Taft was forced to protect their operations by any means. Despite his hesitancy to intervene militarily in the region, Taft was willing to go to extraordinary lengths to protect the American-owned Panama Canal, which the administration knew would become a vital economic artery for the United States. In 1910, Nicaragua's president José Santos Zelaya mulled the creation of a canal across Nicaragua to raise money to fight rebel forces under Juan Estrada. Noting the economic threat which an additional canal posed to American business,

<sup>11</sup> Michael J. Green, *By More Than Providence: Grand Strategy and American Power in the Asia Pacific Since 1783* (A Nancy Bernkopf Tucker and Warren I. Cohen Book on American-East Asian Relations), (New York: Columbia University Press, 2019).

<sup>12</sup> Federal Reserve, "Exports to and from the United States Before and After the Outbreak of the War", Federal Reserve Bulletin October 1 1919.

Taft ordered American troops to assist rebel forces. Though the intervention was successful in toppling the elected government in Nicaragua, the new regime was fragile and prone to instability. After another coup in 1911, Taft sent more American troops to occupy Nicaragua—a move which bred hostility in the country and the region. As a result, America's southern border ended up being less secure.

(14) Mexico was another core component of Taft's southern strategy, but the country was in a precarious position. Long-time strongman Porfirio Diaz was increasingly challenged by domestic opposition and was losing his grip on control. As events escalated, Taft signalled his intent to send in troops should the roughly \$1 billion in American investments in Mexico be threatened. However, the American Congress came out in force against the policy; and after steady opposition, Taft retreated from his original position. The legislature's dislike of Taft's policy revolved around the fear, held by Congressmen from southern states, that their constituents would be unwilling to support an American intervention in Mexico. Abroad, the spectre of intervention created considerable ill-will in the Central and Southern American region. For that reason, it was of little surprise that these states convened a Pan-American conference which considered ways in which to remove US commercial and political influence from the region.

## Conclusion

(15) Taft's failed strategic reset is comprised of at least four components. The first major issue was the potential pitfalls of pivoting towards another region. The Taft administration decided early on that they would remain more distant from European politics, in favour of increasing focus on East Asia. If the United States could increase its commercial and financial foothold in this region, it was believed, it could overturn European global primacy and increase American political influence. It quickly became clear that officials were overlooking more immediate geopolitical considerations. East Asian regional order from 1909-1913 was never strictly defined by Asian powers. Instead, China was divided into spheres of influence by European powers and as unpopular as they were in the region, Britain, France, Russia and Japan still had huge sway over the political, security and economic frameworks within the region. Try as they might, the United States could never succeed in unilaterally upending the balance of power in China when Anglo-Japanese and Franco-Russian alliances were just as strong in Asia as they were in Europe. Events proved that, perversely, deeper involvement in Europe would herald greater benefits for the United States in Asia.

(16) The second major issue was the cost of reliance on a single tool of statecraft. Dollars were indeed an increasingly valuable global currency of exchange and so playing to American financial and monetary strength whilst eschewing the militaristic tendencies of the Roosevelt administration was sound, but only up to a point. Had a mixed approach been utilised that emphasised the use of different tools of statecraft such as short-term coalitions, coercive diplomacy (when absolutely necessary and not as a reaction), bargaining, the application of economic pressure and the use of multilateral forums could have diversified Taft's approach and thus could have better provided for American interests.

(17) The next issue was perhaps the most problematic, in that it contributed significantly to the failures listed above. The Taft administration suffered from a mismanagement of the political economy of grand strategy. Like any national scheme, grand strategy is shaped by stakeholders and elites who determine the success of the project, yet there is a danger in allowing certain individuals and institutions to wield too much influence on the direction of national strategy. Under Taft, big business was given preponderant weight in the foreign policy decision-making process.

(18) Finally, Taft's strategic reset was undermined by a failure on the administration's part to secure the

backing of the American legislature and public. Congress proved to be an ulcer in Taft's foreign policy throughout his tenure, attempting to block the sending of troops into Mexico and rejecting any further attempts to redress the balance of power in Asia. But Congress was parroting the feelings of the American people. Despite an arguable end to isolationism, at least as far as policy went, the American people were still deeply suspicious of entangling alliances, big global commitments and greater global interdependence. Taft's grand strategic reset failed to take stock of these public sentiments. Whether it was southern senators voicing the concerns of their constituents about an intervention in Mexico, or California congressmen voicing their discontent at an absolute decline in the Asia trade, all were representing a constituency that the Taft administration made no attempt to bring on board. Taft's loss of these states and corresponding defeat in the 1912 Presidential Election was in no small part a repudiation of Taft's failure to connect foreign policy to the wider public interest.

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## 7. British strategic resets in the 1940s: The UN and NATO

(1) This report examines certain elements of the British diplomatic planning efforts during and after the Second World War. It focuses on two moments in particular—the creation of the United Nations Organization in 1945 and the creation of the North Atlantic Treaty Organization in 1949—in which British officials initiated strategic realignments in response to external developments. The first came after the dissolution of regional and international order during the Second World War, while the second was a response to what British policymakers considered an existential threat to Western Europe posed by the Soviet Union. This study aims to highlight several insights which are relevant for the ongoing efforts to develop a UK Integrated Review. These points will be taken in turn.

### Part I: The creation of the United Nations Organization

(2) In the early years of the Second World War, British officials and statesmen were preoccupied by the military conflict and gave little attention to a post-war grand strategy. The spur to planning for a post-war world came from the fact that enemy powers, most notably Germany and Japan, were elaborating on their own visions for a post-war regional and international order. Adolf Hitler's 'New Order' for Europe, in particular, forced the new government under Winston Churchill to begin thinking about what the United Kingdom was fighting *for*, as opposed to what it was fighting *against*. There were debates over fundamental principles, with some officials urging that the United Kingdom stand forth as the opposition to totalitarianism and the defender of western civilisation; but these broader philosophical bases then gave way to more concrete thinking. Though some Cabinet ministers gave attention to these questions early on, it was the efforts of more junior officials which drove the strategy-making process forward.

(3) The Foreign Office, in particular, became the locus of post-war political and security planning, as officials prioritised the development of 'long-distance schemes' and a 'grand strategy of peace.' The process of developing strategy—particularly plans which introduced ambitious redirections of foreign policy—was rarely smooth. There were, to be sure, internecine divides within the Foreign Office, territorial battles between government departments, and conceptual differences amongst Cabinet members. Within the Foreign Office alone, there were questions over whether, and to what extent, Britain would take responsibility for peace on the European continent; debates over the post-war reliability of Britain's allies (especially the Soviet Union and the United States); and differences as to the basis of international order. Officials also debated the ideal time-frame on which to base policy, eventually arriving at a suggestion that planners should focus on an outlook of two years, with a review of policy every six months. This was not a standardised procedure, however. Instead, policymakers thought that the scope and review of policy could shift depending on external circumstances.

(4) Strategy in these years was driven by a combination of junior officials who were willing, so to speak, to 'seize the pen' and more senior officials who could deliver on these new ideas. Policy recommendations began on an individual level, with certain officials, particularly within the Foreign Office, drafting documents which were then debated within and between government departments. The crucial point of delivery—where proposals led to deliberation and then policy decisions—was the War Cabinet. Throughout the war, ministers displayed a sporadic interest in post-war questions, with some drawing up ambitious schemes of their own and others remaining on the fringes of such discussions. The Prime Minister, though he criticised planners for taking up speculative post-war questions before the war was won, often elaborated on his own visions which were at odds with those being drawn up by the Foreign Office. The Foreign Secretary Anthony Eden,

while rarely a generator of post-war policy within the Foreign Office, served a valuable role by, at times, standing up to the Prime Minister, and by building support for his officials' policies within the Cabinet. More important was the role of the Permanent Under-Secretary at the Foreign Office, Alexander Cadogan, who served as one of the vital links between policy planning and Cabinet approval. His side-line interventions amongst ministerial meetings—often in the form of clarifying a particular policy recommendation—was crucial not only to the Foreign Office retaining control over post-war security policy but also to their plans being delivered successfully. As such, personalities, personal relationships and policy expertise, especially at critical junctures, were some of the most important vehicles for policy formation.

(5) Turning to the strategy itself, the debates over the fundamental assumptions which underpinned a future British policy were given as much attention as the strategy itself. Many British officials assumed that, despite the United Kingdom being able to derive substantial power from its Empire and connections with its Commonwealth Dominions, it was no longer a world power in the first degree. Thus, the preface to the first major planning document read, 'We must, on the one hand, either have some powerful ally or allies, or cease to be a World Power, and, on the other hand, we cannot expect to have powerful allies unless we are powerful ourselves.' Great attention was thus given to Britain's future relationships with the Soviet Union and the United States. Officials in the Foreign Office believed that the former, while viewed as 'amoral', stubborn and even expansionist partners, could be dealt with diplomatically (a position which differed markedly from that of British military officials). As for Anglo-American relations, the pervasive assumption within Whitehall was that ambitious American statesmen sought a global role but were hindered by a traditionally isolationist public. Nonetheless, American support was vital to British power. As Cadogan warned, 'Everything...will be dependent on the willingness and the ability of the US to share our burden.'

(6) When a coherent post-war grand strategy was put forward by the Foreign Office in 1942, there were three primary objectives of British foreign policy: maintenance of the United Kingdom's position as a world power; keeping its Empire intact and Commonwealth connected; and establishing lasting peace on the European continent. Essential to meeting the third of these objectives was to ensure that American military power was brought into the maintenance of European peace. The primary strategy devised to achieve the objectives was the creation of a post-war international organisation which, comprised of the countries then calling themselves the 'United Nations', would have at its core a great power nucleus—made up of the United Kingdom, the United States, the Soviet Union, China (and later France)—responsible for the maintenance of international peace and security. In this way, the position and influence of Britain within the international system would be secured; and the United States, whose cooperation was deemed essential to European security, would be bound to the maintenance of peace on the continent.

(7) For these British planners, the creation of the United Nations Organization was not so much the triumph of internationalism as it was the product of a practical strategy to further the national interest. Crucially, moral considerations and raw calculations of power were viewed as constitutive, even reinforcing elements within Britain's foreign policy, as opposed to paradoxical forces. Thus, the construction of an international organisation—one which, in theory, bound all powers to regulated behavior and one in which Britain would exercise outsized influence—came to be seen as a way to achieve Britain's overarching foreign policy objectives. As one official framed it, 'All great institutions have been produced by reconciling high principles with vested interests... and the attempt to construct a [United Nations] Charter to meet the peculiar needs of our own age is rooted both in national interests and moral purposes.'

(8) Did the strategy work? In the short-term, no; but in the long-term, yes. The British political and security strategy for the post-war period—as best exemplified in the creation of the United Nations Organization—was not entirely successful in its fundamental objectives of facilitating cooperation amongst the three great

powers and maintaining peace on the European continent. This failure, however, was the result of external events more so than any fundamental shortcoming of British policymakers. The peace proved temporary due to renewed great power rivalry—this time between the Soviet Union and the Western powers. Yet the creation of the United Nations Organization became the foundation-stone of the post-war rules-based international order which, though over-shadowed by the decades-long Cold War, has remained a pillar of the modern international system, and an institution through which the United Kingdom continues to exercise outsized influence.

## Part II: The creation of NATO

(9) By 1946-47, the wartime cooperation which had existed between the Soviet Union, the United States and the United Kingdom had all but evaporated. Suspicion between Moscow, on the one hand, and London and Washington on the other, led to irreconcilable differences and the threat of renewed conflict on the European continent. The United Nations Organization, which was intended to be a foundation-stone of British post-war political and security strategy, was largely ineffective in meeting the United Kingdom's new, most pressing foreign policy challenge. The threat of a further westward Soviet encroachment into Europe meant that a reset was needed, and again, it was largely the work of Foreign Office officials who drove the process.

(10) The mechanics of policymaking largely remained the same in this period. More junior officials took the responsibility for drafting long-term plans which were then revised internally and debated across government. If anything, the new Foreign Secretary, Ernest Bevin, played a more active role in encouraging and facilitating British policy towards the countries of Western Europe and the United States. There was substantial carry-over, both in terms of personnel and policy recommendations, from the wartime period. Indeed, the idea of a western security grouping to protect against, on the one hand, German resurgence as well as the distant possibility of future Soviet encroachment into Europe, was one which Foreign Office officials had been considering for years. The hindrance, however, was a fear that designing such a defensive alliance in Western Europe might provoke the Soviet Union and subsequently undermine the United Nations Organization. By 1946-47, there was now more cross-government support for policy aimed at containing the Soviet Union, a position which British military officials, in particular, had long been advocating.

(11) Similar to the thinking behind the United Nations Organization, British officials accepted that the country's future influence rested in its ability to create institutions that could serve the national interest. One way of building such structures, they believed, was to stress common interests which weaker countries, and in this case the majority of post-war countries in western Europe, might find it beneficial to rally behind. This basic conception of fusing national and multilateral interests and values was one which rested at the heart of British policymaking in the period.

(12) Crucially, British influence in the regional and international structures it sought to create was dependent, to a great extent, on a willingness of the government and public to commit material and energy. A phrase used by Foreign Office officials in the period, and one which would become axiomatic to the planners of both the United Nations and NATO was that 'power and responsibility must be commensurate with one another.' As one official wrote:

If we are to preserve peace and our own safety at the same time, we can only do so by the mobilisation of such a moral and material force as will create confidence and energy on the one side and inspire respect and caution on the other. The alternative is to acquiesce in continued Russian infiltration and helplessly to witness the piecemeal collapse of one Western bastion after another. The policy...will require a lead from us.

(13) There were a series of agreements which built up to the creation of NATO, all of which were, in some way, the result of British planning and diplomacy. The Treaty of Dunkirk, signed between Britain and France in 1947, was followed by a proposal for a Western European Union in 1948.<sup>13</sup> Ernest Bevin, who was adamant that Britain could no longer think of itself as detached from the continent, wrote that such an alliance would be 'backed by power, money and resolution and bound together by the common ideals for which the Western Powers have twice in one generation shed their blood.' American power was viewed as a necessity, and while officials understood that Britain would be a junior partner, it would exercise special influence. 'The countries of Western Europe,' a memorandum read, 'will look to us for political and moral guidance.' The Treaty of Brussels—which provided for 'collective self-defence' should Belgium, Britain, France, the Netherlands or Luxembourg be attacked—was signed in March 1948; and after nearly a year of negotiations with the United States, the North Atlantic Treaty was signed in April 1949.<sup>14</sup> Though recently criticised as 'brain-dead' by French President Emmanuel Macron, the NATO alliance served a valuable purpose in the defence of Western Europe throughout the Cold War and remains, to this day, a cornerstone of British foreign and defence policy.

(14) In examining the thinking behind—and implementation of—a Western European defence organization, one of the great insights is the way in which innovative yet grounded proposals can exercise outsized diplomatic influence. The United States was far and away the superpower upon which the future of the Western European democracies depended; yet by 1947-48, Washington's security policy towards the European continent had yet to be crystallised. There was a feeling among certain quarters of Whitehall that the United States, ambitious in principles but lacking in prescriptions, could be steered into policies which, while collectively beneficial, also served primary British interests.

## Lessons

(15) British policymakers operated with an underlying conception that British interests and future influence could best be achieved by the United Kingdom positioning itself as a leader within international institutions. This approach relied on British policymakers avoiding narrow conceptions of British national interest and instead fusing, where possible, the interests of the United Kingdom with those of other powers.

(16) British policymakers not only valued but prioritised long-term thinking and planning. Among Foreign Office officials, there was an understanding that those who produced ideas were the ones who set the agenda, whether in terms of intra-governmental debates or international deliberations. An ethos of the period was to be, as one official wrote, 'the master, and not the victim, of events.'

(17) The starting point of future British strategy was an assessment of first-order principles and first-order assumptions, all of which would be based on the 'interplay of living forces.' It was only after these basic understandings were decided that strategy could develop.

(18) If Britain was to obtain its foreign policy objectives through leadership of regional and international institutions, it was necessary to engender public support and, crucially, provide financial and material contributions. As a number of officials reiterated in the period, 'power and responsibility are commensurate with one another.'

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<sup>13</sup> To be made up of the United Kingdom, the Benelux countries, France, Portugal, Italy, Greece and the Scandinavian nations.

<sup>14</sup> Signatories were Belgium, Canada, Denmark, France, Iceland, Italy, Luxembourg, the Netherlands, Norway, Portugal, the United Kingdom and the United States.

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## 8. The United Kingdom after Suez: A Strategic Reset?

(1) This report examines whether and to what extent the United Kingdom's strategy after the Suez crisis of 1956 constituted a reset. It argues that:

- a) There was no strategic reset after the Suez crisis of 1956;
- b) A review of strategic priorities was already in train, following a series of geopolitical 'shocks' since 1950, and continued after Suez;
- c) Suez accelerated certain trends, but had little effect on review outcomes;
- d) The need for defence reprioritisation was recognised, based on economic necessity; but
- e) strategy reviews focussed on maintaining the UK's world role, and failed to address the mismatch between resources and commitments.

### The power of the Suez myth

(2) The persistent use in British narratives of Suez as 'shorthand for post-imperial decline, ministerial duplicity and incompetence, humiliation and failure' has distorted the significance of this episode in British strategic thinking.<sup>15</sup> The political fallout from Prime Minister Anthony Eden's decision to collude with France and Israel to provide a pretext for an invasion of Egypt—in an attempt to overthrow Gamal Abdel Nasser and reverse his nationalisation of the Suez Canal in July 1956—was more significant than any strategic consequences. The persistence of the Suez myth has been much greater in Britain than in either France or Israel, the other partners in collusion.

(3) Another myth is that Suez inflicted great damage on the Anglo-American relationship. Even before Suez, there was considerable friction on Middle Eastern issues, including US refusal to join the Bagdad Pact and support for Saudi policies opposed to those of the UK. Eden's key mistake was to try to get support for action against Egypt in a US presidential election year. Eisenhower's refusal, forcing the withdrawal of Anglo-French forces, ended Eden's career but only bruised transatlantic relations. They soon recovered at the diplomatic level and the key security and intelligence relationship remained solid. Shared interests in a Cold War context, in conjunction with multilateral ties, were too strong.

(4) Myth played a part in UK politics in the lead-up to the crisis. Dissatisfaction within the Conservative party over the dismantling of Empire and diminishing British influence in the Middle East encouraged Parliamentary and public 'outrage' when Nasser nationalised the Canal. The media propagated the myth that Arabs were not capable of operating the Canal themselves. Nostalgia in some quarters for wartime special operations fostered the myth that such tactics could work again. On the American side, the myth of the UK as an outdated imperial power served an agenda of US economic dominance in the region (centre on oil, telecommunications, and air routes).

(5) Britain did not become a 'junior partner' to the United States after Suez. It already was one. As Selwyn Lloyd wrote in his memoirs, 'Suez became an excuse. It was scapegoat for what was happening to Britain in

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<sup>15</sup> See Gill Bennett, *Six Moments of Crisis: Inside British Foreign Policy* (Oxford University Press, 2013), Chapter 2.

the world.<sup>16</sup> The imbalance between UK and US power and influence predated the Second World War, but was increased greatly by it.

## Economic Realities, 1945-50

(6) Britain ended the Second World War bankrupt, and facing a 'financial Dunkirk.' Six years of war had exhausted its coffers. During hostilities, financial support from the US and Canada (Lend-Lease and Mutual Aid) had been vital. Reliance on the United States continued with the Loan Agreement of December 1945, Marshall Aid (1948-50) and Defence Aid (1951-57). But aid came with strings attached, particularly the commitment to make sterling balances convertible. Balance of payment deficits, sluggish growth, high raw material prices, a dollar shortage and low productivity made it hard to sustain crippling global obligations. Britain was also developing its own nuclear capability, an expensive business. The early Cold War period saw a series of financial crises and Treasury warnings about the need to retrench.<sup>17</sup>

(7) Despite the financial situation, there was little serious consideration of reducing global obligations. Foreign Secretary Ernest Bevin was at the forefront of strategic initiatives to promote Western Security and European reconstruction (and persuade the US to underwrite them), a key player in constructing the security architecture culminating in the formation of NATO in 1949. He and his colleagues remained convinced of the continuing strategic importance of the UK: through its global 'lift', as a member of the UN Security Council and founder member of NATO; and as one of the 'Three Monroes' (a variation on Churchill's concentric circles), global spheres of influence with Britain occupying a vital position between West and East.

## Strategic shocks and global strategy

(8) Between 1950 and 1952 the UK suffered a series of strategic shocks that exposed its vulnerability and set in train a process of strategic reappraisal. The outbreak of the Korean war in June 1950 raised the spectre of a third world war and reversed the decline of defence spending as a proportion of GDP. The nationalisation in the spring of 1951 of the Anglo-Iranian Oil Company (BP), forcing a withdrawal of western companies from the Abadan refinery, was seen as a humiliating blow to British prestige as well as a supply threat.<sup>18</sup> The Egyptian denunciation of their 1936 treaty with Britain, and serious demonstrations against the presence of British troops in the Canal Zone, presaged further conflict, especially when the Free Officer's coup in July 1952 enabled Nasser to take control in Egypt and set himself up as the figurehead of Arab nationalism. This posed a potential threat to UK interests globally, as Nasser's anti-colonial propaganda spread throughout the Empire. In addition, there was East-West tension in Germany, ongoing conflicts in Malaya, Indo-China, and Burma, as well as between India and Pakistan and Arab-Israeli tension.

(9) Against this background, the Chiefs of Staff produced their annual reports on Defence Policy and Global Strategy. In 1950, they stressed that the British Commonwealth and Europe could not fight the Soviet Union

16 Selwyn Lloyd, *Suez 1956: A Personal Account* (London: Hodder and Stoughton, 1978), p. 252.

17 For details of the relevance of economic factors in the Suez crisis and after, see in particular G.C. Peden, 'Suez and Britain's Decline as a World Power', *Historical Journal*, vol. 55, No. 4, December 2012, 1073-96. See also G.C. Peden, *Arms, Economics and British Strategy: From Dreadnoughts to Hydrogen Bombs* (Cambridge University Press, 2007).

18 Abadan was arguably a worse crisis than Suez. Foreign Office Historical Adviser Rohan Butler wrote a long memorandum, submitted in March 1962, critical not just of British diplomacy but of government policy generally, producing a flood of comment. A second paper of May 1963, 'A new perspective for British diplomacy', described Britain as a 'somewhat impotent middleweight.' This led, among other things, to the formation of a separate Planning Staff in the Foreign Office. Both Butler's memoranda are in the National Archives (TNA) at FO 370/2694. See also Peter J. Beck, 'Using Butler's Abadan to Reappraise British Foreign Policy', in *Using History, Making British Policy: The Treasury and the Foreign Office 1950-76* (London: Palgrave Macmillan, 2006), Chapter 11.

except in alliance with the US, and that it made 'no sense to think in terms of British strategy or Western European strategy as something individual and independent.' Nevertheless, it set out a daunting list of UK priorities: 'measures necessary to win the Cold War', including occupation, garrison and emergency forces in Europe, the Middle East, Far East and Malaya; preparations for a hot war, including the air defence of the UK; and the defence of the Middle East, the 'land bridge between Europe, Asia and Africa', regarded as vital for oil supplies and communications, as well as the siting of key air bases. In 1951, despite intervening events, the Report concluded that although the world situation had become 'more acute', the principles of defence and global strategy set out in 1950, based on 'full collaboration with the United States in policy and method', remained unchanged.

(10) By 1952, however, the Chiefs of Staff recognised that the concepts of war and deterrence had changed. They now recommended the UK should build its own atomic bomber force (not least to strengthen its usefulness to the US), though still according a higher priority to the defence of the UK and its sea communications.<sup>19</sup> Though the global threat remained high, the context was evolving. Nuclear weapons meant the prospect of a hot war was both more dreadful and less likely; the deterrent became more central to UK defence than conventional forces. Also, the Cold War was increasingly spilling over into the economic sphere, as both West and East sought to extend their influence (especially in the Middle East). Throughout, economic problems persisted, and the Treasury persuaded the Cabinet to review defence spending.

(11) These issues were explored extensively in Whitehall, including successive reviews of Global Strategy, and a ministerial 'Radical Review' in 1953 that concluded that the only forces to be maintained were those that contributed in peace to Britain's position as a world power. Yet little emerged (except a lot of paper), and ministerial views of Britain's global role remained unchanged.

## Before and after Suez

(12) A Policy Review was initiated early in 1956, conducted by Cabinet Secretary Sir Norman Brook. The Review Team, a small group of ministers including Eden, held 9 meetings in June and July, discussing a Cabinet Office paper on 'The Future of the United Kingdom in World Affairs.'<sup>20</sup> The centrality of the Anglo-American relationship to UK policy was acknowledged at the outset, and two basic objectives: avoiding global (i.e. nuclear) war, and protecting vital UK interests overseas, particularly access to oil. The review encompassed defence expenditure, nuclear issues and economic policy, including the role of sterling, an important factor in policy on decolonisation and Commonwealth cooperation.

(13) After a pause during the dramatic events of October-December 1956, the Review resumed for a final session in December. Overall, the crisis made little difference, except to concentrate ministerial minds further on the need to reduce the burden of defence spending, and for a reappraisal of strategy in the light of increasing reliance on the nuclear deterrent. Some trends accelerated very slightly. The temporary cooling of Anglo-American relations encouraged ministers to turn more towards Europe, pursuing the prospect of a European Free Trade Agreement (though still rejecting the idea of an EEC). Although the Suez crisis had strengthened arguments in favour of decolonisation, there was general agreement this should not be rushed. There was little sign that Suez had altered the overall conception of the UK's global role.

<sup>19</sup> The two Global Strategy reports for 1950 and 1951 are printed in *DBPO*, Series II, Vol. IV, Appendix I and II. The 1952 report, 'Defence Policy and Global Strategy', D(52)26 of 17 June 1952, is in CAB 131/12, TNA.

<sup>20</sup> PR(56)3, 1 June 1956, drafted by FO, Treasury and defence officials. This paper and other documentation on the Review can be found in CAB 134/1315, TNA.

(14) Macmillan, taking over as Prime Minister in January 1957, favoured the development of Grand Designs, and further reviews were pursued during 1957. But the result, a 1958 report on 'The position of the United Kingdom in World Affairs', reached the usual conclusion that while Britain was no longer as powerful economically and militarily as it had once been, its influence was still important, particularly in bridging the gap between Europe and the US. The UK's global reach and role in the UN and NATO were emphasised yet again, while defence spending continued to rise faster than national income. A further review followed in 1960, recognising the heightened decline of British power, but stressing the continuing importance of its global influence.

(15) The incoming Labour government, in 1964, inherited the pressures of its predecessor without a clear strategic road map to follow. This time, however, there was a Defence Minister, Denis Healey, willing and able to take on the entrenched interests of the armed services and force a serious review of defence spending. Cumulative financial crises in the 1960s, including devaluation in 1967, finally forced a really radical reappraisal of the UK's world role. This culminated in the January 1968 decision to withdraw British forces from east of Suez and the Persian Gulf. Prime Minister Harold Wilson defied US pressure and Commonwealth dismay to drive through Cabinet agreement to this decision, as part of a package of economy measures.<sup>21</sup> It was then that the strategic shocks experienced from 1950 onwards really came home to roost.

## Conclusion

(16) The need for a reappraisal of the UK's world role after the end of the Second World War was both evident and urgent. But successive British governments found it difficult to respond to this pressure. This was partly from an innate belief in the centrality of Britain to the global balance of power. It was also because ministers who had lived through the 1939-45 war were alarmed by the fragility of the peace that followed, and thought it essential to display strength, not weakness. The volatility of international relations, perennial military resistance to spending cuts and pressure from the US to be a significant partner made change difficult to conceptualise or effect.

(17) Some might consider Suez a missed opportunity for a strategic reset. In fact, the underlying trends in UK economic and military decline, combined with determination to resist downward pressures on its global profile, both predated and succeeded the 1956 crisis. In this context Suez was, as George Peden puts it in his article, 'little more than an eddy in the fast-flowing stream of history.' It is true that the crisis offered few strategic insights. But it encapsulated the mismatch between British perceptions of its global role, and the resources it could muster to maintain that role. Even after the 1968 measures, that mismatch continued to bedevil British policy. British global 'lift', membership of the P5, and the fact that the UK spends more on defence than any other NATO member except the US, mean that it is likely to continue to do so.

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<sup>21</sup> See Gill Bennett, *Six Moments of Crisis*, Chapter 4.

## 9. The UK's attempted Strategic Reset under Edward Heath: EEC Membership

(1) This report examines the strategic reset undertaken by the Edward Heath administration between 1970 to 1974. Specifically, it focuses upon the United Kingdom's attempt to gain EEC membership and how, through Heath's vision, it attempted to facilitate national power. There are four key findings in this study. First, Heath's vision was a strategic reset in 'ways' and 'means' of British external policy. The 'ends' remained very similar to the past. Second, EEC membership was perceived to be the "only" option left for British policymakers with regard to economic and foreign policy. Third, Heath's vision came up against significant cultural resistance from the British public, further exasperated by not being entirely transparent about the end goal for Heath. Finally, a combination of world events and EEC actions further rendered Heath's strategy as impotent to British needs. Events outside of Britain's control contributed greatly to Heath's strategic failure.

(2) On 19<sup>th</sup> June 1970, Heath won a surprising victory against the incumbent Labour government under Harold Wilson. The electoral victory came at a time of strategic drift for Britain. Only two years prior, the Wilson government, compelled by worsening economic conditions which culminated in the devaluation of Sterling by 14%, announced the planned withdrawal of British forces from East of the Suez Canal. This 'East of Suez' role had long defined a key aspect of Britain's self-perceived role on the world stage. Its termination placed Britain in search of a strategic reorientation. Wilson believed that admission to the EEC – in what would be Britain's second attempt to gain membership in the 1960s – provided a potential solution. However, citing similar reasons to the first rejection, Charles De Gaulle used France's veto in November 1967 to rebuff Britain's application. Thus, Britain continued its strategic drift, lacking solid tethers to fulfil its requirement for a 'role' in the world.

(3) When Heath entered office, the possibility of the United Kingdom joining the EEC seemed to address several core 'strategic' elements for Britain's world role going forward: the relative power imbalance between Britain and the European Community members, the changing wider international system and how Britain could maximise its influence within it, the weakening Anglo-American 'special relationship' and the deteriorating domestic economy. Whilst Harold Macmillan (Conservative Prime Minister from 1957 to 1963) saw EEC membership as another facilitator of British pursuits of 'leadership' in the world and Wilson viewed the EEC as a replacement for the 'East of Suez' withdrawal and rescuer of the British economy, Heath was far more ambitious. Rather than using EEC membership to bolster and support existing British strategies, Heath's aim was to make Europe the core vehicle of Britain's strategy. In Heath's own words, his plan was to "become a Greater Britain in a Greater Europe..." To "take up once again our proper place in the world" through a Greater European Community.

(4) However, Heath's strategic vision did not bore the results he had hoped for. A combination of world events outside of his control and ingrained cultural resistance on Britain's part led to both Heath's and the EEC's popularity plummeting in the early 1970s. Whilst Britain's accession to the EEC in 1973 (after its third application) would survive the tides of public opinion, Heath's government would not, with the Conservatives failing to secure a majority in the March 1974 elections. Thus, with the return of Wilson to power, so too did Britain witness a return to more 'normal' perceptions of Britain's strategic interests. Heath's strategic vision did not survive his fall.

## Why did the third application succeed?

(5) The key element which facilitated British membership under Heath were the changing circumstances for Britain at the beginning of the 1970s. Under Macmillan and Wilson, the United Kingdom had sought 'special interests' when applying for the EEC, hoping to protect the Sterling Zone and Britain's Commonwealth trade (then comprising roughly 30% of all British trade). These requests proved to be a major barrier to entry and partly caused De Gaulle's two separate vetoes. By 1970, however, British exports to the EEC had outstripped those to the Commonwealth. Moreover, by 1970, it was clear that the Commonwealth could not provide the political 'bloc' from which Britain could draw power. Both politically and economically, the Commonwealth was no longer seen by British officials as an asset to protect. Indeed, several saw it as a liability.

(6) Additionally, and perhaps most importantly, de Gaulle's retirement from office on 12 April 1969 created the opening for Britain to push forward its application. De Gaulle had traditionally vetoed British applications based on his belief that Britain did not see itself as European enough to be fully committed to the Community project. Indeed, he was correct. Whilst Wilson was placed in a position of contracting options, Macmillan certainly saw Europe as ancillary to British strategic interests, rather than the core focus. The combination of Heath, a visible pro-European, and the removal of de Gaulle as an obstacle provided Britain with the space required to push through its planned strategic reset.

## Why did Heath choose the EEC as the core of Britain's Strategic Reset?

(7) It is important to note that underpinning Heath's push for EEC membership was the perceived lack of any alternatives. In the 1980s, the acronym TINA (There Is No Alternative) was used heavily by Margaret Thatcher regarding free market capitalism. The same could be said for Heath's advocacy for the United Kingdom joining the EEC. A "now-or-never" attitude pervasively infected Whitehall, spurred on by a real fear of decline, made obvious by the very clear differences in economic power between the EEC states and Britain. British strategic principles of 'leadership' and 'global role' had both disappeared in the 1960s. Whilst Heath was certainly a believer in Europe, for many officials the decision was *de facto*. Thus, Europe was not just an option for Britain strategically—it was the *only* option for the continuing relevance of Britain on the world stage.

(8) Nonetheless, despite said pressures, Heath's decision to pursue a different strategic line for Britain, through his vision of what a more united EEC could achieve, can be explained, in part, by how he believed the international system was changing. Echoing similar analysis from the rest of Whitehall, Heath believed that the international system was shifting from a bipolar system, consisting of the superpowers, to a more multi-polar one. This resulted, in the Foreign and Commonwealth Office's view, in two key strategic trends which Britain had to be aware of going forward.

(9) The first was simply the relative decline of Britain's ability to influence and shape international events. Both Macmillan and Wilson could *claim* they were heads of a global power, but in reality, they were living through a period of relative decline for Britain. As the FCO noted in September 1970, the economic rise of countries like West Germany, France and Japan—combined with the relative economic decline of Britain—exercised a profound effect on British strategy. The FCO further noted in 1973 that there was a doubt as to whether middle powers—which many now considered Britain to be—could retain power while acting outside of a multilateral vehicle. Thus, for Heath, the EEC posed as either a solution or a threat. As the Government's 1971 White Paper argued, if Britain decided not to join the EEC, the European grouping would continue to consolidate and strengthen—all while Britain remained stuck on the outside, unable to influence events occurring on the Continent. Joining the EEC would both safeguard British interests more widely but additionally act

as a safeguard to prevent the Continent rapidly outstripping power.

(10) The second trend flowed from the first. Though relative economic decline meant that medium powers could no longer rely on freedom of action internationally, what was occurring was a consolidation of power around economic and military superpowers. As argued in a Whitehall document in 1971, in the modern international system, the capacity to exert influence on the traditional Cold War superpowers, the United States and the Soviet Union, was of paramount importance. The report estimated that, in the years ahead, only China, Japan and the European Community would possess such capacity.

(11) This was a key consideration for Heath. Britain's traditional 'circles' of power—the Commonwealth and the Anglo-American 'Special Relationship'—had dwindled. The Commonwealth was politically non-viable and Britain's relationship with the United States was increasingly one of a junior partner having limited capacity to influence American decision-making. For Heath, it was paramount that Britain join the EEC, a predicted future economic superpower, and aid in further integration in order to create an actor of similar standing to the United States. This drew from a 1965 Conservative paper led by Lord Carrington, which argued that the 'Special Relationship' was no longer strategically viable for Britain, but that a United Kingdom in a more integrated Europe could allow the Anglo-American special relationship to be transferred to an American-European one.

(12) Consequently, Heath's plan was to facilitate British aspirations for great power status by bringing the United Kingdom into the EEC and making the latter a great power. Indeed, this objective would readily be recognisable by Prime Ministers of the past. Creating a power base which could make itself heard in world politics and re-rolling Europe, in Heath's mind, into an "outward facing" bloc, able to act with substance in international events outside of the Continent. Britain would naturally play a leading role in this endeavour, as the 1971 White Paper argued that Europe needed Britain in the same way Britain needed Europe. The 'ways' and 'means' of achieving British strategic ends had certainly changed under Heath, given that such multilateral integration was a far cry from the immediate assessment post-war of the 'three great powers' of Britain, the United States and Soviet Union. However, the 'ends', maintaining British power through aspirations of leadership and a global role in the world, were readily identifiable.

## Why did it Fail?

(13) Ultimately the reset in Heath's mind, that is a full commitment to both a more fully integrated economic and political EEC, failed for two primary reasons. The first, and arguably most important as highlighted by the continuous debate on EEC and later European Union (EU) membership, was the cultural resistance to the change. Many anti-market papers and commentators often critique Heath's analysis of the situation, which led to a choice of Europe, as "smacking of weakness" and "talking Britain down", to use a modern critique. This naturally filtered to down to the public and continued to reflect the public mood. Even those who were pro-market would often still refer to Europe as something "other" than Britain. The distinction between Britain and Europe would continue to this very day, with limited ability to bridge the gap.

(14) However, the primary sin for Heath was his disingenuous selling of the Community to the public. Though Heath believed joining was primary a political choice, the White Paper and commentary to the public gave the overwhelming impression that membership was an economic endeavour – that if Britain joined, the "magic" which helped the current six states of the EEC would rub off on Britain. Thus, when all available evidence showed that Britain's economic performance was worse in the immediate years after joining, with UK growth at just over half of the other EEC states between 1973 to 1979 on average, inflation peaking at 26% (1978) and

unemployment rising to 6% (1977), it was only natural that the EEC became the scapegoat. Indeed, only 32.8% of the electorate bothered to vote for MEPs in 1979.

(15) The second reason for failure was world events. Heath was unfortunate that he brought Britain into the EEC when the international system was changing in ways that British policymakers did not anticipate. The American decision to end the Bretton Woods system caused much consternation amongst the 'Western states', which was followed up by the economic turmoil caused by the Yom Kippur War, with oil being wielded as a weapon by Arab states, and America escalating military tensions without consultation. This caused the dual issue of fracturing American-European relations, a key aspect of Heath's strategy, and plunging both Europe and Britain into stagnation and inflation.

(16) The combination of both reasons caused Britain to act like a 'bad European.' Lack of popular commitment led to Wilson—who had returned to power in 1974—to pursue renegotiations on accession, which, in turn, created ill will amongst what were supposed to be Britain's new sources of power. Instead of a position of prominence in the EEC, the ill will re-forged the Franco-German relationship within the Community. From this point forward, the governments of both the Wilson and later James Callaghan kept Britain at arm's length from EEC activities, refusing to send a representative as part of the EEC delegation to the world energy conference and failing to join the Exchange Rate Mechanism in 1979. Instead, under both Prime Ministers, Britain drifted closer to America. Indeed, an outside observer would be forgiven to assume nothing substantial had changed with a Franco-German bloc inside the EEC and Britain close to America.

(17) Nonetheless, the strategic failure was not purely a British issue. Much of Heath's vision was dependent on a rapidly centralising Europe. However, the EEC did not progress at the rapid rate that he would have expected. This can be seen in two key aspects of the *deepening* (centralising) of the EEC, economic and foreign policy. Economic policy, channelled through the European Monetary Union (EMU) planned to be in effect by 1980, lost momentum rapidly in the 1970s and was undermined by international monetary instability caused by world events and, more importantly, clashes of interests between French and German economic strategies. Moreover, a key mechanism on foreign policy deepening, the European Political Cooperation (EPC), failed to live up to expectations. Rather than foster real power from which Europe could draw upon, it ultimately became more procedural in nature rather than substantive. In effect, the EEC, whilst hopeful for Federation, was still ultimately a collection of states pursuing their own agendas through the EEC.

(18) Heath's strategic vision for Britain, whilst being similar in nature to his predecessors, was visionary in its aspirations. The end goal—facilitating British power— remained the same, but the ways in which this was to be achieved differed drastically. For Heath, an integrated Europe was a future superpower, which Britain could no longer afford to ignore. By joining this regional structure, Heath hoped to propel Europe—and by extension, Britain—to superpower status, with a voice in all things international. With the old roadblocks removed, it seemed achievable. However, a combination of world events and a resistant British public resulted not only in Heath's ousting, but also in a failure on Britain's part to fully commit to the Prime Minister's European vision. Even by the 1980s, though Britain was a member of the EEC, it still remained very much distinct—a product, in part, of Heath's failure to carry out his ambitious strategic reset.

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## 10. New LIFFE: A Strategic Reset in the City

This report examines the case of LIFFE, an iconic City open-outcry exchange which became a cliché for the 1980s and then had to reinvent itself as an electronic market to avoid going bust a decade later. The study provides an interesting example of a commercial strategic reset which is relevant because the institution had similarities with government, including a significant bureaucracy and a complex relationship with its owners and customers.

### LIFFE's rise

(1) The London International Financial Futures and Options Exchange, LIFFE (pronounced *life*) was established following Chancellor Geoffrey Howe's abolition of exchange controls in his 1981 budget. Opening in September 1982, the exchange offered futures and options contracts on a growing range of financial instruments including UK government bonds. It enabled the exchange of financial risk.

(2) Like the Chicago exchanges which had pioneered these derivatives, LIFFE was an open-outcry exchange, which brought traders face-to-face in octagonal "pits", each devoted to trade in one type of contract. This meant that space was a crucial factor from the outset. It influenced the structure of the business and created vested interests that made a reset difficult when crisis eventually came.

(3) LIFFE was initially located in the Royal Exchange, opposite the Bank of England. It was, effectively, a club: anyone who wished to trade (a group ranging from international banks to enterprising individuals, known as "locals", who traded their own money) bought membership and one or more "seats" – permits which entitled the holder to trade in specific pits. In due course, as the number of pits grew the exchange converted these permits into 'A', 'B', 'C', 'D' and 'E' shares in the business, which allowed their holders varying levels of market access, and which could themselves be traded. There was a lively market in the shares which soared in value as the appeal of trading at LIFFE grew, because of the money that could be made there, and the constraint of space. In 1982, a seat cost £27,000; by 1997, they were changing hands for as much as £1m. These shares gave their owners a strong interest in maintaining the status quo.

(4) LIFFE's location in the Royal Exchange constrained its ability to expand its business. In 1989 LIFFE moved to much larger premises at Cannon Bridge (on top of Cannon Street station). Trading volumes surged after the exchange cornered the lion's share of the new market in German government 10-year bond futures, which became (in the words of *The Economist*) the "financial barometer of the political drive towards German unity". Trading in the "Bund" as this market was known, came to generate a majority of LIFFE's revenue. Now flush with cash LIFFE spent £40m buying an option to develop an even bigger site in Spitalfields, which would have enabled it to quadruple the size of the trading floor. It commissioned Norman Foster to design a building for the site, and an official history to celebrate its fifteenth anniversary in 1997. In hindsight these were signs of hubris.

### A competitor emerges

(5) Open-outcry markets were tried-and-tested but imposed high fixed costs (cleaners sweeping up the discarded paper tickets used to confirm trades filled 500 rubbish bags every day at LIFFE). They also often left end-customers frequently dissatisfied, because prices invariably moved between the placement of an order over the telephone and its execution by a trader in the relevant pit. The business was vulnerable to disruption.

(6) In contrast to both LIFFE and the Chicago exchanges, the Deutsche Termin Börse (DTB), launched in 1990, was a fully electronic exchange. There was no open-outcry market in Frankfurt, where it was based. Instead its customers advertised their bids and offers and traded using software it provided. DTB had two main advantages: a trade cost half what it did on LIFFE and customers were more likely to get the price they wanted. But initially it did not offer the liquidity customers needed to be sure of getting a good price, and UK regulators had not permitted traders in the UK to access the DTB.

(7) Both of DTB's disadvantages disappeared in early 1998. The UK government granted DTB "recognised investment exchange" status (which permitted UK-based traders to access it directly) and, once this had happened, DTB addressed the lack of liquidity by aggressively using fee holidays (and other incentives, LIFFE executives believed) to lure market makers away from LIFFE. The result was that, in the space of a year, DTB managed to achieve the seemingly impossible. In June 1997, LIFFE had two-thirds of the Bund market; a year later DTB's market share was 85 per cent. The rapid loss of revenue produced a crisis at LIFFE.

## **Crisis and inertia**

(8) LIFFE had developed limited forms of electronic trading to enable business to be done outside normal trading hours by people based less than 25 miles from the exchange. Its management knew that the only way to survive was to adopt electronic trading completely. An open-outcry exchange, with its high fixed costs and middlemen, could never compete with DTB on price.

(9) The view of LIFFE's managers was not shared by all the exchange's members, particularly the "locals" – those individuals who traded on their own account. They had two linked fears. They were extroverts for whom the prospect of sitting on their own in front of a computer to trade held no allure at all. The second was that their share – their admission ticket to trade and in many cases their most valuable asset – would become worthless if LIFFE went electronic, since in a virtual, electronic exchange there is no constraint on physical space: the scarce commodity that had propelled the value of their shares upwards. Faced with the prospect of losing these assets, the locals defended the status quo vociferously, helped by the indisputable fact that 1997 had been a record year for LIFFE. They were well-represented on the 24-strong board to which a majority of the directors were elected by the trading members from among their ranks. Wrangling meant that board meetings that had once taken two hours now lasted five or six and were still indecisive. Many of the elected directors were conflicted between what was best for them as traders, and what was best for LIFFE.

(10) As business in the key contract drained to DTB and the collapse of LIFFE loomed, in April 1998 the board narrowly voted in favour of a shift to electronic trading following a two-day meeting to rehearse the pros and cons again. However, to avoid triggering further anger among the supporters of open-outcry trading, it kicked a decision on whether to cancel the planned development of the Spitalfields site (which would only be necessary if open-outcry trading continued) down the road, and delayed the transition to electronic trading until the end of 1999.

(11) The imminent launch of the euro soon rendered this policy of equivocation unsustainable. LIFFE also offered markets in a range of short-term European currency interest rates, including the deutschmark – markets that were now not only core to its survival but which would be shaken up when the euro came into being on 1 January 1999. Amid warnings that the City would lose out from the UK's decision not to join EMU, and evidence that the Germans were planning to seize more business from LIFFE, the pressure on LIFFE grew to accelerate its transfer to electronic trading. In May 1998, LIFFE's managers decided to bring the transition forward by six months.

(12) LIFFE's managers spent their remaining political capital confronting the other structural issues that were impeding change: the board's own unwieldy size and the fact that the shares tied ownership of the business and the right to trade together – a problem when the exchange's and some of its shareholder-customers' interests had obviously diverged. This second issue was especially controversial because the exchange of members' existing shares for new equity was done according to the voting rights attached to each type of share, not their informal market value because they were also permits to trade, which was in many cases far greater. Holders of many of the existing shares lost out: As one board director put it, "I owned four C shares and nine E shares. The decision to restructure the value of the shares at the exchange was about to cost me almost £1 million!" Nevertheless, faced with the complete loss of his investment if LIFFE went bust, he voted in favour of the reform when the board discussed it. Other customers reluctantly made similar calculations. When the questions of whether to shift to electronic trading and to separate share-ownership from market membership were put to the exchange's members in June 1998, an overwhelming majority of those who voted agreed. LIFFE's managers were now able to abandon the Spitalfields plan and whittle down the size of the board.

(13) New leaders were needed to complete the strategic reset which would mean a complete change in the way LIFFE did business. Where once traders came to the market, LIFFE would now have to take the market to them, wherever they were. An executive chairman, Brian Williamson, was appointed that summer. Williamson had been involved in the establishment of LIFFE and had served as its chairman in the late 1980s, an era when the business had gone from strength to strength. He mixed charm and political nous with an ability to cajole people into doing what he wanted. I was always struck that he knew the security guards who looked after the building by name. Later in 1998, a new chief executive, Hugh Freedberg, was appointed. He was a no-nonsense South African who had been involved in turning around troubled businesses before. He found "a grand total of 113 working groups, committees and sub-committees". Six hundred redundancies followed.

(14) The priority for Williamson and Freedberg was to decide on what technology to use, and to introduce it as fast as possible. The short-term interest rate markets on which LIFFE would now depend were more complicated than the long-term markets like the Bund and there was genuine uncertainty about whether they could be effectively run electronically. For this reason LIFFE decided to develop its own trading system, which it called Connect, rather than buy off-the-shelf. Whereas DTB created a complete system it installed in its customers' offices, LIFFE decided to leave the design of the "front end" (as the terminal a trader would use to trade the market was known), to specialised software providers. This open interface enabled customisation and configuration, and reflected a recognition that the customer was king. LIFFE itself changed profoundly, from a bureaucracy designed to run, manage and police a physical market, into more of a technology company.

(15) The transition to Connect began early in 1999 at the same time as another drama played out. When the euro came into being, LIFFE's interest rate future based on the new currency was anchored to the London Inter-bank Offered Rate (LIBOR). It rapidly became obvious that the market favoured the European Inter-bank Offered Rate (EURIBOR) which, to LIFFE's alarm, was the benchmark for the rival market launched by DTB. Frantic activity followed to rejig the contract and adjust open market positions to the alternative benchmark. This change, and the Connect technology worked, and were key to LIFFE's commercial survival. During the following decade trading volumes and revenues recovered to pre-1997 levels. New investment in the business to commercialise the Connect technology was successfully found and other exchanges bought the software. LIFFE was sold to the continental exchange group, Euronext, in 2001, in what was effectively a reverse take-over in which Euronext conceded the business would run its derivatives operations.

## Conclusions

(14) A strategic reset was forced on LIFFE in 1998 by a loss of business to a foreign competitor which used a completely different business model. LIFFE was unable to confront the threat because its governance structure required buy-in for radical change from people who would be profoundly affected by that change and were able to block it because they owned stakes in the business. The business's recent success, the general buoyancy of the UK economy at that time, and the fact that American exchanges were still able to use the open-outcry model successfully, all provided reasons for inertia. LIFFE's managers' job of convincing its shareholder-customers that change was essential was thus a lonely one. It was not until these stakeholders reconciled themselves to the fall in the value of their investment in the business, and the prospect that it could soon be worthless if they continued to oppose change, that action became possible.

(15) The reset focused chiefly on the ways by which the market was made available to customers. From this both the ends – most urgently, survival, but in due course, increasingly international ambitions – and the means – revived revenues and profit – flowed.

(16) Given that LIFFE's outgoing chairman and chief executive pushed through the changes to the exchange's ownership and decision-making that were necessary for survival, there was an element of theatre to the change of personnel at the top of the business in 1998. However, Williamson and Freedberg manifested a change of approach and provided a clear vision for the future and leadership. They convinced both the government and their major international customers the business was worthy of ongoing support.

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<sup>22</sup> I worked for LIFFE after the events described here but have no connection with, or financial interest in, the business now.

## 11. The Challenge of Strategic Resets

(1) This paper examines the concept of a strategic reset through the prism of the future of conflict. Our point of departure is that the core feature of conflict is its constantly changing character. Shifting political and social forces—along with the emergence of new technologies and new domains in which conflict can be fought—all drive the myriad ways in which conflict constantly changes. For the strategist, there is both opportunity and threat involved. Opportunity because, with sound thinking and some luck, a nation might end up with serious technological and military advantages over its rivals. Threat because equally, the opposite may come about.

(2) Thinking about the future of conflict might be a key activity in defence ministries, but, as this report argues in the second and third sections, it has an inherent dilemma. For all the futures thinking and strategy about the character of future wars, these exercises very rarely bring about major policy change, let alone strategic resets. As this paper suggests, strategic resets butt up against a host of ingrained and implied values, images of national identity and subsequent choices about the future of war, force structure and weapons acquisition.

(3) In the final section, we conclude that all these path dependencies render futures work, horizon-scanning and discussions around strategic resets interesting intellectual exercises, but ones which are difficult (at best) to implement in practice. This report concludes by identifying some implications of our analysis for those planning to embark on a strategic reset.

### Blue Skies and Horizons

(4) The nature of war is constant, as Clausewitz famously noted, but its character is constantly changing. His point was that while war will always bring about misery and mayhem, shifting political and social forces – along with the inexorable march of technology – will constantly shape and change the character of war and how it will be fought in the future. Its ever-changing character and mutability mean that conflicts of the future may not just be marginally but radically different from the wars of the present. They may be fought in completely different domains (space, the deep seas, cyber) with different weapons (viruses, genes, information) and between different actors (robots, computers, autonomous systems).

(5) For the strategist, war's constant evolution and unpredictability bring both a degree of interest and a (perhaps greater) degree of anxiety. There is an opportunity because there is the hope of acquiring some significant advantage over rivals and enemies. With effective planning and resourcing, a nation may end up holding certain decisive advantages: it may have the most advanced weapons and delivery systems; and it may provide advantageous positioning on the battlefield or in some new domain. But it is also possible—and this is a source of anxiety—that one faces an enemy who has acquired these advantages first and who has the ability to deliver a decisive knock-out blow, unstoppable attacks of great speed, or attacks on infrastructure that devastate large proportions of the population.

(6) Bearing this in mind, it is not surprising that national leaders (for which one might read: strategists, generals, military leaders, and ministers of defence) are often fixated on the future of war. Every leader of armed forces wants technological advantage over their enemies, and every leader worries that the enemy might arrive with some advantage that they had not yet planned for and with which they cannot cope.

(7) Gaining the advantage – or being able to pre-empt others' acquisition of it – has meant that ministries of defence are far from shy about attempting to predict the future. In this, their purpose is to understand what the conflicts of the future might look like, and to be able to acquire a game-changing technology, or at least to have pre-empted another's acquisition of it with some method of defending against it. Take the

case of the United Kingdom, for instance, which has invested significant effort and resources in analysing future conflict. Since the early 1990s, it has conducted detailed risk analysis, blue skies thinking, ‘horizon scanning’ and ‘futures’ work, all of which was designed to inform future force development as well as policy and procurement choices in anticipation of potential future operating environments. The Ministry of Defence regards these collective endeavours as an essential component of defence planning, and one that has been a successful exercise.

## Same old, Same old

(8) But how much has this futures work and horizon scanning really changed British defence policy and strategy in practice? As scholars of defence policy have long pointed out, the answer is simple: such work has been largely futile. In the British context, for all of the blue skies thinking, horizon-scanning and futures work that has been conducted by officials, policymakers and academics, British defence strategy and policy has not undergone a radical reset—nor even a fundamental change—since the end of the Second World War. To this day, it remains the UK’s ambition to be a ‘Tier One’ defence power with a nuclear capability and the ability to project conventional military power on a global scale through ‘balanced forces’ across the ‘full spectrum’ of maritime, air and land capabilities.

(9) And yet, almost every commentator and observer rightly points out that the UK needs to balance its ambitions and role on the international stage with the resources it has available for defence. Why has this relatively basic strategic thinking, supported by the kind of futures work conducted by government, had such little effect on UK defence strategy and policy?

(10) For some scholars, it is because the UK—to say nothing of its partners—suffers from a form of self-delusion, in which it sees itself as a guardian of an existing world order. As Patrick Porter has framed it, British policymakers are driven by a ‘coherent, though dangerous, ideological premise, that the West – by virtue of being the far-sighted guardian of world order – brings order into a chaotic world.’<sup>23</sup> In this regard, strategic and military planners assume too much agency and that they can prevent the international system from undergoing anything but slow incremental change.

(11) As the Cabinet Office approaches the current Integrated Review, we also see a more fundamental phenomenon at play. In our view, the UK has not fundamentally strayed from its basic direction of travel in defence and foreign policy terms for the simple reason that it cannot. To do so would cut across, even reject, a whole host of previous decisions and choices that reflect dearly-held beliefs about what international role the UK should play.

(12) This set of beliefs about the UK’s international role are part of a strategic tradition which encapsulates thousands upon thousands of decisions, including about its objectives on the world stage, its procurement choices, its alliances and its rivalries, its force structures, the places where it deploys. In this sense, UK defence policy is primarily a product of choices made in the past, rather than choices about the future.

(13) Taken together all these factors mean that defence choices are inherently limited due to existing traditions and commitments. In short, the strategic reset is a single choice that weighs in against a whole host of choices, ingrained ideas about national identity and so on. Genuine strategic resets cut against so much that is ingrained as to be seemingly impractical, unimplementable and perhaps even impossible.

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23 Patrick Porter, ‘Taking uncertainty seriously: classical realism and national security’, *European Journal of International Security* 1: 2, 2016, p.241

(14) The problem is particularly stark when we look at defence procurement. The attempt to get the most effective weaponry with which to fight wars is crucial. This may be about getting the most advanced equipment, but it may also involve acquiring the most *appropriate* equipment for the conflicts of the future. This requires real foresight, because the lead times to produce military equipment are so long (several years), and their operational lives equally long (decades), that decisions about procurement choices made now are likely to end up with equipment being used in 2050, even 2060. With that kind of time horizon, most defence experts now are encouraging increased investment in cyber, as well as in communications, ISTAR, logistics, quantum and so on. These, they point out, are likely to be the most useful capabilities in the wars of the future.

(15) But, in practice, this seemingly logical advice rarely influences decision-making. Take, for instance, the current debate over whether the UK should mothball its entire complement of Challenger II tanks, possibly along with the Warrior Infantry Fighting Vehicles. The case that this equipment is outdated is not hard: the Challenger II tanks have not been upgraded since 1998 (and the proposed upgrade is largely around improvements to the turret, and improved warning and protection systems) and lags behind most comparator nations' heavy armour. The Warrior Infantry Fighting Vehicle is now forty years old, it cannot fire while on the move, and its weapon systems are manually loaded.

(16) The Options paper, leaked to *The Times* recently, is just that—an Options paper—but the idea of mothballing heavy armour has immediately been seen as one of the 'most fundamental changes to the British Army in the last 100 years.' Similar leaks in recent days over the replacement of the Type 23 Carrier with only three Type 26s, and five Type 31s, as well as an idea to buy only half of the planned 138 Lightning II Fighter jets have been met with similar responses. Obviously, we need to wait and see whether these decisions are taken in practice, but the furore that the very thought of it has already created shows the difficulty that even medium-sized changes to a force can create.

## **The (im)possibility of resetting**

(17) If Challenger II is creating a furore, imagine the uproar of a genuine strategic reset, or even major changes to UK defence policy and strategy. Strategic thinking that says, possibly rightly, that the UK should match Russian investment in cyber capabilities, and give up investment in heavy armour will likely be treated positively in official terms, before being dismissed. Such policy suggestions would butt up against baked-in views about the UK's role, about whether the UK can remain credible without heavy armour, or without a sizeable number of advance fighter jets. There would undoubtedly be costs, too. The long-term nature of defence procurement means that items are often designed and, in part, paid for long before they become available to the armed forces.

(18) What does this mean for a UK strategic reset? Certainly it would be difficult, and perhaps impossible? The fact that there has been no concerted effort towards a strategic realignment in the UK since the end of the Second World War is precisely because those ingrained ideas about the UK's role run so deep as to have become largely internalised. This is also likely to make a strategic reset an even greater challenge in the UK context: ideas about the type of role on the international stage that the UK ought to occupy are now very deeply embedded indeed. Challenging those will not just be about finding clever military solutions, it will also be about changing and shifting a set of perceptions about national identity. Counterintuitively, the best course of action here may be to act fast, rather than slow, to shift ingrained self-perceptions about the UK's role on the global stage. That will require political capital, as well as courage because the detractors will be equally quick to respond.

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