

The 11th SMA and the Discussion on the Application of Increasing Rate in Defense Expenditure

NIDSコメンタリー

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Introduction

According to the US-ROK alliance, it is controversial issues about the defense cost-sharing (hereafter, the “cost-sharing”) for the United States Forces Korea (USFK). The proportion or the rise and fall of the cost have been discussed either at negotiating table or within South Korea.

Since 1991, the cost-sharing is the partial burden sharing, which the South Korean government covered for stable operations of USFK, based on Article V of the US-South Korea Status of Forces Agreement (SOFA). Before 1991, the US had been bearing the full expense of USFK stationing. However, both the US and South Korea agreed on that Korean side also bear the cost as the burden sharing due to US financial deteriorations and South Korea’s economic growth. The specific amount of cost and the contractual arrangement are decided through the negotiations at the U.S.-ROK Special Measures Agreement (SMA)¹. The cost-sharing consists of following three contents: the labor costs of Koreans employee hired by USFK, the construction costs for military facilities such as warehouses and training centers, and the munition support costs for ammunition storage and material transportation. The total cost of three contents is to be consulted by both countries’ delegations², then the South Korea government allocates its cost to each content after the SMA negotiations. The SMA negotiation is to be conducted by delegations from South Korea Ministry of Foreign Affairs (MOFA) and US Department of State, and they try to reach agreement before the current SMA will expire.

However, the 11th SMA negotiations, which would decide the amount of the cost-sharing after 2020, became bogged down and failed to achieve the agreement under the Trump administration until the 10th SMA expired. The Trump administration demanded an extremely higher cost of \$5 billion for the cost sharing. That is why the 11th SMA negotiation came to a standstill. As the inauguration of the Biden administration, both sides of delegation resumed the negotiation, and they agreed on the 11th SMA in March 2021. The signing ceremony was held in Seoul on April 8;

¹ South Korean Ministry of National Defense, "Cost-sharing to Defense Expenditure (방위비 분담)," September 26, 2019.

² Ibid, p.4.

therefore, the only ratification process by South Korea's National Assembly remained at the moment of June 2021.

Why the 11th SMA negotiation prolonged so long? What were the outcomes from? Within South Korea, there are various assessments about the outcomes including the criticism about partial contents. Indeed, this commentary analyzes the process of the SMA negotiation, important contents and disputes in South Korea. Especially, it will be analyzed that the application of increase rate in defense expenditure for calculation of the cost-sharing by South Korea. In addition, it will be discussed those implications of the agreement related to the US-ROK alliance and its future issues.

Stagnations of the 11th SMA negotiations

In September 2019, the US and South Korean delegations began negotiations for the 11th SMA; however, it was unexpectedly drawn-out process. In spite of the imminent expiration of the 10th SMA at the end of 2019, negotiations were stagnated. At the end of March 2020, after the 10th SMA had expired, South Korea announced that it would increase the cost-sharing by about 13% above the previous one (1,038.9 billion won), while accepting the US requests. Although both countries were almost going to achieve final agreement, the negotiations stalemated because former President Donald Trump demanded 400% increase to \$5 billion. Then the final agreement was not achieved, and the negotiation itself stalemated³. That was because the Trump administration's "America First" approach sought reduced financial burdens for the US under the US-ROK alliance and demanded a stronger financial commitments from the Korean side. A joint communique issued after the 52nd US-Korea Security Consultative Meeting (SCM) held on October 14, 2020 stated: "The two sides concurred in the necessity of expeditiously resolving the SMA negotiations, in a fair, equitable, and mutually agreeable manner, particularly in light of the impact of the lapse on the ROK-U.S. Alliance⁴." While recognizing that the early resolution of the SMA was an urgent task for the US-ROK alliance, it was not easy to bridge the gap between their positions. Thus, the 10th SMA expired without reaching the final agreement on the cost-sharing for FY 2020. As a result, payments to Korean employees at the USFK were delayed, and it occurred a period of absence without salary.

Thereafter, the Biden administration resumed negotiations immediately, and the 11th SMA finally reached the conclusion at the 9th consultation meeting held on March 5-7, 2021. The successful result was likely due to the Biden administration's stance of emphasizing alliances and

³ *National Defense Daily*, November 18, 2019; Yonhap News Agency, October 15, 2020.

⁴ South Korean Ministry of National Defense (hereafter, Ministry of National Defense), "Joint Communique of the 52nd U.S.-Republic of Korea Security Consultative Meeting (제 25 차 한미안보협의 (SCM) 공동성명)," December 29, 2020.

concerns about the unstable security environment in East Asia. MOFA viewed the agreement as “a consultation that adhered to our principle of rational and equitable sharing in the former negotiation process⁵.” The important contents in the agreement are as follows.

(1) Agreement is valid for six years from 2020 to 2025

The agreement is the longest expiration period arrangement, covering six years, since SMA negotiations had begun between two countries. Until then, the 8th SMA (2009-2013) and the 9th SMA (2014-2018), agreed under the Obama administration, were the longest at five years respectively. The Biden administration, like the Obama administration, may have had in mind the conclusion of a multi-year agreement from the beginning⁶. Actually, since the cost-sharing was retroactively set to FY 2020, it can be said that the agreement was reached for the next five years. In any case, the multi-year agreement would be of some help to mitigate US-ROK conflicts over the SMA at least during the Biden administration. In addition, the result is expected to strengthen the alliance with the stable operations of USFK.

(2) The total amount of retrospective payment for FY 2020 is 1,038.9 billion won⁷

As mentioned above, South Korea was needed to pay retroactively 1,038.9 billion won as the cost-sharing for FY 2020, which had been delayed due to President Trump's request for an increase. However, the South Korean government covered Korean employees' salary during the unpaid furlough; therefore, the actual payment to the US for FY 2020 will be only 724.5 billion won. The 1,038.9 billion won is the same amount under the 10th SMA, which means the increase rate of cost-sharing applied to FY 2020 is 0%. It can be inferred that this result reflects the wishes of the Korean side. However, it is uncertain whether that will be simply persuasive within Koreans simply because the payment for FY 2020 was minimized since the amount of cost-sharing under the 11th SMA is predicted to increase considerably over the next four years.

(3) The total amount for FY 2021 is 1,183.3 billion won⁸

The total amount for FY 2021 cost-sharing will be 1,183.3 billion won increased by 13.9 percent from the previous one. This rate is equal to the sum of increase rate of South Korea's FY 2020 defense expenditure (7.4%) and the increase in the ratio of labor costs (6.5%). The later one is

⁵ MOFA, "Final Conclusion of Negotiations on the 11th Korea-US Defense Expenditure Cost-sharing Special Measures Agreement (제 11 차 한미 방위비분담특별협정(SMA) 협상 최종 타결)," March 9, 2021.

⁶ Lee Soohoon, "Important Contents and Implications of the 11th Korea-US Defense Expenditure Cost-sharing Special Measures Agreement (제 11 차 한미 방위비분담특별협정의 중요 내용과 함의)," March 17, 2021.

⁷ MOFA.

⁸ Ibid.

due to institutional reform of the SMA to prevent Korean employees at USFK from unpaid furlough that was applied exceptionally in the 11th SMA. In the future, even if SMA negotiations stall again, the latest agreement clearly states that labor costs will be paid at same level as the previous year, so as to prevent a recurrence of unpaid furloughs.

(4) The increase rate in defense expenditure is applied to the calculation of the cost-sharing from FY 2022 to 2025

In the 11th SMA, the increase rate in defense expenditure was applied to the calculation of cost-sharing by South Korea, so the amount might be increase after FY 2022. From the 1st to the 9th SMA, other indexes had been applied to the calculation such as GDP fluctuation rate, consumer price index and other economic measurement methods. However, in the case of the 10th SMA, it was decided to apply the increase rate in defense expenditure of the previous FY, and the 11th SMA was in the same way. It means that the amount of cost-sharing is determined by the increase rate in defense expenditure in the previous FY. For example, the increase rate in defense expenditure in 2021 is 5.4%; therefore, the cost-sharing in 2022 will increase by 5.4%. At the same time, the cost-sharing in 2021 will increase from 1,183.3 billion to 1,247.1 billion won.

The South Korean government announced “2021-2025 Mid-Term Defense Plan” in August 2020. It was stated that defense expenditure was planned to increase by about 301 trillion won between 2021 and 2025⁹. According to this plan, defense expenditure is going to increase by an average of 6.1 % annually over five years. Therefore, it can be assumed that the cost-sharing will continue to increase at the rate of around 6% during the effective period of the 11th SMA.

In South Korea, that policy has faced criticism, but the government's explanation was not persuasive. According to the explanation of MOFA, it was useful to apply the increase rate in defense expenditure. The reason why was that it reflected national finance and defense capabilities, passed the National Assembly, and it was rational index with transparency and credibility¹⁰. Another diplomatic official said, "Ultimately, it is important to responsibly contribute to the stable presence of USFK in line with our national strength. Even though it is partially logical that if our military power is strengthen, it is possible to decrease our reliance on it at the point of military aspect¹¹." He also revealed that the application of the increase rate in defense expenditure was proposed by the South Korea delegation¹². However, that was not explicit explanation why it was linked to the

⁹ MOD, "Competent Security and Strong Defense that No One can Surpass," Establishment of "2021 -25 Mid-term Defense Plan' - 301 trillion over the next five years (누구도 넘볼 수 없는 유능한 안보 튼튼한 국방 「'21-'25 국방중기계획」 수립- 향후 5년간 301 조 투입-), " August 10, 2020.

¹⁰ MOFA; MOD.

¹¹ *JoongAng Daily*, March 10, 2021.

¹² Ibid.

calculation of cost-sharing, and why it was more rational than a GDP fluctuation rate and a consumer price index.

Debates over the 11th SMA in South Korea

In South Korea, the 11th SMA was under broad criticism by groups promoting the unification of the Korean Peninsula, experts such as university professors and lawmakers in the National Assembly. In particular, professors and lawmakers intensively criticized the application of increase rate in defense expenditure. For example, Professor Kim Dong-yup of the University of North Korean Studies analyzed, "If we follow the agreement and raise the defense budget for our security independence, the amount of cost-sharing will automatically increase." In addition, Professor Park Ihn-hwi of Ewha Womans University argues that "the national defense expenditure and cost-sharing are complementary, but that is a contradiction to link them¹³."

A number of criticisms have been voiced by National Defense Committee (NDC). The lawmaker Ahn Gyuback, the Democratic Party of Korea, said that the claim about the adaptation of increase rate in defense expenditure was not understandable as a rational standard, and that reasoning was not convinced by Korean citizens¹⁴. From the same party, Ki Dong-min also expressed concerns about the possibility that the cost-sharing will keep on steadily increasing. "We agreed to increase national defense expenditure by 5-7%. In 25 (2025), it will be 1.5 trillion won (as the cost-sharing), but might reach astronomical levels in 2030 or 2040? The transfer of OPCON (Wartime Operational Control) means that we will continue to strengthen our self-defense capabilities, but I am not convinced that the SMA (the cost-sharing) will rise accordingly," he said¹⁵.

In response to the criticisms from NDC, Lee Kyung-koo, the deputy director of international policy at MOD, who is in charge of the SMA negotiation task force, has stated that during the negotiation process, not only the increase rate in defense expenditure but also the consumer price index or others were discussed¹⁶. However, he explained that we applied the increase rate in defense expenditure since the cost-sharing is a budget that contributes to strengthen the national defense and US-ROK coalition forces¹⁷. If it is so, why were not the 1st to 9th SMAs applied the increase rate in defense expenditure? Professor Park Ihn-hwi indicated the "Trump effect" as a reason for the

¹³ Ibid.

¹⁴ South Korean National Assembly, "Minutes of the 385th 1st NDC Meeting," March 16, 2021.

¹⁵ Ibid.

¹⁶ Ibid.

¹⁷ Ibid.

application of increase rate of defense expenditure at this time¹⁸. During negotiations with the Trump administration, South Korea proposed applying the increase rate in defense expenditure to the calculation of cost-sharing in response to demands from the US¹⁹. As mentioned above, negotiations were temporarily stalled due to the follow-on request for a large increase by President Trump. Under the Biden administration resumed negotiations and refrained from that kind of demand like the former administration while taking over its proposal of applying an increase rate in defense expenditure²⁰. As the result, it is likely that the latest SMA reflects the influence of the Trump administration in no small measure. That means an increase in cost-sharing over the next five years, so it will be difficult to resolve domestic discontent unless clear that benefits for South Korea.

Also, domestic criticisms about the 11th SMA are focused on a contradiction in South Korea's defense policy. South Korea, under the banner of "self-reliant defense," is aiming to transfer OPCON held by the commander of Combined Forces Command (US Army General is in charge of it). The conditions for transferring of OPCON include strengthening the South Korean military capability. Therefore, increasing defense expenditure is a measure for strengthening "self-reliant defense," as enhancing military power and meeting the conditions for transfer of OPCON. Strengthening "self-reliant defense" is equal to reducing the dependence on the US-ROK alliance. In other words, reducing the cost-sharing is equal to reducing the dependence on the alliance. Those conflicting considerations are summarized in Figure 1.

Figure 1. The contradiction between South Korea's defense policy and the 11th SMA



Source: Created by the author.

¹⁸ *Dong-A Ilbo*, March 22, 2021.

¹⁹ *Ibid.*

²⁰ *Dong-A Ilbo*, March 11, 2021.

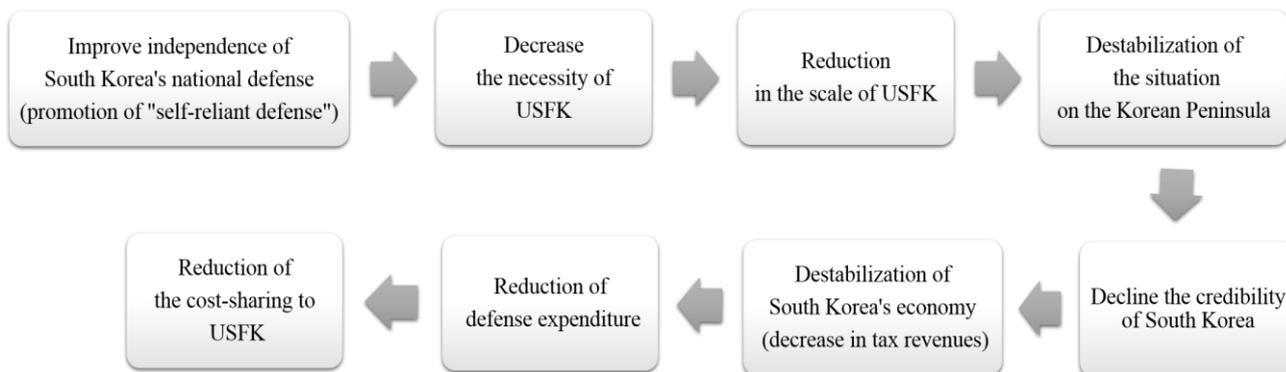
Those are the criticisms that to apply the increase rate in defense expenditure to the calculation of cost-sharing is equivalent to creating a structure for increasing South Korea's burdens, and that is contradicting the original purpose of national defense policy. The 10th SMA was applied the increase rate in defense expenditure in the same way. At that time, the agreement was only for FY 2019. On the other hand, since the 11th SMA is the multiple-year agreement, the cost-sharing is expected to increase automatically during that period. Despite the multi-year agreement was set for the stable operation of USFK, it became a target of criticism at the point of continuous increase structure of cost-sharing over five years. If the future SMA (after FY 2026) applies the same way, it will be necessary to reexamine the validity of the approach and the contradiction with South Korea's national defense policy.

The analysis about the application of increase rate in defense expenditure

As mentioned above, the reason why the South Korean government adopted the increase rate in defense expenditure is that it reflects both national finance and military power and passed deliberations by the National Assembly. In addition, it is the transparent and reliable index. A joint study has been published that justifies the adaptation. The study, conducted by Kwangwoon University, National Defense University, and Defense Acquisition Program Administration, used system thinking to analyze important variables that affect the cost-sharing²¹. According to the joint study, they created an “economic capacity expansion loop” of South Korea and proved the availability of the application of increase rate in defense expenditure. The excerpt of the loop is shown in Figure 2. As follow the loop, if South Korea's military power is strengthened and the "self-reliant defense" is promoted, the need for USFK will be weakened, and the scale of its force will shrink. If the scale of USFK is reduced, the situation on the Korean Peninsula will become unstable, and credibility about South Korea will decline. That will also affect investment and stock prices, destabilize the Korean economy, and lead to a reduction in the national budget by decreasing tax revenues. The study shows that as the national budget is reduced, defense expenditure will decline, and South Korea's cost-sharing to USFK will fall.

²¹ Lee Junghwan, Cho Yonggun, Moon Seongam, Seo Hyeok, "A Leverage Strategy of the US—Korea Cost Sharing Program Based on Systems Thinking (시스템 사고를 이용한 주한미군 방위비 부담 정책 레버리지 전략)," Vol. 11 No. 3, pp. 33-59.

Figure 2. Flowchart of factors that affect the increase or decrease in the cost-sharing



Source: Created by the author, cited from, Lee Junghwan et al., "A Leverage Strategy of the US—Korea Cost Sharing Program Based on Systems Thinking", p. 43. (Excerpt from the "Korea's Economic Capacity Expansion Loop")

Figure 2 shows that the shifting of defense expenditure is the most directly affecting variable for the increase or decrease in the cost-sharing. The volatilities of the GDP deflator and the consumer price index, applied in the 1st to 9th SMAs, are characterized the factors for instability in the Korean economy. The joint study explained that those factors do not directly affect the cost-sharing. Therefore, it needs to set the amount of cost-sharing according to the increase or decrease in defense expenditure, not like former other indexes²².

Furthermore, the study insists the necessity to calculate the cost-sharing with the defense expenditure basis from the viewpoint of promoting "self-reliant defense" and transfer of OPCON²³. In other words, as shown in Figure 1, defense expenditure is increased in order to promote "self-reliant defense" and transfer of OPCON, so if those are achieved, the increase in defense expenditure will be subdued to some extent. That means, by calculating the cost-sharing with the increase rate in defense expenditure, it is possible to save those cost after achieving national defense objectives as above²⁴. Therefore, according to the joint study, it justifies the application of South Korea's defense expenditure increase rate to the calculation.

²² Lee et al., p. 45.

²³ This study was published in 2010. Although defense reform is not the same as the "Defense Reform 2.0" currently advocated by the Moon Jae-in government, it is the same in terms of retrieving OPCON and "self-reliant defense". Therefore, it was judged that it could be applied.

"From a short-term perspective, it is necessary to determine the scale of defense expenditure and the scale of defense expenditure cost-sharing through an evaluation of the degree of promotion of the defense reform basic plan before transfer of OPCON. From a medium- to long-term perspective, even after the transfer of OPCON, the scale of cost-sharing must be determined with respect to the level of promotion of the defense reform basic plan and defense expenditure itself." (p. 57).

²⁴ Lee et al., p. 54.

As a result, the assertions of the joint study and the government's position are almost corresponding. Both recognized that it was appropriate to apply the increase rate in defense expenditure to the calculation. On the other hand, the opposition groups expressed skepticism about it because of the structure of increasing cost-sharing automatically. Those opposing groups actually have something in common: the consideration of "self-reliant defense." The supporting positions insist that the cost-sharing can be held down depending on the reinforcement of "self-reliant defense". The opposing groups, on the other hand, argue that increasing the cost-sharing hinders the pursuit of "self-reliant defense." Both positions use the keyword "self-reliant defense" and focus on how the cost-sharing affects achieving it. Therefore, it is important to make adjustments within a range that does not affect the promotion of "self-reliant defense" rather than simply applying the increase rate in defense expenditure. In addition, the South Korean government should be held accountable for its decision. Moreover, it is indispensable a comprehensive assessments of appropriateness of applying the increase rate in defense expenditure, taking into account not only the SMA but also other direct or indirect factors in the US-ROK alliance.

Conclusion

The 11th SMA was concluded due to the change of the US government in combination with other factors as the strengthening of the US-ROK alliance, the stable operation of USFK and security issues in East Asia. The multi-year agreement can be assessed as the praiseworthy achievement in that it will help reduce frictions between two countries for years to come, avoid blank periods and stabilize the employment of Korean workers. The 11th SMA will be maintained in South Korea's next presidential administration even after Moon Jae-in's term of office which expires in May, 2022. Therefore, any conflict regarding the cost-sharing will be minimized regardless of changes of the South Korea government.

However, the way of cost-sharing calculation was criticized within South Korea because it is concerned significant increase by applying the increase rate in defense expenditure for five years starting from 2021. People who are against the South Korea government argument are concerned about the structure of automatic increases in the cost-sharing and the obstacles to promote "self-reliant defense." On the other hand, the government insists that is rational way of calculation. Given the above considerations, both assertions are consequently concluded in interests in promoting "self-reliant defense." Therefore, South Korean government needs to bridge the gap between the opposing opinions and be accountable for winning over domestic audiences.

In addition, it is important to discuss on which indexes are appropriate for the calculation of

the cost-sharing after 2026, the 12th SMA negotiations. It has to be reasonably judged whether to continue applying the increase rate in defense expenditure like 11th SMA, to reapply the GDP deflator or the consumer price index, or to develop a new calculation method.

Although it is indispensable to achieve a domestic understanding, if the SMA give negative effects on the US-ROK alliance, it is also harmful to the "self-reliant defense" banner. Originally, the agreement should be one of the important components for the alliance. Indeed, it is also important to focus on how to strike a balance between controversial factors such as the compromises meeting both demands and the role of the US-ROK alliance in changing security environments from various perspectives, including the SMA.

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