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The Looming Cost-Sharing Storm

Mitigating the Impacts of Special Measures Agreement Negotiations on the U.S.-Japan Alliance

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Abstract

The Trump administration's quarrelsome position towards alliance cost-sharing spells trouble for the U.S.-Japan security relationship. The current cost-sharing agreement between the two countries is purposely bounded to the areas of labor, utilities, facilities improvement, and training relocation, but the Trump administration's desire to set a new benchmark for stationing costs and higher dividends from cost-sharing threatens to erode decades of carefully negotiated stationing arrangements. The final tally in what Japan pays to support stationing of U.S. forces on its territory is less important than the potential impact to broader alliance management issues. Alliance managers can mitigate potential fallout by taking four steps: (1) enlisting the aid of U.S. officials with direct ties to the White House; (2) adding categories to the Special Measures Agreement that more accurately reflect relative cost-sharing benefits; (3) providing increases in cost-sharing where it makes sense based on real economic conditions (such as the scheduled consumption tax hike); and (4) firmly advocating for long-term alliance benefits over potential short-term financial gains.

Cost-Sharing in the U.S.-Japan Alliance and the Special Measures Agreement (SMA)

The United States and Japan began cost-sharing in the 1970s in response to the sharp increase in stationing costs for U.S. forces in Japan. Up until 1971, the yen was pegged with a fixed exchange rate of 360 yen to the dollar. By 1978, the rate was already dipping below 200 yen.[1] Meanwhile, construction costs and labor wages in Japan were increasing. In short, costs like utilities, employees, and construction became more expensive as the dollar weakened relative to the yen. It made long-term, unilateral sustainment of U.S. bases less economically feasible while the Japanese economy was at the same time booming. As a result of all these factors, the two governments negotiated a host nation support agreement in 1978 to reduce the financial burden on U.S. forces.[2]

Over the years, the host nation support agreement evolved. It originally focused on labor cost sharing but earned the name "Special Measures Agreement" (SMA) in 1987 while adding the category of utilities cost-sharing. In 1996, the Japanese government began funding U.S. military training events outside of Okinawa prefecture under the SMA heading of "training relocation."[3] The last change came in negotiations for the 2012 SMA when the two governments decided formally to incorporate the already extant Facilities Improvement Program[4] as part of total SMA negotiations.

This evolution of the SMA reveals two facts related to cost-sharing. First, all the agreements were bounded to specific cost areas. Neither side's negotiators agreed to use *overall* stationing costs as the benchmark for cost-sharing decisions. Second, aside from training relocation which was a politically-driven "burden reduction" measure, the SMA targeted areas especially susceptible to perturbations in economic conditions. The cost of utilities and labor both fluctuate significantly depending on factors such as the yen-dollar exchange rate, tax rates, and labor costs in Japan. They are areas which make sense to re-examine every few years,

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[1] Yen rates (annual average) for each year marking a new cost-sharing agreements: (1978) 210.39; (1987) 144.60; (1991) 134.59; (1996) 108.78; (2001) 121.57; (2006) 116.31; (2008) 103.39; (2012) 79.82; (2017) 112.15.

[2] "Zainichi Beigun Churyu Keihi Futan no Ikisatsu [The history of U.S. military stationing expense burden in Japan]," *Ministry of Defense*, https://www.mod.go.jp/j/approach/zaibeigun/us_keihi/keii.html.

[3] This followed the Special Action Committee on Okinawa's bilateral push to decrease U.S. footprint on Okinawa.

[4] The facilities improvement program covers Japanese-funded construction and renovation projects for U.S. facilities and training areas in Japan.

not because of changing political perceptions of alliance utility, but because of practical economic issues.

The most recent product of this evolution is the 2016 SMA, a mutually beneficial five-year agreement.[5] For the United States, money that the Japanese government spends on stationing U.S. forces means less that must come from the U.S. defense budget. Specifically, the current SMA provides the following: Japanese government payment of salaries for approximately 23,000 base workers; 61% of annual utilities costs (with an upper limit of 24.9 billion yen); 75% of training relocation costs; and over $200 million provided for Facilities Improvement.[6] In return, Japan receives enduring U.S. forces presence that is obligated by treaty to provide for its defense, stable employment of over 23,000 Japanese citizens and countless construction firms, and execution of U.S. forces training in different prefectures throughout Japan to satisfy domestic political requirements.

The Belief that "Allies Don't Pay Enough"

On the campaign trail in 2016, Donald Trump made clear his position that allies do not pay enough for the security benefits they receive from the United States, carrying this philosophy into the Oval Office. He is not alone in this belief, nor the first American political leader to champion this concept.[7] The mantra coming from the White House empowers groups inside the government who firmly ascribe to the notion that America's allies are free-riding.

Aside from the many bad assumptions[8] underwriting this logic, one problem with the term "free-rider" is that it is often applied loosely to both "burden-sharing" and "cost-sharing." These are separate concepts regarding parity in alliance arrangements that are often conflated. Burden-sharing relates to the amount that each ally spends on its own defense. The current marker, albeit a flawed one, tends to be percentage of a nation's GDP dedicated to annual defense budget. Cost-sharing relates to a host nation's contributions to a foreign ally's stationing costs; in other words, how much a country spends to host an ally's forces. Cost-sharing

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[5] The current SMA expires in April 2021, though conclusion of negotiations must be done by January 2021 before Japan's Diet deliberates the next fiscal year budget.
[6] "Entry into Force of the New Special Measures Agreement (SMA)," *Ministry of Foreign Affairs* (1 April 2016): https://www.mofa.go.jp/press/release/press4e_001104.html.
[7] The first major example of a postwar President targeting "free-riding" allies came in the early 1970s when President Richard Nixon issued the "Nixon Doctrine" calling for America's allies to do more to provide for their own defense.
[8] Michael Bosack, "Bad Assumptions behind 'Cost Plus 50' Plan," *Japan Times* (March 13, 2019): https://www.japantimes.co.jp/opinion/2019/03/13/commentary/japan-commentary/bad-assumptions-behind-cost-plus-50-plan/.

designs do not apply to every host nation-foreign military relationship; for example, Djibouti does not contribute to U.S. stationing costs at Camp Lemonnier.[9]

The misapplication of the "free-riding ally" logic has generated momentum towards demanding exorbitant increases in existing cost-sharing designs. The most prominent example of those demands is the so-called "Cost plus 50" formula, which means the White House is aiming for allies to pay 100 percent of U.S. stationing costs plus a premium of 50 percent on top of that.[10] While acting Secretary of Defense Patrick Shanahan asserted to Congress that the Pentagon is not pursuing such goals,[11] his remarks do not mean that allies like Japan should not be concerned. One need only look to the lessons learned from the U.S.-South Korea SMA negotiations that went on for over a year from 2018 to early 2019 to conclude that U.S.-Japan SMA negotiations will be contentious.

Lessons Learned from U.S.-Korea SMA Talks

Alliance managers from both the United States and Japan have the benefit of learning from the troubled negotiations that recently took place with Korea. After ten rounds of hard-nosed negotiations, the two sides came to an ad referendum agreement.[12] For the U.S. side, the draft agreement went from the State Department to the White House via the National Security Council, only to be returned with demands for higher Korean payments. This threw the negotiation process into turmoil. The result was what amounts to a one-year "continuing" agreement until a longer-term SMA can be negotiated. There were four key lessons learned here:

1) The U.S.-side ratifier is in the White House. The U.S.-side signatory for the SMA is traditionally the Ambassador, but actual approval authority within the administration depends on the attention level of the White House. The 2019 U.S.-Korea SMA demonstrated that not only was final approval authority for cost-

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[9] In cases such as these, basing arrangements are transactional and not tied to a governing alliance treaty. Other recent examples include the former Manas Air Base in the Kyrgyz Republic and Karshi-Khanabad (K2) Air Base in Uzbekistan.
[10] "Trump Seeks Huge Premium From Allies Hosting U.S. Troops," *Bloomberg* (8 March 2019): https://www.bloomberg.com/news/articles/2019-03-08/trump-said-to-seek-huge-premium-from-allies-hosting-u-s-troops.
[11] "Shanahan: Charging allies to house US troops, plus 50 percent surcharge, isn't happening," *Defense News* (14 March 2019): https://www.defensenews.com/pentagon/2019/03/14/shanahan-charging-allies-cost-plus-50-percent-for-basing-not-happening/.
[12] Ad referendum, or "for referral," is the term applied to an agreement made at the negotiating table that requires ratification from higher level government authorities.

sharing agreements in the White House, but the first department-approved ad referendum agreement differed from the final policy decision.

2) The U.S. government is looking for major increases. The U.S.-side came to the table with a mandate of getting as much as double the payments guaranteed in the previous agreement.[13]

3) Cost-sharing negotiations will only intensify. The one-year agreement was a stop-gap just so cost-sharing did not lapse. It did not resolve any lingering issues in the negotiation, merely delaying decisions until a new set of negotiations could begin.

4) Other alliance factors do not influence SMA negotiations. Despite inter-Korean dialogues aimed at reducing tensions with North Korea, the South Korean government decided upon an 8.2 percent increase in its defense budget—a clear counter argument to the notion of a "free riding" ally.[14] From an economic relationship standpoint, the South Korean government readily renegotiated the Korea-U.S. (KORUS) Free Trade Agreement and ratified it in parliament in 2018.[15] None of this mattered; the only consideration for the White House was the previous SMA score sheet and the new one.

Looming Problems

There are four problems that promise to spell trouble for the U.S.-Japan alliance. The first is the definitional problem that there is no bilaterally agreed-upon measure for the amount Japan contributes toward U.S. "stationing costs." The Japanese government's position is that it spent $5.4 billion on U.S. forces last year between the SMA, rents for U.S. exclusive-use land, construction on facilities in

[13] "Trump Wants South Korea to Pay More for U.S. Troop Presence," *Wall Street Journal* (7 December 2018): https://www.wsj.com/articles/trump-wants-south-korea-to-pay-more-for-u-s-troop-presence-1544221727.
[14] "S. Korea seeks to increase defense budget 8.2% next year," *The Korea Herald* (29 August 2018): http://m.koreaherald.com/view.php?ud=20180829000781#cb.
[15] "South Korea's parliament ratifies revised FTA with U.S.," *Reuters* (8 December 2018): https://www.reuters.com/article/us-southkorea-trade-usa/south-koreas-parliament-ratifies-revised-fta-with-u-s-idUSKBN1O61Y7?il=0

Guam, and "burden reduction" measures, among other things.[16] There are also the ancillary financial benefits the U.S. government enjoys from the government of Japan. For example, Japan has budgeted $3.7 billion on procurement of U.S. military equipment in 2019.[17] Further, unlike other military partners which the United States subsidizes, the Japanese government pays its own way (often with a premium) for use of U.S. training areas, exchange officers at various U.S. military institutions, and engagement in joint-training exercises. Meanwhile, there is no formal U.S. government assessment for stationing costs from a specific U.S.-Japan alliance cost-sharing perspective.[18] The closest thing the U.S. government has is a fiscal year stationing cost report that goes to Congress, but that includes salaries, operations and maintenance (O&M) budgets, and other sunk costs[19] while excluding several other line items that could be considered.[20] The absence of an agreed-upon cost sheet for annual stationing costs means that both sides will bring their own assessments to the negotiating table.

The absence of a bilateral definition of cost-sharing leads to the second problem, which centers on alliance designs. Attempting to broaden the scope of the SMA opens the door to protest of issues that the two governments had previously settled, such as whether non-military entities, recreation facilities, or support services should be allowable under existing host nation agreements, let alone cost-sharing deals. By debating costs of line items in SMA negotiations and demanding major increases, the U.S. government is inviting Japan to weigh in on what should or should not be covered under alliance designs. As a result, the U.S. government may inadvertently upset long-standing, beneficial arrangements in an attempt to extract additional cost-sharing payments.

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[16] "Zainichi Beigun Kankei Keihi (Heisei 30 nendo yosan) [Expenditures related to U.S. Forces Japan (2018 Budget)]," *Ministry of Defense*: https://www.mod.go.jp/j/approach/zaibeigun/us_keihi/keihi.html.

[17] This number only includes the amount via Foreign Military Sales. It does not include Direct Commercial Sales, which would bring the number even higher.

[18] Several organizations like RAND have taken a shot at identifying stationing costs, but even they had to establish cut lines unilaterally. See "Overseas Basing of U.S. Military Forces: An Assessment of Relative Costs and Strategic Benefits," *RAND* (2013): https://www.rand.org/content/dam/rand/pubs/research_reports/RR200/RR201/RAND_RR201.pdf.

[19] That is, costs that the U.S. government would incur regardless of location of forces.

[20] There are many questions associated with the "cost" of stationing U.S. forces in Japan: Should units be included if they are there for something other than the direct defense of Japan? What about costs for moving personnel and their families? How about rotational units that are only in a host nation for a few months out of the year? Do you add the cost of running overseas schools for dependent family members? Commissaries? Recreation areas? Uniform clothing sales stores? How about research and development for the equipment that is stationed there? Should a country pay more if it has fifth generation fighters stationed there instead of fourth?

The third problem is that exorbitant cost-sharing demands will lead to self-imposed friction between the United States and Japan. Such contentious negotiations could undermine Japanese confidence in U.S. commitment to the alliance and the region while affecting Japanese domestic support for U.S. forces in Japan. They could also distract alliance managers from implementation of other key alliance initiatives[21] while perhaps emboldening potential adversaries to take advantage of this seam between the allies.

The fourth problem is political. The Trump administration will want a "win" from SMA negotiations. The specifics of that "win" are not important—as long as it can be spun as a positive outcome for the United States. Fortunately, if alliance managers can tackle the political problem first, they might be able to avoid the other three.

The Solution

There are four ways to overcome the aforementioned problems. The first is enlisting the aid of officials with direct ties to the White House. The obvious candidate here is the U.S. Ambassador to Japan, William Hagerty. Hagerty served as a senior member of Trump's transition team and has a line to the Oval Office.[22] If someone like Hagerty petitioned on behalf of the alliance, it could soften the administration's position on cost-sharing and allow for greater flexibility at the negotiating table.

The second way is to clarify an agreed definition of the SMA that more accurately reflects relative cost-sharing benefits. Rather than negotiating the overall cost-sharing designs, alliance managers should identify other existing areas of cost-sharing to incorporate in the SMA. A good example includes realignment projects. The Japanese government spends about $1.9 billion annually on realignment, meaning inclusion of this amount in the SMA would double the amount of the previous agreement without introducing shocks to alliance cost-sharing designs.

Third, alliance managers can negotiate increases in existing cost-sharing areas where it makes sense based on changing economic conditions. For example, the Japanese government has scheduled a two-percent consumption tax hike in October 2019, and those additional taxes should be considered in the next SMA.

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[21] The most recent joint statement of the Security Consultative Committee provides a detailed list of the ongoing alliance initiatives; see "Joint Statement of the Security Consultative Committee," *Ministry of Foreign Affairs* (19 April 2019): https://www.mofa.go.jp/files/000470738.pdf.

[22] Prior to his nomination as Ambassador, Hagerty was Transition Director for Trump's presidential appointments.

Even modest increases will support the narrative that Japan is not a free-riding ally.

Finally, alliance managers on the U.S. side will need to earn their keep, advocating firmly for long-term alliance benefits over potential short-term financial gains. Japan-side advocacy will likely fall on deaf ears, but reinforcement from career alliance managers and lower-level political appointees within the U.S. government will be necessary to avoid the pitfalls of excessive cost-sharing demands. The United States derives a great deal of benefit from its alliance with Japan beyond financial compensation, and this message must be reinforced prior to and during cost-sharing negotiations.

There are numerous indications that the next U.S.-Japan SMA negotiations will be contentious, but there are also opportunities for alliance managers to prevent long-term damage to the security relationship. Given the precedent set in the U.S.-Korea SMA negotiations last year and the President's standing position towards free-riding allies, it is likely the White House will direct U.S. negotiators to enter SMA talks with an exorbitant opening position. However, with a combination of advocacy, flexibility, and creativity, there is an opportunity to ensure the negotiations satisfy the Trump administration's political goals while minimizing friction en route to a reasonable, mutually acceptable deal. The White House just issued a statement congratulating the new Emperor and Empress, noting that "'Reiwa' means 'beautiful harmony', and it is our sincere wish that our alliance continue to flourish and deepen in this spirit."[23] With the right consideration and action from both sides, it may be possible to realize this goal despite the tough negotiations that lie ahead.

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[23] "Statement from the President Regarding the Enthronement of His Majesty the Emperor Naruhito," *White House* (30 April 2019): https://www.whitehouse.gov/briefings-statements/statement-president-regarding-enthronement-majesty-emperor-naruhito/?utm_source=link.