

**Structural Coupling in Engagement Diplomacy:
Case Study on South Korea's Engagement Coalition for Buying Peace**

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To solve contentious issues in international relations involves engagement and interaction with other partners rather than exclusion and containment. Engagement diplomacy needs a like-minded coalition between the state and the business sector in the domestic arena, a coalition that is apparently an essential aspect of structural coupling from the systems perspective. In the Cold War era, interstate security arrangements basically determined the economic relations among nations, whereas in times of globalization, business advances in both trade and investment frequently facilitate security cooperation. Centering on the theme of structural coupling, the paper examines the case of South Korea's engagement policy toward North Korea after the launch of the Kim Dae-jung administration in 1998. In particular, this paper responds to the three following questions:

What are the criteria by which one can rigorously appraise the effects that the structural coupling of the economy and security has had on "buying peace" in the inter-Korean case?

What factors made the respective preferences and interests of the state and the business sector in South Korea converge to lead (and sustain) a domestic coalition that has underpinned the engagement policy toward North Korea?

What are the requisite factors for South Korea's persistent engagement coalition for peace?

Keywords: engagement coalition; structural coupling; Sunshine Policy

Introduction: Structural Coupling between Economy and Politics

In the study of international relations, scholars have made a clear distinction between two traditions. One tradition has involved the analysis of the international economic order as a consequence of composite policy outcomes of states. Under the umbrella notion of international political economy, proponents of this tradition have discussed international relations mainly in terms of foreign economic policies related to trade, finance, and investment issues. The other tradition has concerned the security issue, war and peace, a subject that has long been dominated by realist viewpoints wherein the state is a unitary actor pursuing survival under anarchy. In recent decades, this tradition has adopted an approach that links domestic politics to the study of international conflict or cooperation.

Scholars who subscribe to this approach have investigated the pluralistic dispersion of power in domestic politics and its effect on foreign policy. What should be noted is that these distinct traditions—international political economy and international security—have interfered with our comprehensive understanding of international relations and have contributed to a simplified division of labor in scholarly circles.

Indeed, economy and security (politics in domestic affairs) have been closely intertwined with each other in the history of human beings. Peter Gourevitch has aptly noted that trade and war shape the development of a country;¹ that is, international economy and international security combine with each other in ways that affect a country's developmental path. Also, the economy and politics interact with each other to determine the direction of a country's foreign policy, whether that direction leads to confrontation or to peaceful resolutions. In the study of international relations, a group of scholars with liberal beliefs have been aware of the interrelationship between economy and security; these scholars argue that economic interdependence among countries would enhance international cooperation.² Even though this hypothesis has not been completely proved in an empirical sense, the scholars have attracted theoretical attention to the relationship between economy and politics.

The logic wherein economy and politics are inseparable from each other may be applied to the domestic development of North Korea and of South Korea and to inter-Korean relations. During the period of the oppressive authoritarian regime in the South, Park Chung-hee and Chun Doo-hwan adopted a strategy for the pursuit of both national security and economic development. An underlying assumption of the strategy was that expansion of the South's export-oriented economy would guarantee the South's defense capacity against the North. Despite abusing the strategy by using it to rationalize oppression, South Korea's successful economic performance not only enhanced the country's physical and psychological security relative to the North's threats but also contributed to South Korea's democratic transition at the end of the 1980s. More importantly, rapid economic growth in South Korea brought about changes in the country's long-held notion of inter-Korean relations. In 1988, South Korea under the Roh Tae-woo administration launched the so-called Nordpolitik, whose term and conception seemingly derived from Willy Brandt's 1970s-era Ostpolitik. South Korea intended that Nordpolitik would normalize their relations with the Soviet Union (later Russia) and East European countries. It was South Korea's first grand plan to engage with the communist countries and North Korea through a series of talks. It is noteworthy that the policy team for Nordpolitik, which was led by Park Chol-un, closely worked with the Hyundai group, a leading business conglomerate led by Chung Ju-yong, in unfolding its ambitious plan to advance to Siberia in case of normalized relations between South Korea and the Soviet Union.

¹ Peter Gourevitch, "The Second Image Reversed: The International Sources of Domestic Politics," *International Organization*, Vol. 32, No. 4 (Autumn 1978), p. 883.

² For a comprehensive theoretical survey, refer to Edward D. Mansfield and Brian M. Pollins, eds., *Economic Interdependence and International Conflict: New Perspectives on an Enduring Debate* (Ann Arbor: University of Michigan Press, 2003).

The Sunshine Policy, launched by the Kim Dae-jung administration in 1998, was an engagement policy toward the North. The policy was to reduce the costs incurred by confrontation between the two Koreas. The policy makers had to consider seriously the importance of improved relations between South Korea and North Korea, particularly because any cost increase for the South's defenses would delay the South's economic recovery from the Asian financial crisis. The engagement policy has been persistent enough to survive over the tenure of Kim's presidency and his successor Roh Moo-hyun's presidency. In spite of the two naval skirmishes on the Northern Limit Line in 1999 and 2002 and of the eruption of the second North Korean nuclear crisis in 2002, South Korea's economic engagement with the North has deepened. The Mount Kumgang tourism project started in 1999, and the Kaesong industrial complex project started in 2000. South Korean policymakers' adherence to the engagement policy was best depicted by a symbolic expression: cruise ships float near touristy Mount Kumgang in the East Sea even when gun smoke spirals up in the West Sea. And in spite of the North Korean nuclear crisis, trade volume and visitor numbers between the two Koreas have gradually increased.

The purpose of this paper is to examine the *actors* in South Korea who have been involved in the country's engagement with the North, engagement that closely links economic cooperation to security affairs. Herein, this article responds to the three following questions. What made the interests of the Kim administration (1998-2003) and the interests of the business sector converge together, producing an "engagement coalition"? How can the interests of these actors have sustained themselves during Roh's presidency (2003-present), a period when the North Korean nuclear crisis has complicated South Korea's lenient policy toward the North? And then, is it or is it not the case that South Korea's engagement coalition contributes to peace-prone inter-Korean relations?

Any rigorous examination of an engagement coalition involves an identification of the structural coupling between economy and security, the coupling that is intended to buy peace in the South Korean case. The notion of structural coupling has been well explored by Humberto R. Maturana and Francisco J. Varela and by Niklas Luhmann, and later further examined by Kenneth D. Bailey, John Mingers, and Michael King and Chris Thornhill.³ This paper extends the notion's focus to (1) agents of structural coupling and (2) appraisals of empirically discernable coupling effects. To this end, the paper accounts for changes in the domestic situation of South Korea's engagement coalition and identifies any changes in the norms and the practices of inter-Korean relations.

³ For a survey treatment of the notion, see Kenneth D. Bailey, *Sociology and the New Systems Theory: Toward a Theoretical Synthesis* (Albany: State University of New York Press, 1994); John Mingers, *Self-Producing Systems: Implications and Applications of Autopoiesis* (New York: Plenum Press, 1995); Michael King and Chris Thornhill, *Niklas Luhmann's Theory of Politics and Law* (New York: Palgrave, 2003).

Engagement Coalition: Definition and Assessment Criteria

For a clearer understanding of the structural coupling between economy and security, it is necessary for us to identify the actors. The actors are not segregated from one another but are identical or overlap or closely interlock in terms of their interests and preferences. Whether they are governmental officials or business leaders, certain groups directly or indirectly engage in both economic affairs and security affairs. And whether the actors work as civil servants or as merchants, the interests and the preferences of certain groups may converge both in domestic affairs and in international relations. Regardless of the traditional disciplinary distinction between international political economy and international security, the actors—groups or individuals—integrate economic issues into security issues and vice versa. If the convergence of the interests and the preferences of the actors sustains itself for a significant period of time and gradually transforms the configuration of a country's overall foreign policy, then the convergence may be called a coalition.

By definition, domestic coalitions are not always peace-prone. They may pursue a certain policy goal through peaceful means or confrontational means. Jack Snyder and Etel Solingen have contributed greatly to the explanation of the coalition and its role in international relations.⁴ Snyder's penetrating work on expansionism explains how nationalist ruling groups logrolled potential and existing opposition groups in imperial countries, whereas Solingen explains how different types of domestic coalitions—the internationalization coalition and the nationalist coalition—yield different outcomes in international relations. Both scholars' contributions lie in that they have carefully traced how domestic forces view domestic and external situations and make a coalition to uphold a concerted strategy in dealing with the situations.

The notion of the internationalization coalition might be useful in the explanation of inter-Korean relations, but we need another notion, *engagement coalition*, in order to discern the exact implications of the particular coalition that emerged at the end of the 1990s. Although there is no doubt that South Korea's engagement with the North has been in the stream of internationalization, it differs from the overall strategy undertaken by the authoritarian regime under Park and Chun. Under the security umbrella of the United States, the authoritarian regime adopted a strategy of export-oriented development. While confronting and competing with the North, the regime formed a broad coalition, even if collusive, with business circles and adopted opening-up policies rather than nationalist, protectionist policies in external economic relations. In this regard, authoritarianism in domestic politics was compatible with internationalization in foreign affairs, even though the term "internationalization" came to be extensively used by the civilian president Kim Young-sam in the mid-1990s. The Kim Dae-jung administration further opened and liberalized the economy under the pressure of the IMF, and this event took the unique form of a domestic coalition with special reference to inter-Korean

⁴ Jack Snyder, *Myths of Empire: Domestic Politics and International Ambition* (Ithaca and London: Cornell University Press, 1991); Etel Solingen, *Regional Orders at Century's Dawn: Global and Domestic Influences on Grand Strategy* (Princeton, NJ: Princeton University Press, 1998).

relations. At the outset, it was the Hyundai group, rather than all chaebols (business conglomerates), that became a partner of the coalition in the South's risky business advances to the North. The goal of the previous internationalization coalition had corresponded to the containment policy for the North, whereas the new coalition has sought peaceful existence through hoped-for changes in North Korea.

There are three ways to appraise the engagement policy, particularly regarding the effectiveness of the existing engagement coalition's strategy for "buying peace." First, the fate of the engagement policy depends on the durability of the coalition in the South, and in turn, the durability relies on the institutionalization of economic transactions. Second, the success of the engagement lies in whether or not the South's coalition has cultivated a certain degree of economic autonomy from political influence in the North. Third, the policy effect of the South's engagement coalition depends on whether or not the coalition has led North Korea to be cooperative on the security of neighboring countries as well as South Korea. Let us elaborate the three criteria.

Durability of the engagement coalition: Durable coalition is one of the essential requirements for successful policy effects of the South's engagement with the North. To assess the durability, one must observe whether or not the coalition is strong enough to cope with challenges that arise both on the domestic front and in inter-Korean relations. This kind of assessment involves analyses of (a) how well the South Korean government quells opposition and resistance on the domestic front; and (b) the extent to which the two Koreas may institutionalize commercial practices that take place between the different modes of economic systems.

Independent economic behavior space: As far as the engagement aims at buying peace, one of the most challenging tasks concerns the ways in which the South fosters the emergence of independent economic actors—that is, entrepreneurs—in the North. Success of the engagement policy depends specifically on the degree to which effective continuous economic transactions between the North and the South can cultivate the growth of a parallel economic partner in the North. Under the North's current "politicization of the command economy," it is hard to imagine any immediate rise of entrepreneurs there.⁵ And without independent economic space in the North, interdependence between the two Koreas and resulting peaceful coexistence cannot be achieved.

Feasibility of inducing a cooperative security policy: The South's engagement coalition should lead the North to a sufficiently favorable view of economic benefits such that the North cooperates over security concerns of both South Korea and neighboring countries.

⁵ King and Thornhill, *Niklas Luhmann's Theory*, pp. 82-83.

Outset of the Engagement Coalition

A question arises as to *why* the newly launched Kim Dae-jung administration and the Hyundai group became coalition partners at the end of the 1990s. On the outset, there was the Asian financial crisis at the end of 1997. The IMF's stand-by package to save South Korea's draining reserves included a harsh condition, that is, the restructuring of South Korean economy. The Kim administration used, in a sense, the IMF's conditionality as an opportunity to root out chronic problems of the development-oriented economy and embarked a restructuring of private, the public, the labor, and the banking sectors.

For the private sector, the government promoted transparent management, profit-oriented organizational reshuffling, debt curtailing, and mergers and acquisitions. The government made it easier for foreign investors to invest in South Korean businesses and thus to help revitalize moribund economy.⁶ For the public sector, the government implemented such measures as down-sizing of administrative organizations, privatization of major state-owned enterprises, and cutting of pension and retirement benefits. For the labor sector, the Tripartite Commission, which included government, business, and labor representatives, promoted both social agreements that might enhance the flexibility of the labor market and social safety networks to protect workers in the situation of mass layoff. For the banking sector, the government's restructuring program required commercial banks to increase the ratio of their own capital and to reduce their outstanding debts so as to enhance profitability and safety.⁷ All these measures ran parallel to economic liberalization and the general trend of internationalization.

The policy trend of liberalization and internationalization was not new at that time, but its growing strength was attributable to the populist-turned neoliberalist Kim Dae-jung's orientation and to the financial crisis.⁸ Motivated by the IMF package and by its accompanying harsh conditions, the government sought to eradicate old, dreadful practices in the economy: banks' favoritism on chaebol loans, family management, excessive expansion of chaebols, and waste and exaggeration in state-owned enterprises. The government upheld the slogan of the simultaneous development of "democracy and

⁶ This new policy orientation contrasted with the Kim Young-sam administration's policy preferences right before the financial crisis. On these policy preferences in the mid-1990s, see Chung-in Moon and Dae-Won Ko, "Korea's Perspective on Economic and Security Cooperation in Northeast Asia," in Tsuneo Akaha, ed., *Politics and Economics in Northeast Asia: Nationalism and Regionalism in Contention* (New York: St. Martin's Press, 1999), pp. 178-83.

⁷ Kim Gyoung-won and Kwon Soon-woo, eds., *How Has the Korean Economy Changed in the Five Years of Financial Crisis?* (Seoul: Samsung Economic Research Institute, 2003) [in Korean], pp. 248-49.

⁸ Kim Dae-jung's original ideological disposition was populism. In his book entitled *Mass Participatory Economy* in 1971, Kim was critical of conglomerates, proposing an idea about how to restrict the concentration of wealth in their hands. His alternative approach was mass ownership and mass participation in management. But in the 1997 revised edition, Kim included important elements of a liberal approach, particularly in the banking sector. These elements included independence of the central bank and liberalization of interest rates. See Kim Dae-jung, *Mass Participatory Economy* (Seoul: Sanha, 1997), chap. 8.

the market economy.”⁹ This slogan represented a neoliberal approach whereby the state plays a leading role neither in the protection of enterprises nor in the from-cradle-to-grave welfare system, nor yet again in the assuring of public servants’ job security.

Given the situation of restructuring the economy, efforts to reduce tensions between the two Koreas was not a simple policy choice but an important requirement for the successful implementation of the economic policy. In the public’s eyes, success or failure of the restructuring seemed to determine the new administration’s economic performance and, in turn, seemed to indicate the legitimacy or the illegitimacy of the old opposition’s victory in the 1997 presidential election. If military tensions on the Korean peninsula continued to weaken South Korea’s ability to attract foreign investment, or if the tensions continued to promote increased defense spending, then the restructuring would not result in an intended consequence. To shield the economic restructuring from the insecurity on the Korean peninsula was an imminent task of the Kim administration. In addition to Kim Dae-jung’s personal belief in the formula for peaceful unification, South Korea’s economic situation amid Asian financial crisis characterized the Sunshine Policy’s initial context. The Sunshine Policy as a means to peaceful North-South coexistence, if not to immediate national reunification, came to attract public attention and support and later came to receive a reputation as a practical policy toward the longtime enemy, North Korea.

There was a logic of interplay between politics and economy, the structural coupling. Amid the financial crisis, high numbers of jobless people poured out into the streets because of the bankruptcy of enterprises that could not survive the high interest rates enforced by the IMF conditions. According to the data of the Korea National Statistical Office, the unemployment rate skyrocketed right after the financial crisis. The relatively low rate of 2.0% in 1996 and 2.6% in 1997 rapidly rose to 7.0% in 1998 and 6.3% in 1999.¹⁰ Successful restructuring, which might guarantee the creation of new jobs, became an important agenda of the newly launched administration. The administration stressed the significance of security and peace, in general, and tension reduction on the Korean peninsula, in particular. If unable to develop positive relations with Pyongyang, Seoul might not revitalize the economy. In other words, the government’s economic policy, whether it was adaptive or forced, was interconnected to the government’s engagement policy toward North Korea.

As soon as Kim’s inauguration as president in February 1998, his administration presented the three principles of its policy toward the North: no tolerance of armed provocation by the North, no intention of absorbing the North, and cooperation and reconciliation with the North. It is worth noting that the administration adopted a practical measure of “distinction between politics and the economy,” which was certainly intended to economically engage with the North, leaving uncertain and unsolved political matters behind. By pointing to the North’s geographical proximity and the North’s cheap

⁹ *Dong-a Ilbo*, December 20, 1997.

¹⁰ The highest unemployment rate in the past decade was recorded as 8.5% in the first quarter of 1999. See www.nso.go.kr/cgi-bin/sws_888.cgi.

but abundant labor, the engagement policy encouraged South Korean businesses to invest in the North. South Korea's strong desire for economic engagement with the North was well depicted in the so-called Berlin Declaration. In a speech that he delivered on the occasion of his visit to the Free University of Berlin in May 2000, Kim offered the North the construction of social infrastructure, including highways, harbors, railroads, and electric and communications facilities. There is no doubt that the Berlin Declaration contributed in part to the North Korean side's serious consideration of the summit between Kim Dae-jung and Kim Jong Il in June of that year.

The summit in June 2000 was a historic event in the sense that it was the first meeting between top political leaders of the divided Korea. At the same time, the summit was an important event for the rising momentum of economic engagement with the North. About the Joint Declaration, signed at the summit, political debates arose, particularly on the two agreements: One was the independent solution of Korean issue, and the other was the collective effort for Korean reunification in following common elements of North and South Korean unification models. Critics maintained that the declaration was simply Seoul's acceptance of Pyongyang's longtime insistence on both an exclusion of foreign power, particularly of American military presence, and Pyongyang's federation unification formula. However, such criticism does not account for the whole story of the summit. Kim intended, through the summit, to lessen the tensions on the Korean peninsula and aimed at peaceful coexistence with the North. For this goal, he maintained a surprisingly traditional security approach, that is, the American military presence and the security alliance with the United States. He stated only one month after the summit that the American forces based on the security alliance were crucial for the peace on the Korean peninsula and would be necessary even after unification.¹¹ Furthermore, Kim reiterated his belief that the summit could gear down the overall cost caused by the inter-Korean confrontation.

In sum, the South Korean government gave serious consideration to its engagement policy toward North Korea and did so in accordance with the domestic context of South Korea's economic restructuring. For this reason, it is fair to say that the engagement policy started with a governmental initiative but had *double-edged* aspects requiring both domestic support and inter-Korean cooperation for peace.

The Kim administration was the prime mover; the president's political orientation—and his presidential campaign slogan “Improve the inter-Korean relationship within a year”—might have prompted the North to expect changes in South Korea's traditional hard-line posture. But North Korea was the passive respondent in the South's engagement policy; the North was suspicious of the openly stated idea that sunshine would disarm the militant North Korea and that the change in the North would, in turn, guarantee economic prosperity of the two Koreas. The North was also uncomfortable with exposing its vulnerability to the South, particularly regarding the former's hunger-stricken economy

¹¹ *Dong-a Ilbo*, July 10, 2000. Kim's statement on the necessity—even after unification—of American forces on the peninsula was a means by which Kim might quell the criticisms from the opposition party. However, this statement could not undo the opposition's skepticism of Kim's lenience toward Pyongyang.

and diplomatic isolation. South Korea therefore has tried to demonstrate its sincerity by supporting the North in the international community. Indeed, with diplomatic support from Seoul, Pyongyang has established normalized relations with sixteen countries and the European Union in only three years (from 2000 through 2002).¹² The diplomatic opening up enabled North Korea to receive humanitarian aid from the international community as well as from South Korean NGOs.

The Kim administration had to confront strong resistance from conservative forces in the political arena. The administration did its utmost to promote the legitimacy of its policy. The Ministry of Unification and the National Unification Advisory Council became the spearhead of policy-related information dissemination and of public-opinion measures that derived from frequent survey studies. The role of non-governmental organizations, particularly those related to humanitarian assistance targeting the North and to peace movements, became more visible than before. The NGOs acted not only as aid providers but also as forerunners for the dismantlement of deeply rooted Cold War mentalities—namely, anti-communism—in South Korean society. It is also notable that the Korean Council for Reconciliation and Cooperation was launched in September 1998 as an overarching organization that includes existing NGOs whose ideological spectrum ranges widely from left to right. The organization is *de jure* private, but has not been free from governmental influence in that the organization has appointed former Kim associates to leading posts therein.

More important, the Kim administration needed a domestic economic partner for the successful implementation of the engagement policy. On the one hand, because the North was in a poverty-stricken situation at that time, the South's engagement with the North was meant to concern chiefly economic affairs, and the business advances emerged as the most promising component of the policy. On the other hand, both the South Korean government and South Korean businesses acknowledged more keenly than ever before the importance of the absence of conflict in inter-Korean relations. They commonly accepted the conception of “buying peace” or “investment in the peace.” The engagement coalition first appeared in a rudimentary fashion, a collusive coalition, as shall be discussed. The collusive coalition was evidenced by the scandal surrounding the Hyundai group's remittance to a North Korean trading company's account. But the engagement coalition has sustained itself for two presidential terms, under Kim Dae-jung and Rho Moo-hyun.

¹² Making an opportunity out of Seoul's engagement policy, North Korea opened normalized relations with the non-communist countries and the European Union as follows: Italy (January 4, 2000), Australia (May 8, 2000), the Philippines (July 12, 2000), the United Kingdom (December 12, 2000), the Netherlands (January 15, 2001), Belgium (January 23, 2001), Canada (February 6, 2001), Spain (February 7, 2001), Germany (March 1, 2001), Luxemburg (March 5, 2001), Greece (March 8, 2001), Brazil (March 9, 2001), New Zealand (March 26, 2001), Kuwait (April 6, 2001), Bahrain (May 23, 2001), Turkey (June 27, 2001), and the European Union (May 14, 2001). Yonhap News, *North Korea Yearbook 2003* (Seoul: Yonhap News, 2002), in Korean, p. 424.

Collusive Coalition for Engagement

The engagement coalition is not necessarily a pink-colored architecture laid out by a prudent peace-oriented political leader and altruistic businessmen. The emergence of the coalition especially between the Kim administration and the Hyundai group depended on the historical experience of the symbiosis of politics and the economy. In the period of rapid economic growth under the authoritarian regime, the government not only facilitated the expansion of chaebols but was involved in corruption, as well. The historical profile of collusion remained mostly intact even under the civilian government led by Kim Young-sam. Even in the intensifying trend of globalization in the mid-1990s, South Korea's business sector had been reluctant to change its collusive patterns, simply relying on government favors for procurements of domestic bank loans and for access to foreign financial sources. The businesses' heavy dependence on short-term loans with high interest rates had culminated into a dangerous liability on the eve of the financial crisis.¹³ Indeed, the structural source of the financial crisis was attributable to the chaebols' chronic reliance on short-term high-interest debts from domestic and foreign financial institutions.¹⁴ In this context, the collusive form of the coalition under Kim Dae-jung's administration should not be a surprise.

The collusive form of the coalition was publicly revealed by an independent counsel's investigation team in August 2003. With the special mission of investigating the scandal of remittance to North Korea by Hyundai Asan, a firm of the Hyundai group, the independent counsel probed an alleged collusion, between the Kim Dae-jung administration and the Hyundai Asan, of arranging the summit talk with Kim Jong Il in June 2000. According to the investigation result, US \$ 450 million in cash and US \$ 50 million in goods and services, in the name of economic cooperation funds, were sent to North Korea by Hyundai Asan right before the inter-Korean summit.¹⁵ The independent counsel concluded that the cash remittance was closely linked to the summit. In addition, the independent counsel found that the government had arranged for Hyundai Asan to get

¹³ South Korean chaebols' mode of capital acquisition was different from that of Latin American enterprises. South Korean chaebols have relied largely on the domestic and international loans, whereas the Latin American enterprises have equity-based financial structures. In addition, the South Korean case was peculiar in that the development-oriented government even guaranteed the conglomerates' procurement of capital from foreign bankers. Marcus Noland, *Avoiding the Apocalypse: The Future of the Two Koreas* (Washington, DC: Institute for International Economics, 2000), p. 215.

¹⁴ The ratio of short-term debts continuously increased in the 1990s and reached 58.5% in 1996. This unhealthy reliance, along with the poor performance of the banks, rendered chaebols vulnerable to the crisis in 1997. Stephan Haggard, *The Political Economy of the Asian Financial Crisis* (Washington, DC: Institute for International Economics, 2000), pp. 18-19.

¹⁵ The former chairman of Hyundai Asan, Chung Mong-Hun, who killed himself because of the psychological burden of the scandal, was quoted as telling the independent counsel that South Korea and North Korea had agreed that his company would pay US \$400 million to North Korea and that the government would pay the North US \$100 million. Chung alleged that this agreement had taken shape in May 2000, when Seoul and Pyongyang had been negotiating the first inter-Korean summit. However, the company shouldered the entire financial burden, including the amount that was supposed to be paid by the government.

illegal loans from the state-run Korean Development Bank and took measures to help Hyundai Asan covertly remit the cash to a North Korean bank account.¹⁶

The “remittance scandal” evidenced persistence of collusion even in the period of economic restructuring. Under the given tense situation between the two Koreas, Hyundai Asan considered the summit an effective means to open the path for its entrepreneurial advance to the North, that is, a way to obtain monopoly rights in businesses in the North, such as the Mount Kumgang tourism project and the construction of the Kaesong industrial complex.

Let us first look at the government side of the collusive coalition. The Kim Dae-jung administration’s engagement policy toward Pyongyang was, in principle, based on the president’s three-stage formula for national unification: first, a confederation of the two Koreas; second, a federation with a central government; and third, complete unification. The engagement policy clearly differed from the North Korea policy during the Cold War, and also from the Roh Tae-woo administration’s Nordpolitik in many respects. While the Roh administration initially undertook clandestine talks with communist countries and North Korea, the Kim administration openly declared its intention to engage the North economically. Hyundai group became a coalition partner of the Kim administration’s policy toward North Korea.

Why did Hyundai, not other conglomerates, become the main partner of the government in relation to the South’s engagement with the North? This question is legitimate, since all conglomerates had experienced collusion with previous administrations and had faced similar pressures of forced adaptation under both the IMF conditions and the ensuing restructuring.

At the individual level, the personal motivations and the regional origins of the founder of Hyundai were important. The late honorary chairman Chung Ju-young was born in Tongchon in Kangwon Province, located just north of the present North-South border, in November 1915. When he visited his hometown in 1989 for the first time, the adventurous entrepreneur not only reunited with his separated relatives but surveyed business opportunities, as well. He presented to North Korean authorities a blueprint of the development project for Mount Kumgang tourism, which was the first and most ambitious offer that a South Korean businessman had ever made to Pyongyang. Chung’s business adventure was realized as Kim Dae-jung took the presidential office in February 1998. Of note is that Chung’s 1989 visit to North Korea was supported by the Roh Tae-woo administration’s Nordpolitik. That is, despite the many differences between Nordpolitik at the end of the 1980s and the engagement policy a decade later, the two incarnations had a commonality insofar as each accounted for the government’s need of an economic partner.

At the corporate level, the Hyundai group had a relatively less severe burden of short-term debts than other chaebols did. Under the harsh pressure of restructuring, most businesses attempted to downsize their scale and lessen management and labor costs. An

¹⁶ *Korea Times*, August 4, 2003.

important criterion for the downsizing was profitability. After the Daewoo group established business ties with the North in the first half of the 1990s,¹⁷ many other conglomerates and small corporations gradually made overtures to the North in order to survey markets and industrial bases there. The businesses were looking into the unforeseeable future rather than reach for tangible results in the short term. Facing the financial crisis in general and the debt problem in particular, however, most of them had to minimize the size of the inter-Korean business projects because of low profitability and thus to maintain only the projects' minimal functions, like information collection and any existing trade.¹⁸ But the Hyundai group took its own path toward the establishment of an adventurous business in North Korea, particularly toward the realization of the tourism project at Mount Kumgang.

The Hyundai group's advance to the North may be attributable also to the repression of the previous administration was under Kim Young-sam between 1993 and 1997. The political landscape at the beginning of the 1990s was seemingly a battlefield occupied by old politicians pitted against empowered businessmen, even though collusion still existed behind the battle lines. One of the sources of the empowerment was the chaebols' ownership of non-banking financial institutions in the 1980s. These institutions involved insurance, securities, and short-term finance companies for the accumulation of their own financial resources.¹⁹ The battle between the government and the business sector culminated in the Hyundai group's explicit involvement in politics in 1992. At the nationwide election of the National Assembly in March, the new Hyundai-sponsored party, the Unification National Party, made a surprising political showing, 17% of the votes and 10% of the seats.²⁰ Furthermore, the Hyundai group's honorary chairman, Chung, ran an aborted bid for the presidency in the December election. With the aborted political journey, Chung as a businessman wasted money on the campaign. Also, the Hyundai group as a conglomerate lost a chance for entrepreneurial expansion under President Kim Young-sam's years in office between 1993 and 1997.

¹⁷ The first inter-Korean economic ties surfaced as a result of a meeting between Kim Woo-jung, chairman of the Daewoo group, and North Korean leader Kim Il Sung in 1992. Between 1992 and 1996, Daewoo dominated inter-Korean economic relations, both in transactions and information. In 1996, the Daewoo group and North Korea's Samcholli Company finally established a joint venture company named Minjok Sanop in Nampo, the gateway harbor of Pyongyang. The other South Korean conglomerates gathered information leaked from Daewoo's North Korea channel. See, Lee Jhong-keun, "A study on the Structure and the Prospects of Inter-Korea Processing Trade" (M.A. Thesis of the Graduate School of North Korean Studies, Kyungnam University, 2002) [in Korean], pp. 29-32.

¹⁸ Interviews with Lee Jhong-keun (Senior manager of North Korea Team, LG International Co.) and Kim Yeon Chul (Research Assistant Professor, Asiatic Research Center, Korea University) on February 2, 2004.

¹⁹ On the empowerment of the conglomerates, see Eun Mee Kim, *Big Business, Strong State: Collusion and Conflict in South Korean Development, 1960-1990* (Albany: State University of New York Press, 1997), pp. 194-200.

²⁰ Stephan Haggard and Chung-in Moon, "The State, Politics, and Economic Development in Postwar South Korea," in Hagen Koo, ed., *State and Society in Contemporary Korea* (Ithaca: Cornell University Press, 1993), p. 92.

Other chaebols that had been in business competition with the Hyundai group expanded from the manufacturing industry to service industries such as finance and imports. In contrast, the Hyundai group maintained a relatively calm status in the business circle, under the cold gaze of the Kim Young-sam administration. Hyundai undertook no new business expansion during the period, with a single exception of the establishment of an aerospace technology corporation. Even this was an existing venture from Hyundai Precision Machinery, whose origin dated back to the 1970s.²¹ For the Hyundai group, the end of Kim Young-sam's rule was a chance to jump into a new field, in contrast to Hyundai's competitors.

What did the Hyundai group aim at in arranging—with tremendous cash payments—the inter-Korean summit in 2000? The Hyundai group pursued long-term monopolistic land-use rights. The concrete targets were the Mount Kumgang tourism project and the Kaesong industrial complex. The tourism project started even before the 2000 summit,²² whereas the Kaesong industrial complex project gathered momentum in August 2000, right after the inter-Korean summit. Chairman of Hyundai Asan Chung Mong-hun met Kim Jong Il and announced that the Kaesong area would be a special economic zone in which the company would have development rights for 50 years. Because the Kaesong project involves the development of various types of infrastructure, including electricity, telecommunications, water, roads, housing, and leisure facilities, its scale reaches to 66 million square meters and requires long-term investment.

It is noteworthy that the Hyundai group's business engagement in the North was followed by the North's legalization of the projects and by the South's offer of economic assistance to the North. In November 2002, the Supreme People's Assembly in Pyongyang passed two laws that specifically indicated two regions: Mount Kumgang and Kaesong. Before Pyongyang's adoption of the two laws, the North had passed general laws that governed foreign direct investment and joint ventures. By the laws concerning Mount Kumgang and the Kaesong area, however, Pyongyang for the first time acknowledged South Korean companies' independent management, not joint ventures but direct investment. The Mount Kumgang project was initiated by Hyundai Asan alone, but the Kaesong project has been undertaken by both the Korea Land Corporation and Hyundai Asan because of the latter's substantial losses in the Mount Kumgang project.

Coupling Effect in the Engagement Coalition?

Seoul's engagement policy and the domestic coalition for this policy has continued during the Roh Moo-hyun administration, despite some difficulties caused by George W. Bush's pressing policy toward Pyongyang since 2001, the second nuclear crisis of North

²¹ Jung Dae-yong, *Entrepreneurship of Asan Chung Ju-yong* (Seoul: Samyoungsa, 2001) [in Korean], pp. 216-17.

²² Taking advantage of Honorary Chairman Chung's meeting with North Korean leader Kim Jong Il, the Hyundai group could take a decisive step in the tourism project. In October 1998, the Hyundai group and Pyongyang committed themselves to the "Agreement on the Mount Kumgang Tourism Industry," on the basis of which Hyundai started its operation of cruise ships on the East Sea in November.

Korea since 2002, and the deadlock of the Six-Party Talks since the emergence of the North Korea's counterfeit issue in 2005. As the new president Roh inaugurated in February 2003, he proclaimed the launch of the "Peace and Prosperity Policy," whose basic principle derives from the Sunshine Policy.

The Roh administration's engagement policy differed from the Kim administration's engagement policy at the outset. Owing to the improved economic situation after the Kim administration's repayment of the IMF emergency loans, Roh Moo-hyun was able to envision the hub role of South Korea in Northeast Asia. But his management of domestic economic affairs, particularly in labor issues, evolved into a populist policy. The government frequently intervened in the adjustment of wages and working conditions in favor of workers. With government assistance, the workers, particularly in the manufacturing and transportation sectors, restored to a certain extent their job security and their wage increases, a situation that had been considered taboo in the previous administration under economic restructuring. The previous administration's neoliberal policies apparently softened.

In security affairs, South Korea had to cope with two challenges: anti-American sentiment and the North Korean nuclear development. The anti-American sentiment was partly a result of the previous administration's efforts to dismantle anti-communist vestiges. The South's perception of North Korea changed; Koreans came to search for a new self-identity; they rethought the origins of the national division and the U.S.-South Korea relationship.²³ With the death of two schoolgirls by an American armored vehicle in training during the 2002 presidential election campaign period, anti-American demonstrations erupted and spread nationwide. The personal orientation of Roh Moo-hyun, then a presidential candidate, was also important. He stated during the campaign period that he had never visited the United States, and his eventual presidential victory benefited partly from this statement and the corresponding sentiment. The newly embarked Roh administration, however, inherited the second nuclear crisis from the Kim administration. North Korea's nuclear development, which had been submerged by the 1994 Agreed Framework, entered another phase, as North Korea's Deputy Foreign Minister Kang Suk-ju admitted to an enriched uranium program on the occasion of Assistant Secretary James Kelly's visit to Pyongyang in October 2002. With the South Korean public's anti-American sentiment and the South Korean president's personal orientation, the Roh administration resisted the Bush administration's unilateralist approach, wherein lay the suggested possibility of a preemptive attack on North Korea's nuclear facilities. The Roh administration could not resolve the nuclear crisis by its own capacity. The Roh administration had no other way but to consistently advocate a "peaceful solution" to the nuclear crisis.

Under the Kim administration, the South's engagement with the North (buying peace) was a matter of urgency, whereas under the Roh administration, the engagement needed *policy effect*. Here, policy effect means the effect of structural coupling, intended for the

²³ Author interview with Lee Dae-hoon (civic activist, Deputy Secretary of People's Solidarity for Participatory Democracy) on February 11, 2005.

achievement of peace in association with economic engagement. The Roh administration was under great pressure to successfully achieve certain results. Meanwhile, the Hyundai group remained a coalition partner to the government, but it was no longer a collusive partner. There were two reasons for this change: One was Roh's strong will to eliminate corruption and collusion between politicians and businessmen, and the other was the high political risk that attended any government collusion with the business sector in inter-Korean affairs, especially after the 2003 investigation report on the Hyundai group's remittance scandal. Although the South's non-collusion engagement with the North was a desirable development, the situation itself did not help the economic engagement achieve any tangible policy effect. The engagement expanded, and it seemed more institutionalized than before. But the new developments in the security environment hampered the way toward peaceful existence between the two Koreas.

The engagement policy under Roh has been a double-edged policy, just as in the previous administration. On the diplomatic front, the Roh administration made desperate efforts to resolve the North Korean nuclear crisis through the Six-Party Talks and contributed to the issuing of the Joint Declaration at the fourth round in December 2005. But the United States' financial sanctions against North Korea for its alleged state-led production of counterfeit US currency, rendered the South Korean efforts abortive; North Korea stepped back from the negotiation table on the nuclear issue. On the domestic front, the Roh administration has felt strong pressure to win public support for the policy, particularly given the situation of Roh's declining popularity during the second half of his presidency. As the US financial sanctions against the North aggravated the perceived effect of the engagement policy, Unification Minister Chung Dong-young promoted the notion of "Korea peace economics" (economy for peace, peace for economy). This notion seems to have functioned as a force of inertia in the South's continuation of the engagement policy. In the public's eyes, however, the policy has remained precarious in terms of the effect.

The South's economic engagement with the North has been visible in numerical indicators and interests. The trade volume between the two Koreas expanded from US \$222 million in 1998 to US \$1,055 million in 2005. The number of visitors from the South to the North increased from 3,317 in 1998 to 87,028 in 2005; and the number of visitors from the North to the South also increased, if not to the same degree, from zero to 1,313.²⁴ With the increase in economic interactions, South Korean business groups became more acquainted with the situation in the North and came to be more interested in the northern adventure than before. The development project of the Kaesong industrial complex has successfully attracted the attention of small South Korean corporations, evidence that the engagement coalition has continued. According to a survey analysis conducted by the Federation of Korean Industries in 2003, 41.7% of 171 responding companies professed their intention to open businesses in North Korea, provided that the economic relations between the two Koreas improved. In particular, respondents from

²⁴ See www.unikorea.go.kr/index.jsp (accessed May 27, 2006).

trade (75.0%), information technology (73.3%), and transportation (62.5%) exhibited relatively high interest in business in North Korea.²⁵

It is remarkable that the South's expanded economic engagement with the North has been accompanied by South Korean business circles' expression of preferences and wants to the South Korean government regarding a better North-South business environment. The preferences and wants include not only the South's securing of North Korea's commitment to business agreements. Meanwhile, South Korean business, realizing that these demands require a long gestation period, has focused on the processing trade. In reality, processing has been the most important North-South commercial transaction since the engagement policy started. A significant portion of inter-Korean trade has involved the South's sending of materials to the North for processing and the South's receiving of products from the North. In 2004, inter-Korean trade was composed largely of North Korean exports of agricultural and fishery products (39.5%) and textiles (37.2%) to the South and of the North's import of South Korean chemical products (31.0%) and textiles (20.4%). Here, the textiles in both the exports and the imports are related chiefly to processing.²⁶ South Korean processing corporations have provided their partners in the North with all needed supplies, and the North has provided the labor only. Processing, a labor-intensive industry, is now gradually expanding in the Kaesong industrial complex.

How have South Korean business circles transmitted their preferences, as well as their grievances, to the government? First, businesses have articulated their concerns to the Ministry of Unification in the process of business-plan proposals, of plan approvals, and of reports of their contacts with North Korean partners. Officials at the ministry consider the businesses' concerns and recent histories, including obstacles and difficulties. The officials then apply the information to future South Korean negotiations with Pyongyang. Second, some South Korean businesses and non-governmental organizations have made frequent direct and organized demands.²⁷ Meetings and forums, sponsored or organized by the Korea Trade-Investment Promotion Agency and the Korea International Trade Association, have provided prospective corporations with opportunities to articulate their preferences to the South Korean government.²⁸

After all, the two Koreas put into effect the "four economic agreements" in August 2003: investment guarantees, the elimination of double taxation, mediation of trade disputes, and settlements through South and North Korean banks. It is noteworthy that there was

²⁵ Kwon Sun-bom, "Inter-Korean Economic Relations of Major Industries in 2003: Situation and Tasks" (CEO Report on Current Issues, Federation of Korean Industries, August 2003) [in Korean], p. 6.

²⁶ Kim Young-yoon, "Inter-Korean Economic Cooperation and the Prosperity in Korean Peninsula," Korea Institute for National Unification, ed., *June 15th South-North Joint Declaration and Peace and Prosperity in Korean Peninsula* (Seoul: KINU, 2005) [in Korean], pp. 122-23.

²⁷ The most recent umbrella organization is the Council of Private Economic Cooperation between South and North Korea, which was established in November 2003.

²⁸ Interview with Dong Myong-Han (Senior Manager of Inter-Korean Economic Cooperation Team, Small Business Corporation) on February 3, 2004.

withinput in the South Korean government,²⁹ as well as input from business circles, in the expediting of the agreements with the North. South Korean government officials had understood the necessity of them since the Basic Agreement between the North and the South in December 1991. They knew that the agreement was a well-documented principle on inter-Korean relations but that it needed further details for the expansion of North-South economic exchanges. South Korean officials in the negotiation process in 2003 pushed for the four economic agreements. In this respect, there emerged a new convergence of preferences and of interests between the South Korean government and the business sector regarding the legalization of business advance to the North. This convergence pattern apparently has differed from the previous collusive pattern. The recent pattern has allowed for a more institutionalized engagement coalition than before.

Assessment and Conclusion

The engagement policy of South Korea is an exemplary case of structural coupling between the economy and politics: buying peace. South Korea has pursued a solution to the security problem on the Korean peninsula by undertaking economic engagement with the North. South Korea launched the engagement policy at the particular moment when the internationalization of its economy through restructuring. The South Korean government envisioned an ideal of common prosperity between the two Koreas, and at the same time, it proceeded with a realistic effort to reduce business risks for South Korean businesses in the North and to upgrade its own credit-ratings represented by the indicators of Standard & Poor's and Moody's. But the domestic coalition pattern for the engagement with the North could not overcome the old collusive patterns, particularly between the Kim administration and the Hyundai group.

The second phase of the engagement, by the Roh administration, has been under pressure to produce tangible results, that is, a coupling effect relative to the engagement coalition. The effect has been limited, as seen below.

Durability of the Coalition: First of all, the domestic situation in the South has discouraged the engagement coalition. Because the policy is double-edged, the ideological polarization and sensitization of the policy have led the South Korean government to adhere to visible indicators rather than to the long-term and original goal, peaceful coexistence. The ideological polarization between the ruling group (the present administration, the ruling Uri Party, and some NGOs) and the opposition party (the Grand National Party) originated from their different perceptions of North Korea. Both of the sides share the idea that South Korea should engage with and support North Korea, but they differ as to the approach that South Korea should eventually take in dealing with the Kim Jong Il regime. The opposition party has long been the stronghold of anti-communism and previous authoritarian vestiges, so it sticks to the notion of regime change in North Korea. The ruling group, representing progressive political figures and former opposition leaders, seems to fear the possibility of a sudden collapse of the

²⁹ On the concept of withinputs, see David Easton, *A Framework for Political Analysis* (Chicago, IL: University of Chicago Press, 1965), p. 114.

regime, and it takes lenient measures in relation to North Korea under Kim Jong Il. On the other hand, the issues on North Korea and the policy toward North Korea are sensitized, as the South's engagement with the North has proceeded. Important daily news topics concern not only the nuclear development but also revision of the National Security Law in the South, human rights violations in the North, abduction of South Koreans by North Korean agents, South Korean POWs living in the North, and humanitarian aid to the North. Both the ruling party and the opposition party are very sensitive to North Korean affairs. Polarization and sensitization go together in this case. For example, the polarized issue in October 2005 of whether or not the South Korean government should prosecute a professor in Seoul who allegedly violated the National Security Law, which was still in effect, triggered a chain reaction in South Korean society on inter-Korean relations.³⁰ The issue encouraged further advances by the "new right"—a self-identified group of former student opposition leaders who had been empathetic to North Korea but who are now critical of the existing Kim Jong Il regime—and constituted an additional factor in domestic polarization, basically on the North Korea issue.

Second, South Korea's domestic coalition for the engagement policy has achieved its institutionalization to a certain extent, but the coalition has not yet rendered the North Korean side engaged with the South. Despite successive bankruptcies of South Korean corporations in North Korea and despite South Korea's domestic polarization over North Korean affairs, small- and medium-sized enterprises continue to show interest in cheap North Korean labor (no unions, no labor disputes) in the Kaesong industrial complex. The 2003 agreement on economic cooperation contributed to the institutionalization of North-South economic transactions in that it paved a way for safer South Korean investment in the North than existed before the agreement. But the agreement has a deficiency particularly in cases of disputes: under the present conditions, legal arbitration would not result in any tangible outcome because there is room not for a third, objective party to intervene but only for North and South arbitrary committee members in same number. The Kaesong industrial complex that aims eventually to attract foreign direct investment needs to be in accordance with international commercial norms and practices. Furthermore, the Hyundai group's predominant role, if not exclusive power, in Mount Kumgang and possibly Mount Paekdu has prevented rational business practices and any spill-over effect. Taking into account the factors above, one can see that the engagement coalition seems durable to some certain extent but also that it has limited scope because of a lack of international standards for business advances.

Independent Economic Behavior Space: There is no question that the engagement coalition needs to facilitate a certain degree of economic independence from the state control in the North. Without parallel partners in the North, South Korean businesses would find it difficult to extend their business opportunities, a situation that would produce little policy effect. In the Kaesong industrial complex, North Korea controls the labor supply that feeds the South Korean factories; the South Korean side does not have power over personnel affairs. It is apparent that North Korea, through its labor control,

³⁰ *Korea Times*, October 18, 2005.

does not want to lose social control of its own society. The problem does not stop here. The inter-Korean economic relations may reveal vulnerability to politicized economy in the North. Any top-down political decision may overturn North-South economic exchanges. For instance, Kim Jong Il's acceptance of the military's concerns regarding the security of the borders may suddenly delay or cancel the agreed-upon plan, exemplified by the case of the cross-border railway test run, as seen in May 2006.

The state's control over economic affairs in North Korea often negatively affects the South Korean business side also. When Hyundai Asan dismissed Vice Chairman Kim Yoon-kyu in October 2005, North Korea warned that the previous agreement between the North Korean authority and Hyundai Asan would be threatened.³¹ This case shows that North Korea intervened in the personnel affairs of the South Korean investor by favoring a particular person, an intervention that is apparently none of North Korean business. The South Korean government had no leverage in this regard and can simply persuade Hyundai Asan to resolve the issue through negotiations with the North Korean authority.

Therefore, the engagement coalition in South Korea should always pursue means by which it can cultivate relatively independent economic actors in the North. This effort involves differentiation between subsystems in North Korean system from a systems perspective; with a certain degree of differentiation, the interactions between the two Korean systems may remain consistent. Otherwise, domestic disturbances in any system will result in perturbation in the relations between the two systems.

Feasibility of Inducing a Cooperative Security Policy: This is the most challenging part of the engagement coalition in the South, which has not achieved any concrete result, even in inter-Korean military affairs, not to mention the nuclear development issue. The test run of the cross-border railway was aborted before former South Korean President Kim's informal visit to Pyongyang, scheduled in June 2006. This situation strikingly differs from the case that North Korea has allowed the commute—across the same border—of South Koreans to and from the Kaesong industrial complex. North Korea believes that the railroad is more harmful to the regime than the wire-fenced industrial complex. Furthermore, the general-level talks between the two Koreas have failed to reach an agreement on the matter of avoidance of clashes around the disputed sea border, the Northern Limit Line, in the Yellow Sea. The lack of cooperation on the military affairs evidences the limited effect of the South's engagement coalition.

The South's engagement coalition has failed in inducing North Korea to believe that the inter-Korean economic exchanges has been and will be paid enough to take a major change in the security posture toward the South. The major reason for the North Korea's unchanged belief is Pyongyang's persistent perception of Washington as the key for the solution of its security dilemma. Given this situation, it is noteworthy that North Korea has become more dependent since 2002 on economic exchanges with China, which supports for the persistence of the existing regime under Kim Jong Il and shields North Korea from the United States in relation to its position to the ongoing nuclear

³¹ *Korea Times*, October 20, 2005.

development issue. Chinese investment in North Korea, whether through direct investment or joint ventures, rapidly increased from US \$1.3 million in 2003 to US \$173.5 million in 2004. Furthermore, the Chinese share in North Korea's trade volume increased from 23.5% in 2000 to 39.0% in 2004. North Korea's reliance on Chinese oil and food has continued; some 93.2% of oil and 29.8% of food in the yearly average between 2000 and 2004 came from China.³² North Korea's rising dependence on China seems not a zero-sum game with South Korea's engagement policy, but the situation reveals the limitation of the policy effect of the South's engagement with the North.

³² Park Jong-chul, et al., "North Korea's Dependence on China" (Analysis Report 2006-4) (Seoul: KINU, March 2006) [in Korean], pp. 10-11.