

**The Evolution and Practice of Economic Statecraft
in South Korea:
The Case Study of South Korea's Positive Engagement
towards North Korea**

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The candidate confirms that the work submitted is his own and that appropriate credit has been given where reference has been made to the work of others.

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Abstract

This thesis aims to investigate the use of positive economic statecraft in South Korea in relation to its policy on North Korea between 1988 and 2007, and examines the impact of economic incentives on inter-Korean relations under the governments of Kim Dae-jung and Roh Moo-hyun. To address the question of whether South Korea's policy on North Korea could induce cooperation in inter-Korean relations and lead to changes in the political behaviour of North Korea, this thesis re-conceptualises the practice and process of the use of economic incentives as positive engagement. This thesis argues that the impact of positive engagement on inter-Korean relations is corroborated by the changes made at the level of economic ties between the two Koreas. This increased level of asymmetrical interdependence between the two Koreas is expected to dissuade Pyongyang from conducting hostile behaviour thereby reducing the danger of military conflict while providing the impetus for further structural changes within North Korea. However, this thesis demonstrates that the increased inter-Korean economic cooperation and North Korea's subsequent economic dependence on South Korea fails to induce North Korea to open up, undergo reform, and dissuade it from carrying out nuclear or missile tests. This thesis argues that while it is correct that North Korea's pursuit of a nuclear weapons programme imposes constraints on the dynamics of engagement, the determinants of positive engagement also stem from the nature of South Korea's policy on North Korea itself and divergent forces derived from sanctions and incentives-oriented policy between the United States and South Korea.

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A Note on the Korean Text

This thesis follows the Revised Romanisation system for Korean words and names, especially for the transliteration of authors' work cited in the bibliography. The Revised Romanisation of Korean was developed by the National Institute of the Korean language in South Korea and was officially adopted as the system of romanisation for Korean in 2000. For certain surnames, such as Park and Lee, and specific names, companies, and terms, like Syngman Rhee, Hyundai, and *yushin*, the thesis uses another romanisation that is widely recognised and accepted in the academic publication. In the text, most Korean names are listed with the family name first, followed by the given name, and a hyphen is inserted between the two given-name syllables. Exceptions are made for some individual authors who prefer to write their given names without a hyphen.

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CHAPTER ONE

Introduction

1.1 Background of Research

1.1.1 Introduction

Throughout history states have sought power by means of military force and territorial expansion. However the emergence of highly industrialised countries focused on economic development and foreign trade has changed the pattern of pursuing national security relying on conventional military measures to secure economic power to achieve prominence and prosperity (Keohane and Nye 1977; Rosecrance 1986; Mastanduno 1998; Jackson and Sørensen 2007). Thus, it has been an important issue for policymakers and researchers to understand the political economy of national security and the relationship between security and economics (Mansfield 1994). Many contemporary liberals have expressed hope that the recent dramatic growth of international trade and capital flows will foster political cooperation among states (Doyle 1997; Keohane 1990; Polachek 1980). Furthermore, the particularly widespread use of economic tools of statecraft since the end of the Cold War has prompted a surge of interest in the effectiveness of these instruments (Blanchard *et al.* 1999). As economic instruments are employed so prominently in foreign policy, the central debate in the literature is the relationship between economic interdependence and political conflict and the utility of sanctions or incentives in international relations (Baldwin 1985; Copeland 1996; Mansfield and Pollins 2003). In this vein, economic engagement, where a country deliberately expands economic ties with an adversary to change the target's behaviour and improve bilateral political relations, has received considerable attention as an alternative means of tackling international security (Mastanduno 1992, 2003, 2008; Davis 1999; Skålnes 2000; Papayouanou and Kastner 2000; Copeland 2000; Abdelal and Kirshner 2000; Blanchard *et al.* 2000; Kahler and Kastner 2006). For instance, the United States has resorted to strategies of economic instruments to deal with not only its two most important potential competitors, Russia and China, but also other countries such

as Cuba, Iran, and Iraq. Germany¹ and Japan² have also placed a heavy emphasis on economic instruments in their foreign policy strategies (Mastanduno 2003). However, the pursuit of economic statecraft has not been the sole preserve of the great powers.

1.1.2 Positive engagement policy in South Korea

The inauguration of Kim Dae-jung as Republic of Korea (ROK or South Korea)'s 15th President in February 1998 yielded a new policy of engagement dubbed the 'Sunshine Policy' towards the Democratic People's Republic of Korea (DPRK or North Korea). While previous governments had also tried to diplomatically resolve inter-Korean conflict and improve political relations with North Korea, Kim Dae-jung government's 'Sunshine Policy' adopted unprecedentedly positive engagement through expanding inter-Korean exchanges and cooperation to advance political relations with North Korea. The basic postulation was that as inter-Korean economic interactions strengthened, political relations with North Korea would improve and military tensions would abate (Govindasamy 2006; Lee 2010). The Kim administration believed that inter-Korean economic integration would change North Korea's behaviour and improve North Korea's quality of life to the eventual benefit and prosperity of the Korean peninsula (Ministry of Unification, hereafter MOU, 2003a). The South Korean government refrains from using economic sanctions to punish North Korea, but instead encourages increased bilateral economic ties without imposing conditions (Bluth 2008). As a result, economic cooperation was actively pursued, not only from a government level, but also with the private sector, non-profit organisation, and other civil society groups. In particular, the Hyundai group's tourism industry in Mount Geumgang and the Gaeseong Industrial Complex project have played an important role in expanding inter-Korean exchanges and cooperation. The policy of engagement was also maintained by the succeeding progressive government. The 16th President Roh Moo-hyun began his term in February 2003, and launched the 'Peace and Prosperity Policy' which shared the basic principle of Kim Dae-jung's 'Sunshine Policy'. The Roh government's 'Peace and Prosperity Policy' emphasised that the promotion of peace and pursuit of the mutual prosperity through expanding inter-Korean economic

¹ Davis (1999) shows Germany, beginning in 1969, used economic statecraft to build the political foundation for a rapprochement with one of its most distrustful neighbours, Poland.

² According to Mastanduno (2003), Japan used economic inducements towards Arab states during the 1973 oil crisis and also offered economic incentives to bring territorial concessions from Russia.

relations would not only contribute to building peace on the Korean Peninsula, but also add to the overall economic development of the Northeast Asian region (MOU 2003b). Although the beginning of the second North Korean nuclear crisis on 5 July, 2006 caused scepticism about whether or not the Sunshine Policy could be successful, the Roh government still made reconciliation with Pyongyang its top priority, and the fundamentals of South Korea's engagement strategy were not changed. Indeed, the stability of inter-Korean relations was fortified through increased trade, investment and aid (Yoon and Yang 2005).

The theoretical underpinning of the engagement strategies of economic statecraft stems from the perspective of commercial liberalists who believe that positive economic linkage promoting the level of economic interdependence can change political behaviour of the target states (Doyle 1997; Oneal and Russett 1997; Polachek 1980; Mansfield 1994). According to commercial liberalism, economic interdependence through expanded trade and exchange leads to a reduction in the threat of military conflicts for the following reasons. Firstly, economic benefits from the growth of world trade mitigate the motivation of using force among states (Rosecrance 1986). Secondly, increasing contact and communication among trade-actors promotes mutual understanding and multiple channels that connect societies, as well as fostering a sense of international community (Viner 1951; Keohane and Nye 1977; Stein 1993). Thirdly, since economic interdependence tends to generate opportunity costs for both parties, the anticipation that interstate conflicts will lead to a loss of gains from trade helps to deter state' leaders from waging wars or conflicts against trading partners (Polachek 1980; Russett and Oneal 2001). As states depend on foreign trade to at least some degree, economic interdependence between states started to be recognised as the power to influence, or the effects on each state of their trade linkages (Keohane and Nye 1977; Baldwin 1980). Thus many liberals argued that expansion of trade ties could not only reduce the likelihood of armed conflict between states, but could also be used as a substitute for military strategies in foreign policy. Such commercial liberalists' positions impact on policymakers, arguing that economic instruments causing high economic benefits can be used as a tool for achieving foreign policy goals as an alternative to punishment or coercion in dealing with an adversary's hostile behaviour (Crumm 1995; Cortright 2000; Haass and O'Sullivan 2000b; Newnham 2002). Compared with the strategies of containment or sanctions generating isolation and economic pain in the target society, economic incentives can signal cooperative intent

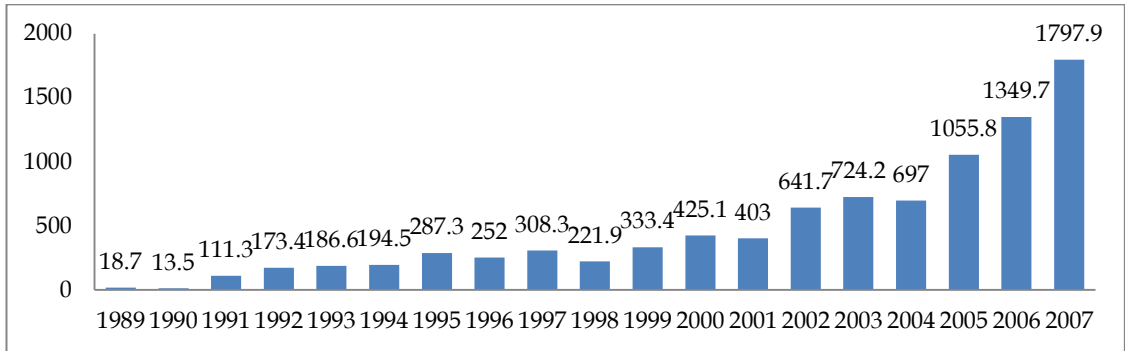
toward the target government and its populations. If economic interaction between the two states can be sustained for a long time, the deepening interdependence can cause economic interests leading to extensive cooperation that will pave the way for establishing trust-building and eventual reconciliation, and also encourage sufficient evolution in a target state's internal practices and external behaviour (Haggard and Noland 2007). Through this line of reasoning, the sender states expect that economic mutual benefits caused by interdependence will not only yield a reduced threat of military conflict, but also bring about transformative effects by changing a target state's policy preferences and its behaviour. Within the existing literature, there are two types of economic incentives which the sender states can use as an instrument for achieving foreign policy objectives (Mastanduno 2003, 2008; Kahler and Kastner 2006). The first type is 'tactical linkage' or 'conditional engagement' in which economic incentives tend to be provided in return for specific policy changes, thus rendering the expansion of economic ties as contingent on change in the target state's behaviour. However, the second type entails sender states pursuing 'structural linkage' or 'unconditional engagement' through which, they sustain continual economic incentives even in the absence of sufficient change in the target state's behaviour. By doing so, an effort to use a steady stream of economic benefits promoting the level of asymmetrical interdependence can constantly foster mutual interests between the two states, and gradually enable vested interests to exert influence over foreign policy. From this perspective, the sender states expect that economic benefits caused by interdependence will not only yield a reduced threat of military conflict, but also eventually reconfigure domestic political interests and preferences in the target states (Solingen 2007, 2012; Nincic 2011).

Along those lines, Presidents Kim Dae-jung and Roh Moo-hyun both of whom had a progressive perspective on political relations with North Korea assumed that North Korean behaviour could be changed if proper external incentives were offered (Moon 1999; Park 2001). In addition, Kim and Roh basically held the view that the North Korean regime would not collapse immediately (Kim 1997; Roh 2007). Accordingly, they attempted to seek political change in North Korea through the expansion of inter-Korean economic cooperation and the formation of interdependent relationship (Moon 2000; Lee 2010). These approaches are rooted in the belief that if the two Koreas become mutually dependent, the North Korean government would avoid militarised disputes that would jeopardise the gains from trade and, at the same time,

Seoul would gain political leverage in moderating Pyongyang's belligerent attitude by using the North's economic dependence on the South (Kim and Winters 2004; Cho 2006; Jang 2009). Hence, Presidents Kim and Roh expected that the gradual expansion of economic trade and cooperation would not only produce mutual benefits and understanding between the two Koreas, but it would also contribute to changing North Korea's political behaviour, leading to a reduction of military tension and an acceleration of the process toward a peaceful unification. In other words, the Sunshine Policy and the Peace and Prosperity Policy are designed to develop inter-Korean relations by promoting economic cooperation and individual exchange as a basic goal of engagement policy. Meanwhile, the two administrations expected that the engagement approach would have a transformative effect on North Korea's internal reform and external behaviour by using economic interdependence as a tool of influence (Kahler and Kastner 2006). In the process of implementing these engagement policies, the principle of flexible reciprocity was adopted as a guideline that emphasised the separation between South-North economic relations and the bilateral political relationship (Moon 2000). This principle made it possible for the administrations of Kim Dae-jung and Roh Moo-hyun to provide economic incentives toward North Korea even under politically and militarily tense circumstances (Kim and Kang 2009). While Seoul, in some cases, sought a specific link between economic incentives and political concession from Pyongyang, they mostly pursued structure linkage in the hopes that unconditional rewards aimed at enhancing the level of economic interdependence would contribute to changing the North into a less threatening state, and ultimately lead to the settlement of peace in the Peninsula. Owing to the South's engagement policy, the trade volume between the two Koreas expanded more than eight times from 222 million US dollars in 1998 to 1,798 million US dollars in 2007 (Figure 1.1).

Figure 1.1 Volume of annual inter-Korean trade

(Unit: millions of US dollars)



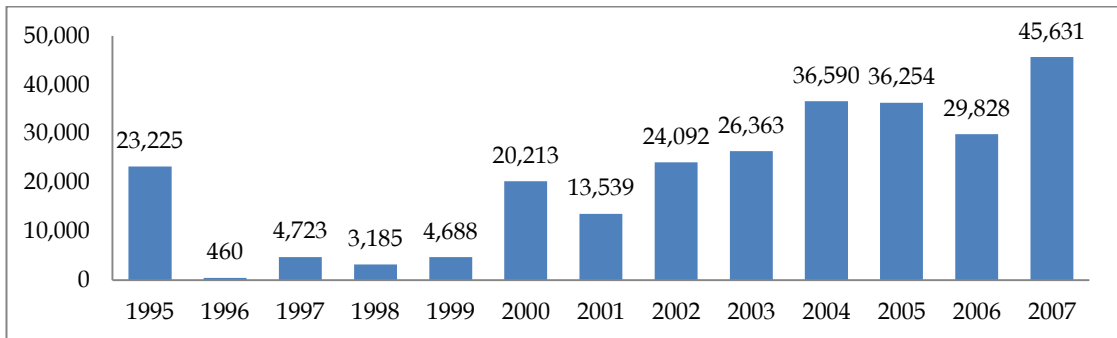
Source: MOU

Note: The aggregate volume of inter-Korean trade included export from the South and import into the South. The former included general exports, commission-based processing trade, investments, and humanitarian and other cooperation supports to the North while the latter included only purchases by the South.

The volume of humanitarian aid also steadily increased from 1996. Between 1998 and 2007, the total aid from the government and the private sector reached 2.4 billion US dollars, including food loans (Figure 1.2).

Figure 1.2 South Korean humanitarian assistance to the North Korea

(Unit: ten thousand US dollars)



Source: MOU

Note: South Korea's humanitarian aid towards North Korea included the government-level and the private-level assistance. South Korea's food loans were also added to the government-level assistance.

Against this backdrop, it is noteworthy that positive engagement towards North Korea achieved tangible outcomes within the economic sphere. However, the effectiveness of economic incentives on the political sphere has been highly controversial both at home and abroad. Despite Seoul's engagement efforts to promote political reconciliation and resolve the nuclear problem on the Korean Peninsula,

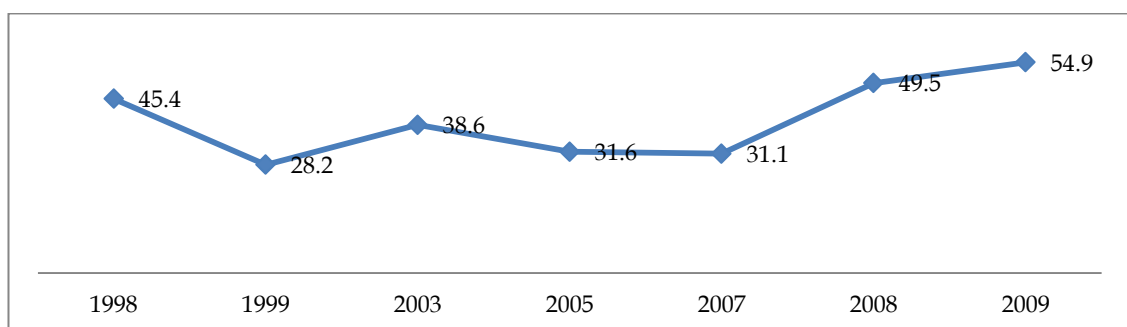
Pyongyang conducted nuclear tests in October 2006 and May 2009, defying international warnings. Internally, the progressive party has failed to return to power since Lee Myung-bak took office on 25 February 2008 as a new President backed by South Korean conservatives. This leadership change reflected South Korea's public opinion which wanted a fundamental shift in the engagement paradigm towards North Korea. During the presidential election campaign, the conservative party (Grand National Party) criticised the previous progressive government's '10 lost years', and asserted that they would end the 10-year reign of the leftist' liberal party (which is referred to as the United Democratic Party) (Hwang 2008). The main opposition party and other conservative groups believed that the North Korean regime was incapable of change, and economic incentives only helped to sustain the militarisation of the North Korean regime. Since the North Korean government understood that the ultimate goal of engagement policy was to induce Pyongyang's regime change, North Korea would not embark on any measures that would jeopardise its national security and stability regardless of how many incentives offered by the engagement process (Petrov 2009). Thus, opponents claimed that it would be naïve to expect Pyongyang to stop and dismantle its nuclear programme or initiate reform measures related to encouraging economic opening and political change.

These criticisms of engagement approach also existed during the Kim and Roh presidency. The first point which had been the centrepiece of the conservatives' criticism of the former progressive administration's North Korea policy was that the use of economic engagement policy threatened South Korea's national security. They claimed that a steady stream of economic incentives had been used to improve North Korea's military development. Throughout ten years of engagement policy, opponents consistently criticised the 'Sunshine Policy' and 'Peace and Prosperity Policy' labelling them as 'give-away policy' that weakened South Korea's national security (Paik 2002). Their detractors argued that the economic benefits from inter-Korean economic cooperation had not been used to build the economy or improve the quality of life among North Korean ordinary citizens. Rather, it had only enabled Pyongyang to develop missiles and nuclear weapons that could target Seoul. Secondly, opponents pointed out that the two previous governments' engagement policy aggravated South Korea's alliance with the United States. For the conservatives, coordination with the United States is extremely important, because South Korea fundamentally maintained its national security system through the U.S.-South Korea alliance (Kim 2006; Cho 2008). However, due to the Kim and Roh administrations' focus on reconciliation and

cooperation with North Korea, the traditional security alliance between South Korea and the United States deteriorated because of differences in their views on dealing with North Korea (Snyder *et al.* 2010). This, in turn, led to fierce ideological debate known as ‘South-South conflict’ between its pro and cons within South Korean society (Paik 2002; Cho 2003; Kim 2006; Kim 2007). The third criticism raised by the opponents stemmed from the lack of reciprocity in inter-Korean trade and exchange. They claimed that although South Korea seemingly had a trade surplus in its transacting with the North, in terms of aggregate monetary settlements, North Korea had, in fact, gained most of the pecuniary advantage in its transactions with South Korea (Hwang 2008). Similarly, the political return from the North had been too small compared to the South’s substantial economic incentives toward the North. As a result, many conservative South Koreans argued that the South had unilaterally poured money into the North, and that the North was only interested in taking more economic benefits from the South to be channelled toward its nuclear weapons and missile projects. Therefore, critics proclaimed that the ‘Sunshine Policy’ had failed, claiming that an improvement in inter-Korean relations had not been made despite the expansion of inter-Korean economic cooperation. Such sceptical views on positive engagement can also be found among ordinary people in South Korea (Park and Kim 2010). According to an annual survey conducted by the Institute for Peace and Unification Studies (IPUS) at Seoul National University, the number of South Koreans who expressed a negative attitude toward North Korea has increased. People who responded to the statement “North Korea has not changed” increased from 28.2 percent in 1999 to 38.6 percent in 2003, and then to 54.9 percent in 2009 (Figure 1.3).

Figure 1.3 Negative attitude toward North Korea: “It has not changed”

(Unit: percent)



Source: Annual Survey on Unification, Institute for Peace and Unification Studies at Seoul National University (2008, 2009); Park and Kim (2010: 122).

The line of the conservatives reasoning stems from realist views on the relationship between interdependence and conflict. Contrasting with liberalist thoughts, Realists and Marxists claimed that unfettered trade and economic exchange can undermine national security. Albert Hirschman (1945) maintained that since the benefits from trade often do not accrue to states proportionately, asymmetric interdependence can serve as a source of conflict to produce hostilities between trading partners. Neorealists contribute to this argument by adding that while the absolute gains contribute to economic growth and cooperation, the relative gains causing asymmetrical dependence are more likely to produce disproportionate costs and benefits, and will raise tensions as a consequence (Grieco 1988; Huntington 1993). Neorealist scholar, Kenneth Waltz (1970, 1979) criticised the liberal claim that the positive impact of close contact and communication through interdependence would foster peace. He argued that close interdependence may lead to increased conflict since increased contact creates potential opportunities for discord (Waltz 1970). Along those lines, Realist scholars also disagree with the liberal claim that the considerations of opportunity costs associated with war discourage state leaders from using force (Levy 2003; Hess 2003). From the Realist perspective, despite the existence of the opportunity costs, the acquisition of resources through conflict remains a viable and, at times, more desirable option than trade. They emphasised that it is impossible to conclude whether the opportunity costs of war will lead to peace, without considering additional information about each side's expectations on the economic benefits or costs from trade as well as domestic leaders' willingness to take risks (Levy 2003; Hess 2003). These overall Realist perspectives on economic interdependence consequently impact on the use economic statecraft as a tool for achieving security objectives. Although the frequency of the use of economic statecraft has increased over the years, Realists assert that the benefit of interdependence or the loss of gains from trade does not cause political change among states because the political and strategic goals of national leaders take precedence over economic ones (Waltz 1979; Mearsheimer 1990). Realists traditionally relegated economic concerns to the domain of 'low politics', as opposed to the 'high politics' of international security issues (Buzan 1984). In this sense, economic considerations remain subordinate to military concerns and maintain that the use of economic statecraft is unlikely to achieve its policy goals, and they are far less useful than military force (Galtung 1967; Losman 1979). In terms of economic incentives, while Realists do not conclude that positive means of influences are futile, they mainly claim that rewarding methods are unlikely to achieve political concession, in particular,

related to territory and national security. Thus, Realists believe that states cannot achieve national security objectives by offering aid, investment, and trade opportunities to the target states.

1.1.3 Summary

As examined above, the basic argument of the two competing frameworks, Commercial Liberalism and Realism is providing important understanding of why each position supports or rejects the policy of economic engagement. Commercial Liberalists' stance, arguing that economic instruments causing high economic benefits can be used as a tool for achieving foreign policy goals, is applicable to South Korea's engagement policy. The underlying logic of South Korea's positive engagement was supported by the liberal proposition that economic interdependence can promote peace and the benefits and costs of interdependence can increase the prospect of cooperation and inhibit conflict. Meanwhile Realists' propositions maintaining that economic linkage promoting the level of interdependence does not cause political change because national interests take precedence over economic interests reflect the conservatives views on why they were sceptical of the ideas of the 'Sunshine Policy' and 'Peace and Prosperity Policy'. However, this thesis attempts to expand the existing framework between Commercial Liberalism and Realism and takes from the conditionalists' view that economic statecraft creating economic costs and benefits are only likely to achieve desired results if certain political conditions are met (Blanchard and Ripsman 2008). While liberals argue that heightened interdependence fosters cooperative political relations, the pacifying effects of trade cannot be universal. Critics of Commercial Liberalism contend that all economic relations are not created equal. As Barbieri (2002: 27) argued, "some trading relationships may promote harmonious, beneficial interstate relations, while others are plagued by tension." Thus, the expansion of economic ties between trade partners does not always bring about conflict-inhibiting effects on their political relationship. In reality, the option of economic incentives faced myriad obstacles at both domestic and international levels. This criticism of Commercial Liberalism is relevant to inter-Korean relations.

The engagement policy pursued by the administrations of Kim Dae-jung and Roh Moo-hyun had to confront unceasing criticism from opponents who believed that it undermined South Korea's national security. Far from transforming North Korea, economic benefits from increased trade, investment and aid only sustained the regime

and helped North Korea to develop missiles and nuclear weapons. Moreover, expanding bilateral economic ties have not moved Pyongyang to either open up its economy or implement political change. Indeed, the Lee Myung-bak government suspended all inter-Korean relations with the exception of the Gaeseong industrial complex after the sinking of South Korea's warship *Cheonan* on 26 March 2010. Under these circumstances, the Commercial Liberalist proposition was limited in explaining why the 'Sunshine Policy' and positive engagement had been ineffective in reducing military tensions and changing the behaviour of North Korea. By contrast, Realists rejecting the liberal claim, argue that economic interdependence heightens the potential for political friction and exposes the vulnerabilities of insecure states in an anarchic setting. Although Realists discount economic statecraft and assert that economic tools are highly unlikely to achieve their policy goals, punishments and rewards have been important instruments in the history of international politics. Indeed, a number of empirical studies have shown that the use of economic sanctions and incentives has occasionally achieved important political objectives (Daoudi and Dajani 1983; Drezner 1999; Hufbauer *et al.* 2007; Solingen 2012). Illuminating inter-Korean relations, notwithstanding the limitation of growing economic interdependence to produce transformative effects on North Korea's behaviour, it is noteworthy that the ten years' positive engagement made it possible to create greater inter-Korean cooperation, unprecedented personal exchanges and increased political dialogue at governmental levels. What is most remarkable is that the Sunshine Policy yielded the 2000 and 2007 summits and that the North and South Korean leaders reached agreements, which contained commitment to institutionalise inter-Korean cooperation and end their hostile military relations through the establishment of a peace regime (Moon 2007). This shows that despite the Realist attempts to neglect the efficacy of economic instruments, the North and South can accept the other's priority issues and agree on partial or tentative cooperation even under antagonistic relations between the two Koreas. In this respect, it is fair to say that the existing Commercial Liberalist and Realist approaches to economic statecraft would likely be limited in elucidating the structural dynamics between cooperation and conflict in inter-Korean relations. Therefore, it is pertinent to examine the conditions under which positive engagement is likely to be effective in achieving its policy objectives. Therefore, the key concern is what factors facilitate or hinder effective economic statecraft, and how political and economic conditions affect the use of economic incentives.

1.2 Research objectives and questions

This thesis investigates the use of positive economic statecraft in South Korea in relation to North Korea policy between 1988 and 2007, and seeks to examine to what extent South Korea's positive engagement policy was effective in achieving their policy objectives toward North Korea. For this analysis, particular attention is paid to the period from the Kim Dae-jung government (1998-2003) to the Roh Moo-hyun government (2003-2008).

The primary research question:

To what extent did South Korea's use of positive economic statecraft induce cooperation in inter-Korean relations and change in North Korea's behaviour?

Specific research questions:

1. To what extent can the strategies using economic incentives be understood within the context of international relations and foreign policy?
2. How has the concept of positive engagement evolved in South Korea's policy toward North Korea? In particular, why did the two Koreas initiate economic relations in 1989?
3. To what extent can the Kim Dae-jung and Roh Moo-hyun governments' 'Sunshine Policy' be identified within the frames of positive engagement?
4. How and to what extent did the Sunshine Policy affect economic interdependence between North and South Korea?
5. Has South Korea's employment of positive economic statecraft between 1998 and 2007 achieved a reduction in military tensions between the two Koreas and a *de facto* unification?
6. Which factors facilitated or hindered the success of engagement policy objectives, and how did these determinants affect the implementation of economic incentives to North Korea?

1.3 Analytical framework

In order to understand the structural dynamics between cooperation and conflict in inter-Korean relations, this thesis employs a theoretical analysis of the relationship between economic interdependence and political conflict. The two different schools of thought, Liberalism and Realism, provide a theoretical background of positive engagement. In general, Commercial Liberalists argue that open international markets and a higher level of trade inhibit interstate hostilities. In this sense, most liberals advocate that economic interdependence promotes peace. However, Realists and Marxists focus on the negative aspects of economic dependence and reject liberal theories, and argue that heightened trade and interdependence may stimulate interstate conflict. Another group of Realists argue that economic exchange has no significant bearing on the high politics of national security. For theoretical understanding of how economic costs and benefits impact on interstate relations, Albert Hirschman's 1945 study, *National Power and the Structure of Foreign Trade*, and Robert Keohane and Joseph Nye's 1977 work, *Power and Interdependence* are utilised as a starting point for this research.

Given the systematic analysis of the relations between economic interdependence and interstate conflict, this thesis focuses on the nature and context of economic statecraft which refers to the use of economic instruments by a government to influence the behaviour of another state (Baldwin 1985; Blanchard *et al.* 1999; Mastanduno: 2003) (Table 1).

Table 1.1 The objectives of economic statecraft

<ul style="list-style-type: none">• Influence another country's domestic policies• Influence another country's foreign policies• Weaken or strengthen another country economic or military capabilities• Undermine the government or political system of another country

Source: Mastanduno (2008: 180)

In terms of the general concepts of economic statecraft, David Baldwin's *Economic Statecraft* published in 1985, is reviewed to understand certain situations in which states use economic tools and relations to achieve foreign policy objectives. Based on a literature review on the use of positive incentives and the existing concept of economic statecraft and engagement policy, this thesis attempts to reconceptualise the practice and process of the use of positive inducements to achieve foreign policy objectives.

Since the end of the Cold War, positive economic statecraft has received attention from policymakers and academics as a non-military and non-punitive tool to advance a state's national interests. These tools of statecraft and modes of behaviour have been defined in various ways. Even though it was widely known and understood as a mode of engagement within the foreign policy context, the type of behaviour was rarely defined as a coherent concept among academics and practitioners. For a better understanding of the idea and practice of influencing other states through economic incentives, this thesis redefines the term 'positive engagement', as referring to a strategy which primarily employs positive economic statecraft as an instrument to induce changes in behaviour of a target state. In this context, the thesis firstly explores the theoretical background of the study of economic statecraft, and then presents the analytical framework for understanding the way in which positive engagement works. The work on the analytical framework of positive engagement in this thesis explains how engagement policy using economic incentives can be conceptualised in international relations, and it is used for the empirical examination of the South Korean government's engagement approach. Regarding the latter, the analytical framework helps to answer the questions on why South Korea adopted engagement approaches rather than sanctions and other coercive methods from 1998 to 2007, and for what purpose and interests South Korea pursued engagement through inter-Korean economic cooperation. On the basis of this analysis, this thesis clarifies and illustrates the underlying logic and causal mechanisms of Presidents Kim Dae-jung and Roh Moo-hyun's strategies of engagement towards North Korea.

1.4 Research methodology and data collections

This thesis is primarily based on qualitative case study, employing qualitative research methods such as intensive interviewing techniques and documentary analysis (Yin 2009; Swanborn 2010). As a single case, South Korea's policy on North Korea is the main object of this study. Precisely, the aim of qualitative case study is to answer how and why questions with regard to South Korean politics and to seek causal linkages between economic incentives and political change. The understanding of ideas, political motivation and the decision making process of South Korea's policymakers are critical factors to examine the goals, instruments and the logic of engagement policy. In this sense, qualitative methodology is the more appropriate in that it makes an important contribution to understanding political phenomena and explanations of

human behaviour (Denzin and Lincoln 2011; Burnham *et al.* 2008). However, to assess economic relations between the two Koreas, this thesis also employs quantitative analysis using descriptive statistics on inter-Korean economic cooperation. In light of these numbers, this thesis examines the effectiveness of the economic incentives on inter-Korean relations by analysing several indicators reflecting political relations on the Korean Peninsula. This numerical data supports the theoretical side of the research by providing further practical evidence on inter-Korean economic relations. To collect interview sources and numerical data, field work was conducted, lasting five months in South Korea. This field work plan was approved by the Research Ethics Committee at the University of Leeds on 17 August 2010.

1.4.1 Elite interviewing and documentary analysis

First, this thesis adopted the technique of elite interviewing. In qualitative research, elite interviewing is one of the most effective research tools to obtain information about decision makers and decision-making processes inside the formal political arena (Burnham *et al.* 2008). In this thesis, twenty three in-depth interviews were conducted, and participants comprised of governmental officials, scholars and NGO workers. With regard to governmental officials, interviewees were departmental ministers and officials from South Korea's Ministry of Foreign Affairs and Trade (MOFAT) and Ministry of Unification, and they mostly had experience in working with the Kim Dae-jung and Roh Moo-hyun administrations. High-level governmental officials included the former Director of the National Intelligence Service and Minister of Unification, Lim Dong-won, former Minister of Foreign Affairs and Trade, Yoon Young-kwan, former Minister of Unification, Lee Jong-seok, and former Vice Minister of Unification, Kim Hyung-ki and Lee Kwan-se. An additional group of informants were academic scholars whose areas of expertise were based on International Relations, inter-Korean relations and inter-Korean economic cooperation. Some of them participated in designing and implementing engagement policy in South Korea's government from 1998 to 2007. In order to enhance confidence in the interview finding and lessen bias from interviewees, multiple sources ranging from archival sources, government publications, and previous interviewees' articles were examined before and after the interview. Additionally, this research conducted informal interviews with North Korean defectors living in South Korea and the United Kingdom. Due to the issue of confidentiality, information provided from North Korean defectors was not

highlighted in this thesis. However, these interviews were especially useful to understand their views on South Korean aid toward North Korea. To conduct elite interviews, the format of the semi-structured interview based on an interview guide and open-ended questions was used. In most cases, the participants were notified at least one month in advance. They were provided with a short summary of the research in a written form and a consent form to sign. For comparison and cross-checking, the same open-ended questions were applied to most formal interviewees.

Second, this thesis used documentary analysis. Along with interviews, it was an appropriate means of research for the analysis and interpretation of data sources (Yin 2009). A literature review was conducted by utilising secondary sources including books, academic journal articles and annual reports published by major think tanks and other research institutions. Based on this extensive investigation of secondary sources, this thesis examined competing theories concerned with cooperation and conflict in the context of International Relations and the historical background of South Korea's policy toward North Korea. It then evaluated the extent of economic interdependence between the two Koreas by analysing numerical data in terms of inter-Korean economic cooperation. It meant that in order to connect a specific event of South Korean politics to a wider implication to world politics, a theoretical dimension is incorporated into qualitative case study. To address any potential imbalance by relying on single institution's records, primary and secondary documents were gathered through government publications, statistics of economic ministries, national archives, and the presidential libraries. This thesis reviewed the official documentary record of *Foreign Relations of the United States* (FRUS) to examine the history of inter-Korean relations and South Korea's strategy concerning North Korea during Park Chung-hee's political rule. Documentary material, *The ROK-US Foreign relations in the early 1960s and in 1970s*, published at South Korea's national archives was also reviewed. These sources were primarily used in Chapter 4 of this thesis. Along with government publications and archival sources, selected speeches of President Kim Dae-jung and Roh Moo-hyun were used to examine South Korea's policy on North Korea. This thesis also involved the use and analysis of official statistics on inter-Korean economic cooperation and inter-Korean agreements and talks. Analysis combining numerical data was significant to this thesis because it played a role in enhancing reliability of findings (Guba and Lincoln 1994). A result of the analysis was presented in Chapter 7 of this thesis. This documentary analysis in combination with descriptive statistics contributed to this thesis, serving to not only identify the motives

and intentions of South Korean policymakers and the process of the policy's implementation, but also to test the theoretical assumptions put forward in this thesis. The significance of multi-methods approach was also attributed to its role in preventing potential bias from personal interviews and in cross-checking findings. This is because the principle of triangulation is likely to be encountered when the research uses an additional method or source of data (Bryman 2001; Pierce 2008).

1.4.2 Data collection and statistical issues

This thesis was concerned with an analysis of economic gains caused by the persistence and extension of inter-Korean economic cooperation since its formal inception in 1989. In identifying the logic of engagement and the impact of economic incentives on inter-Korean relations, it was particularly devoted to a comprehensive overview of inter-Korean economic relations from 1998 to 2007.

Statistical information and data on economic interaction between the two Koreas were mainly collected from South Korea's Ministry of Unification and the Korea Trade and Investment Promotion Agency (KOTRA). It is worth noting that trade data related to North Korea's external economic relations is 'estimated data' because North Korea does not regularly publish official economic data. It meant that this thesis should rely on the so-called 'mirror statistics' through which the volume of import and export in North Korea was estimated by extracting trade data from its trading partners (Lee 2006; Eberstadt 2007; Haggard and Noland 2008). With regard to the estimated North Korean trade data, the two facts need to be considered. First, the accuracy of North Korea's trade data might be questioned because most of the North Korean trade statistics provided by KOTRA, the International Monetary Fund (IMF), and the United Nations (UN) were normally compiled by extracting trade data from North Korea's trading partners. Thus, 'mirror statistics' based on the agency's own investigation was unlikely to cover all of North Korea's trading partners and its trade volume in reality, so there has been a risk of errors and fallacies present in each dataset (Lee *et al.* 2010). Second, the extent of North Korea's illicit activities was still opaque in North Korea's foreign economic relations. In this sense, the IMF, UN, and KOTRA statistics of North Korea's international trade were unlikely to sum up North Korea's illicit or unobserved economic activities including the illegal arms trade and sales of military equipment. It indicated that the actual volume of North Korean trade might be different from the estimated trade statistics.

To further clarify the scope of inter-Korean economic cooperation, this thesis adopted a classification system which was used by the South Korean administration from 2005. According to this classification system, inter-Korean economic cooperation was divided into two main categories, namely commercial and non-commercial transactions. The commercial transactions consisted of three main sub-categories which were general commercial trade (GT), processing-on-commission (POC) trade and economic cooperation (EC) including the Mount Geumgang (or Kumgang) project, Gaeseong (or Kaesong) Industrial Complex (GIC), and others. The non-commercial transactions included humanitarian assistance, and the flows of goods associated with socio-cultural exchanges and cooperation, the Korean Peninsula Energy Development Organisation (KEDO) light-water reactor (LWR) project and heavy fuel oil (HFO) supplies.

Based on South Korea's official data on inter-Korean economic cooperation, this thesis assessed the level of economic interdependence between North and South Korea. In the political sciences, economic interdependence could be measured in various ways, but this thesis focused on the aspect of 'vulnerability interdependence' which referred to the relative costs of changing or forgoing the structure of a system of interdependence (Baldwin 1980; Keohane and Nye 1977). Researchers who emphasised the vulnerability interdependence often paid their attention to the asymmetry of interdependence between states. Such indicators of trade asymmetry were measured using the portion of bilateral trade, represented in total trade of each trade partner. (Mansfield and Pollins 2003: 12). In addition, the extent of 'sensitivity independence' could be measured using the ratio of trade flows between states to their national income (Oneal and Russett 1997). Analyses using a total trade-to-gross domestic product (GDP) measure were useful for investigating the openness dimension interdependence (Oneal and Russett 1999; Mansfield and Pollins 2003). Yet, this thesis that focused more on bilateral trade relations measured asymmetric interdependence by using the share of trade with a dyadic partner of a state's total trade. Given the theoretical and measuring concepts of economic interdependence, this thesis assessed the level of trade asymmetry between South and North Korea from 1998 to 2007 by analysing the weight on the trade with North Korea within South Korea's economy and the weight on the trade with South Korea within North Korea's economy. For this, this thesis primarily used KOTRA's data on North Korea's foreign trade, but North Korea's export and import volume was compiled by adding inter-Korean trade to the original KOTRA data. This is because KOTRA regarded it as intra-national transactions

between the two Koreas, omitting the volume of inter-Korean trade from the total North Korean trade.

In light of numerical data on inter-Korean economic relations, this thesis evaluated the contribution of positive engagement to cooperative political relations on the Korean Peninsula by examining different indicators. This thesis looked into the number of people exchanges between South and North Korea between 1989 and 2012, and the number of inter-Korean talks and agreements between 1988 and 2012. These statistics were from the Special Office for Inter-Korean Dialogue Ministry of Unification. The patterns of defence spending by South Korea and record of North Korean provocations against South Korea were considered to understand whether positive engagement contributed to reducing military tension between the two Koreas. To investigate the trends and its implications, this thesis primarily used data and information which was made by South Korea's Ministry of National Defence (MND).

1.5 Structures of the thesis

The following chapter explores ideas and theories of economic statecraft through reviewing the existing literature. Chapter 3 presents analytical frameworks for understanding the ways in which positive engagement can work in the context of international relations. In Chapter 4, this thesis examines South Korea's statecraft in the Park Chung-hee and Chun Doo-hwan eras, looking at how the nexus between politics and economy affected the early years of inter-Korean relations. Chapter 5 is devoted to a comprehensive overview of the initial development of positive engagement in South Korea's administrations of Roh Tae-woo and Kim Young-sam. This chapter argues that the early development of inter-Korean economic relations was determined not only by South Korea's policy initiatives toward North Korea itself, but also by North Korea's economic hardships and geopolitical changes between the late 1980s and the mid-1990s. Chapter 6 makes an in-depth analysis of the ideas of the 'Sunshine Policy', and investigates its attribute within the analytical perspective of positive engagement. This chapter claims that the underlying logic and causal mechanism of the Sunshine Policy could be identified within the framework of positive engagement and its concept of the interdependence model. Chapter 7 looks into the practice of inter-Korean economic cooperation under the administrations of Kim Dae-jung and Roh Moo-hyun and then elaborates on the dynamics that influence outcomes and limitations of South Korea's positive engagement. Through analysing the effect of economic interdependence on inter-Korean relations between 1998 and 2007, this chapter substantiates that high economic benefits, which come from inter-Korean economic cooperation, were not strongly associated with the changing confrontational behaviour of North Korea. In addition, it demonstrates that the constraints on South Korea's positive engagement were not only associated with North Korea's pursuit of nuclear weapons, but were also linked to South Korea's positive engagement itself and the international environment.

CHAPTER TWO

Literature Review of Economic Statecraft

2.1 Introduction

The aim of this chapter is to examine the theoretical background of economic statecraft and to discuss the use and limitation of economic sanctions as a tool of foreign policy. Although 'sticks' and 'carrots' had been important subjects in the study of international relations, discussions about the nation's statecraft have been centred on one dimension of power that was exerted through punishment or coercion. Confronted with numerous international crises and disputes, it was military power that states mainly employed as a means of attaining a political goal. However, since the end of the Cold War, the use of economic sanctions and incentives - more generally, economic statecraft - has received a great deal of attention among scholars and policymakers. This tendency was more observable as states became more interdependent in the international system, and major powers were less inclined to use military power when dealing with security issues. Although the use of economic instruments and relationships to influence the behaviour of another state has become increasingly popular in international politics and economy, the effectiveness of economic statecraft, especially economic sanctions, has been highly controversial among international relations theorists and policymakers. In this light, this chapter will first present ideas and theories of economic statecraft by reviewing the existing literature, and then discuss how and to what extent economic sanctions have achieved the objectives of states, and how they have exposed their limitations as an instrument of statecraft.

2.2 Economic statecraft: definitions, background, and assumptions

2.2.1 Definitions and concepts

In the field of foreign policy studies, economic statecraft is generally understood as one of the techniques of statecraft³ which uses economics as an instrument of politics (Baldwin 1985). The study of economic statecraft can be traced to Albert Hirschman's theoretical analysis on the influence effect of foreign trade on interstate power relations in his seminal book *National Power and the Structure of International Trade* published in 1945. However, early attention paid to how foreign trade affects political conflict and the potential role of economic power for its national security has been neglected by academics and practitioners due to the dominant discourse of Realism. It was after the end of the Cold War that the nature of economic interactions and interdependence among states was recognised as a potential tool of statecraft to service foreign policy purposes.

Scholars of International Relations (IR) and International Political Economy (IPE) investigated and argued that the roles of economy and economic measures were not limited to the realm of 'low politics', but could be expanded to 'high politics' on security matters. This increased awareness of the economic basis of national security and the interrelationship between international politics and economics led to a focus on the tools of statecraft – that is, what instruments do states use and do they serve to achieve their desired objectives (Okano-Heijmans 2011). The concept that economics can be used as a foreign policy instrument was further developed by David Baldwin, in his book *Economic Statecraft* in which he described economic statecraft as governmental "influence attempts relying primarily on resources that have a reasonable semblance of a market price in terms of money" (Baldwin 1985: 14). He went on to outline that "attempts by statesmen to influence the pattern of international trade through manipulating this legal and political framework can be regarded as acts of economic statecraft" (Baldwin 1985: 46). In a similar vein, Michael Mastanduno recognising the critical role of economic power and relations in international security, defined economic statecraft as "the use of economic instruments and relationships to influence the behaviour of another state" (Mastanduno 1999; 2008: 172). Significantly, after the

³ In line with Baldwin and Mastanduno's definitions, statecraft in this study is understood as a government's use of multiple instruments - military, diplomacy, and economy - with the aim of attaining foreign policy objectives (Baldwin 1985: 8; Mastanduno 1999: 826).

end of the Cold War, economic power and economics as an instrument of statecraft began to be both the subject and object of analysis in the field of IR and IPE, premising that they could serve 'high politics' and issues related to national security of states.

According to this logic, economic statecraft is here identified as an instrument driven by the state for the purpose of attaining their foreign policy goals. Technically the action of implementing economic costs or benefits can be adopted not only by a state but also by non-state actors such as multinational firms, international institutions, and nongovernmental organisations (NGOs). However, since this thesis regards economic statecraft as an instrument of the state, economic statecraft is undertaken as the practice of a state for dealing with their security concerns in international relations. Although this thesis conceptualises that economic statecraft are driven by the state and used in the context of foreign policy, it does not ignore the role of private and non-governmental sectors. This is because the connection between governments and private business and NGOs and the resultant form of coalition is one of the key factors determining the durability of the policy which employs economic statecraft in sender states and the receptivity to the effect of gains or costs which were extended to target states. Taken together, economic statecraft is here understood as a means by which statesmen utilise economic resources, either as rewards or sanctions, and when it is adopted by the state, it has an end to achieve a particular foreign policy objective. During the course of action, the state is the prominent actor implementing policy strategies, but at the same time, the state takes account of the roles and influence non-state actors have.

Given this background, in this thesis, economic statecraft refers to an instrument of a nation's statecraft to influence the political relationship between states or the behaviour of a specific state by employing economic sanctions and incentives. Since economic statecraft can cause both economic costs, in the form of sanctions, and benefits, in the form of promises and grants according to why and how policymakers implement their tools in a particular situation, economic statecraft can be theoretically implemented in both coercive and non-coercive ways. The former is often referred to as 'negative sanctions', 'negative economic statecraft' or 'economic sanctions', and in the latter case, the employment of economic statecraft refers to 'positive sanctions', 'positive economic statecraft', 'economic incentives' or 'positive inducements'. Economic sanctions are generally imposed for the purpose of coercing compliance with the sender's wishes by restricting target states' economic activities, while positive incentives are primarily used to secure the target state's compliance or alter its

behaviour by offering aid, investment, and trade opportunities (Blanchard *et al.* 1999). While there is an obvious difference between the two instruments in terms of purposes and measures to achieve strategic objectives, each approach is commonly employed by the state to influence the target and bring about a desired change of political behaviour.

Economic sanctions have been imposed as a means of dissuading states from pursuing nuclear weapons and pressuring abusive regimes to cease aggression or human rights violations, while positive incentives have been employed to encourage disarmament, military demobilisation, conflict settlement, and the growth of democracy (Cortright and Lopez 1998). For instance, in the past three decades, economic sanctions have been imposed to relinquish nuclear programmes in Iran, Libya, and North Korea, contain military aggression in Iraq, Pakistan, and the former Yugoslavia, to restore democracy in Haiti and Burundi and to advance human rights in South Africa. Economic incentives have been employed to prevent nuclear proliferation in North Korea and the former Soviet Union, to encourage peace processes in El Salvador and Eastern Europe, and to promote democracy in Greece, Hungary and the Czech Republic (Cortright and Lopez 1998; Collins 2009).

In discussing the role of economic instruments in power relations, it is important to emphasise that the study of economic statecraft is dominated by the role and effects of negative sanctions as a tool of coercive instruments. Despite the empirical claims based on the few successes about the utility of sanctions, policymakers and practitioners still favour the use of economic sanctions as a tool of foreign policy (Baldwin 1971, 1999, 2000; Haass 1997; Hufbauer *et al.* 2007). Against this pattern of emphasising sanctions, scholars and policymakers recently started to pay attention to the use of positive economic statecraft, because it tends to create more opportunities for cooperation and increased economic interaction among states. The reasoning behind this strategy is based on the 'liberal peace' school of thought, which claim that heightened economic exchange would reduce escalation of conflicts among states. These expected effects are captured by policymakers formulated into the form of engagement policy which is designed to change the attitude and behaviour of the target state.

The rationale behind employing economic statecraft goes beyond causing economic costs or benefits to the target states. Rather, as a means to an end, its ultimate objective is to achieve a state's 'political objectives'. These goals can vary and include the advancement of political relations, changes in policy and behaviour of a target state, satisfaction for their own domestic constituencies, and signalling commitment to a

third party. This is an important characteristic of economic statecraft in elucidating why it is adopted by governments to promote their own national interests, and why the application of economic statecraft has political and security dimensions in international relations. More importantly, in comparison with other techniques of statecraft, economic statecraft began to be considered as a non-military alternative to force which complements or strengthens diplomatic bargaining and negotiating. In this light, policymaking and academic communities focused on using economic statecraft as an alternative to military strategies and investigated whether the practice of economic statecraft such as economic sanctions and inducements could serve foreign policy purposes.

2.2.2 Emergence

There were a number of factors affecting the advent of economic statecraft during the Cold War. Above all, the recognition of a potential role of economic power for its national security and an increasingly integrated global economy played an important role in creating a new international environment for economic statecraft. This meant that economic statecraft started to be considered as a critical foreign policy option to ensure national interests of states.

For a long time, statesmen have applied political and military power to deal with the spread of interstate conflicts and threats, and for states, military force per se was “central to statecraft” (Art 1996: 10). Although there have been attempts to diverge from this conventional wisdom, the outbreak of the Second World War only served to legitimise the logic of power politics in international relations. The failure of appeasement to curtail Hitler’s ambitions through negotiation and compromise, and the flaw of the principle of collective security which was central to the League of Nations, made it difficult to envisage an alternative course of action in their foreign policies. Rather, the failed action for peace through international law and organisation during the inter-war period provided theoretical justification for Realists’ claim that “the moral reasoning and the application of moral principles” could not overcome the lust for power in international relations (Kaufman 2006: 28). At that time, Realists such as E. H. Carr, who rebuked the pursuit of idealist goals, claimed that “the role of power is greater and that of morality less” (Carr 1946: 168). From the Realist point of view, “between its ideal and its concern about power”, the state had to privilege power over ideals (Mearshemier 2005: 142). In line with the theory of Realism, the national security

of a state was regarded as a primary concern to ensure the protection of its vital interests and the deterrence of attacks by other states (Baldwin 1995). As Walter (1943) has noted, a nation's security depended on a nation's ability to respond to an attack. For this reason, military capability has been the main requirement for a state confronting a harsh international environment.

However, throughout the Cold War era, major powers that had traditionally relied on military action to deal with international conflict started to give more credence to economic power. Since there was a consideration that economic wealth was the main source of military power and other tools of influence, economic gains that generated and distributed wealth became increasingly important for a state to secure power as well as welfare (Baldwin 1980). It does not necessarily mean that there was no consideration of the political economy of power before the Cold War period. Even before the First World War, a state's productive capacity had been recognised as the foundation of military power. For this reason, economic development and cooperation had been the centrepiece of the role of the state. However, after the Second World War, states "more directly engaged in the competition for shares of the world's wealth" (Stopford *et al.* 1991: 204). As Gilpin (2001) has pointed out, with the end of the Cold War, technological advances, the removal of trade barriers, and financial deregulation significantly encouraged the expansion of international trade and thus led to more intense trade competition among states. With growing concern over the primacy of economics and economic capabilities for building up military power, a country's economic stability and growth has become the central national security priority (Gilpin 1981; Kennedy 1976).

Next, along with the recognition of economic power for its national security, the developments in the liberal world economy during the twentieth century also played a considerable role in creating a new international environment for economic statecraft attempts. As many scholars have observed, one of the most significant changes of the post-Cold War world has been the widespread expansion of free markets and substantially increased international trade (Gilpin 1981; Keohane 1984; Mansfield 1994). The Bretton Woods institutions including IMF, the International Bank for Reconstruction and Development (IBRD, now called World Bank) and the General Agreement on Trade and Tariffs (GATT) lay at the heart of setting all new economic orders and ushering open trade between the 1950s and 1960s. Along with the first oil crisis of 1973, its institutional weakness led to the breakdown of the system, facing stagflation in the early 1970s. Nevertheless, the world economy continually grew until

the 1980s in terms of the scale of capital market and financial flows (Woods 2001). Under these circumstances, the efforts of individual states to cope with a highly interdependent and competitive economy were important because they were linked not only to promoting their economic interests, but also to strengthening their autonomy pertaining to security and political interests (Gilpin 2001: 11). On the one hand, this pattern of globalisation increased the likelihood that states could find out various markets and supplies which were essential for economic prosperity and development. On the other hand, however, states became potentially more vulnerable to the international system because they became increasingly dependent on the world economy (Mastanduno 2008). As Nye (1977) has pointed out, it meant that the nature of economic interaction and interdependent relations could be constrained by a less dependent or more powerful state's national interests.

This feature made policymakers face a new challenge to ensure a stable supply of resources under international economic competition, and, at the same time, they were under domestic pressure to use economic and foreign policy to prevent unintended consequences of the asymmetries of interdependence while meeting a country's economic interests (Kahler 2005). In this vein, as economic interactions and interdependence were increased among states in the era of globalisation, economic power served not only as the foundation for promoting political security and economic growth within states, but also as the instruments for achieving foreign policy goals among states. In other words, economic considerations of power not only play a significant role in mobilising resources and manpower and developing weapons technologies, which can satisfy all states' national security requirements, they also create potential opportunities for states to achieve their strategic goals in interstate power relations by employing economic statecraft (Ripsman 2006). This understanding showed that increased economic exchange and other economic ties have become a central feature of domestic and foreign policy agendas of many states (Newnham 2004).

One obvious fact is that coupled with the process of globalisation, the trend of asymmetric interdependence in an anarchic and competitive international system has had a significant impact on the policy community and their foreign policy strategies. While the use of armed forces remained a tool of statecraft to them, the practice of economic statecraft provided a second option before waging war. In this vein, economic statecraft brought a new implication of the nature of power politics where statesmen only care about power based on military security. Recognising the potential and utility of economic statecraft as an instrument for foreign policy objectives, strong

powers began to employ economic sanctions and incentives to advance their national interests and security goals toward allies and adversaries. In particular, the United States was considered as the most powerful military state and the most prominent actor leading the new order of the world economy has prominently adopted economic statecraft as a key foreign policy measure. For the United States, the application of economic statecraft has served as a momentum to spread their virtue of liberal democracy and free trade which became a channel in promoting their own national interests. Meanwhile, the employment of economic instruments in the conduct of foreign policy matched the US interests to expand their tools of statecraft which traditionally relied on military intervention into economic statecraft which made it possible to reduce the frequency of use of military power and to supplement diplomatic means. Indeed, the use of economic sanctions has been a preferred policy option for the United States to deal with other states' objectionable behaviour since the 1970s (Drezner 1999). While the reason behind the growing use of economic sanctions was in part attributed to the United States' position in their economy and military and its eagerness to punish regimes regarded as adversaries, it was an undeniable fact that the structure of increased trade and economic ties created more opportunities for sanction (Cox and Drury 2006). Under these circumstances, as the link between economics and security in the grand strategies of powerful states was becoming more observable and prominent, the role of economic statecraft was considered a critical foreign policy measure to complement and reinforce their national security strategies.

In short, by the end of the Cold War, the growing awareness of the connection between economics and security and the continuing expansion of the international economy, these features have created an opportunity to consider the new instrument of statecraft in a state's national and international policy. This attention indicated that the nature of economic interactions and interdependence among states has in itself the potential for being a tool in the service of foreign policy objectives. Consequently, economic statecraft has brought increased attention to both academic and policy circles, and the question of whether or not economic statecraft produces the desired outcome, has become one of the most heated controversies in the literature and realpolitik.

2.2.3 Ideas and assumptions

Economic statecraft is rooted in the two underlying beliefs that (1) the roles of economy and economic measures are not limited to the realm of 'low politics', but can be expanded to 'high politics' of national security, and (2) economic statecraft causing high economic costs and benefits and the asymmetries of interdependence can be used as an instrument for influencing the target state's behaviour. These ideas and assumptions of economic statecraft are linked to theoretical debate in IR scholarship on the connection between economics and security, and the effects of economic costs and benefits of political change (Baldwin 1985; Knorr 1975; Friedberg 1991; Mastanduno 1998; Blanchard and Ripsman 2008).

First, economic statecraft is predicated upon the perspective of economic liberals⁴ assuming that economic and security concerns are integrated in international relations. Based on this idea, liberals argue that economics and economic interaction can affect political affairs, and they play an important role in attaining a state's security objectives. In contrast, the classical Realists abide by the distinction between economic affairs as 'low politics' and national security as 'high politics', ignoring the interaction between economics and security. However, a number of contemporary political scientists contend that the traditional dichotomy is no longer appropriate, because economic matters have profound implications for national security objectives (Ripsman 2006). For instance, Hans Morgenthau (1985) lists natural resources and industrial capacity as essential prerequisites of great power status. A parallel argument was offered by Kenneth Waltz who concluded that "The distinction frequently drawn between matters of high and low politics is misplaced. States use economic means for military and political ends; and military and political means for the achievement of economic interests" (Waltz 1979: 94). An offensive Realist, John Mearsheimer similarly affirmed that "...greater economic prosperity invariably means greater wealth, which has significant implications for security, because wealth is the foundation of military power" (Mearsheimer 2001: 46).

However, this is not meant to imply that modern Realists align with the liberal' perspectives on the relationship between economics and security. While structural Realists and Neo-realists implicitly admit the economic foundation of military power, they reject liberals' core idea that international economic cooperation is possible. They

⁴ The term of economic liberals has been used differently according to scholars. This thesis will use the terms economic liberals, commercial liberals, and interdependence liberals interchangeably.

had basically claimed that since the behaviour of states was still constrained by the condition of anarchy and competition, all states were more concerned with 'high politics' issues such as military security and political independence despite the increases in economic intercourse (Grieco 1988). In the area of security studies, scholars also paid attention to the relationship between economics and politics. For instance, Stephen Walt (1991: 227) argued that there were three areas in which the relationship between economics and security grew: the connection between military spending and economic performance, the strategic importance of economic resources and their role as potential sources of conflicts, and the political influence of the military-industrial complex. Despite this awareness, they focused on that fact that, in an environment of anarchy, states are more concerned with military power than with economic gains from trade and cooperation. In this vein, modern Realists and security scholars recognise the economic underpinnings of military and national security, and admit the growing importance of the market and the role of economic activities in enhancing states' wealth and power. However, for most Realists, economic considerations are still subordinate to political factors and security interests regarding economic power as one component of national power (Gilpin 1981).

The early debate in scholarly communities over the role of economy on security expands to the implication of the gains from international economic activity on political interaction among states. Neo-liberals argue that states engaging in interdependent relations seek absolute gains, thereby leading respective states to gain benefits from the relations and this mechanism provided incentives for cooperation. In contrast to Neo-liberals, Neo-realists who are pessimistic about the prospects for international cooperation claim that the distribution of these gains from such relationships is usually uneven, and results in concerns over relative gains causing conflicts between states (Grieco 1988; Huntington 1993). Despite this different contention between Realists and Neo-liberals, it is noteworthy that many states began to recognise the interplay between economics and security and to accept that economic interdependence and integration might be promoted because of its positive security.

Second, economic statecraft is based on the assumption that economic instruments causing economic costs and benefits can be used as a foreign policy tool to affect the behaviour of nation-states. Accordingly, a broad range of theoretical debates have been addressed in the field of international relations. Realists, who traditionally relegate economic concerns to the domain of 'low politics', as opposed to the 'high politics' of international security issues tend to discount economic statecraft. They

argue that: (1) security concerns cannot take a back seat to economic concerns; (2) economic statecraft does not lead to political change among states; thus (3) economics cannot be a critical instrument of statecraft in the conduct of foreign policy. In fact, modern Realists do not completely reject the value of economic considerations in policy making (Gowa 1994; Skålnes 1998). However, Realists expect that when national security interests are involved, leaders of states will give greater attention to political and strategic considerations than to economic gains and losses when making policy choices. For instance, Mearsheimer (1992: 222) has asserted that “States are surely concerned about prosperity, and thus economic calculations are not trivial for them. However, states operate in both an international political environment and an international economic environment, and the former dominates the latter in cases where the two come into conflict.” By this logic, they maintain that economic costs and benefits do not create a sufficient deterrent to conflict, and are far less useful than military force (Pape 1997; Galtung 1967; Losman 1979). According to their claims, a number of empirical studies have shown that economic sanctions and incentives have not achieved important political goals against other states. In contrast to Realist views, economic liberals argue that economic statecraft can be used as a critical tool for achieving political goals with other states. The reasoning behind this argument is that states are rational actors, primarily seeking to maximise economic benefits and minimise economic losses (Blanchard and Ripsman 2008). In this vein, they believe that the infliction of economic pain and the provision of economic gain by using economic power and relationships can be an instrument of statecraft (Daoudi and Dajani 1983; Hoagland 1993; Drury 1998; Hufbauer *et al.* 2007; Crumm 1995; Mastanduno 1998). Recognising the phenomenon of being economically interdependent in the post-Cold War era and the lessened tensions associated with *détente*, they focus their attention on the utility of economic instruments in the conduct of international policy. Thus, with the concern over the high cost of military actions, economic liberals contend that the economic dimension of statecraft can be an alternative means of tackling international insecurity (Baldwin 1985).

2.3 Economic statecraft: interdependence and conflict

As the importance of the economic aspects of national security emerged throughout the Cold War period, the political and strategic dimensions of international economic relations have captured the attention of scholars and policymakers. In particular, the

relationship between economic interdependence and political conflict has long attracted substantial scholarly interest, and remains the subject of vigorous debate (Keohane and Nye 1977; Baldwin 1980; Barbieri 1996; Blanchard *et al.* 2000; Mansfield and Pollins 2003; Kastner 2009). In fact, this debate between Liberals and Realists was a central to understanding the benefits and potential costs of trade and the underlying logic of economic statecraft. In the literature, there are three dominant perspectives on the nature and strength of this relationship, and the following arguments analyse each of these positions.

2.3.1 Liberal claim: independence promotes peace

The liberal school of thought relating economic interdependence to the reduction of the danger of war has a long tradition in both economics and political science. The traditional liberal argument has been put forward by such writers as Adam Smith, Thomas Paine, Norman Angell, and in recent times, Edward Morse (Doyle 1997; Paine 1956; Angell 1913; Morse 1970). This liberal argument can be traced back to Immanuel Kant and his 1795 work *Perpetual Peace*. Kant's basic hypothesis suggested that economic interdependence may dampen the probability of war between republican constitutions (i.e. representative democracy) (Gelpi and Grieco 2003). A similar argument was also expressed by nineteenth century Manchester school liberals, who argue that "in the world of shared economic growth and prosperity, war has become increasingly obsolete" (Moon 1998; Mueller 1989). The contemporary liberals seeking to explain the trade-peace connection began to publicly and systematically claim that open international markets and heightened economic exchange promote peace and reduce the likelihood of armed conflict. At least three arguments are commonly used to link economic integration with a reduced likelihood of militarised conflict, at both the dyadic and systemic levels (Polachek 1980; Mansfield 1994; Oneal and Russett 1999; Russett and Oneal 2001).

The first variant of liberal thinking emphasises that economic exchange and military conquest are substitute means of acquiring the resources needed to promote political security and economic growth (Staley 1939). After the Second World War, states which had traditionally relied on military intervention to acquire prosperity and territorial expansion, pursued other means of gaining national welfare, since the cost of using force increased and its benefits declined (Mueller 1989; Kaysen 1990; Mandelbaum 1998-9). In these circumstances, liberals argue that economic benefits

from the growth of world trade mitigate the motivation of using force among states. According to the liberals' view, given the choice between military expansion to achieve self-sufficiency and trade expansion to procure necessary markets and raw materials, states would choose the latter (Rosecrance 1986, 1995). Thus, as trade and foreign investment expands, the incentives to achieve these ends through territorial expansion, imperialism, and foreign aggression decline (Rosecrance 1986).

The second liberal argument is that by increasing levels of contact and communication among individuals and governments, unfettered trade encourages international friendship and understanding, thereby promoting cooperative political relations (Viner 1951; Stein 1993; Hirschman 1977; Doyle 1997). According to Kant (1795), foreign trade impacted not only on economic ground, but also related to human interaction among politically separated peoples. Ricardo (1817: 81) claimed that unhindered commerce "binds together, by one common tie of interest and intercourse, the universal society of nations throughout the civilised world." Similarly Jean Bodin believed that increased foreign trade made it possible "to maintain communication and keep up good feeling among nations" (Spiegel 1991: 91). Modern liberals incorporate these views, contending that increased social interaction and communication as well as the free flow of ideas contributes to peaceful relations among states. Conversely, the absence of communication and the restriction of free trade and other interstate interactions can be the cause of wars (Blainey 1973). According to this logic, where two states have a high level of economic integration, actors within their respective societies will come into greater contact with each other. In this environment, rising contact and communication, in turn are expected to foster cooperative political relations and form an important channel for averting interstate conflict (Russett and Oneal 2001). Here, scholars argue that economic interdependence contributes to the construction of a 'security community' (Deutsch *et al.* 1957), in which shared values make resorting to force inconceivable. According to Deutsch *et al.* (1957), trade would tend to encourage states to communicate and exchange with each other, thus it could be a means of yielding prosperity to foster community and, in the end, security. As such, supporters of economic interdependence believed that increased contact and communication would eradicate differences and promote better understanding between actors, thereby creating more of an opportunity for peace.

The third liberal argument receiving the most scholarly attention in related literature suggests that economic interdependence can act as a constraint on state leaders due to the opportunity costs. As trade generates economic benefits for both

parties, the anticipation that war will disrupt trade and lead to a loss or reduction of the gains from trade helps to deter decision makers from taking actions that are likely to lead to war (Polachek 1980; Russett and Oneal 2001). This liberal belief is based on the premise that trade provides mutual benefits to its participants, although the benefits of trade are not equal for all actors. In this respect, Montesquieu, in *The Spirit of Laws*, (1749) maintained that

“The natural effect of commerce is to bring about peace. Two nations which trade together, render themselves reciprocally dependent; if the one has an interest in buying and the other has an interest in selling; and all unions are based upon mutual needs” (quoted in Hirschman 1977: 80).

Liberal economists argue that these trade patterns and the perceptions of the costs or benefits of trade affect a rational leader’s foreign policy behaviour as they seek to maximise national welfare (Polachek 1980). According to their views, increases in gains from trade in a particular relationship are believed to reduce incentives for conflict within that relationship. Rosecrance (1986) also addresses a similar cost-benefit analysis. He argues that states pursue trading strategies when military options become too costly and less efficient for trade. This opportunity cost mechanism affects not only policymakers’ decisions, but also the domestic groups related to economic activities. Expanding trade and exchange increases the influence of internationalists who benefit from trade and they have incentives to pressure the government to maintain a peaceful environment for trade (Rogowski 1989; Solingen 1998). In other words, the more two states become economically interdependent, the more they will have an interest in maintaining cooperative political relations in order to sustain economic interactions and avoid potential trade losses (Mochizuki 1998). However, the liberals’ claims that trade promotes peace and reduces conflict have been criticised by others.

2.3.2 Realists’ claim: interdependence promotes conflict

The second perspective on the relationship between commerce and conflict is argued by Marxists and Realists who have insisted that unfettered economic trade and exchange can undermine national security. They generally argue that economic interdependence heightens the potential for political frictions and exposes the vulnerabilities of insecure states in a competitive and anarchic setting. This second

group of theorists' claim can be summarised with the following three aspects.

One line of Realist argument suggests that trade actually increases conflict between trading partners due to its asymmetric nature (Gilpin 1981; Levy 1989; Mearsheimer 1990; Barbieri 1996). In terms of this view, Hirschman (1945) has maintained that the benefits from trade often do not accrue to states proportionately and that the distribution of these gains is important to international relations, as asymmetric interdependence can be a source of power (Keohane and Nye 1977; Kroll 1993). Dependency theorists particularly claim that trade creates not interdependence but dependency, because asymmetrical dependence confers unequal power on the less dependent state. For instance, the large country which is able to acquire benefits from commerce would seek the opportunity to exploit its trading partners. Conversely, a small country, if it is dominated by a powerful state, might resent what it sees as unfair treatment and exploitation, and these realities of trade lead to conflict or violence (Russett and Oneal 2001). By this logic, Mearsheimer (1992: 222) describe interdependence as "a situation in which two states are mutually vulnerable; each is hostage of the other in economic realm." This negative consequence of dependence is even worse when one state maintains most of its trade with a given partner and lacks the freedom to change existing trade patterns. Thus, the dynamics of asymmetrical dependence serves as a source of conflict to produce hostilities among states and among actors in different states. Neorealists contribute to this argument by adding that even when absolute gains exist, concerns about relative gains may create conflicts or frictions. This is because in the relative-gain argument, one state's gain in trade is another state's potential loss. On this point, Lamy (2001: 192) highlighted that "For neo-realists, the important question is not will we all gain from this cooperation, but who will gain more?" This perspective, in fact, brings up a fundamental question of politics, 'Who gets what?' Thus, even when states are thought to benefit absolutely from trade, one state might consider its partner's disproportionate gain to be a loss to itself in terms of relative power.

A second group of theorists go beyond the trade-promote-conflict proposition, and argue that states' political motivations to minimise their dependence or maximise their dominance on foreign commerce would increase the probability of military disputes or war. In this case, as trade flows and the extent of interdependence expands, so do the incentives for the target states to take military actions to reduce their economic vulnerability (Gilpin 1981; Liberman 1996). For powerful states, they may employ aggressive policies leading to trade wars in order to expand their national

interests. As Marxist-Leninists and Neo-mercantilist theorists argue, the greater conflicts can lead to trade wars between major powers because they seek dominant powers over markets and resources. Conversely, for weaker states, asymmetric trade can be a crucial motivation to engage in conflict since they seek the opportunity to gain markets or at least attempt to minimise the relations of dependence (Barbieri 2002). Furthermore, realist scholars criticise the liberal claim over whether close contact and communication through commerce or interdependence is beneficial for fostering peace. For instance, Kenneth Waltz asserted in 1970 that since

“Close interdependence means closeness of contact and raises the prospect of at least occasional conflict... the [liberal] myth of interdependence... asserts a false belief about the conditions that may promote peace” (quoted in Mansfield and Pollins 2001).

Consistent with such arguments, Forbes (1997) reviews the empirical evidence and suggests that while contact at an individual level can reduce prejudices and improve relationships, increased contact and communication between groups or nations can lead to conflict.

A third group of Realists suppose that the widely repeated argument that the fear of the loss of gains from trade helps to deter conflict is logically incomplete (Gartzke *et al.* 2001). Realists argue that liberal claims about the effects of economic interdependence on political conflict ignore an explanation of the interaction or bargaining between trading partners. Levy (2003: 15) argues that while the liberal economic opportunity cost argument suggesting large economic losses from conflict should reduce the likelihood of conflict, “the economic opportunity cost mode requires a theory of bargaining that explains how trading partners interact in situations involving serious conflicts of interest.” He suggests, for instance, that when one side concludes that its partner/adversary is eager for peace and fearful of war, the first side can secure additional concessions by increasing its own demands without an appreciable risk of war and its associated economic costs. In a similar vein, Hess (2003) points out that the relationship between the opportunity costs and the likelihood of conflict is further complicated, because the decision of the states’ leaders will sometimes have a greater impact on trading relations than the expectation of economic calculations. He argues that “while more costly wars make citizens want to face fewer of them, selfish leaders who decide whether or not to engage in a conflict can obtain

more by 'gambling for resurrection' if they reveal good war-handling ability" (Hess 2003: 151). In this case, economic ties make foreign trade raise the probability of conflict. As such, Realists argue that while the anticipated benefits from trade affect a rational leader's foreign policy to not choose the cessation of trade or engage in military actions which would lead to welfare losses, the acquisition of resources through conflict remains a viable and, at times, more desirable option than trade (Lieberman 1996). Thus, Realists emphasise that it is impossible to conclude whether the opportunity costs of lost trade will lead to peace, unless considering additional information about each side's expectations regarding the economic benefits or costs from trade as well as domestic leaders' willingness to take risks.

2.3.3 Interdependence has an insignificant effect on conflict

Whereas liberals and Marxists both hold that trade influences conflict, a wide variety of studies conclude that economic relations have no systematic bearing on political conflict (Ripsman and Blanchard 1996). Realist theorists of international relations argue that trade is irrelevant to relations between states (Buzan 1984; Gilpin 1987). They have traditionally considered economic concern as the domain of 'low politics' and deem economic interactions to rarely determine the nature of security affairs in the realm of 'high politics'. Realist literature often points to the fact that economic ties between the major powers were significant prior to the First World War but far less extensive prior to the Second World War as far as evidence that economic links have little systematic impact on armed conflict when core national interests are primarily concerned (Mansfield and Pollins 2001). According to the Realist logic, states struggle to exist within an anarchic system, thus their primary concern is state survival (Waltz 1979). Survival, Realists argue, necessitates that states must naturally seek economic interests in order to balance military power. Thus economic interdependence was not a significant cause of peace, but a result of the strategic nature of the bipolar system that existed after 1945 (Goenner 2004). In terms of this argument, other scholars state that the association between economic interdependence and peace may be the result of other factors that simultaneously affect both variables. Gowa and Mansfield (1993) take this view, arguing that observed relations between trade and conflict do not imply a causal relationship but are the result of common interests. For instance, states with common interests tend to trade with each other, and their common interests generate fewer issues to contest (Morrow *et al.* 1998). Hence, common interests, which are

important in a bipolar system, lead to increased trade and reduced levels of conflict. A related argument suggests that alliance may be a decisive factor on the association between trade and peace. It contends that there is more trade between allies than between adversaries (Gowa 1994), and allies are less likely to go to war with each other (Ray 1990). Consistent with such arguments, Copeland (1996) explains that the intervening variable to lead to political peace is not the level or extent of interdependence, but the states' expectations about future trade prospects. He argues that while two states trade is substantial, if states expect trade to decline, and if they expect to lose access to vital goods in the process, states may resort to military force to acquire those goods. Thus, high levels of interdependence can lead to either peace or war, depending on whether future expectations are optimistic or pessimistic. Similarly, Gasiorowski (1986) challenges both schools of thought, claiming that economic interdependence has both positive and negative relationships with trade flows and interstate conflict. In this sense, the pacifying effect from trade depends on the existing different forms of trading relationship.

For more than a century, and particularly during the past three decades, the study of the relationship between economic interdependence and international conflict constitutes one of the most vibrant debates in the international relations field. Liberals in general argue that heightened interdependence fosters cooperative political relations and lowers the likelihood of war, but Realists, on the contrary, maintain that economic interdependence is more likely to lead to interstate conflict. Even more widespread is the argument that economic exchange has no strong bearing on the 'high politics' of national security. This prolonged debate between Liberals and Realists shows that the idea that economic ties deterring war remains controversial. One of the most noteworthy facts, however, is that positive or sceptical views on the political consequences of trade not only challenge IR theorists between liberals and Realists, but also motivate central political authorities to use economic relations and instruments in pursuit of foreign policy objectives. This is because, as Keohane and Nye (1977) have indicated, economic interdependence has aspects of 'potential power resources' in the sense that it is associated with a positive or negative influence on each state of their economic links. It means that as the nature of 'unevenly balanced mutual dependence' among countries or among actors entails significant costly effects, 'asymmetries' in their economic and strategic relationship with each other begin to be understood as a source of power or means of exercising influence (Nye 1990).

2.4 Negative economic statecraft in foreign policy

2.4.1 Economic sanctions as a coercive instrument of statecraft

In the context of foreign policy, economic sanctions are a coercive instrument to secure political objectives by pressing the target economically. Economic sanctions can be used entirely to punish the target states' undesirable behaviour or to destabilise the regime itself, but they are generally designed to compel the target to make changes to its policies. To achieve these ends, the application of economic sanctions involves arms embargoes, a reduction in financial aid or loans, restrictions on foreign trade or investment, the seizure of assets or the manipulation of tariff rates. These actions can be imposed by a single state, a group of states, or an international institution. While there is no unanimity on the definition of economic sanctions among contemporary observers, economic sanctions refer to a coercive foreign policy tool in which a nation-state or coalition of nation-states disrupts its normal economic relations with another state in order to force the targeted country to change its behaviour or policies (Galtung 1966; Nincic and Wallensteen 1983; Hufbauer *et al.* 1990; Blanchard and Ripsman 1999; Drezner 1999).

In terms of the type of sanctions, scholars generally describe two categories of economic sanctions. The first category is that of 'comprehensive' or 'general trade sanctions'. In this case, sanctions are designed to impose economic costs of a target state by using embargoes or general import and export restrictions. The logic behind comprehensive sanctions is that as the costs imposed on the economy of the target state increase, so will the likelihood of success (Drezner 2003b). However, scholars and policymakers have recognised that the use of general trade sanctions has failed to coerce the targeted states (elites) into compliance, rather than creating economic difficulties, humanitarian costs, and political violence among ordinary citizens (Weiss *et al.* 1997; Drezner 2003b; Tostensen and Bull 2002; Peksen 2009). These adverse effects of general sanctions lead to designing the second type of economic sanctions, namely 'targeted sanctions' or the so-called 'smart sanctions' (Weiss 1999; Cortright and Lopez 2002; Tostensen and Bull 2002; Drezner 2003b). Smart sanctions are designed to maximise the target regime's costs of noncompliance while minimising the general suffering of the mass public that comprehensive sanctions often create (Drezner 2003b, 2011). They focus on restricting on specific products or financial flows, for instance an arms embargo or the freezing of bank assets, and attempt to target certain groups or

individuals by imposing asset freezes or travel bans (Kaplan 2007).

The utilisation of economic sanctions as a tool of coercive instrument dates back to the aftermath of the First World War, when U.S. President Woodrow Wilson suggested the adoption of sanctions in the League of Nations in 1919 (Drezner 1999; Frank 2006). By describing sanctions as an “economic, peaceful, silent, deadly remedy”, he believed that sanctions would be an alternative method to make the world free of war (Hufbauer *et al.* 1990: 9; Gordon 1999a). Until the early 1990s, the UN Security Council imposed only two sanctions toward Rhodesia in 1966 and South Africa in 1977. However, fourteen sanctions were enacted between 1990 and 2000. As the Cold War progressed, economic sanctions were especially popular in the United States. They enacted a series of sanctions against 35 countries between 1993 and 1996 (Haass 1997). Over the last two decades, the application of rising pressure, often starting with economic sanctions, against ‘rogue’ states has come to typify the recent American approach to coercive diplomacy.

Despite its prominence in many states’ foreign policy, conventional wisdom that the imposition of economic punishment helps the senders to meet their political demands has prompted a number of scholars to review its assumptions and empirical evidence. David Baldwin (1985) argued that the economic instrument was considerably more useful than scholars generally acknowledged, but the assessment of success or failures could only be made convincingly by comparing the costs and benefits of economic statecraft with an alternative course of action. The empirical analyses conducted by Gary Clyde Hufbauer, Jeffrey Schott, and Kimberly Ann Elliott (1990; henceforth HSE) addressed a similar conclusion. They reviewed the full array of economic sanctions cases from 1914 to 1990, and found that economic sanctions were successful in 40 of 115 cases, a rate of approximately 34 percent. HSE suggest that although it is not true that sanctions never work, they have limited utility in achieving foreign policy goals that depend on compelling the target country to take actions (Hufbauer *et al.* 1990). Although the data of HSE was used as empirical evidence to support the usefulness of sanctions, other analysts maintained their views that sanctions, in most cases, did not work. After examining HSE’s 40 cases in which economic sanctions were claimed to have been successful, Robert Pape (1998) contended that only 5 of 115 cases could be considered as a success. In this vein, he concluded that since it was extremely difficult for economic sanctions to generate concessions, policymakers should not employ them to achieve major foreign policy goals (Pape 1997, 1998). According to Bossuyt (2000), economic sanctions were

successful at a mere five percent rate, and there was only a two percent success rate for sanctions against authoritarian regimes. Other scholars claimed that the ultimate success of sanctions depend on whether they were employed in conjunction with other techniques of statecraft (Pape 1997; Drezner 1999; Ripsman 2006). Namely, what appeared to be a sanctions success was usually the consequences of an implicit or explicit military threat or political pressure.

This pessimism was not rare among policymakers and pundits. Richard Nixon stated that "Some people think of economic leverage as the punitive use of economic sanctions, with highly publicized conditions set for their removal. This is highly ineffective, and sometimes counterproductive" (Daoudi and Dajani 1983: 47). In a similar vein, Jimmy Carter, in his 2002 Nobel lecture, argued that states must "strive to correct the injustice of economic sanctions that seek to penalize abusive leaders but all too often inflict punishment on those who are already suffering from the abuse" (Drezner 2003b: 107). Richard Haass (1997: 75) had even argued that, "with few exceptions, the growing use of economic sanctions to promote foreign political objectives is deplorable". The UN Secretary General, Kofi Annan (2000: 50) commented that "When robust and comprehensive economic sanctions are directed against authoritarian regimes, it is usually the people who suffer, not the political elites." With regard to the effect of economic sanctions on Iran's nuclear programme, International Atomic Energy Agency (IAEA) director-general Yukiya Amano stated that "We are verifying the activities at the nuclear sites in Iran and we do not see any effect" (*Washington Post* 2012). South Korea's former Minister of Unification, Lee Jong-seok (2011) asserted that "North Korea's pursuit of nuclear weapons was connected to a strategy of regime survival, being a matter of life or death. If the use of economic sanctions was aimed at eliminating North Korea's nuclear programme, the sanctions approach would be highly unlikely to attain the policy goals."⁵ These arguments indicate that the prevailing view on the effectiveness of economic sanctions is not positive in both academic and policy circles.

The two issues are related to this negative evaluation of the effectiveness of economic sanctions. The first point often emphasised by sanctions scholars is about the logic of sanctions in underlining that the more economic pain yields better political results. From this point of view, the sender of sanctions deliberately inflicts damage on the population, expecting that their pain will translate into resistance against their leaders or regimes, who are the actual target of sanctions. This logic of sanctions is

⁵ Interview with Lee Jong-seok in Seoul, 20 June 2011.

based upon a premise that economic pressure on civilians will translate into pressure on the government for change (Frank 2006). Many contemporary observers argue, however, that this typical logic is too naïve, and there is no predictable relationship between economic pain and political influence (Kaempfer and Lowenberg 1992; Kirshner 1997). They submit that external pressure often strengthens the links between the incumbent regime and its population by offering a convenient target for anger about the punishment received. Through the case study of Rhodesia, Galtung (1967) noted that a target state can use economic pain created by sanctions to cause an *esprit de corps* among the citizenry. In this vein, he points out that, in many cases, economic pain does not necessarily translate into political gain, because sanctions may create a 'rally around the flag' effect. As the cases of Castro's Cuba and Saddam Hussein's Iraq demonstrate, leaders can often mobilise domestic political support for their regimes by pointing to the existence of an external threat (Mastanduno 2000). In this regard, economic hardship from sanctions does not produce the desired results, but rather reinforces the adversary regime's hostility. On this point, Kirshner (1997) argues that the key to an effective translation is not the extent of economic pressure, but the existence of favourable political conditions. Blanchard and Ripsman (1999) similarly suggest that a necessary condition to successfully enacting economic sanctions is not focusing on the economic costs to the target, but on the international and domestic political costs of compliance and non-compliance.

Secondly, scholars point out the counterproductive destruction caused by economic sanctions. Throughout the 1990s, many studies have reflected on sanctions cases in Iran and Iraq, arguing that comprehensive trade, financial and investment sanctions could harm the civilian population more than the regimes of the target (Weiss 1999; Cortright and Lopez 2002). Gordon (1999a) calls this 'inverted discrimination', because the general sanctions do not hurt those who allegedly deserve punishment, but rather they hurt those who are innocent. Since the authoritarian regimes tend to allocate scarce resources to influential groups such as military or the pro-regime sector, the damage of sanctions to disadvantaged groups is likely to in fact worsen. In many cases, economic sanctions not only cause humanitarian concerns for vulnerable groups, but also create a heavy burden on average civilians (Weiss *et al.* 1997; Cortright and Lopez 1995, 2000b). Peksen and Drury (2009) recognise this problem, and argue that economic sanctions deteriorate the poverty level, unemployment, inflation and the public health condition in a targeted state. As severe economic sanctions harm the livelihood of the domestic middle class, the sanctions

create more frustration and resentment in the sanctioned states. Furthermore, the literature states that economic coercion often incites the regime to rely on illicit transactions to make up its current account deficits (Cortright and Lopez 2000; Dorussen and Mo 2001; Shagabutdinova and Berejikian 2007). Under these circumstances, political elites attempt to reduce the cost of sanctions by generating revenues and securing supplies through illegal smuggling and other underground transnational economic channels (Andreas 2005; Pecksen 2009). For instance, in the case of North Korea, Haggard and Noland (2008) have noted that economic sanctions did not cause any major damage to the regime's stability. Instead, they boosted illegal economic activities such as weapon trade, counterfeiting and drug trafficking. In such circumstances, economic sanctions are hardly likely to achieve their policy goals, since the targeted elites will most likely remain unharmed by coercion.

In sum, the use of economic sanctions as an instrument of foreign policy had become particularly widespread as they were considered as a middle ground between diplomacy and military action. However, the negative assessment on sanctions has hardened during the past two decades. It shows that the effectiveness of economic sanctions has been highly controversial among policymakers and scholars.

2.4.2 Political motives and intentions to coerce

As discussed above, if economic sanctions are very unlikely to work the way they are intended to change the target state's behaviour and may even be counterproductive, the question is then, why do states so prominently employ negative economic statecraft in spite of its poor results as a means of foreign policy? Three main reasons for this can be discussed.

First, sanctions can be imposed with the symbolic purpose of satisfying a domestic audience, and this action brings political advantages to policymakers (Nincic and Wallenstein 1983; Haass 1997). When states seek to employ negative economic statecraft, the sanctioning states' leaders anticipate domestic political gains, even though sanctions are unlikely to be effective. From the sender's point of view, the act of imposing sanctions can convey an image of an 'active actor' to domestic populations. If sanctions are enacted, in the name of punishment, against recalcitrant regimes to deal with their objectionable behaviour such as extreme human rights abuses or threat of weapons of mass destruction, policymakers in the sanctioning states can display their 'tough' image to the public or parliament as a leader who confronts adversaries. This

course of actions that punish perceived 'badness' with punitive measures provides moral justification on the leaders' behaviour as a way of casting 'do the right thing'. Regarding this point, Galtung (1967: 412) explained:

“if economic sanctions do not make a receiving nation comply, they may nevertheless serve functions that are useful in the eyes of the sending nation(s)... When military action is impossible for one reason or another, and when doing nothing is seen as tantamount to complicity, then something has to be done to express morality, something that at least serves as a clear signal to everyone that what the receiving nation has done is disapproved of. If the sanctions do not serve instrumental purposes, they can at least have expressive functions.”

While the empirical study on how the symbolic value of sanctions can provide political incentives with the sanctioning states' policymakers is scant, some scholars have investigated the link between the symbolic purpose of sanctions and domestic political gains. For instance, Whang (2011) reviewed the effect of sanctions imposition on U.S. presidential approval ratings from 1948 to 1999, arguing that U.S. presidents reliably derived benefit from sanctions and the act of imposing sanctions served to increase public support for policymakers. In a similar vein, Davies (2007), by examining that the American presidents were willing to coerce North Korea when they were relatively unpopular at home, argued that coercive diplomacy could be employed by democratic leaders for their domestic political and economic interests. Nincic (2011) contended that the propensity for punitive foreign policy strategies has to do with the ethically rooted notion of powerful political players for punishments, which viewed harsh treatment toward a hostile state as morally just and proper. In this vein, Nincic (2011) claimed that the opposite party or presidential candidates in the U.S. have often sought political gains as they positioned themselves on the tougher and more assertive side of foreign policy choices than the ruling political leadership. These findings imply that the leadership's motives and intentions to support and justify punitive measures including military threat and economic sanctions are often related to domestic political consideration.

Second, the utility of sanctions can be a prerequisite measure for the sender to legitimise the eventual use of military power. In this case, economic sanctions can be

imposed even though they do not seem to work, and policymakers often use economic sanctions in conjunction with other coercive strategies such as military threat or force. As most of the literature point out, the underlying aim of sanctions is to change the target state's policies and behaviour by inflicting pain on the economy of the target state (Nincic and Wallenstein 1983; Hufbauer *et al.* 1990; Blanchard and Ripsman 1999; Drezner 1999). Namely, in most cases, the practice of imposing costs through economic pressure is not aimed at eradicating the target states, but rather causes them to adjust (Schelling 1966: 3). However, if economic sanctions fail to force a change in the target state, policymakers have a reason to opt for further tough means of coercion, even though these decisions such as the use of limited or full-scale military force may incur huge costs and damage for both the target and sanctioning states. In fact, the measurement of costs and benefits of the means available to policymakers is not straightforward. Not all failures of sanctions lead to acceptance of the potential risk of using force to punish a target state. Nevertheless, given the failure of the previous sanctions' plan, policymakers and Congress faced with crises of war and deadly conflict are willing to take aggressive military action toward a targeted state, if they consider it as the most appropriate means. On this point, Baldwin (1985) has argued that among the three tools of statecraft including diplomacy, economic sanctions and military force, economic sanctions are the second most commonly used of the three options available to a decision maker wanting to take some coercive action. In this light, if diplomacy and economic sanctions turn out to be inadequate in terms of bringing about the desired policy change, and if the unsolved conflict escalates to a crisis level, military force will be considered as substitutable means of exercising coercive diplomacy (Snyder and Deising 1977; Leng 1993).

Drury takes the U.S. sanctions imposed on Iraq as an example to address this logic. "When Iraq invaded Kuwait, the first reaction of the international community was to demand the withdrawal of Iraqi troops. On the heels of this demand was a set of comprehensive economic sanctions. When Iraq refused to comply, tensions mounted, and Operation Desert Storm was initiated" (Drury 2001: 487). In a similar vein, Mastanduno (2008: 179) reviews the U.S. sanctions toward Iraq during 1990, arguing that "Even though the sanctions did not work by themselves, they played a vital role in enabling US officials to build a credible coalition for the eventual use of military force". These cases indicate that economic sanctions - if tried and unsuccessful - can build support for the threat or actual use of military force among countries. Thus, its verdict on ineffectiveness of sanctions is a necessary condition for decision makers to rely on

military might as a tool of foreign policy.

Third, the use of economic sanctions can be an alternative option for policymakers in conditions where military measures are either unavailable or too risky (Hoffmann 1976; Baldwin 1999). When states want to coerce other states, it is reasonable for policymakers to consider the political and economic costs of foreign policy strategies. Between the two most widely used means of negative pressure against the target state, military force and economic coercion, the latter is more likely to become an alternative course of action to the sender, if they judge that military action will not yield the desired success. One further basic analysis was presented by David Baldwin (1985), who argued that when policymakers consider how best to deal with adversaries with tools of statecraft, the cost-benefit assessment plays an important role in deciding a course of action. There is consensus in the field that sanctions are much less costly than military operation, and military threat and the use of force are much more difficult to employ than other tools of statecraft. According to this line of reasoning, although the use of military threat or force is more recommendable than economic sanctions, if the probability of effectiveness is low and the relative cost is high, the utility of economic sanctions will be better than other coercive options. Unless the imposition of sanctions causes substantial economic damage to its own people, it is unlikely to be difficult for the sender states' leaders to receive congressional support for employing sanctions. When the sanctioning states' leaders and Congress exclude the option of military force due to its immeasurable costs and risks, economic sanctions will emerge as an alternative means to achieve their desired policy outcome. Indeed, in some circumstances, even if the probability of attaining their direct policy goal is not sufficiently high, after taking careful consideration of the policy's real benefits and costs, policymakers tend to choose sanctions as a tool of intervention.

North Korea's case illustrated this line of reasoning. North Korea threatened to withdraw from the Nuclear Non-proliferation Treaty (NPT) in 1993, and the tension between the US and the DPRK has heightened when North Korea had started removing fuel rods from the 5 MWe reactor at Yongbyon in May 1994. When the crisis was dangerously escalated by unloading the nuclear reactor, the U.S. seriously discussed increasing U.S. forces and a possible strike on North Korea's nuclear facilities in June 1994 (Sigal 2006; Bluth 2011). Yet, after reviewing the estimated casualties of war on the Korean Peninsula, the Clinton administration abandoned the military option even though they confirmed that the U.S and South Korea would win a war.

These strategic considerations led the U.S. to call for sanctions on North Korea. After that, sanctions did not deter the regime from testing missiles and nuclear devices. This case shows that when resorting to force is undesirable or unfeasible, the utility of sanctions can be considered as the second best tool.

2.4.3 Limitations of economic sanctions

Despite the strategic dimensions of economic sanctions as a tool of statecraft, the remaining question is why is it difficult to achieve their policy objectives using economic sanctions. Three points deserve emphasis concerning the limitations of economic sanctions.

First, economic sanctions often fail to set the optimal objectives satisfying both what the sender states ideally want to achieve and, at the same time, what they actually achieve. The general argument among sanctions scholars is that states will improve chances for success of economic sanctions when the sender's policy goals are relatively modest in nature (Hufbauer *et al.* 1990; Dashti-Gibson *et al.* 1997; Haas 1998; O'Sullivan 2010). In other words, the implementation of sanctions is unlikely to achieve desired results if their objectives are overly ambitious or unrealistic. Jentleson (2006) has touched on this issue with the concept of 'proportionality' which refers to the relationship between the scope and nature of the objectives being pursued and the leverage being applied in their pursuit. He argued that "the main proportionality problem that arises for current policy is the extraordinary stakes associated with the call for regime change in the target state rather than merely policy change" (Jentleson 2006: 3). Feaver and Lorber (2010: 14) similarly commented that "If the goal sought is prized too highly by the target to be surrendered for the amount of pain the coercer is willing or able to inflict, then the coercion attempt will fail".

The dilemma is largely attributed to the fact that economic sanctions often have multiple objectives in practice, and the motives and intentions of the sender are perceived differently by the target's leadership (Baldwin 1985). With regard to the former, Kirshner (1997: 34) remarks,

"The full range of goals refers to the fact that a state may initiate sanctions not simply to compel action on the part of the target, but to communicate its preferences, support allies, deter others from engaging in similar activity, and dissuade the target from expanding its objectionable activity. Sanctions may

also be designed to punish, weaken, distract, or contain the adversary.”

Even though a sender state uses economic sanctions to coerce a target state into a modest policy concession, the target leadership may perceive foreign pressure as a threat to sovereignty, particularly to regime survival (Morgan 1995; Morgan and Schwebach 1997). For countries who have been the target of sanctions, such as Iran and Iraq, their development of unconventional weapons was considered as essential asset to their survival. In this vein, in the perception of the target, to concede the sender’s demands are tantamount to regime change particularly when the sanctioner demands domestic reform or compels the target to abandon its nuclear programme (Peksen and Drury 2010; Frank 2006). The North Korean case illustrates this problem at least to some extent. Since North Korea’s vital interest is regime survival based on the possession of nuclear weapons, regardless of the degree of punishment imposed by the international community, North Korea is not likely to give up its valuable and only deterrent asset.

If economic sanctions are designed to punish abusive states whose behaviour involves ill-treatment of its own people, pursuit of weapons of mass destruction or support for international terrorism, the sender’s goals to apply greater pressure are more likely to be legitimised by domestic constituencies or the international community. However, even in such cases, this problem can affect both the sanctioning and sanctioned state. For the sender, although the infliction of pain without resorting to military action is more likely to meet with the approval of both Congress and the administration in view of it being a relatively low cost means of dealing with these pressing issues, it is extremely difficult to find an appropriate and viable level of coercion while achieving its goals. From the target’s point of view, since the sender state is more likely to require larger concessions that are deeply involved in the target’s vital interest, they will be more reluctant to concede to the sender’s demands.

In fact, the sender states impose economic sanctions in order to degrade targets’ economic or military capabilities by restricting their access to vital natural resource and imposing a comprehensive trade embargo to prevent the target from earning hard currency or trading strategic materials on the market. In an extreme case, economic coercion occurs when the sender states attempt to destabilise the target regime or to bring about regime change, thereby undermining the very existence of the regime itself. In this vein, even though the sender state is advised not to set ambitious goals or major changes in the target’s foreign policy, in many situations, the real goals of the

policymaker are hidden, and the aim of imposing economic sanctions incorporates a broader variety of objectives that cannot easily elicit acquiescence from the target.

Second, criticism levelled against the effectiveness of sanctions focuses on the causal link between economic pressure and policy change. As noted earlier, the application of economic sanctions rests on the assumption that if the imposition of economic pain is increased, the targeted public who is suffering from the economic hardship may pressure their government to change its behaviour (Barber 1979). On this straightforward logic of conventional economic sanctions, many contemporary scholars argue that considerable economic pain does not necessarily translate into a desire for political change. In fact, the empirical records of the use of economic sanctions do not support the causal link.

U.S. sanctions against Cuba are a typical example. In spite of the ongoing U.S. sanctions spanning over four decades against Cuba, the Castro regime's position appears not to have been affected so far. The case of the U.S. sanctions against Iran has also shown the logical failure of the relationship between economic pain and policy change. The US sanctions have been in place since 1979, re-imposed in 1987, and they were further tightened in 1995 by the Iran and Libya Sanctions Acts to condemn Tehran's involvement in international terrorist activities (Mastanduno 2008). Nevertheless, a series of economically coercive measures has not, to date, achieved their desired policy outcomes by compelling an Iran decision to accept a compromise that would limit its nuclear development (Katzman 2011). The North Korean case is no exception. David Asher (2013: 3) who took a leading role in designing financial sanctions toward North Korea in 2005 stated that "Although heavy sanctions are in place, they are obviously not sufficient. They are neither deterring the regime, nor interfering effectively in its WMD programs."

From a technical standpoint, there is another reason why this conventional logic, which assumes that greater deprivation brings probable change, may be wrong. The target states, in many cases, can find alternative options to make up their leeway, although sanctions cause considerable economic loss. During the 1990s, Iraq managed to smuggle goods through Jordan and to engage in illicit behaviour to move its oil onto the world market (Mastanduno 2008). Despite being hit with progressively tougher sanctions between 2006 and 2009 (UN Security Council Resolution 1718 of 2006 and UN Security Council Resolution 1874 of 2009), North Korea's trade has grown steadily owing to its trade with China and South Korea during this period. According to

Haggard and Noland (2008), North Korea has been replacing the trade deficit with arms sales and illicit sources including drug trafficking and counterfeiting to reduce the financing gap. As such, politically created scarcity resulted from the imposition of sanctions drives the target states to find new partners or alternative third-party suppliers who are encouraged to supply the target state (Long 1996). These examples indicate that the imposition of economic pain does not guarantee the desired political change.

Third, the imposition of economic sanctions may provide the target regime with endogenous incentives to strengthen their commitment to the misbehaviour rather than altering its policies as a result of sanctions. Scholars pointed out that the imposition of economic sanctions enables a targeted regime to strengthen its power by controlling domestic resources and increasing its ability to limit the activities of opposition power (Mahoney-Norris 2000; Cortright and Lopez 2000; Brooks 2002). It is a well-known fact that the added economic hardship under sanctions can directly affect average citizens as a result of the sanctions' undesirable human costs such as growing poverty, unemployment and the gap in income distribution. However, these circumstances paradoxically lead to the opening up a new opportunity for the ruling elites to make a profit throughout the duration of economic sanctions. From the target's point of view, the ability of securing and controlling domestic resources is crucial for the target's leadership, because the distribution of economic resources is a key means for the regime elites to manage their core supporters to help maintain the status quo (Mahoney-Norris 2000).

The targeted leadership is likely to profit in two ways. First, they can clamp down on the domestic economic groups who hold monopoly positions in the provision of scarce products. Shagabutdinova and Berejikian (2007) claimed that under certain circumstances, the ruling elites are directly involved in exploiting internal resources and securing substitute goods by way to circumventing the restriction via the black or grey market. Second, they indirectly have a back-scratching alliance with the domestic producers and smugglers who can make large profits due to the increase of prices on importable goods through illegal and immoral behaviours. Since the domestic groups may realise their improved positions, they will be more willing to sustain various privileges by supporting their ruling government.

Such processes can be understood as rent seeking (Buchanan 1980: 4). Sanctions unintentionally generate economic benefits for specific groups within society, and

these rent seekers need political allies to maintain their profitable situation, thus the target regime grants economic rents and secured access to scarce resources in return for the group's loyalty. Regarding a process of rent seeking, Dorussen and Mo (2001: 407) argue that "sanctions provide government with a currency to buy political support. The rents from sanctions either present direct economic benefits for the government or allow it to increase political control-that is, political benefits". Similarly, Allen (2008: 9) claims that, "in autocratic states, leaders may actually benefit from sanctions, as domestic publics are unable to impose political costs and the economic constraints of sanctions often allow leaders to extract greater rents while overseeing the trade of scarce goods." On this point, Gibbons (1999) examined the counterproductive effect of the U.S.-led sanctions against Haiti (1991-1994), arguing that economic sanctions made it possible for the Haitian army to control the black market, the route of the embargoed goods and fuel. The huge economic profits not only created a strong perverse incentive to continue sanctions which increased the military's independence from patrons, but also helped the army to consolidate its power by organising the paramilitary group whose role was to repress the population (Gibbons 1999).

Other scholars argue that the targeted government's capability of controlling scarce resources can be exercised as political leverage on their rivals (Woodward 1995; Gibbons 1999, Cortright and Lopez 2000). In other words, the economic hardship caused by sanctions can be used not only as a strategic tool by the targeted regime to consolidate its authoritarian rule, but also to weaken the opposition. As a result of increased repression and decreased resources for opposition actors, it is too costly for the rivals to organise political activities towards the wealthy governing group. Several cases have shown that the imposition of sanctions brought the opposite effect. For example, Slobodan Milosevic benefited during the early and mid-1990s from the economic sanctions imposed against Yugoslavia. During the period of the sanctions in the 1990s, although the majority of Iraq's population was suffering under the economic predicament, Saddam Hussein's authoritarian Baathist regime continued to enjoy luxuries in the face of sanctions, and even less threatened by internal rivals. This sequence also happened in the 1980s when the U.S. imposed sanctions against Panama. Noriega could consolidate his power by intimidating and suppressing the opposition group despite suffering significant damage to the Panamanian economy. The bottom line is that, as economic pressure may not harm the leaders in power, but hurt poor and middle class populations, the sanctioned leaders and elites in a political system may be able to consolidate power which sanctions were intended to undermine.

2.5 Conclusion

E. H. Carr highlighted that a successful foreign policy would be possible if it was coordinated between, on the one side, poles of force and coercion and, on the other side, poles of appeasement and consent (Morgenthau 1948: 130). However, the conventional practice of statecraft was relatively more focused on the military statecraft to ensure the country's national interests and security. Since the end of the Cold War, as states became more integrated into the liberal global economy and major powers realised the importance of economic power for its national security, economic statecraft was becoming more prominent in the domain of foreign policy.

Over the last three decades, this increasing attention being paid to economic statecraft has caused vigorous debates in international relations scholars on the potential role of economic instruments as a means of statecraft. While liberals argue that economic statecraft that threatens economic costs or promises economic gains can affect political changes, Realists and other foreign policy hardliners believing the political and strategic goals of national leaders take precedence over economic ones, argue that economic statecraft is unlikely to achieve political objectives. Viewed from the other side, a heated debate among scholars of international politics on the feasibility and performance of economic statecraft reflects its increasing importance. In particular, the practice of imposing pain through economic sanctions is often justified as a means of changing the behaviour of a target state while avoiding the high costs of military intervention. However, while economic sanctions are so often imposed in the pursuit of foreign policy objectives, historical records provide no credible evidence for the effectiveness of economic sanctions, and the scholarship on sanctions express deep scepticism about their usefulness as well.

The political motivations and interests in imposing economic sanctions despite the fact that they are criticised for being ineffective still persist, but for different reasons. Sanctions tend to be employed with a symbolic purpose; the sanctioning states' leaders anticipate domestic political gains by conveying an image of a tough negotiator or 'doing something' for domestic populations. The imposition of sanctions can be justified when leaders confront certain situations for which the use of military force is either unfeasible or undesirable. In some situations, sanctions can be a prerequisite for the sender to legitimise the eventual use of military power. A state's propensity to rely on the use of economic sanctions may have to do with the moral convictions for punishing perceived 'badness' with punitive policies and the political bias on non-confrontational approaches to dealing with an adversary such as engagement or

appeasement.

Even though political reasons behind sanctions seem to be rational and the need to intervene is occasionally legitimised, the increasing evidence in sanctions literatures points out that economic sanctions are very unlikely to achieve their political goals, and may even prove counterproductive. In practice, to set the optimal goals to satisfy an economically viable and politically achievable one is not a simple work. In many cases, the nature of the sanctioner's goals tends to be deeply involved with the target states' vital interest which may make it difficult to gain the target's acquiescence. Even the modest goal designed by the sender is often interpreted as a threat to sovereignty, and they tend to evoke resistance and resentment within the target leadership and society in general as well. Criticism also stems from the causal mechanisms by which sanctions operate. Architects of sanctions stress economic pains resulting from sanctions will harm the legitimacy and capacity of the target political leadership, and thereby pressure the targeted regime to concede to the sender's demands. Nevertheless, a number of case studies have shown that economic sanctions provided opportunities for autocratic regimes to strengthen its hold on power, and their commitment to the misbehaviour including black marketeering and rent seeking behaviour. Furthermore, other studies demonstrate that economic sanctions cause unintended humanitarian consequences. Smart sanctions which are designed to hurt not the target country's mass public but key elites seem like a more precise policy tool, but they are less convincing in coercing the target leadership into making concessions. In this vein, when strong powers contemplate the ways in which to deal with a state's undesirable behaviour, they have primarily adapted economic sanctions as a tool of coercion. Nevertheless, the empirical results for more than the last two decades do not provide a reason to believe that economic sanctions may be more effective in securing policy changes than other policy tools. Therefore, the increasing doubts about their effectiveness and irreversible damage of sanctions have made policymaking communities consider the potential role of positive economic statecraft as a tool of foreign policy.

CHAPTER THREE

Analytical Framework for Positive Engagement

3.1 Introduction

The previous chapter demonstrated that in the face of a state's hostile or undesirable behaviour, policymakers have primarily focused on the utility of economic sanctions, because it was considered as an alternative punitive strategy that could minimise the general costs of military action. Yet, as noted above, the record of these policies of punishment has been disappointing and the effectiveness of economic sanctions has been highly controversial among international relations theorists. This is because the use of economic sanctions has produced unsatisfactory consequences and been unexpectedly counterproductive. Given the disappointments about the results of sanctions-dominated strategies, the rationale for revisiting foreign policies makes room for considering the use of positive incentives as a means of influencing the behaviour of the target. As economic statecraft had been far more common in international affairs for the last three decades, political scientists have been rediscovering economic incentive strategies that had often been treated as a synonym for appeasement. Policymakers also paid much attention to a non-punitive aspect of economic statecraft, investigating the potential costs and benefits of using economic incentives as a tool of foreign policy. The recent series of case studies support this view, suggesting that economic inducements can complement or substitute for the use of military force and economic sanctions. These trends imply that economic statecraft can be used as not only coercive tools, but also engagement tools. The central question is thus: to what extent can the strategies using economic incentives be understood within the context of foreign policy? This chapter will explore the underlying basis of positive economic statecraft, and then attempt to present analytical framework for understanding in what ways positive engagement can work in comparison with economic sanctions. This analytical framework of positive engagement will be the foundation of South Korea's use of economic incentives in its policy on North Korea.

3.2 Conceptualisation of positive engagement

Activities of offering economic benefits or rewards for the purpose of foreign policy are a matter of frequent occurrence in inter-state relations and global politics, but this type of behaviour is seldom defined as a coherent concept in academics and practitioners. To address these issues, this section will first review how the use of economic incentives for political purposes is understood in the scholarly literature, and then propose an improved definition. Thereafter, it will elucidate how this refined definition differentiates itself from and relates to other concepts, particularly in the context of economic statecraft.

3.2.1 Background

The strategic use of economic tools and relations to advance a nation's interests has been identified within the concept and practice of economic statecraft (Baldwin 1971, 1985). As argued previously, economic statecraft is understood as an instrument of a nation's foreign policy to influence the political relationship or the behaviour of the targeted regime by employing economic sanctions and incentives. Since the end of the Cold War, economic statecraft has received attention as a non-military tool of statecraft available to modern states for dealing with objectionable behaviour such as human rights abuses and nuclear proliferation issues. Whereas negative economic statecraft has been used as a coercive policy tool for pressure and punishments, positive economic statecraft has been employed in the context of engagement policies for inducement and persuasion. The latter indicates that economic statecraft can be applied in non-coercive ways or a cooperative fashion in the realm of foreign policy (Baldwin 1971). In academic circles, neo-liberals support this idea, arguing that increased trade and interdependence can foster cooperative political relations. In the post-Cold War era, economic incentives, in conjunction with other types of incentives, became significant means of exercising influence, and they have been used in state and government's engagement strategies to reduce military tensions and reset political relationships (Baldwin 1980, 1985; Mastanduno 2003; Mansfield and Pollins 2003; Kahler and Kastner 2006). In other words, as states were concerned about the feasibility of economic statecraft as a non-punitive measure to provide an incentive for cooperation or to influence other states' behaviour, an engagement strategy by increasing trade, exchange and interdependence has gained importance in the realm of foreign policy. This development then leads to more questions of how the term

'engagement' can be conceptualised, and why this is relates to the use of positive economic statecraft in foreign policy strategies.

3.2.2 Problematic term 'engagement'

The term 'engagement', which has become widely used over the past decade, concerns the discourse of foreign policy strategy to deal with the behaviour of recalcitrant or unsavoury states. For Haass and O'Sullivan (2000: 2), engagement is referred to as "a foreign policy strategy that depends to a significant degree on positive incentives to achieve its objectives." Resnick (2001: 559) defines engagement as "the attempt to influence the political behaviour of a target states through the comprehensive establishment and enhancement of contacts with that state across multiple issue-areas." Cortright defined the term in a slightly different way, calling it 'incentives strategies' which are "the granting of a political or economic benefit in exchange for a specified policy adjustment by the recipient nation" (Cortright 1997: 6). In contrast to coercive strategies such as the form of deterrence and compellence, Kim and Kang (2009: 5) highlighted that engagement is the idea of "positive inducements and the extension of benefits, rather than the promise of harm or the imposition of current costs" to "either produce a change in the adversary's actions or transform the target state by creating new interests in the long run". For Nincic (2010) it was described as 'positive inducements' which refer to a strategy, designed to offer a quid pro quo in exchange for concession or transform the other side's basic priorities via political reward structure. Taking these notions into account, engagement, in general, refers to a foreign policy approach when states attempt to influence or modify political behaviour of a target state through the use of diplomacy and material incentives.

It is reasonable to classify engagement as one of the foreign policy strategies such as appeasement, isolation, containment and rollback. To accurately trace the origin of the term engagement in political culture is complicated, but it was generally assumed that engagement strategies were devised by Western democracies, particularly the United States for dealing with the destabilising or undesirable behaviour of problem countries, referred to as 'rogue' states (Dueck 2006). Compared with other foreign policy approaches, the distinguishing feature of engagement is its reliance on the use of political or economic contact with an existing counterpart or adversary (Shambaugh 1996). However, this characteristic of engagement often provoked controversy due to a perceived similarity to appeasement. While both

appeasement and engagement are understood as non-military and non-punitive strategies, resting on the assumption that states can shape the behaviour of other states through rationale negotiations and inducements, engagement is different from appeasement. This is because engagement expects and requires reciprocal concessions, beyond what was delivered with the unilateral provision of rewards or benefits. On this point, Morgenthau claims that, “we speak of appeasement when a nation surrenders one of its vital interests without obtaining anything worthwhile it return” (Morgenthau 1951: 137).⁶ Treisman (2004: 345) similarly defines appeasement as “a policy of making unilateral concessions in the hope of avoiding conflict.” In line with this view, Dueck (2006: 224) contends that appeasement only refers to “those cases where one country attempts to alter or satiate the aggressive intentions of another through unilateral political, economic, and/or military concessions”. In this sense both appeasement and engagement are similar in that they can be employed “when there is no guarantee of reciprocation”, but the latter assumes that initial acts or limited conciliatory moves will eventually lead to reciprocated cooperation (Wheeler 2013: 484). Although the doubt charged at engagement as to whether it is synonymous with a form of appeasement may be resolved, the feature of engagement which relies on the extension or provision of material incentives still causes the issue of conceptualisation on what it actually means, and how it can draw a distinction between tools and goals.

Two problems should be addressed. First, the term ‘engagement’ is rather broad and loose in the sense that it includes a wide variety of means to interact with other states. In its broadest sense, the termination or lifting of sanctions is also considered as a part of incentives. Although the components of the means to influence a target state are likely to depend on the circumstances, engagement strategies often do not completely rule out the simultaneous use of economic sanctions and the threat of force (Haass and O’Sullivan 2000). Even if the concept of engagement excludes any form of coercive diplomacy, particularly economic sanctions, the nature of engagement allowing a state to choose a variety of types of incentives or rewards make it difficult to examine its role in leading to a complex outcome, and to distinguish the actual means employed from others. Given the differences in the application of various incentives to the behaviour adjustment, accounting for the logical process of how it leads to alter the behaviour of another state is likely to be difficult.

Second, the notion of engagement is rather obscure as to whether it indicates a means of economic and other types of positive incentives, or an ends which was

⁶ Quoted in Rock (2000: 11)

designed to cause certain types results in the domain of behaviours and policies. The last case is particularly problematic. If the strategy of engagement or the use of inducements is understood as ends rather than means, it is difficult to discern the motives and intentions that will lead to the adoption of this strategy in comparison with alternative options. In addition, it makes it difficult to examine the causal mechanisms by which they operate; how the engagement approach elicits concessions or cooperative response from a target state. On this point, Baldwin (1999/2000) claimed that since deciding policy instruments is a matter of choice among other techniques of statecraft, it is necessary to be defined as means rather than ends. He went on to say that “as tools of foreign policy, they are presumably available to policymakers for a variety of purposes and not restricted to particular foreign policy goals” (Baldwin 1999/2000: 82). In a similar vein, Resnick (2001: 556) argued that “because the act of policymaking consists of selecting from a variety of alternative means in the pursuit of a given end(s), it stands to reason that policy instruments are more effectively conceptualised in terms of means rather than ends.” From this perspective, he claimed that “considering engagement as a set of means would enable analysts to more fairly assess the effectiveness of engagement relative to other policies in achieving an array of ends” (Resnick 2001: 557).

3.2.3 Definition of positive engagement

For a better conceptualisation of engagement, this thesis proposes the term ‘positive engagement’. If a state strategically employs positive economic statecraft as an instrument of dealing with adversaries or a recalcitrant regime at the level of foreign policy, this strategy is here defined as ‘positive engagement’ in the broader context in which a state may operate with other types of incentives. It indicates that when positive engagement was undertaken by a strategy of the government, it was based on the use of incentives, excluding the simultaneous use of sanctions. In theory, engagement can take on a wide variety of incentives including political, economic, military and even cultural incentives to achieve its objectives (Haass and O’Sullivan 2000: 5; Resnick 2001: 559; Nincic 2011: 61). However, in practice, implementing engagement tends to heavily rely on the economic elements of incentives, primarily in the areas of trade, investment and aid to influence the target state’s policy and behaviour (Mastanduno 2003). This is because that economic incentives have been considered as not only one of the most practical tools for a sender state without causing

collateral damage to civilians, but also as a powerful inducement for a target state to access the system of political cooperation and economic development. In this vein, although engagement strategies are not always limited by an economic boundary, the use of economic incentives is given a great deal of weight in the realm of engagement policy. This is the reason for the need for a better conceptualisation of engagement activities which primarily rely on economic measures. However, it does not necessarily mean that other types of incentives or contacts are unnecessary and unimportant. Certainly, 'positive engagement' does not preclude the simultaneous use of other incentives including political measures such as diplomatic recognition and security guarantees (Haass and O'Sullivan 2000). In some cases, they can be a part of positive engagement when a sender state calibrates the desired counterconcession that requires equivalent values with a target's political concession (Cortright 1997; Chun 2003; Nincic 2011). Hence, 'positive engagement' is a rather flexible concept, in which the type of benefits or rewards can vary in specific conditions. Nevertheless, the primary means of implementing positive engagement is likely to be economic incentives. Thus, the term positive engagement is here defined in a much more specific sense to connote strategies employing positive economic statecraft as a main policy instrument. In so doing, positive engagement is distinguished from other conceptions of engagement not so much by its goals but by its means: it relies primarily, but not exclusively, on economic incentives.

Under similar circumstances, this strategy also refers to 'positive economic statecraft' in narrow terms, meaning that it purely emphasises on the use of economic incentives with the aim of influencing the political behaviour of a target state. The latter part of definition is based on the conceptualisation of Mastanduno (2008: 182), who defined 'positive economic statecraft' as "the provision or promise of economic benefits to induce changes in the behaviour of a target state." In the literature, the concept of 'positive economic statecraft' is often understood as 'economic engagement' (Mastanduno 2003). With regard to the latter term, Kahler and Kastner (2006: 524) defined it as "a policy of deliberately expanding economic ties with an adversary in order to change the behaviour of the target state and improve bilateral political relations." While there are subtle differences between the two terms, they are similar concepts in that economic incentives seem inseparable from each approach. Both concepts also define the promotion of commercial activities such as trade, investment and aid as a stimulus or encouragement to action, and the increasing of economic interdependence is the primary impetus to influence the target state's behaviour. From

this perspective, the two terms are sometimes used interchangeably in this thesis.

The theoretical underpinning of positive economic statecraft stems from the perspective of Commercial Liberalists who believe that positive economic linkage promoting the level of economic interdependence can change political behaviour of target states. Adhering to this tradition, the liberal scholars basically argued that economic incentives can not only produce specific short-term return as part of a *quid pro quo*, but also influence the long-term political behaviour of a target. Even when positive engagement is framed with this relatively narrow definition, states can choose various forms of economic incentives as a tool for influencing political behaviour to other states. The composition of the incentives can vary and the choices available to a sender state depend on the nature of the issues, the scale of objectives and the extent of external and domestic constraints. According to the studies of David Baldwin and Michael Mastanduno, the primary form of positive economic statecraft generally refers to:

Table 3.1 The tools of positive economic statecraft

Economic Incentives (Positive Sanctions) ⁷
<ul style="list-style-type: none">• Increases in foreign aid• Encouragement of trade, foreign direct or portfolio investment• Preferential trade arrangements• Support for the value of another currency• Favourable taxation• Providing export and import licenses

Source: Baldwin (1985) and Mastanduno (2008)

The bottom line is, whether it is defined as ‘positive engagement’ or ‘economic engagement’, in either case, it refers to a tool of external leverage which emphasises the centrality of positive economic statecraft to influence or induce other states.

For improved understanding of the practice of positive engagement, this thesis agrees that the term engagement needs to be defined in terms of means. The characteristic of positive engagement as a set of means is attributed to the nature of economic statecraft. As noted earlier, whether economic statecraft is implemented

⁷ David Baldwin, perhaps the leading theorist of economic statecraft, termed it with ‘positive sanction’ in his classic work, *Economic Statecraft*.

either negatively or positively, it is a means to an end rather than an end in and of itself. However, it should be emphasised that when economic statecraft was employed by governments in the pursuit of their foreign policies, it involves a particular purpose linked to their own national interests. In other words, activities pursuing positive engagement with economic instruments are driven by political and strategic purposes. Here, the act of choosing and implementing positive engagement generates a political objective to achieve as it is formed under certain domestic and international milieu and the elite's view. From the target's perspective, the condition determining the receptivity of positive economic statecraft also involves both economic and political logic. These insights illustrate that the primary drivers behind positive engagement are the strategic goals of a government or state. In the process of positive engagement in which the state operates, the policy context for decision-making, the domestic calculus of who gains and who loses from external benefits, and the causal process leading to the desired outcomes converge on political purposes and socioeconomic interests.

When academics or policymakers judge an instrument of foreign policy to be effective or ineffective, they should consider the rightfulness and usefulness of this practice based on its cost-benefits analysis. Meanwhile, they should evaluate whether or not a state or government achieves its desired policy objectives through a particular technique of statecraft. It indicates that the policy goals should be ascertained; the policymaker's choice of a strategy should be clarified; and the policy outcome of implementation should be assessed (Baldwin 2000). Thus, the issue of the effects of positive engagement is fundamentally linked to the quest for its domestic context of a state or government employing that statecraft. Its consideration should also be extended to how the target state reacts against the external influence attempts. For these analyses, it is first important to understand the casual mechanism through which positive engagement and sequential stages can lead to modification of policies or abandonment of objectionable behaviour. This is because economic statecraft, like other tools of statecraft such as military force or diplomacy, is to be chosen as a means in pursuit of a given ends. More importantly, it has its own dynamics and course in which positive economic statecraft works. These issues will be addressed in the next section.

3.3 Analytical models of positive engagement

3.3.1 Transactional model

The first type of positive engagement can be conceptualised with the transactional model. The usual purpose of providing incentives or rewards under the transactional model is to produce an intended political concession on a specific issue from a target state. It is basically assumed that economic and other types of incentives can offset the cost of policy change in a target when a sender state directly links an economic or political benefit to a target's particular action or response. The interaction between the two sides is generally based on a single exchange through negotiation and dialogue, but it may be repeated when the interaction involves a process of staged negotiation that requires a sequence of steps to be completed. Incentives offered in this model aim to produce the intended concession. Accordingly, the sender does not anticipate that the particular *quid pro quo* can alter the target state's policy preferences and priorities over the long run. However, the sender may expect that past practice will lead to broaden interactions across multiple domains through the on-going political or economic contact with an existing counterpart or adversary.

One of the key dimensions of this transactional model is that give and take practice occurs through negotiation between the sender and target countries, but it should not be maintained as a mechanical channel to confer a symbolic gesture or promise unilateral rewards. This is important in the sense that the sender can avoid domestic criticism of appeasement even if the sender state fails to secure compliance of the target state. This (failed) negotiation process provides an opportunity to discern the other party's motives and intentions and to estimate an appropriate value of benefits for the sender and the size of political concessions for the target, given that the previous bargaining does not yield results on both sides.

The transactional model of positive engagement has a conditional element in making political exchanges or agreements between the sender and target states. Since the sender offers specific rewards in exchange for specific compliance, the transaction tends to work through the conditional provision of *quid pro quos* to a target state. With regard to this conditional element of the transactional model, Mastanduno (1992) contends that positive economic statecraft can be characterised with 'tactical linkage' which involves the promise of specified economic concession in order to change specific foreign and domestic policies of the target state. In this way, positive

engagement under the transactional model tends to be conditional, and this type of strategy is also labelled as 'carrots', or 'positive specific sanctions' (Drezner 1999; Newnham 2000). Kahler and Kastner (2006) similarly have argued that economic incentive strategies can be used by the sender states with 'conditional policies' that directly link economic ties to changed behaviour in the target state.

A strategy under the transactional model requires reciprocal actions to satisfy both sides. It means that there are certain conditions when the use of incentives is more likely to achieve the desired policy outcome. To create this transactional effect, the political concession from the other party should be of equivalent value to the provision of a particular type of inducement offered by the initiating party. The logic underpinning this argument is that the different type of reciprocity can exist in a field of the trading and political relationships and in a situation where the sender and the target states act in their own interests, a tit-for-tat style strict reciprocity can play an important role to foster or maintain cooperation (Axelrod 1984). Robert Keohane (1986) refers to this type of exchange as 'specific reciprocity' when certain partners exchange items of equivalent value specified in terms of the rights and duties of particular actors. Accordingly, from the sender's perspective, the effectiveness of the transactional model depends on the scale of an adjustment in the target state's behaviour in exchange for incentives.

The concept of specific reciprocity is also significant to the target state. The use of incentives under the transaction model is likely to work if the target political leadership concedes to the sender's specific demands. In other words, a *quid pro quo* offered from the sender should outweigh the potential cost and risk of resistance that the target would bear. If a target state contemplates that the potential benefits by taking a *quid pro quo* are less than the potential costs of resistance, the granting of political or economic incentives is highly unlikely to make a receiving state comply with the sender's demands. Regarding this point, Nincic (2011: 66) argued that "the political benefits of continuing to pursue the internationally objectionable course must be considered relative to the advantage of possible *quid pro quos*; such benefits very much depend on the type of and magnitude of the concessions offered." From the target's perspective, to meet the sender's demands may appear to be the political concessions that cause domestic resistance or criticism. Thus, the appropriate value of a *quid pro quo* is a critical factor that determines cooperative moves for agreements.

3.3.2 Interdependence model

The second type of a strategy applying economic incentives to influence the behaviour of another state can be conceptualised with the interdependence model. The main purpose of the positive use of economic incentives attempts to develop a relationship of increasing interdependence that creates and distributes mutual benefits between the sender and target states. The basic expectation is that a steady stream of economic benefits from expanding economic ties may help to not only facilitate bilateral cooperation and broaden contacts in areas, but also prevent future aggression on the part of the target states and establish improved relations (Rosecrance 1986; Viner 1951; Doyle 1997; Hirschman 1977; Stein 1993; Mansfield and Pollins 2003). Since economic incentives are primarily aimed at expanding economic ties between the two states, it is often a long-term approach in that it may not be effective at immediate level, but its utility is expected to increase over the long term (Papayoanou and Kastner 2000).

The logic of underpinning this type of positive economic statecraft rests on the conflict-inhibiting effects of economic interdependence. Namely, the target state is constrained to avoid the escalation of militarised disputes due to the benefits from trade, and this desire to achieve gains from a trading relationship creates incentives for both states to maintain cooperative relations (Polachek 1980; Mansfield and Pollins 2001). According to liberal claims, economic interdependence through open international markets and heightened economic exchange leads to a reduced danger of military conflict, because the opportunity cost, specifically the fear of the loss of gains from trade, deters states from war. Subsequently, positive economic statecraft based on the conflict-reducing effects of economic interdependence is not ostensibly aimed at bringing about a prompt change in political behaviour in the target state. Rather, it expects that military conflict becomes a less appealing option, and the beneficial commercial relationship creates long-term prospects for peace and cooperation (Long 1996).

Accordingly, this mechanism tends to be more passive than the transactional model in that it does not demand a specific concession. During the period of attempted integration with a target, the sender state may expect changes in the policies or behaviour of a target state through an existing pattern of strategic interaction between two sides, but policymakers do not link economic benefits to a target's behaviour on one specific issue. Instead, they employ positive engagement in order to encourage a process of dialogue and negotiation, and create new leverage for engagement by using the interdependent relationship as a source of power (Keohane and Nye 1987; Kahler

and Kastner 2006). Even if economic incentives under the interdependence model do not produce an immediate concession or meaningful changes in behaviour of the target, economic inducement strategies, in principle, can persist over time. As a result, positive engagement can operate in a more flexible and unconditional manner. This logic is similar to 'diffuse reciprocity' in the sense that it does not require a precise equivalent. It means that the exchange between the two sides does not have to be as rigorously framed as is the case with specific reciprocity (Keohane 1986). In the case of diffuse reciprocity, states can have a time lag between when the sender proposes or provides incentives and when the target responds to these external incentives. Multilateral arrangements are also possible under diffuse reciprocity.

Within the logic of the interdependence model, the sender does not focus on rewards or incentives by themselves, but finds them useful for their potential or long-term effect on the target's policies and behaviour. By offering incentives and expanding economic ties, the sender hopes to gain some bargaining advantage in that a valued economic relationship provides enduring benefits to the target as long as the relationship is viewed as mutually beneficial. More importantly, the sender anticipates that it will be difficult for the target to impair bilateral relationship, since its objectionable behaviour leads to a reduction in gains which are a key means for consolidating the ruling power, and thus financial shortcomings damage the economy of the target state. In practice, sources of the target state's revenue are unlikely to be limited to a single state, and the extent of costs also depends on economic structure. However, as states become more economically interdependent, the potential cost resulting from dangerous and destabilising behaviour that negatively affects the nature of bilateral relations will be increased. On the contrary, if the target values the economic relationship more than the behaviour the sender wants changed, it is more likely to make policy concessions or refrain from the offending behaviour.

Although internal political uncertainty in both the sender and target states is a significant obstacle to the operation of positive engagement strategies, two scenarios can be predicted. If the target does not alter their overall behaviour, and continues with its objectionable conduct that cannot be acceptable when an incentive-based strategy operates, the sender is more likely to control economic relations by changing regulations, implementing limited incentives or halting offers of further incentives until a mutually satisfactory solution is found. On the other hand, if the target changes its behaviour within the duration of an engagement episode, the sender is more likely to attempt to induce greater changes in the target by exercising the asymmetries of

interdependence. In either case, the domestic political circumstance between the sender and target states plays an important role to determine the potential effectiveness of positive economic statecraft.

3.3.3 Transformative model

The third type of strategy adapting positive economic statecraft is the transformative model when it attempts to not only promote economic interdependence, but ultimately reconfigure the basic political interests and priorities of a target state. This idea basically assumes that the use of economic incentives and the cultivation of economic ties can not only form a desired political concession and generate less confrontational behaviour, but they can also produce political transformation and desirable changes in the target. Although it does not exclude the potential use of the conditional approach, incentives under the transformative model are mostly employed in an unconditional manner. The sender states use an incentive-based strategy with the principle of diffuse reciprocity in that it does not require immediate political concessions or precise equivalent exchange from a target state. As Cortright and Lopez (1997, 2000a) stated, relations based on unconditional rewards, in principle, can persist even though the scope of the foreign policy goal that the economic incentives are intended to achieve is limited. In the meantime, the pace of cooperative action will be accelerated if a target state reciprocates positively.

The transformative model has a lot in common with the interdependence model, in that both models are based on a long-term approach and a relatively unconditional form of assistance. They are also similar because the relations can exist even in the absence of a reciprocal response. However, compared with the interdependence model, the existence of a bilateral interdependent relationship is a necessary condition for engagement of the transformative model to be successful. Furthermore, relations require the existence of a minimum degree of trust or confidence in the bilateral relationship. A key dimension of the transformative model that distinguishes it from other models stems from the ultimate goal that the sender states intend to achieve. The policies of offering incentives and expanding economic ties deliberately aim to produce behavioural change in target states by altering their policy preferences and interests. Thus, propitious political conditions that are inclined to transform regime policies and priorities within the target are crucial for their success.

The logic underpinning this argument rests on the supposed causal

mechanisms where economic interdependence is meant to effect a transformation in the foreign policy goals of the target state (Hirschman 1945; Long 1996; Davis 1999; Mastanduno 2000). The sender expects that economic benefits caused by interdependence will not only reduce the probability of militarised disputes, but also eventually transform domestic political interests in the target states. Liberals have argued that economic interdependence by itself would bring about a systemic transformation of the target's preference and values away from military orientation to peace (Morse 1976; Rosecrance 1986). Hirschman, in his classic work of *National Power and the Structure of Foreign Trade* in 1945, observed that as one state gradually expands economic integration with its target, the resulting asymmetrical interdependence creates vested interests, and a group benefiting from bilateral economic ties within the target state (Mastanduno 2003). Other scholars point out that due to the fear of losing their economic benefits, these domestic groups are more likely to pressure the government to comply with the senders' demands and to seek to maintain economic ties (Hirschman 1945; Abdelal and Kirshner 1999; Long 1996; Mastanduno 2003). Similarly, Long (1996) has argued that incentives can create groups and constituencies within the target states who benefit economically and are motivated to see incentives continue. These groups will, in turn, influence the recipient state to adapt the desired policy adaptation sought by the sender state. More recent analysis from Solingen (1995), has suggested that the domestic composition of political coalition plays a key role in determining the responsiveness of a target state to external incentives. According to Solingen (1995, 2007), if leaders and ruling coalitions rely on 'outward-looking' bases of support, they are much more in favour of economic growth, regional cooperation, international stabilities, global access to markets and capital and technology.

In the mechanisms of the transformative model, the target's leadership and powerful domestic groups tend to gain profits from interdependence relationships. Such incentives are likely to serve the development of vested interests, and thereby create an impetus for a target regime to be rooted in outward-oriented coalitions. In situations where the target political leadership prefers 'inward-looking coalitions' that resist economic reform and trade liberalisation, the transformative model assumes that positive engagement can still be an option for the sender state. If a long-term strategy of engagement is used, the external incentives that encourage a more open and market-friendly economic growth in a target are expected to gradually consolidate the position of new interest groups who are in favour of 'outward-looking coalitions'.

The logic of positive engagement under the transformative model is based on

the assumption that economic benefits from the interdependent relationship can alter the power structure of the targeted regime to the extent that it will form a new political coalition. To achieve this end, two factors should be considered. First, the perception of the target state's leadership on external incentives is an important factor to determine the receptiveness of external incentives. If a target state adopts a positive attitude to secure external resources, they are more likely to maintain extensive economic ties with a sender state. In this case, the prospect of a transformative effect would be increased. In fact, securing economic benefits generated from commercial activities is important, because it makes it possible for the target's elites to secure material benefits or fungible resources which are a key means to reward domestic key supporters such as military, police and civil services (Peksen and Drury 2009).

Second, the creation of vested interests or a new interest group within the target state is a critical factor for positive engagement to work properly. If domestic sectors successfully enlarge their leverage to influence the leadership compared to the regime's existing traditional supporters, this group who benefits from economic interdependence attempts to make a new coalition with the regime's ruling leadership who need material resources as a means to maintain its power. If the ruling leadership adapts the interests of pro-incentives groups as alternative coalition partners even at the risk of alienating old supporters, the position of a new economic and political group can be bolstered, and these new domestic clusters are more likely to encourage the decision-maker to improve regime behaviour (Solingen 2012; Nincic 2011). Thus, the sender states who anticipate this effect are more likely to help to promote the rise of new groups by deliberately targeting its incentives at potential allies, and a new formed political coalition, to secure their interests, eventually urges their political leaders to adjust foreign policy in a more cooperative direction. On this point, Nincic (2011: 80) has argued that "The more that political leadership depends on the support of such groups, the greater their leverage over the regime and the better the prospects for desired policy transformations." According to this line of reasoning, economic benefits resulting from economic interdependence in the long-term can transform the target's policy preference and its behaviour. This effect is more likely to occur when an inducement-based strategy strengthens the position of pro-internationalists benefiting from bilateral economic ties while reducing the power of groups advocating aggressive and hostile foreign policies (Nincic 2006).

3.4 Positive economic statecraft in foreign policy

3.4.1 Critics on positive economic statecraft

Although economic statecraft literature stresses the positive effect of economic incentives on securing political concessions or improving bilateral cooperation, other theorists criticise these mechanisms of positive engagement for having real limits as to what they can achieve. The pessimistic view on the utility of positive economic statecraft has been expressed in all types of engagement approaches, and this discussion can be divided into two categories.

One group of scholars has remained sceptical of the transactional model's approach which is often referred to as 'tactical linkage' or 'conditional engagement'. This debate can be summarised with the following three points. First, theorists argue that the general efficacy of incentive methods depend on the regime type. Thus, in autocratic regimes, the sender's attempts to exert influence with economic incentives are unlikely to elicit meaningful concessions from a target state. The logic behind this assessment rests on the fact that, under autocratic regimes, the incumbent target leaders are not as responsive to the welfare of the civilian population as democratic administrations (Hufbauer *et al.* 1990; Brooks 2002; Pecksen and Drury 2010; Solingen 2012). With regard to the target's regime type, Kahler and Kastner (2006) pointed out that if the target states are dictatorships or military autocracies, authoritarian leaders are less likely to be sensitive to the political benefits of a series of economic incentives. Patchen (1988) noted that incentive strategies are more likely to work in influencing domestic politics when the target state is democratic and they allow political factions to engage in open discussion. In a similar vein, Drezner (1999) stated the successful use of conditional engagement is most likely between democracies, within the context of international regimes. Amid hostile relations, conditional engagement could be successful only after coercive threats are first used.

The effectiveness of positive economic statecraft also concerns the extent of the necessity of economic incentives offered to the target state. Even when economic sanctions are imposed on target states, autocratic regimes often manage to avoid economic pain by relying on rent seeking or black market activities. Although the sender states provide a considerable *quid pro quo* in exchange for intended policy changes, if autocrats have enough material benefits or fungible resources to gratify the regime's core group of supporters and thereby successfully consolidate power, they

have little reason to accept the sender's offer, and strategic *quid pro quos*, in turn, are unlikely to yield political concessions from the target states. This feature is more likely to be seen in autocratic regimes because the rulers in such regimes have fewer incentives to respond to the benefits or costs to the general population than their democratic counterparts.

The second challenge to the transactional model involves the measurement of equivalence in specific reciprocity. As Keohane (1986) points out, the problem for specific reciprocity is that it is difficult to determine whether an exchange between economic incentives and political concessions involves equivalent values. In fact, for a number of social and political exchanges it is difficult to apply a strict standard of reciprocity. In many cases, the judgement of the equivalence is more likely to be contingent on the perception of both the sender and target states. In the incentives literature, there is a general consensus on the fact that greater changes require larger incentives, and the magnitude of incentives is one of the key factors determining successful cooperation. However, realistically, it is difficult to calibrate appropriate amounts of offers which are deemed to be acceptable by a target and also are deemed not to be very substantial by a sender. In the case of the latter, providing considerable incentives or *quid pro quo* to adversaries are often interpreted as inappropriate rewards for 'bad' behaviour. From the viewpoint of a target state, substantial incentives have potential to be reckoned as 'poison' carrots or bribes entailing doubtful intentions. In this vein, the use of economic incentives within the transactional model present a dilemma on the management or combination of incentives that should be sufficiently valuable to cause the target's concessions and should not be interpreted as unilateral concessions.

Third, the inherent unpredictability of target states in the negotiation process often undermines the successful use of the transactional approach. As Mastanduno (2003) argues, while the sender states evaluate that their economic benefits are sufficient to accommodate certain foreign policy, in many cases, target governments do not always react as the sender states anticipate. Sorokin (1996: 676) argues that "states are more likely to accept rewards when the rewards are valuable and the demands are small." However, if the targeted state considers the initial demands from the sender to be excessive compared with economic benefits, the bargaining process will reach stalemate due to the intransigence of the target state. As Baldwin (1985) has observed, the success of an inducement strategy depends on the recipient's perceptions of the situation and subjective judgement on its effectiveness. Consequently, it is not easy for

the sender to predict the target's reactions, even though the offers on specific concessions are attractive to the targeted states.

Another group of theorists and policymakers have criticised the use of economic incentives in the context of both interdependence and transformative models. Four arguments should be emphasised with regard to the underlying logic of these incentive-based strategies. First, scholars commonly point out the causal mechanisms posited to lead from interdependence to peace. The constraining impact of the interdependence model is predicated upon the effect of the opportunity costs on political conflict. However, as indicated earlier, Realists emphasise that it is impossible to conclude whether the effect of opportunity costs associated with interdependence will decrease the probability of conflict, without considering additional factors such as each side's expectations on the economic benefits or costs from trade as well as domestic leaders' willingness to take risks (Levy 2003; Hess 2003).

More theoretical criticisms arise from Neo-realists claims over security and relative gains (Gilpin 1981; Levy 1989; Mearsheimer 1990; Barbieri 1996). According to them, states are primarily concerned about military security, physical survival and their political independence. With the sensitivity to relative gains and the uneven distribution of wealth, Realists predict that economic interdependence leads states to restrict economic cooperation (Liberman 1996). This is because one state may be more vulnerable than another state to pressure when a state being less dependent attempts to manipulate the asymmetries of interdependence (Keohane and Nye 1987). Wagner (1998) claims that, in some cases, states who obtain relatively less gain from relations may confront an objection from their domestic populations with the concern over economic deprivation. Thus, estimates of these relative gains often lead to hostilities despite the target's recognition of expected gains from relations.

Another counter argument is that the relations of asymmetric interdependence impose constraints on not only the target with the fear of the loss of gains, but also the sender with the risk of unreasonable demands. Critics argue that an interdependence strategy could fail if the target might believe the sender state to be similarly constrained, thus requiring more rewards or compensations than before (Morrow 1999; Gartzke *et al.* 2001). A related argument was offered by Mastanduno (2003) who contended that engagement strategies using unconditional incentives could raise the risk of blackmail when they particularly dealt with adversaries. From this perspective, when positive economic statecraft operates with diffuse reciprocity and unconditional

approach, the equivalent of the sender's benefits are not likely to expect, thus, a state that pays for good behaviour in one instance may encounter further demands in subsequent instances. Besides, those states who realise that severe conflict is unlikely to be provoked in spite of the lack of political change may be tempted to take a policy of brinkmanship against the initiating states to obtain further concessions.

Second, critics argued that the success of positive engagement was contingent on domestic politics. Papayoanou and Kastner (2000) contend that the effectiveness of economic inducements depends on domestic politics within the target state. In particular, they claim that democratic states can reap the benefits of long-term engagement toward a non-democratic target only if internationalists who support and gain from integration into the world economy have more power than nationalists who depend primarily on the domestic market. Thus, if nationalist forces prevail in the target countries, the external attempts at influence may not be capable of mobilising intended beneficiaries who embrace inducements. As a result, the sender's effort to catalyse a transformative process is unlikely to be successful. In such circumstances, the sender's attempt to influence a specific support group or potential reformists via incentives may provoke political antagonism and a nationalist backlash.

Scholars stress that it is difficult to alter the domestic political economy in inward-looking autocratic regimes with external incentives (Solingen 2012; Haggard and Noland 2012). Crucially, the target leadership's monopoly position that is able to manipulate access to and redistribute scarce resources subsequently makes it possible to strengthen its hold on power while weakening pro-reform opposition groups. In these circumstances, if the incumbent target leaders are satisfied with the coalitions with their key supporters, meaningful changes in policy and behaviour are much less likely to occur. This is because the regime's existing traditional supporters are more likely to prevent the possibility for mobilising dissenters or internal rivals who would prefer continuation of the cooperation. Even when an alternative group or opposition can be formed and they are willing to make new political coalitions to push economic liberalisation such as expanding trade and economic interdependence, if the created crisis resulting from the scarcity of commodities or economic isolation does not threaten the regime's survival or stability, there is no reason for the ruling leadership to rely on a new basis of political coalitions, and there are minimal incentives to adapt behaviour modification.

Third, unconditional types of incentive often cause controversy or raise a moral dilemma. This problem is more likely to arise when economic incentives are offered to

autocratic regimes. As noted earlier, since engagement of transformational strategies requires long-term commitment on the part of the sender state, it may take considerable time and effort before results are seen, and repeated disappointments may often be encountered (Copeland 1996; Mastanduno 2000). In such circumstances, the typical concern expressed among domestic political sectors is about the likelihood of moral hazards that they are providing rewards for wrongdoing.

These moral concerns may further intensify when positive engagement with the interdependence and transformative models is construed as a sign of weakness or appeasement by Congress or domestic constituencies. If unconditional types of incentives are not deemed to induce meaningful changes in target behaviour, or a sender state, meanwhile, experiences a behaviour that is considered objectionable, the use of positive economic statecraft are embroiled in additional controversy over moral hazards and the risk of blackmail. Haass and O'Sullivan (2000b: 4) point out that, "the provision of incentives to curtail offensive behaviour could encourage others to engage in similar activities in the hopes of extracting benefits." In a similar vein, Cortright (1997: 5) stated "making offers to aggressors can be interpreted as a sign of weakness or vacillation and may embolden an outlaw regime to further acts of belligerence." Thus, even assuming that the sender's incentives elicit reciprocal actions from the target, if the sender cannot convince its domestic audience that long-term incentives do not carry a moral hazard, positive engagement will struggle to persist in the initiating states. In this vein, when the policies are designed to foster cooperative political relations or influence fundamental transformation of regime policies and behaviour, the successful use of positive economic statecraft is contingent not only on appropriate domestic politics of the target states but, equally, also on a broad consensus and stable support in the sender states.

Finally, positive engagement can cause security-related consequences (Gowa 1994; Kastner 2009). At times, when incentives strategies are framed with the interdependence and transformative objectives, they can present a security challenge to both the sender and target states. This issue is far more likely to arise if positive engagement is employed toward unsavoury adversaries with a form of unconditional and diffuse reciprocity, and they are not deemed to bring about immediate changes in the target state. From the sender state's perspective, if an incentive-based strategy is designed to induce changes within an autocratic regime, the external influence attempts must consider whether economic incentives are properly targeted to empower the potential support groups who favour policy changes or commercial

openness, or unintentionally buttress the traditional political allies that refuse to reform and support political repression. In the former case, continued positive engagement will be more likely to produce fundamental changes in the target's policies and behaviour; in the latter case, the political control is more likely to be tightened, and the likelihood of unpredictable or non-cooperative behaviour will be increased. Since the benefits from trade or aid can be used to strengthen the economic and military capabilities of a potential enemy, policymakers tend to hesitate to use long-term engagement strategies (Kastner 2009). If economic incentives are directly delivered to military elites or to corrupt political leaders, engagement policies are less likely to obtain preferred outcomes, and those unintended consequences are more likely to cause security dilemmas in initiating states. In terms of this issue, Cortright (1997: 16) argues that since economic incentives can improve an adversary's military capabilities, "such an approach should not be employed when dealing with outlaw states."

The sender state's incentives strategies also pose a grave security concern to the targeted state. Although the sender's strategic purposes of offering incentives are often hidden, from the target states' standpoint, the transformative engagement can be perceived as a direct threat to the political leadership. If the exchange issues are closely linked to the realm of national security, the target states are less likely to deal with the sender even though they, indeed, benefit from existing cooperation. The vital interest of any regime is invariably to maintain and strengthen its hold on power. As Bluth (2008) points out, most leaders may not want to be transformed. For some non-democratic states, system changes mean system collapse (Bluth 2008; Lankov 2013). Therefore, they are resistant to strategies of transformative engagement despite its obvious benefits, and the sender's goal of political transformation may be very unlikely to be achieved.

3.4.2 Conditions for effective economic incentives

Although the use of economic incentives has various advantages over economic sanctions, it does not necessarily mean that the sender states can always obtain preferred outcomes through incentive-based policies. This fact indicates that there are certain conditions where positive economic statecraft can properly operate. While several factors impact on the utility of economic incentives, essentially four conditions should be met for achieving the desired policy objectives.

First, the effectiveness of incentive strategies depends on the relative

magnitude of economic interaction and the intensity of economic interdependence (Knorr 1975). The sender state's capability to offer economic incentives and maintain asymmetric interdependence is a critical factor for determining the effectiveness of incentive strategies. In the incentives literature, scholars have a broad consensus that incentives employed from a strong position of a state rather than a weak one will bring about a better result, and less dependent states are more likely to have a larger market power and a better position in bargaining than more dependent states (Cortright 1997; Mastanduno 2003; Keohane and Nye 1977). Under this rationale, since the use of economic incentives tends to foster mutual benefits between economically interdependent states, those accumulated benefits are expected to influence the target state's overall policy objectives and reduce the possibility of military conflict. Keohane and Nye (1977) submitted that, if the initiating states set up a relationship of asymmetrical interdependence, this asymmetry brings with it bargaining power over noneconomic issues. In this respect, the larger asymmetries of interdependence will create more potential power capable of changing behaviour in a target state. By the same token, if the bilateral economic interaction is limited, mutual benefits from interstate trade and cooperation will be decreased, and consequently the intensity of asymmetrical interdependence is gradually weakened. In that case, the use of economic incentive is more likely to fail because the leverage of economic incentives is not strong enough to secure the target's compliance or alter its behaviour. Hence, although the phenomenon of economic interdependence does not necessarily directly yield the desired effects, for a successful incentive strategy, the sender states should have strong economic capacity over the target, and they should be able to deepen economic interdependence in the long-term.

Second, the prospects for positive engagement success are more likely to be high if it focuses on modest policy goals, and is consistently sustained over time. The importance of modest goals is mainly debated in the literature on economic sanctions. They generally argue that the sender is more likely to improve the chance of success of economic sanctions when its foreign policy goals are relatively modest in nature (Hufbauer *et al.* 1990; Dashti-Gibson *et al.* 1997; Haass 1998). This principle is also applicable to the efficacy of economic incentives. Cortright and Lopez (2000a) point out that the implementation of incentives is unlikely to achieve desired policy goals if the states intended to achieve multiple or conflicting goals. In a similar vein, Haass and O'Sullivan (2000: 119) argue that "engagement works best when pursuing modest goals and often falters when pursuing ambitious ones." The underlying logic between

the prominence of modest goals and the receptivity to economic incentives has to do with the perception of benefits in the target states. In the realm of foreign policy, the use of economic incentives is designed to have the spillover effect on matters of 'high politics'. However, if sender states attempt to achieve their major changes in the short-term, the target states may view economic incentives as partly having an offensive dimension, rather than reciprocal exchange. In this type of situation, the expansion of economic incentives is more likely to be perceived as a disguised tool by the target's leadership to threaten its survival, so incentives are less likely to obtain policy objectives, and probably will not bring about the desired spillover effect on other noneconomic areas.

In addition, the efficacy of economic incentives concerns the durability of rewards (Hirschman 1945). Positive engagement aimed at interdependence or transformative effects is generally based on the long-term process in order to foster cooperative political relations or transform political interests in the targeted state. To achieve this end, the sender states should be capable of continually providing economic incentives over a considerable period despite a lack of immediate reciprocation or the occurrence of adverse events. Similarly, Osgood (1962) argued that, in order to achieve the assumed goals, the sender states should enact a series of incentive measures and continue these even in the absence of a reciprocal response. Along with on-going political contact with a counterpart or adversary, an extended period of bilateral commercial relations play a significant role in creating a shared understanding of rewarding structure and fostering the prospects for future cooperation. If positive engagement fails to generate mutual benefits for both states, and falls short of building mutual trust and sincerity of others, the sender is unlikely to make a credible impression on the target, and the likelihood of positive reciprocation will be consequently reduced.

Third, successful economic incentives are contingent on the domestic political situation within the target and sender states. As argued previously, if the sender states employ positive engagement within the logic of the interdependence and transformative models, the appropriate domestic politics of the target states is an important necessary condition for economic incentives to succeed. From the transformative perspective, the sender state deliberately targets incentives at a particular group i.e., economic actors and politically important groups within the targeted state, and expects those beneficiaries to be able to place pressure on their regimes to accede the sender's demands, or more radically form a new coalition with

their ruling elites. If the target's leadership forms a coalition and relies on support from pro-internationalists benefiting from bilateral economic interactions, they are more likely to push for deeper trade openness and accommodate the sender's objectives in order to consolidate their political position.

However, this logic simply presumes that an iterative process of incentive strategy always yields positive results on domestic groups in the targeted state, and internationalists who support and benefit from economic incentives always prevails over nationalists who mainly rely on a state's existing domestic market. According to Cortright and Lopez (2000a), just as sanctions can generate a 'rally around the flag' backlash, incentive strategies may spark nationalist resentment against external influence attempts to bribe the targeted state. These adverse effects of incentives can substantially impact on the prospect of changes in domestic political coalitions. In such circumstances, internationalists can neither form a coalition with their ruling elites, nor challenge the regime's existing traditional supporters. It means that nationalists' power is dominant over internationalists in the targeted states, and they will consequently oppose their regimes' behaviour modification. Regarding this argument, Papayoanou and Kastner (2000) state that the sender states can genuinely hope to change the targeted state's policy only when internationalists have more dominant power than nationalists. Conversely, a lack of internationalist forces in the targeted states will reduce the probable effectiveness of economic incentives. On this internal dynamics of domestic coalitions point, Nincic (2011: 71) similarly argued that, "when regime incumbents reckon that attracting new sources of support matters more than conciliating old ones, or when they decide that old sources can best be gratified by new methods, meaningful possibilities for external leverage appear: economic openings and diplomatic and symbolic overtures matter more to regime than before." Thus, the effectiveness of incentive strategies depends on the configuration of the target state's domestic politics: inducements should be able to strengthen the position of pro-internationalists or pro-reformers, and these pro-incentives groups should be able to emerge as an alternative coalition partner for the incumbent target's leaders competing against the regime's traditional nationalists or hardliners. The target's leaders would only change their course of action if the benefit of forming a new coalition exceeds the cost of alienating the regime's existing old supporters.

However, the domestic political situation is also a critical factor for the sender states. If incentives strategies are framed with interdependence and transformative objectives, the sender states should have the economic capability to supply economic

incentives to the target states in the long term. In these circumstances, the critical condition is that the sender's economic strength intrinsically necessitates the internationalists' support and participation in incentive based strategies. For the senders, sustaining a constant stream of economic benefits depends on whether leaders can form a strong coalition with domestic internationalists, especially in the economic sector. As Norris (2010) argues, the ability of the state to control the behaviour of the commercial actors that conduct international economic activity will determine the likelihood of success of economic statecraft. The reasoning behind this assumption is that, as the partnership between the state and commercial actors is strong, the durability of engagement efforts will last a long time, and therefore positive engagement is likely to succeed in achieving policy goals.

In a similar vein, a solid coalition with a state is also important to the domestic commercial sector. When the unconditional type of positive engagement operates constantly, domestic firms can at least make profits from engaging in economic trade and cooperation with the targeted state. If the sender's incentive-based strategies involve economic cooperation or foreign direct investment, these kinds of economic activities tend to generate sunk costs that have already been incurred and cannot be recovered (Kastner 2009). Namely, domestic economic actors also have a reason to be afraid that any kind of interstate conflicts will distort the bilateral economic flow and investment leading to a loss of profits. From this perspective, the commercial sector which engages in economic activities will likely support its ruling state's positive engagement in order to secure expected profits from economic ties with a targeted state. Therefore, the success of positive engagement within both interdependence and transformative models depends on how well the sender states form a solid coalition with the commercial sector, and how long the sender's leadership maintains this policy even under domestic pressure and criticism. If the target states are dictatorships or military autocracies, a sender state should be able to convince its domestic audience that long-term incentives do not entail a moral hazard. This is particularly critical when the sender states experience dangerous and destabilising behaviour during which they provide material incentives and fungible resources to the autocratic regimes.

Finally, the successful use of economic incentives depends on policy coordination with other states. In the literature on sanctions, there is a general consensus among most scholars that multilateral sanctions are more likely to be effective than their unilateral alternative. This is mainly because an agreement with a multilateral sanctioning coalition tends to have binding power, making it more

difficult for the target to evade sanctions by relying on other states. In the same vein, this prominence of multilateral coordination is also applicable to incentive strategies. In principle, incentives can be implemented either by a single state or a multilateral state. Each approach has its own advantages and disadvantages. If incentive strategies are pursued unilaterally, a single state has a better position in that it can independently make decisions and coherently implement incentives strategies toward a targeted state. However, a unilateral approach is less likely to achieve policy goals if the economic incentives in return for a specific concession bring about too considerable cost for one state, or if implementing incentives strategies affect other states' strategic interests such as security concerns. Besides, one state cannot prohibit another from offering equivalent benefits to its target state.

According to this line of reasoning, there are arguments that multilateral involvement is more likely to succeed in securing the sender's policy goals. Stein (2012: 50) claims that "despite the fact that not all outside powers need to offer inducements, they must nonetheless coordinate their actions. If they do not, a strategy of unilateral inducements is equivalent to a policy of sanction-busting." When it comes to multilateral engagement, Kim and Kang (2009) contend that economic incentives applied multilaterally are more likely to be successful than unilateral incentives. However, even though multilateral application has an obvious merit compared with unilateral, it does not necessarily mean that they are always successful in achieving policy objectives. If one state breaks the agreement or a target state finds alternative resources or benefits from others, the efficacy of the multilateral efforts is likely to be ineffective. It is also difficult to adjust different interests among members of states, since each state has its own cost and benefit calculations for specific negotiation toward a target state. Thus, the lack of coordination among multilateral states undermines the effectiveness of economic incentives. In other words, if the sender states can coordinate the common goals and adjust the level of incentives with other states, multilateral efforts are more likely to be effective in pressing the targeted states to comply with the sender's demands.

In sum, while economic incentives have advantages over economic sanctions, the use of positive economic statecraft as an instrument of foreign policy by no means guarantees success in all political situations. Therefore, it is pertinent to examine the conditions that determine the effectiveness of economic incentives. In order to increase the potential utility of economic incentives, firstly, the initiating state should have the relative magnitude of the economic interaction with a targeted state. Secondly, the

sender states must focus on modest policy goals, consistently sustained over time. Thirdly, economic incentives should be able to form a strong domestic coalition which supports the sender's approach. Finally, the sender must consider the policy coordination with other states. If these four conditions are met, the sender states are more likely to achieve their foreign policy goals.

3.5 Conclusion

Since the end of the Cold War, there has been a sharp increase among policymakers and academics in the use and perception of positive economic statecraft as a tool for intervention. Indeed, when major powers contemplated the policy options available for recalcitrant regimes, economic incentives were implemented to reset political relationships or dissuade those targets from pursuing nuclear weapons.

However, as the states began to use positive economic statecraft for the purpose of engaging with other states, the tools of statecraft and modes of behaviour were defined with various ways. For a better conceptualisation of the practice of engagement, this research proposes the term 'positive engagement', referring to a strategy which primarily employs positive economic statecraft as an instrument to induce changes in policy or behaviour of a target state. While positive engagement emphasises the primacy of positive economic statecraft, its character is rather flexible in that it can take other types of incentives in the course of action. This strategy is also referred to as 'positive economic statecraft' in narrow terms, when it purely emphasises on the use of economic incentives with the aim of altering the political behaviour of a target state. Whether it is defined as positive engagement or positive economic statecraft, in either case the vital point is that economic incentives can produce a specific change in the target's actions and influence the overall political behaviour of target states, even those that are hostile to the initiating state.

Positive engagement can be applied in different ways according to the nature of the issues, the target's domestic conditions, and the extent of goals that the sender wants to achieve. In the transactional model, the purpose of providing incentives is primarily to produce an intended political concession on a specific issue from a target state. If a strategy applying economic incentives towards a particular state is operated as a part of the interdependence model, the usual purpose is not limited to an exchange of a specific *quid pro quo* for a balanced concession. Rather, it is aimed at developing a relationship of increasing interdependence with the expectation that a valued

economic relationship generating mutual gains can bring about bargaining advantages and sufficiently deter the target's objectionable behaviour. Positive economic statecraft can also be framed with a transformative purpose. It basically assumes that the use of economic incentives and the cultivation of economic ties can not only yield an intended political concession and generate less confrontational behaviour from the target, but also produce transformation of regimes policies and behaviour. Under the transformative model, the strategy is expected to form potential outward-oriented political coalitions within a target state. This development of coalition gives an impetus to be more receptive to external incentives, and be in favour of more open and market-friendly policy direction. Thus, the sender hopes that its influence attempts drive the target's leadership to become more inclined to adjust its behaviour in accordance with the sender's national interests.

Despite a different causal logic underlying positive economic statecraft, all three models have one characteristic in common: positive economic statecraft is used as political means to induce changes in policy or behaviour of a target state. While there has been a difference in causal mechanisms between the interdependence and transformative models, in both models countries deploy an economic link with target states in the belief that economic power will impact on the political environment, including contentious 'high-political' issues related to national security. Considering that the practice and strategy involves a number of contacts and negotiations, creating networks and linkages through incentives, the pattern of practicing economic statecraft is regarded as a process in character. If this process and network broadens, the effect of positive engagement is more likely to occur in the target's politics and economy.

However, a number of observers have argued that positive economic statecraft is unlikely to be effective on matters of 'high politics' and opponents have responded that, it is naïve to expect that the relationship of increasing interdependence will affect the target state's domestic reconfiguration, consequently bringing about foreign policy change. Positive engagement under the transactional model is faced with difficult implementation under hostile relations, the complex measurements of equivalence with exchanging economic benefits for political concession and the possibilities of unpredictable behaviour within the target states. Moreover, positive engagement within the logic of the interdependence and transformative models has the potential to cause moral hazards and security concerns. Perhaps the greatest challenge to positive economic statecraft is that it is fundamentally restrained by domestic political conditions that determine the success or failure in both models. Thus, it is imperative

for the sender states to contemplate certain conditions that make positive economic statecraft more sufficient to cause changes. In this respect, it is better that the sender states have enough economic power to offer incentives and the capability to forge interdependence relations. The effectiveness of positive engagement especially in the transactional model is affected by the scale of objectives that should be valuable but not too substantial, satisfying both sides' willingness to make an exchange. In seeking to achieve interdependence or transformative results, sufficient time and consistent efforts should be given by the sender state while avoiding the latent possibility of moral hazard and the risk of blackmail. At the strategic level, appropriate domestic political conditions within the target states is one of the most important conditions for the success of incentives policies. It means that if the transformative strategy is to succeed, positive economic statecraft should focus on consolidating the position of pro-internationalists who stand to gain from positive engagement, and these pro-incentives groups should be able to form a domestic coalition which may support the sender's policy changes or opening of economic ties. In any case, the critical point to be noted is that sustained commitment, domestic support, and superior military and economic power of the sender are necessary preconditions for the effective implementation of incentives. Therefore, the successful application of positive economic statecraft greatly depends on whether these conditions can be met. The policymakers considering positive engagement must investigate internal and external conditions that determine the target's receptivity to the use of economic incentives.

CHAPTER FOUR

South Korea's Statecraft

in the Park Chung-hee and Chun Doo-hwan era:

Competition for Survival

4.1 Introduction

When the sender states employ economic statecraft with the aim of achieving their political objectives, it is important to have strong military and economic power for the successful operation of positive engagement strategies. It means that the initiating states should retain the capability to use economic instruments and relationship to influence the political behaviour of a target state while deterring its hostile acts. In the context of South Korean politics, there was a process in that South Korea was able to become a 'sender' of economic incentives or an 'initiator' of positive engagement towards North Korea. This chapter examines South Korea's statecraft in the Park Chung-hee and Chun Doo-hwan era. A historical review on the early period of South Korean politics is significant because it illuminates the underlying causes of the South's sense of insecurity during the course of nation-building competitions with the North and the resultant confrontational structure on the Korean peninsula. It also helps us to understand how the security-economic nexus was formed in South Korea, and why authoritarian regimes focused eagerly on economic development and military deterrence. During the 1970s and 1980s, South Korea made active efforts to build up its national strength in the realm of military, politics and economy. During the course of modernisation, the maintenance of stability while managing the North Korean communist regime was of vital interest for South Korea. From a longer perspective, it was a preparation period for South Korea to be able to adopt a strategy of engagement with North Korea in the late 1980s. Against this backdrop, this chapter first explores South Korean politics during the Park Chung-hee and Chun Doo-hwan era, especially looking at inter-Korean relations, and then presents the main features that shaped Park and Chun's beliefs, interests, and their strategies towards North Korea.

4.2 The historical outline of South Korea's relations with North Korea

After the Korean War (1950-53), the most important national agenda in South Korea was to foster economic development and cultivate sufficient defence capabilities to deter a North Korean attack. In the face of Kim Il-sung's intention to reunite and communise the whole of Korea by force, it was imperative for the South to build and strengthen their defence capabilities and security alliance. However, the goal of strong military defence basically required a highly developed industrial structure, in particular the development of the heavy and chemical industries (Kim 2005). Recognising the necessity and urgency of the industrial economy, it was natural that South Korea, under the leadership of President Park Chung-hee and Chun Doo-hwan, placed a greater priority on the goal for economic modernisation. The Park regime's earlier national vision of a 'rich nation' and 'strong army' (*bugukgangbyeong*) had signified that economic prosperity and military strength were intrinsically linked, and only a state attaining strong industrial economy would enhance national security and the latter would be a prerequisite for preserving economic and political development (Moon and Jun 2011). From this perspective, South Korea's situation faced the major challenge of the urgent task of economic reconstruction and the responsibility to maintain military deterrence against North Korean threats exercised a great influence on South Korean leaders to embody their perception and interests, shaping the South's political agenda in inter-Korean relations.

4.2.1 Inter-Korean regime competition under Park Chung-hee's rule, 1963-1971

After the end of the Second World War, a conflict between the two superpowers, the United States and the Soviet Union played a critical role in the division of Korea. The external powers engaged in the partial occupation of Korea, the decision on the trusteeship, and the establishment of separate government. In the process of Korean division, the confrontation between the two superpowers not only created external tensions, but also influenced domestic ideological struggle between the Korean right and left (Lee 2012). As the legacy of the Cold War left both divided Koreas to focus on competition in the regime's supremacy, both the South and the North had no room to consider improving political and economic relations between each other. Rather, since

each government was established in 1948, the two Koreas had been reluctant to admit the existence of another Korea, embarking on a fierce regime competition for their own survival and prosperity. In particular, the Korean War, which lasted from June 1950 to July 1953, not only brought about enormous material damage to both North and South Korea, but also caused resentment and enmity between the two Koreas. The combined external influence of the United States and the Soviet Union over each Korea's nation-building and internal ethnic antagonism between the two Koreas strengthened the division structure, and the subsequent trend of focusing on regime security under the rule of Kim Il-sung and Syngman Rhee made 'the ending of the Korean Cold War' and a process of rapprochement between the two Koreas unthinkable (Westad 2001). As the threat of invading another Korea had not completely disappeared under unsettled peace constructed by the 1953 armistice, both North and South Korea considered national security as a top priority. In the meantime, since the nation-building competition was also determined by economic power, and it was directly connected to military security, postwar reconstruction and economic development had become an important national agenda of the two Koreas.

The fundamental difference which determined the nature and direction of nation-building and modernisation was attributed to the basis of ideological competition between democracy and dictatorship, and the South's authoritarian capitalism seemed to be more efficient than the North's socialist command economy with regard to the economic performance and management in the 1960s (Armstrong 2001; Kim 2005; Brazinsky 2007). However, it did not necessarily mean that the South had already surpassed its Northern rival in the realm of economy. Between the 1950s and the early 1970s, the overall North Korean economy, which was based on an inward-oriented industrialisation with greater emphasis on heavy industry, had been growing for the period as whole (Koo and Jo 1995; Yang 2008). By the mid-1960s, it was generally believed that South Korea did not catch up with North Korea. North Korea's two successful economic plans, the Three Years Plan (1954-1956) and the first Five Year Plan (1957-1961) and mass mobilisation campaigns such as the '*Cheonrima* (Thousand-li Winged Horse) Movement' in 1958 played an important role to sustain their moderate growth (Lee 1995; Armstrong 2007). In fact, South Korean GNP per capita, by several estimates, did not exceed North Korea's until the mid-1970s (Eberstadt 2007; Yang 2008; Park 2009). According to Eberstadt (2010), during this early period through the 1960s and early 1970s, Kim Il-sung's North Korea may actually have been more urbanised than South Korea, and North Korea's level of development in heavy industry was

higher than the South's in the early 1960s. While the official figures on North Korean economy have been controversial, these facts indicated that North Korea had economic superiority over the South until at least the late 1960s.

Given the economic challenges, since Park's junta first seized power in May 1961, it had been imperative for the Park regime to build up the national economy even if his policy direction had to retard the entrenchment of democracy. With the belief that a strong economy would enhance national security and vice versa, Park had a vision to transform South Korea into an economically prosperous and militarily strong state (*bugukgangbyeong*). For instance, when Park first visited the United States in November, 1961 as a position of Chairman of the Supreme Council for National Reconstruction, he stated that, facing the Communist threat and Pyongyang's provocative behaviour, South Korea should strengthen its armed forces strength of 600,000 men, and at the same time develop its economy. It added that "these two major problems must go together" (Memorandum of Conversation 246 1961). In a meeting with President John Kennedy in November, 1961, Park pointed out that "North Korea was putting great emphasis on industrialization and South Korea was in danger of falling far behind." Thus, the most urgent task for South Korea "was to maintain his armed strength and at the same time to build up the economy" (Memorandum of Conversation 247 1961). Considering that an economic gap could be translated into a military gap, the Park government aggressively instigated economic development policies. Despite the limited resources and the lack of capital and technology, Park adopted the strategy of export promotion and import substitution. It was, in turn, carried out through two Five-Year Economic Development Plans (FYEDP) focused on export-oriented industrialisation each from 1962 to 1966 and from 1967 to 1971. As a result, Park's dogged determination to pursue economic growth proved to be effective in spurring the process of industrialisation. As Park successfully consolidated his power through his re-election in 1967, his economic development plan led to rapid economic growth in South Korea, and the gap between the two Koreas gradually narrowed.

Although Park successfully laid the groundwork for the initial stage of industrialisation through the first and second FYEDP in the 1960s, the North Korean threat had been an ever-present concern of the Park regime. During his presidency, Park believed that the danger of a North Korean attack was imminent and that threat was real. When he met with President Richard Nixon in August 1969, Park stated that "Kim Il-Song during the past 10 years or so has almost completed war preparations to unify the country by force. He is looking for an opportunity to invade the South...Kim

will provoke a war if he believes that this American policy toward the ROK is going to change or has changed" (Memorandum of Conversation 35 1969). The Park regime was concerned that South Korea's military strength was a bit behind North Korea. In a meeting with President Nixon on 1 April 1969, South Korean Prime Minister Chung Il-kwon conceded that "South Korean air force and navy are half the strength of the North Korean forces" (Memorandum of Conversation 5 1969). Park's interpretation of the North Korean threat and the negative imbalance in military power played a significant role in determining the ultimate course of South Korean politics throughout his rule.

However, despite these considerations, the Park regime was not entirely antagonistic towards North Korea. Park expressed his willingness to improve relations, and firstly proposed to the North a 'well-intentioned competition' in 1970. When he gave a speech commemorating the 25th Liberation Day on 15 August, 1970, Park (1976: 22) stated that "If the North ceases military provocations and renounces the forceful overthrow of the South Korean government, the South is ready to suggest more advanced measures to build a solid foundation for unification. Let's have peaceful competition to see which part of the Korea's regime could promote the welfare of the people". Despite this political gesture, his tough stance against North Korea had not changed. Rather, Park had taken a somewhat more aggressive or more cautious position.

During the years between 1961 and 1971 President Park made great progress in developing its economic strength, and it had resulted in Park's successful completion of two FYEDPs. Nevertheless, growing confidence in their economic performance was not enough to overcome Seoul's sense of insecurity. Although South Korea had maintained deterrence against an attack by North Korea through the joint ROK-U.S. forces, the Park regime had been concerned that the level of South Korea's military capability was not enough strong to deter North Korean aggression. To raise its anxiety even more, the declaration of Nixon's 1969 Guam Doctrine and the withdrawal of 20,000 men of American troops in 1971 caused South Korea to worry about abandonment by the Americans and any North Korean attempt on an adventurist action toward the South. Furthermore, a series of aggressive and provocative acts from the North including the guerrilla attacks on the Blue House, the capture of the USS *Pueblo*, and armed infiltration at Ulchin and Samchok in 1968 had only hardened mutual distrust and antagonism. This continued belligerent posture of North Korea not only discouraged Park's efforts to ameliorate the military tension on the Korean

peninsula, but also served to aggravate South's hostility and fear of the Korean communists. In other words, President Park's perception on North Korean threats formed by the external security factors and the recurrent acts of aggression from North Korea continually pushed Park to concentrate on the goal of building a strong economy and military while legitimising his anti-communist ideology and authoritarian rule.

During his 1971 re-election campaign, the North Korean military threat had been stressed in the name of national security. As well as emphasising the significance of his role in the South Korean economic 'miracle', he reminded the public of the continued aggressive action by the North,⁸ emphasising that "their evil scheme for unification and communization of the country by force" had not changed (Park 1976: 21). Such projections of the negative image of the North worked as an effective means of stimulating domestic concern over the danger of North Korean hostilities. The important fact was that Park's way of the discourse on the North Korean threat ironically contributed to justifying its strict social control and a preferential duty for unceasing economic development, legitimising his authoritarian rule.

4.2.2 Rise and demise of détente, 1971-1979

The situation of national security that Park faced had not changed when he commenced his third term in April, 1971. The emphasis on Pyongyang's military threat and the resultant atmosphere of tension made it more difficult to expect détente between North and South Korea (Shin 2011; Kim 2012). Against this background, an unexpected attempt to break in antagonistic North-South relations was initiated. Amid rapprochement between the United States and China in 1972, Seoul activated a new initiative to seek a relaxation of tension and increased communication with Pyongyang. The South proposed Red Cross talks to the North on 12 August 1971, and the first face-to-face negotiations since the end of the Korean War began between Seoul and Pyongyang. This dialogue which aimed to seek agreements on humanitarian issues⁹ led to a series of high-level government-to-government negotiations to discuss various political issues including an exchange of high-level secret envoys and a discussion for a summit. Although a summit meeting between Park Chung-hee and Kim Il-sung had not been agreed, the political talks finally resulted in the 'South-North Joint

⁸ It refers to major infiltration attempts by the North in 1968.

⁹ The main agenda was then the investigation and exchange visits of the separated families from North Korea and South Korea.

Communiqué' of 4 July 1972. It was the first official document to be agreed upon by both North Korea and South Korea after the division of the Korean Peninsula in 1945. The two sides agreed upon three principles for future reunification based on 'independence, peace and great national unity' and a set of tension-easing measures such as more communication, active cooperation, and the installation of a direct hotline. From Seoul's standpoint, the 1972 Joint Communiqué was a pledge to resolve the Korean conflict through dialogue and negotiations. More importantly, it meant that "the South would consent to *de facto*, if not *de jure*, recognition of the North" (Kim 1993: 251).

However, despite these reconciliation measures, the basic characteristic of Park government's North Korea policy was based on a competitive and confrontational mentality. While the Communiqué's key agenda was the peaceful reunification of the country, neither Park Chung-hee nor Kim Il-sung thought that actual reunification was viable (Ma 2003). In retrospect, both Park and Kim did not have much interest in actual reunification at that moment. Adopting unification as the central goal of policy was hardly feasible under the condition that two different political communities adhering to hostile ideologies and institutions existed between the two Koreas. Rather, it acted as a contact point for the two leaders who needed to instil nationalistic hope for domestic reasons. In fact, the actual domestic political environment within North and South Korea ran counter to the spirit of reconciliation. In December 1972, North Korea promulgated *juche* ideology (self-identity or self-reliance) as the official state ideology through the 'Socialist' Constitution. This showed that Kim Il-sung officially legitimised his rule over a submissive population by emphasising their distinctiveness and independence which were embodied in *juche* philosophy (Armstrong 2009; Sonn and Bang 2012). In the meantime, domestic politics in South Korea had nothing to do with a course of reconciliation with the North. The path that the South Korean government took during the 1970s was a step in the opposite direction. Several factors accounted for the opposite trend of reducing tensions on the Korean peninsula.

First, the Park regime exercised increasing authoritarian control over political and economic activity. While the Red Cross talks took place, Park declared an 'emergency situation' on 6 December 1971 and tightened his control over South Korea. By emphasising the continuing existence of the North Korean threat, Park's government limited the press and activities of the National Assembly and also increased military authority to suppress opposition. Furthermore, only after three months of Joint Communiqué, Park promulgated the '*yushin*' (restoration or

revitalization in Korean) Constitution on 17 October 1972 with the aim of extending his authoritarian rule (Kim 2012; Ma 2003). It is true that the stated purpose was for the process of peaceful unification, the sound development of the democratic institution and the maintenance of the social order (Park 1976). But, with the declaration of martial law, the ROK National Assembly was dismissed, all political activities were suspended, the nation's universities were shut down, and prior censorship was imposed on all media. More tightened controls on the population and especially opposition groups - the press, students, academic leaders, and the opposition party - were placed through the Army and the Korea Central Intelligence Agency (KCIA). Against the opposition party's criticism, Park amended the Constitution through a referendum held on 21 November. The promulgation of the *yushin* demonstrated that Park who already had three four-year terms in 1963, 1967, and 1971, had a way to perpetuate his hold on power (Im 2011). By describing that the past presidential elections caused disorder and confusion in a society, the new constitution removed term limits for presidents and changed direct presidential elections into indirect ones through an electoral group. Although Park's government claimed that the intention of the *yushin* was not to establish a dictatorship, the constitutional changes, in essence, made President Park have indefinite tenure of office (Lynn 2009).

Second, the course of South Korean domestic politics at the time showed that Seoul doubted Pyongyang's intention on the North-South dialogue. Over time the Park regime became convinced that, as long as Kim Il-sung remained in power in the North, a fundamental hostility from the North would hardly change. In this respect, the important task for Park was not to rush to open dialogue and discussion on reunification, which would be a difficult political problem, but to check the sincerity of the North's intentions while trying to resolve easy matters (Park 1976). In a telegram shortly before the July Joint Communiqué, the U.S. Assistant Secretary of State delivered Park's view on the South-North communiqué, saying "he [President Park] did not consider North Korean acceptance of the proposal for a dialogue an act of sincerity or sign of good intentions by Kim Il Sung. He [President Park] anticipated there could even be unfavourable things arising during the course of the negotiations, knowing the nature and past record of the North Korean Communists. Agreement in principle in itself does not give the South Koreans reason to trust the North Koreans" (Telegram 150 1972). It went on to describe that "the ROK will wait to test his credibility and hope that there will be no unacceptable recklessness" (Telegram 150 1972).

Namely, for Park, the Communists in the northern part of Korea were still a distrustful partner. For instance, Park made an address at the anniversary of the 22nd years of the Korean War on 25 June 1972, nine days before the Joint Communiqué, saying that “we should not believe in communism. We shall not trust their words. Twenty two years ago, North Korea made a proposal for exchanging a patriot, Cho, Man-sik who was arrested by the North and Communist party members being placed under arrest in the South, but they suddenly invaded South Korea. Therefore, we should not get entangled in their sudden ‘peace offensive’ of Communists” (Kim 2011: 260). For Park, without the easing of tension and assurance of ceasing any armed aggression, any approach advocating ‘peaceful unification’, ‘North-South negotiation’, and ‘Red Cross talks’ was nothing but a means to disguise the North’s real intentions. Thus it was not viable for Park to discuss a unification matter with the North as the two sides had not even initiated any elementary measures toward relaxation of tensions and establishment of mutual trust. This was also the reason why Park turned down the North’s proposal for a summit meeting. In a New Year’s press conference on 27 January, 1973, Park contended that “we must approach our objectives step by step. There are people who may hastily demand that government should speed up the talks and push for reunification immediately. Yet, that is not realistic thinking. We will have to solve matters that are easy to solve first; the south and the north have to try to discuss and agree on the issues that can be agreed on easily” (Park 1976: 74). Since Park was not convinced that Kim Il-sung explicitly renounced his ambition of armed communisation and Socialist unification, the Park regime took a wait-and-see stance.

Thirdly, another reason why the South was still suspicious of the North’s intentions was that Park understood that the truth of Kim Il-sung’s approach was ‘deceptive peace propaganda’ to cover up their aggressiveness. Park believed that the reason behind these actions of showing interest in dialogue was Pyongyang’s changed tactics from a ‘revolutionary’ stance to a more ‘peaceful’ approach. In a sense of Pyongyang’s new conciliatory tactics, on the one hand they were trying to open up some dialogue and contacts with South Korea, but on the other hand they persistently demanded measures that would foment instability and confusion in South Korean society. Indeed, Kim Il-sung, in a meeting with the KCIA Director, Lee, Hu-rak in May 1972 expressed his regret on the North Korean assassination attempt against Park in 1968. By emphasising the North would not “repeat the Korean War”, Kim even stated that “I have no intention whatever of making war” (Memorandum 140 1972). Notwithstanding, Park still doubted North Korea’s intention, believing the North was

seeking to weaken the South's security system by projecting an active and more reasonable image towards the matter of relaxation of tensions and establishment of peace. In a meeting with the American Ambassador, Philip C. Habib on 10 June 1972, Park showed his concern by emphasising that "North Korea is more interested in dividing South Korea's national consensus" (Telegram 145 1972). It went on to describe that "North is trying to mislead the American public through a false peace offensive, thus promoting demand for early withdrawal of US forces from Korea and an end to the military modernisation program" (Telegram 145 1972).

Park's distrust toward Pyongyang's approach became more stiffened when Kim, Il-sung laid out a 'four-phase troop reduction plan' in his interview with *Washington Post* on 21 June 1972. Although Kim Il-sung suggested the withdrawal of U.S. forces along with the reduction of North and South Korean forces, Kim's proposals were perceived as a nonsensical idea to South Korea. Even assuming that Kim had a willingness to implement an interim force reduction, this situation would not be acceptable to Park. This is because this meant that the two Koreas would carry out the larger issue of reunification under the condition of less US forces and their influence on the Korean peninsula, which might endanger the security of South Korea. From Park's perspective, Kim's four-phase troop reduction plan was neither theoretically nor realistically possible. In a telegram shortly after the Joint Communiqué Park told the U.S. Assistant Secretary of State that "The intention of Kim Il-sung is to realize his long-term demand that U.S. forces should withdraw from Korea" (Telegram 150 1972). It went on to describe that "Another intention of Kim Il-sung is to use the communiqué to try and influence U.S. public opinion to call for an end of U.S. military aid to South Korea" (Telegram 150 1972). Park considered that the North's intent also had to do with distracting or weakening the South's anticommunism system while stirring up anti-American imperialism and nationalist sentiments in the South. In a special statement on 4 July 1975, on the occasion of the third anniversary of the Joint Communiqué, Park asserted that "they suspended the South-North dialogue unilaterally on August 28 of the same year[1973] on nonsensical excuses, putting forth demands such as repeal of our domestic Anti-communist and National Security Laws knowing as they do that it is the last thing we can accept" (Park 1976: 118). Believing the North Korean Communists had not renounced a delusion of unifying Korea under Communist rule, although the Park regime proceeded with dialogue with the North, Seoul was still suspicious of Pyongyang's intention. Thus, Park remained sceptical that the South-North Joint Communiqué of 4 July 1972 could lead to the

settlement of issue of unification which promised change.

4.2.3 On-going competition and hostility under the Chun Doo-hwan government, 1980-1988

Park's successor, the former president, Chun Doo-hwan made a bold proposal in his 1982 'New Year Policy Statement', urging that "unnatural relations" between the two Koreas should be end and replaced by "normal contacts that promote the national well-being" (Levin and Han 2002). He even suggested normalised relations, North-South exchanges and cooperation, and the exchange of high-level delegations to work out procedures for a summit meeting (National Unification Board 1988). Notwithstanding his proposals, the practical steps for recognising the legitimacy of each system and ameliorating a long-lasting confrontational relationship had not made progress. Rather, the two Koreas continuously vied against each other for membership in the United Nations throughout the 1970s and 1980s. Furthermore, a bomb assassination in Burma, October 1983 toward the presidential entourage was a serious blow to developing an atmosphere of reconciliation between two Koreas.

Amid these series of events raising tension on the peninsula, Pyongyang showed its soft stance on talks with Seoul. Previously suspended talks were resumed in October 1984, telephone 'hotlines' were reconnected, and several rounds of North-South economic talks were held in September 1985. At that time, Chun Doo-hwan's government first proposed the inter-Korean economic cooperation through 'The Agreement on the Implementation of Trade and Economic Co-operation and the Establishment of the South-North Joint Economic Committee' signed by both the North and the South representatives on 20 June, 1985, at Panmunjom (Hwang 2008). In addition, there had been secret higher-level meetings for discussing North-South summit, and Kim Il-sung even sent a personal letter to Chun Doo-hwan. However, the South was not able to accept the North's proposals for a federation as the formula for achieving unification and the withdrawal of U.S. troops. The direct cause of the rupture in the negotiations is that while these talks had been underway, Pyongyang had demanded the cancellation of the ROK-U.S joint military exercise, 'Team Spirit' in 1986. When President Chun refused this demand, all channels of dialogue collapsed in January 1986, thereby the proposal for inter-Korean economic exchanges and cooperation could not make progress until 1988.

Chun Doo-hwan seized power through the December 12th Coup, 1979, the May

17th Coup, 1980 and the bloody suppression of the Gwangju Popular Uprising, 1980. Since then, in the name of concerns about national security, the government continued to crack down on pro-democracy protestors, tighten vigilance, and often deal severely with dissenters. These repressive measures undermined the legitimacy of the Chun government and led to the explosive growth of the democratisation movement among students, labour and the middle-class citizenry against Chun's authoritarian regime (Jung and Kim 2009). Thus, during Chun's tenure, the pursuit of security, economic development and domestic stability has been imperative agendas and this government's focus was expected to cover up their lack of legitimacy. In this respect, the Chun government largely concentrated on maintaining economic growth and political stability as its predecessor, President Park. In fact, President Chun adopted an appeasement policy by releasing students and professors engaged in the democratisation movements to soften the domestic dissatisfaction. Meanwhile, Chun government successfully host the 1986 Seoul Asian Olympic Game and the 1988 Seoul Olympic Games. Shin (2013) argued that Chun's strong desire to host the Seoul Olympic Games was attributed to the anticipated political effect that it would have in helping to overcome the lack of his government's legitimacy and to gain an advantage in inter-Korean regime competition. Considering that military deterrence and economic development were still cardinal goals of Chun's government, it was important to make progress in inter-Korean relations as a part of foreign and unification policies. However, at the same time, Chun used anticommunism rhetoric and stressed on the North Korean threat as a means of legitimating his rule.

For instance, in October 1986, South Korean government officials had warned that 'Geumgang Dam', located downriver from North Korea's Mount Geumgang could be used to flood Seoul as a part of a water attack. This created an air of anxiety and fostered a public movement to build the Peace Dam as preparation for the possibility (Syder 2004). Geumgang Dam's episodes exemplified how Chun government distracted the South Korean public from domestic political agendas by permeating North Korean threat over society. Although Seoul diplomatically showed friendly postures to Pyongyang including South Korea's first suggestion on inter-Korean trade, Chun government's basic stance towards North Korea based on competition and hostility had not changed. As for the Chun Doo-hwan government, to reflect the ideas of rapprochement and détente on North-South relations as a mainstream of the post-Cold War era was considered as idealistic, rather than realistic. The North Korean threat for Chun's government experiencing the assassination attempt would only

heighten Seoul's perception of North Korea as a direct menace, and in the other way round, it validated their authoritarian rule and the US military presence in South Korea. The consideration on maintaining a strong capability to deter North Korea along with the South Korea-U.S. alliance was a top priority that there was no room for compromise. Within this reality, the North's demand to suspend the joint military exercise was unlikely to be accepted. Under the divided nation where enmity and mistrust still lingered between the two Koreas, the concept of reconciliation and cooperation was hardly acceptable even though both Koreas ostensibly expressed promise to bring about the reunification of Korean peninsula.

4.3 The main features of inter-Korean relations

During the state-building era the confrontational nature of the division between the two Koreas and Park and Chun's perception on North Korean threats continually pushed them to concentrate the goal of building a strong economy and military while legitimising their anti-communist ideologies and authoritarian rules. Given this background, this section seeks to answer two questions: (1) what were the key dynamics to determine the course of South Korean politics on inter-Korean relations? and (2) how did they affect South Korea's mode of interaction with North Korea?

4.3.1 Mutual linkage between economic development and national security

The economy-security nexus played a significant role in shaping the early years of South Korean policies and strategies. After the Korean War, the most pressing objective was to transform South Korea from an underdeveloped country due to their economic poverty into an industrialised country with economic prosperity and welfare. Considering the South's disadvantageous position in economic performance and military industry, it was important to catch up with and overtake gaps in economy vis-à-vis the North. Seoul's stark reality in nation-building competition with Pyongyang had led Park to rush for economic development by adopting an export-orientation policy and heavy and chemical industrialisation. In the meantime, having been faced with the North Korean threat, the South Korean government had another supreme mission to safeguard their national sovereignty against the danger of a second Korean War. In this respect, national security was given top priority in the course of

implementing their economic policies for the task of modernisation. For Park, the goals of economic development and national security were intrinsically inseparable and complementary. Building up strong defence was a prerequisite for ensuring basic survival and economic prosperity. Meantime the goal of maintaining their deterrence and defence capabilities against North Korea was only possible on the basis of a strong national economy. The pursuit of security and development and excessive emphasises on anti-communism were not any different during the Chun Doo-hwan era. This phenomenon of perceiving strong economy as a means of national security and the survival of the state as the foremost national preoccupation became the dominant doctrine of South Korea's national security policy.

The critical point to be noted is that, as South Korea's military governments emphasised the North Korean threat and the existence of Communist North Korea, the anti-communism and security consciousness driven by the state played a role in forming public perception and discourse on fears of communism (Kim 2010). They consequently became an effective tool to legitimise their own authoritarian rules' overriding goal of *bugukgangbyeong* despite the sacrifice of the development of democracy and human rights. In this respect, the ultimate goal of the peaceful unification was not attainable until South Korea achieved their twofold task of a self-sustainable economy (*jaripgyeongje*) and a self-reliant defence (*jajugukbang*). In Park's statement delivered on 9 January 1970, he asserted that "with the country modernized, its economy on a solid based of self-reliance, its national defence equipped with self-dependent capabilities, ... we will have a in our firm grasp the necessary initiative in vital matters related to the task of unification" (Park 1976: 16). Put another way, from the early 1960s through the 1970s, South Korea's top priority was to strengthen the state militarily, economically and politically. As Kang (2010) noted, the Park government had been 'construction' first and 'unification' later. With awareness and determination, Park was committed on nation-building competition with Pyongyang by pushing for the modernisation of South Korea.

Despite the increased economic and military strength, the nature of relations between two Koreas did not change until the end of Park's political rule. Along with strong U.S. support for his regime, the Chun government's national interest was also to ensure national survival and wealth based on Park's legacy. It meant that Park's goal of making South Korea wealthy and militarily strong was continually followed on by the Chun government. The new order in the détente at the level of great power relations in 1970s had not been able to turn the relations driven by competition and confrontation

into cooperation and reconciliation on the Korean peninsula. Faced with the heightened North Korean military provocations and uneasy domestic condition due to pro-democracy movements, the goals of economic growth and political stability had been largely emphasised throughout their rules. Namely, Park's goal of making South Korea wealthy and militarily strong continually and extensively affected the governance of South Korea and the nature of relations between the two Koreas.

4.3.2 U.S. influence as a means to ensure national interests

In principle, South Korea's way to ensure national survival, sovereignty and wealth was only possible on the basis of its own military self-help and strong defence. Yet, believing that the North Korean threat was real, the Park government was not convinced that its own status in the ROK armed forces could deter the North Korean military threat without the United States' security commitments to South Korea through the Mutual Defence Treaty and the presence of American troops. It meant that Park's ambitious twin objectives of 'self-sustainable economy' and 'self-reliant defence' was not attainable without the U.S. political, military and economic support. As Ikenberry (2004) has noted, in the era of the Cold War, South Korea could not help but rely on the American-led 'liberal hegemonic order' to secure bilateral security ties, military and economic assistance, and access to the American market. These multiple and complex economy-security interests put South Korea under asymmetrical power relations with the United States, driving the South Korean leadership to maximise their own national interests while accommodating their strong ally's demands and minimising their intervention in domestic affairs.

The fact was that Park accepted this reality of their dependency on the United States in the security realm, taking risks by using American influence as an opportunity for ensuring South Korea's national interests. In the foreign policy arena, the normalisation of relations with Japan in 1965 and the troop dispatch in South Vietnam in 1965 were such cases. As the weak side in the alliance, the important motive for taking these initiatives was driven by domestic economic and political interests. Although these controversial decisions caused severe criticism and protests at home, it was considered as the surest way to accelerate its industrialisation strategy and military modernisation while accommodating the U.S. demands as an ally. It is noteworthy that, the normalisation of relations between South Korea and Japan was a matter of grave concern to the United States (National Security Action Memorandum

No. 151 1961; Memorandum 261 1962; Memorandum 345 1964). Nevertheless, it is an undeniable fact that Park actively pursued the normalisation of relations with Japan despite the challenges of domestic opposition and an all-pervading anti-Japan sentiment in South Korean society. Through intense negotiations, Japan agreed to provide the South Korea “\$300 million in grants and \$200 million in Official Development Assistance (ODA) loans, and over \$100 million dollars in commercial loans” (Lee 2011: 445). At the expense of sending combat troops to South Vietnam, the South earned \$402 million from the United States. In fact, during the 1965-1970 period, the U.S. total aid transferred to South Korea was “amounted to as much as 19 percent of its total foreign exchange earnings” (Kim 2011: 174). Considering its opportunity to export markets in Japan and Vietnam, these decisions resulted in enormous benefits for South Korea’s political and economic terrain. By doing so, the Park regime not only acquired substantial sources of foreign capital and technology which paved way for promoting economic development, but also strengthened alliance with the United States. However, the most significant dimension of Park’s foreign policy initiatives was the fact that by paying the price for the normalisation of relations with Japan and the dispatch of armed forces to South Vietnam the authoritarian government consolidated its political rule through the American legitimating effect. Since these decisions were directly related to American security interest in the Asia Pacific to deter the expansion of Soviet power and communism, by accommodating the U.S. demands, the Park regime could reassure the U.S. domestic concern over Park’s nationalism, and projected a more positive image of himself as a reliable ally. At that time, for Park who needed U.S. acquiescence to his authoritarian rule, the decision to intervene in the Vietnam War and the diplomatic normalisation with Japan was an opportunity to portray himself as indispensable partner of the United States (Lee 2011).

From a security perspective, these initiatives stemmed from the American military strategic doctrine to form a solid stance against the Communist movement. As South Korea supported the American security strategy, the dispatch of South Korean troops to Vietnam brought with it intangible benefits for South Korea. The U.S. officials were concerned over the communists influence over Cuba, Congo, Laos and Vietnam. In particular, they believed that the Communist invasion of South Vietnam was a serious threat to all of non-Communist states in Asia. President Nixon later asserted that “If the North Vietnamese, with their sophisticated weaponry provided by the Soviet Union and China, were to succeed, then certainly the threat would be greatly increased for the Republic of Korea itself. More importantly, Moscow would be

encouraged to continue this kind of proxy aggression” (Memorandum 136 1972). Against this challenge, the dispatching of combat troops to South Vietnam was a symbol of collaboration between Washington and Seoul on the policy of containment of communist threats in East Asia. By sending the largest number of military troops among the U.S. allies, South Korea could imprint that they were an anti-communist power in East Asia and a trusty ally to the United States. Considering that Japan, another important ally for the U.S. could not play an active ‘military role’ despite its advanced economic development, it served to highlight South Korea’s ‘military role’ in East Asia (Telegram 31 1965; Park 2011). As a result, Park’s intervention in the Vietnam War was an opportunity for South Korean armed forces to improve military capabilities and gain combat experience.

Along similar lines, a breakthrough between South Korea and Japan relations meant that the South joined the United States’ triangular East Asian security alignment against the Communist Bloc’s trilateral alliance network among China, Soviet Union, and North Korea (Lee 2011: 174). Despite the initial slow process of ROK-Japan normalisation,¹⁰ domestic opposition, and complex process of negotiation, the Park administration decided to promote normalisation with Japan, because it was expected to be welcomed by the U.S that sought to forge “an anti-Communist alliance between Japan and [South] Korea”(Hong 2008: 37). This initiative met both the strategic considerations of the U.S. government and economic necessity of the South Korean government. In South Korean context, all these measures were considered as an instrument to build a firm security environment against the nature of the North Korean threat. The reason behind Park’s decision to dispatch combat troops to South Vietnam and the normalisation of relations with Japan was attributed to his aspiration for the modernisation of South Korea which required economic development, military strength, and alliance enhancement. To this end, the strengthening of the United States’ security commitment to South Korea was a prerequisite for national security, and the South had to pay the price to cement the alliance. Park’s excessive obsession on power was big enough to dilute criticism on trading Japanese colonial wrongdoings with economic rewards, and taking risks of heavy casualties due to getting involved in the Vietnam War. In both cases, the expected benefits of the decisions are higher than the potential costs of the decisions.

¹⁰ In fact, this negotiation had already been underway during the Syngman Rhee government, but both South Korea and Japan were not active to normalise their relations with each other.

4.3.3 North Korean threats as a driving force to set national agendas

South Korean leadership's interpretation on North Korean threats would continue to have a decisive influence on political agenda and mode of interactions with North Korea. This feature was salient in the Park regime during the 1970s. Although Park's judgement of the level of the North Korean threat and South Korea's defence capabilities did not accord with the U.S. view, his interpretation ironically provided a reason to strengthen a tendency toward security-seeking behaviour and continue to cling to his vision of *bugukgangbyeong*.

As noted earlier, Park had held his ground that the chance of a North Korean military assault was real and the possibility of a North Korean invasion by force was imminent. In his New Year message to the nation on 1 January, 1971, he contended "the North Korean Communists, having completed their war preparations and impatiently waiting for an opportunity to impose a communist military solution to the problem of Korean unification, may well strike again in the manner of the tragic Korean War" (Park 1976: 25). Park's threat perception of North Korea persisted until late in his term in office. In his interview with the *Washington Star-News* on 11 June 1975, he made the point that "while the nature of North Korean aggression may not be that of an all-out war, they may attempt to attack and occupy certain specific areas. ... There was a strong possibility that North Korean may delude themselves into believing that they can defeat the 40,000 American in South Korea" (Park 1976: 148).

Compared to Park's judgement, the U.S. had maintained a cautious attitude toward the possibility of military attack from the North. While Washington continued to regard North Korean military forces as dangerous, it judged that the threat of a renewed invasion by North Korea was no longer imminent. The U.S. basically adhered to the position that, even assuming that North Korea would attempt to invade South Korea, the combined U.S.-ROK forces at present "constitutes an adequate deterrent" (Memorandum 101 1971). According to the National Security Council Meeting report on 3 March 1970, the director of the CIA, Richard Helms, reported to President Nixon on the intelligence situation in Korea, saying that "North Korea has no intention of initiating conventional operations against South Korea in the foreseeable future, adding that neither the Soviets nor the Chinese Communists are encouraging such operations" (Draft 55 1970). The U.S. view on the North Korean threat had not changed much in 1975. When James R. Schlesinger, Secretary of Defence visited President Park on 27 August 1975, for instance, President Park stressed that "war on the Korean peninsula will be due to miscalculation on the part of Kim Il-sung." Regarding Park's

concern over a danger of the outbreak of war, Secretary Schlesinger anticipated “South Korea will make progress with regard to its capability for dealing with the North”. He added that “we will deal with conflict with adequate determination and force. A North Korea miscalculation would be tragic for the North” (Memorandum of Conversation 271 1975).

However, despite the differences in their opinion, Park believed that the North Korean Communist regime had sufficient power to launch an aggressive military action against South Korea at any time. In the 1960s and 1970s, he consistently requested the U.S. to reaffirm the American military commitment to South Korea and military assistance for the modernisation of ROK forces. For instance, at the Memorandum from the President’s Assistant for National Security Affairs to President Nixon, the President Park talked to General Wheeler on 2 October 1969 that “the North Koreans will not attempt all-out war if the South Korean economy prospers and US forces remain, but war is “inevitable” if US forces are withdrawn” (Memorandum 46 1969). Along similar lines, Park, in an interview with *the United Press International* on 11 June 1975, commented that “the possibility of the North Korean aggression is real and present.” He went on to describe that “in the event of communist aggression in Korea, I do not believe that the United States will abandon its commitment in Korea under such circumstance” (Park 1976: 145). Regarding U.S. assistance in the modernisation of ROK forces, Park also made a point that “what is meant by the term modernisation, for the present purpose, is to raise our military capabilities to that level where we can withstand the aggression by the North Korean Communists alone” (Park 1976: 157).

Therefore, considering that the ROK needed to overwhelmingly match North Korean armed forces to deter or defeat aggression Park not only requested military assistance for the modernisation of the ROK forces for compensating South Korea’s participation in the Vietnam War and the reduction of U.S. Forces in Korea, but also concentrated on increasing an independent defence capability by initiating an aggressive military spending to build South Korea’s armed forces. The clandestine attempt to develop South Korean nuclear weapons was the culmination of Park’s willingness to deter the North Korean threat and his ambition to have a strong defence posture (Memorandum 264 1975; Memorandum of Conversation 272 1975). This episode illustrated that although the U.S. played an indispensable role in constructing South Korean national security system through the Mutual Defence Treaty and the presence of American troops, the South was also determined to increase ROK self-reliance defence capabilities to deal on its own with North Korea. Under threat from

the superior North Korean armed forces and his concern over the uncertainty of the continued U.S. military presence, his risky plan to develop South Korea's own nuclear capabilities was the peak of Park's inclination for extreme concentration of power.

4.3.4 Will to power as a barrier to détente

In the name of national security and economic development, Park and Chun were predisposed to consolidate their authoritarian rule by emphasising the North Korean military threats and urgent task of modernisation. Such distinctive feature and political proclivity did not leave room to manoeuvre for relaxing tensions between the two Koreas. The question was, then, why South Korea's first experiment with rapprochement had not led to further inter-Korean reconciliation. Several factors accounted for this reason. It can be divided into two major causes: Park's personal passive attitude and his tenacity for the prolongation of his rule.

It was true that the Park government showed its willingness to enter engagement with the North through dialogue on humanitarian issues through Red Cross talks, and their tentative measures led to agreement relating to unification, through the 4 July 'South-North Joint Communiqué'. However, other evidence demonstrated that Park was pessimistic on the progress of negotiations with North Korea. Two primary facts which have been identified as the passive attitude toward the North were the refusal of a summit meeting suggested by Pyongyang and the delay in making public of the 4 July 'South-North Joint Communiqué' (Kim 2012). When North Korean Vice Premier Pak Sang-chol visited Seoul on 29 May 1972, and proposed a summit meeting, Park told Pak Sang-chol that "now was not the time for a summit meeting which needed a great deal more preparation if it was to be useful" (Telegram 145 1972). The South Korean Prime Minister Kim Jong-pil not only objected the summit idea but also criticised Lee Hu-rak's efforts during his earlier visit to Pyongyang. Kim did not hesitate to express his view that Lee had conducted negotiations for his personal prestige. Namely, Lee rushed a summit meeting so that the negotiations were progressed without greater prudence (Telegram 168 1972). As mentioned in previous section, Park's passive attitude on the summit was related to his doubt about the North's intention. Park believed that Pyongyang's political motives towards the North-South dialogue and negotiation emanated from Kim-Il-sung's strategy of 'deceptive peace propaganda' putting on a 'peaceful' face, while hiding their hostilities.

Next, President Park did not show an active attitude towards making public the North-South political contacts and negotiation on a joint communiqué. When the North Korean delegation headed by Vice Premier Pak Sang-chol visited to Seoul from 29 May to 1 June, Pak proposed the opening of the joint communiqué and the North-South secret meetings and discussions involving Lee in Pyongyang and Pak's visit to Seoul. Yet, President Park rejected this proposal (Telegram 147 1972). Park's passive attitude on the issuance of a joint communiqué was attributed in part to a matter of security reason or his own strategy of solving the easier issues first and then the more difficult issues later. Yet it was more related to his pessimistic view on the prospects for an improvement in North-South relations.

However, an underlying reason for not moving towards further inter-Korean rapprochement was largely attributed to Park's will for power, and a political necessity to prolong his rule. It is important to emphasise that Park had sought justification for the actions of the 'emergency situation' of 1971 on the basis of the North Korean threat. Even while inter-Korean political talks had been under way, the nature of North Korean aggressive attitude and military tension had continually been stressed by the Park regime. For instance, when the American Ambassador, Philip C. Habib met with Prime Minister Kim Jong-pil on 22 December 1971, Kim said that "North Korea was at a peak in terms of its strength and preparations for war. It was not known when these preparations would be used but ROK had to be alert to the danger" (Telegram 121 1971). Although the U.S had warned that they had no evidence a North Korean attack was imminent, President Park claimed that "we must always be aware of the Communist capacity to commit aggression at any time" (Telegram 119 1971). As an answer to an inquiry from the U.S. for the reason of South Korea's declaration of emergency, Park contended that it had two purposes. First it was "to warn Kim Il Song that even though there are moves for lowering tension such as Red Cross talks he should not think the ROK is unwary" (Telegram 119 1971). Second, it aimed "to warn the Korean public who had fallen into a degree of apathy by believing the international situation is such that war is not possible and peace is in the offing" (Telegram 119 1971).

Given the fact that the two Koreas had signed the historical agreement on the Joint Communiqué, there was an atmosphere of the Korean version of détente that would encourage moves for the relaxation of military tension and further South-North dialogue on other political pending issues. However, soon after that, Park initiated the process of extending his rule through the proclamation of the *yushin* in October 1972. The decision of Park's *yushin* was a decisive moment to turn the emerging regional

environment of détente and atmosphere of inter-Korean rapprochement into an extreme centralisation of power interlocked with personal determination for a lifelong rule. Park had claimed the rationale behind the revitalising reform was to maintain a firm and stable situation in Korea and to deal more effectively with peaceful unification. Nevertheless, the course of *yushin* progressed under the heightened social controls and violent repression of protesters and opposition politicians by using detention, house arrest, and torture.

Although the *yushin* regime made it possible to institute Park's lifelong rule, in the long run it undermined internal cohesion and regime legitimacy. After proclaiming the *yushin* constitution, Park could aggressively drive the development of heavy and chemical industries, which was essential for South Korea's military security and modernisation strategy. However, the mounting criticisms and dissent against to Park's way of political rule and the constitutional changes served as a momentum to form a coalition of anti-Park and anti-dictatorship among South Korean dissident intellectuals, religious leaders, student activists and opposition politicians. In this sense, the main justification of Park's retention of power for the maintenance of national security and public order, and the promotion of peaceful unification would no longer be persuasive to the public. Rather, the *yushin* regime only confirmed that Park intended to consolidate his dictatorial power for life.

Considering Park's step and course to the *yushin* regime, what really mattered was to perpetuate his rule, accordingly making a favourable political environment for regime change (Im 2011). As he successfully removed the legal obstacle of prohibiting a third running for presidential term through the 1969 constitutional revision, what remained for Park was to stabilise external security environment. Under this circumstance, to create the atmosphere of détente with the North was necessary for his regime change. Thus, a series of inter-Korean rapprochement measures through the Red Cross talks, and the 4 July joint communiqué by the two Koreas played a critical role in building inter-Korean stability. Even assuming that Park did not have any intent to link the tentative inter-Korean rapprochement measures to his ultimate goal for perpetuating his lifelong rule, Park's path of *yushin* made South Korea focus on its own national agenda such as their modernisation strategy and military security, consequently waning the regime's interests and energy for any domestic efforts of amelioration in North-South relations. In a similar vein, the launching of *yushin* synchronised to convey Park's message to the North that the South would not get entangled in Pyongyang's deceptive peace propaganda aiming to divide South Korea's

national consensus and weakening its anti-communist ideology. Taken together, Park doubted the North's intention on the opening of talks and negotiation, believing that the 4 July communiqué would not lead to the 'Korean version of détente'. However, at the same time, it was not bad moves in that he needed a certain level of lowering tension to realise his goal of lifelong rule.

4.4. Conclusion

Since the end of the Korean War, the division of the Korean peninsula had caused both political leaderships to place a greater emphasis on the concentration of power and focus more on their military build-up and security alliance. At the same time, the two Koreas had internally concentrated on the goal of nation-building by forming own political organisation, economic system and societal institutions. Such a fierce competition for their own survival and prosperity meant that the two Koreas substantially focused on the realistic agenda of nation construction rather than the sacred task of national reunification. In other words, although North and South Korea declared that their ultimate goal was to achieve reunification, both sides primarily emphasised the importance of the build-up of national strength that contributed to deterrence and the status quo. Faced with external security threats and domestic tasks for launching industrialisation, the most important national goal for the Park regime was to modernise the economy and enhance self-defence capabilities. Such a twofold national agenda-fostering economic development while preserving a sufficient military deterrent against North Korean threats-deeply affected the governance of South Korea and the nature of relations between the two Koreas. Under the situation that both Koreas have vigorously competed against each other in almost every field, the Park government had placed a greater priority on own nation-building, rather than on national reconciliation with the North. With the military gap favouring the North, the repeated military provocations of North Korea and their existent manoeuvres for communising the whole of Korea by force had a profound effect on Park's own perception of North Korean threats and his attitude towards the concentration of power. Therefore, the nation's vital interests in the task of modernisation and Park's interpretation, believing the North Korean threat was substantial and imminent played a major role in shaping his regime's actions, policies and strategies.

As Park's EYEDPs successfully led to the hyper economic growth in 1960s, South Korea's authoritarian capitalism seemed to prove its suitability for the 'Korean

modernisation'. In fact, Park's industrialising drive made it possible to consolidate his rule through his second and third re-election in 1967 and in 1971. To be sure, South Korea's authoritarian rule by Park had shown its improved competitiveness and rapid growth through the 1960s, thereby being convinced by themselves of being more effective than North Korea in the field of economy beginning in the late 1970s. However, its achievements on political and economic domain neither eliminated South Korea's anxiety about North Korean communists, nor changed the security structure on the Korean peninsula. In addition, since its goals of military self-help and strong defence was not attainable without the U.S. treaty commitment and military assistance, the situation of national security that Park faced had made the state externally rely on military alliance with the United States. It meant that South Korea's path to modernisation had been undertaken by staying on the American bandwagon, and South Korea's political and security policies were profoundly affected by the American hegemonic order and its national interests.

More importantly, Park's sense of insecurity and his tenacity to perpetuate his power served as an internal dynamic for legitimising Park's authoritarian rule. Since the South Korean military government lacked legitimacy, the continued North Korean military threat throughout the Park era provided a reason to emphasise the importance of the role of a powerful leader to catch up economically with the North and political motives for prolonging his rules as pretext to preserve national security. To this end, anti-communism was perceived as an intangible asset since it played a role in strengthening the solidarity of its people for the goal of *bugukgangbyeong*, and assuaging American concern for his military dictatorship. Of course, there were political moves to change the nature of the hostile political relations between the two Koreas. Amid rapprochement between the United States and China in the early 1970s, North and South Korea unprecedentedly agreed on the principles of reunification, but the détente between the two Koreas had not been made. Park's passive attitude and his own will to power precluded the Park regime to make a breakthrough in inter-Korean relation. Meanwhile, a series of aggressive and provocative acts from the North not only hardened mutual distrust and antagonism, highlighting the North Korean aggressive proclivities, but only served to justify strict social control, anti-communist laws, human rights violations and limited democracy. In a sense, Park and Chun might not have wanted a diminished wariness about the North Korean threat and a relaxation of tension between the two Koreas which would undermine their rationale for legitimising political and social repression under tight authoritarian rule. Rather,

Park and Chun skillfully took advantage of them to over-emphasise anti-communist ideology as a means of upholding the domestic cohesion of South Korea.

Between 1963 and 1988, South Korea had become acknowledged as the only legitimate representative state in Korea and had successfully modernised its economy, military and politics compared with the North. The undeniable fact, however, was that South Korea's developmental authoritarianism limited the advancement of the nation's democracy and the promotion of human rights. Ironically, the South Korean leadership's apprehension on the North Korean threat and its achievements of rapid industrialisation served to consolidate their strong rule, making it more difficult to envisage political reconciliation and economic cooperation with North Korea. Put differently, Park's vision of Korea to build a 'rich nation, strong army' led the political leadership to fight the challenge for South Korea's modernisation on the basis of economic development and deterrent power, leaving no room for the path toward détente on the Korean peninsula. While Park's will to power made him a lifetime president, and the legacies of the authoritarian era caused to tilt inter-Korean balance of power in favour of the South, Seoul's enduring fear of North Korean communists had not diminished. Neither the moves of détente at the level of great power relations nor the dialogue opened between the North and South could change the dynamics of political and military reality on the Korean peninsula.

In a way it was natural for Park and Chun to commit to the goal of economic prosperity and military strength in the face of North Korean threats. However, paradoxically, to achieve such a goal, they needed a certain level of tension and public fear of the North Korean communists as long as it would not escalate to the level of crisis to threaten South Korea national security. In short, since the end of the Korean War, survival has been a paramount concern for South Korea. Although the authoritarian leadership emphasised unification, they indeed sought power that centred on the status quo. What Park and Chun needed, in the strictest sense, was not peace, rather the absence of war or the balance of power in the peninsula in order to enable South Korea to embark on its path to modernisation without any fatal tension or interference from the North Korean regime. As a whole, South Korea was not ready to consider engagement with North Korea in earnest.

CHAPTER FIVE

South Korea's Positive Economic Statecraft in the Roh Tae-woo and Kim Young-sam era: Inception and Frustration

5.1 Introduction

The aim of this chapter is to examine what political and economic motives and intentions drove both North and South Korea to commence economic interactions, and why engagement through economic cooperation under the administrations of Roh Tae-woo and Kim Young-sam was not employed as a key element in their policies on North Korea. The Roh Tae-woo administration had a significant meaning in the development of inter-Korean relations and the evolution of positive engagement in South Korea. It was in the Roh Tae-woo era that South Korea's economic exchanges and cooperation, which had been non-existent for more than three decades since the end of the Korean War, officially began towards North Korea. Indeed, it was an important shift in South Korea's policy on North Korea considering that the past authoritarian regimes had placed a greater priority on own nation-building and economic modernisation, rather than on political reconciliation and economic cooperation with the North. It meant that South Korea moved away from fear of communisation by the North and inferiority in national power, taking the lead in inter-Korean relations with confidence on the disparity in economic power between the two Koreas. However, the South's new initiative for changing dynamics in inter-Korean relations through economic statecraft was frustrated by North Korea's nuclear weapons ambitions, reversing the nature of inter-Korean relations into new dimensions of conflicts. Given this background, this chapter firstly examines how Roh Tae-woo and Kim Young-sam administrations developed inter-Korean relations, and to what extent inter-Korean economic cooperation affects political relations, and vice versa. Thereafter, through this historical review, four major features of inter-Korean relations will be addressed.

5.2 The historical outline of South Korea's relations with North Korea

The idea of inter-Korean economic cooperation was proposed by South Korean President Chun Doo-hwan in June 1985. But it was only after the Roh Tae-woo government in 1988 that trade between the two Koreas officially commenced. Since its first trade with the cross-border shipments of artistic products in 1988, inter-Korean trade has continued to grow over the 1990s, so that the trade volume between the two Koreas that was a mere 18.7 million US dollars in 1989 rose by sixteen times to 308 million US dollars in 1997. However, despite its tangible achievements, the overall scale of the commercial and non-commercial trade between the two Koreas has been relatively meagre, and the growth pattern has been inconsistent, often being interrupted with conflict and confrontation. It shows that as the political factors had a larger effect on inter-Korean economic relations, the South's initial mode of engagement had been focused on the transactional model. In this vein, it is important to examine how the Roh Tae-woo and Kim Young-sam administrations developed inter-Korean relations, and what kind of political and economic factors had affected the initiation of South Korea's engagement towards North Korea.

5.2.1 The Roh Tae-woo government, 1988-1993

Political and economic relations between the two Koreas broke new ground from the Roh Tae-woo government, who succeeded the former president, Chun, Doo-hwan. With the new reconciliatory atmosphere between the United States and the Soviet Union at the end of the 1980s, President Roh Tae-woo launched a new initiative, called *Bukbangjeongchaek* or *Nordpolitik*, which enabled South Korea to normalise its relations with the allies of communist North Korea. As a result, South Korea established diplomatic relations first with former communist countries in Eastern Europe, including Hungary, Poland, and Yugoslavia in 1989, followed by ties with Czechoslovakia, Bulgaria, Romania, East Germany, Mongolia, and the Soviet Union in 1990, and finally with China and Vietnam in 1992 (Kihl 2005). However, Roh's *Nordpolitik* was not only a diplomatic initiative for seeking improvement of relations with communist-bloc countries, but it also aimed at achieving relaxation of tension with North Korea and national unification (Kihl 2005; Kim 2006). Park Chul-un who played a key role in making Roh government's *Nordpolitik* evaluated that *Nordpolitik*

was the first initiative that linked the matter of Northern policy to the agenda of national integration (Park 2005: 24). Under this policy directive, Seoul showed signs of a policy change from confrontation to coexistence and willingness to implement a positive shift in its North Korea policy. This was officially expressed through 'Special Presidential Declaration for National Self-Esteem, Unification and Prosperity' on 7 July, 1988 (henceforth '7.7 Declaration'). The '7.7 Declaration', which primarily focused on economic exchanges and humanitarian issues rather than on security issues, carried an important meaning because it reflected the South Korea's basic position toward inter-Korean relations (Park 2012). More than anything, it showed Seoul's willingness to accept the North as a valid negotiation and trade partner. On this point, Lee Kwan-se, former Vice Minister of Unification argued that the '7.7 Declaration' recognising North Korea as not 'the enemy' but 'the partner', was the first official document which made it possible for South Korea to engage with North Korea rather than confront with them (Lee 2011).¹¹ Given the South Korean government's conventional conception towards North Korea, seeing it as an adversary or at least a competitor, the announcement of the '7.7 Declaration' was the beginning of a change in direction of national strategy and North-South relations in the post-Cold War era.

Although *Nordpolitik* was formulated as a foreign policy initiative which had a structure to influence North Korea policy, the driver of policy was also attributed to domestic political consideration. At that time, South Korea was preparing for the Summer Olympics for the first time in Seoul 1988, so it was imperative for the Roh government to form a favourable environment by eliminating the slightest possibility of aggressive behaviour from North Korea. Along with this, leading a full participation of the camps of East and West at the Olympics was an important condition for the successful Seoul Olympic Games (Kim 2011). Considering that Seoul's *Nordpolitik* played a key role in improving the relations with the socialist bloc, it contributed to hosting both sides in certain aspects. However, there was not an issue more important to Roh's government than to deliver a safe and secure Olympics in which North Korea did not attempt to disrupt. Namely, the prevention of any provocative actions from the North was a sufficient condition for the successful completion of the Olympic Games.

The successful hosting of the 1988 Seoul Olympic Games was also linked to a matter of the Roh Tae-woo government's political legitimacy. This is because it would make it possible to rally domestic support for the regime among the population, and it would lead to promote political standing as a firm accomplishment. On this point, the

¹¹ Interview with Lee Kwan-se in Seoul, 30 May 2011.

former Vice-Minister of the Unification, Kim Hyung-ki (2013) stated that “although Roh Tae-woo was elected through a direct presidential election system, and that made his government different from the former military governments, he had inherited a weakness. This is because he had a political background, playing a key role in the past years of authoritarian rule such as ‘12 December coup d’état’ in 1979 and the armed crackdown at ‘Gwangju Democratisation Movement’ in 1980.”¹² In a similar vein, Paik (2013) claimed that “in order to overcome their lack of legitimacy, the governments of Chun Doo-hwan and Roh Tae-woo attempted to promote the political standing and legitimacy by promising a direct presidential election system, a single term presidency, hosting the Asian Games in 1986 and Seoul Olympic Games in 1988.”¹³ In this sense, considering that North Korea indeed tried to sabotage and even thwart the Olympic Games, there was reason for the Roh government to mitigate North Korean belligerency by suggesting friendly gestures (Shin 2013).

The launching of Seoul’s *Nordpolitik* and following the ‘7.7 Declaration’ certainly produced improvement of North Korean relations. The actual implementation of economic exchanges and cooperation was initiated for the first time in 1989. Since then, an exchange of people including athletes and artists between the two sides began, and a number of South Korean businessmen were able to visit the North (Park 2001). As following measures, South Korea lifted economic sanctions against North Korea in October 1988 and subsequently promulgated various trade measures. In an effort to form the legal basis of inter-Korean transaction, South Korea arranged the ‘Primer on Inter-Korean Exchange and Cooperation’ in June 1989, and enacted the ‘Inter-Korean Exchange and Cooperation Act’ in August 1990 along with the establishment of the ‘Inter-Korean Cooperation Fund’. These initiatives not only meant legal support for the impending inter-Korean economic cooperation, but also reflected a paradigm shift of the Roh government, viewing North-South relations more as a potential partnership in the pursuit of common prosperity and peaceful coexistence. According to Yoon and Yang (2005), since then, both the South and the North have been able to begin building a foundation for economic cooperation and exchange.

Notwithstanding these positive initiatives for improving inter-Korean relationship, it was rather controversial whether President Roh launched *Nordpolitik* and the ‘7.7 Declaration’ with the aim to achieve unification by absorbing the North.

¹² Interview with Kim Hyung-ki in Seoul, 14 June 2011.

¹³ Interview with Paik Haksoon in Seoul, 15 June 2011.

Kim (2011: 67) argued that since a practical improvement of inter-Korean relationship might threaten the continued existence of the North Korean regime, taking the risk of unification through absorption, the underlying goal of *Nordpolitik* was no better than reunification by isolation or absorption of North Korea. Chun (2012: 228) also claimed that although *Nordpolitik* sought to achieve peaceful and independent unification, “it was obvious that it ultimately did not rule out unification through absorption of the North.” However, even if the Roh administration planned a forward looking engagement policy with the objective of altering the overall nature of the status quo on the Korean peninsula and achieving an ultimate unification, they did not favour immediate radical change in inter-Korean relations. Rather, the rationale for these initiatives was based on a gradual approach to unification through the improvement of North-South relations and establishment of peaceful coexistence between the two different systems (MOU 1992: 114). In August 1990, President Roh said that “We should begin a process to end the Cold War on the Korean peninsula by capturing the momentum of the Cold War’s end. To do so, we should first end hostile relations between the North and the South and begin a new inter-Korean relationship” (Lim 2012: 84). In addition, President Roh did not take on the view that the collapse of North Korea was imminent unless China entirely stopped the role of a reliable buttress for North Korea. Given this background, it was considered desirable for the South to seek a process of gradual transformation and to forge a new relationship with the North. To this end, the initial area that the South decided to discuss and resolve was the relatively easy issues of exchanges and cooperation rather than the resolution of political and military issues.

It is noteworthy that the change of attitude behind inter-Korean relationship and its inception of economic cooperation are attributed to not only Seoul’s domestic politics and the government’s judgement with regard to a gradual step by step process, but also Pyongyang’s strategic consideration in the face of the challenges of the stagnant domestic economy and the unfavourable development of international environment. Despite the North’s intensive growth strategy in 1971 until the early 1980s, North Korea’s parallel development of the defence and economic sectors had not successfully boosted its own domestic economy. As North Korea expanded the size of military forces in the 1970s and 1980s, the enormous expense of upholding military build-up laid a heavy burden on the North Korean economy (Yang 2008; Eberstadt 2010). During those years, the major portion of the defence budget relatively shrunk the budget allocated to non-defence sectors such as light industry and agriculture (Park

2009). As time passed, North Korea's self-reliant strategy, giving more priority to the development of heavy industry and the trend of excessive defence expenditures not only aggravated the situation of the domestic economy, but also imposed constraints on North Korea's foreign trade. The structure of the North Korean economy required large-scale input of capital equipment and imported machinery. Yet, beginning in the mid-1970s, North Korea could not repay the debts that it had with Western Europe and Japan. In conjunction with the diminishing patron aid from the Soviet Union, North Korea was faced with serious economic deterioration in the 1980s.

Meanwhile, there were large-scale changes in the international system that precipitated the end of the Cold War. In the mid-1980s, Soviet leader, Mikhail Gorbachev, launched the '*Perestroika*' and '*Glasnost*' for the renovation of the Soviet political and economic system, and his liberal reform program led to a change in the realm of foreign policies as well. The two presidents of the United States and the Soviet Union, George H. W. Bush and Mikhail Gorbachev declared the end of the Cold War on 2 December 1989 in Malta. Furthermore, the Soviet Union, a traditional close ally of North Korea, normalised diplomatic relations with South Korea in September 1990, and even decided to end its barter trade with the North. Having undergone economic predicaments due to shortages in food, energy and foreign trade, these domestic and international concerns were considered too much of a political and economic liability to North Korea. On this point, Lim (2012: 86) argued that "in order to survive these enormous changes in the international environment, North Korea had to be flexible to avoid future international isolation and economic difficulties. In this sense, the high-level talks between the two Koreas seemed to be an exit strategy." During this time, Seoul declared a greater openness toward North Korea, and Pyongyang accepted Seoul's proposal for a high-level North-South talk.

Since the first North-South high-level talks were held in Seoul on 5 September 1990, both North and South Korea had discussed agenda items such as economic cooperation, the issue of UN membership, unification formulas and other political and military issues. As a result, an important landmark the '*Agreement on Reconciliation, Non-Aggression, and Exchanges and Cooperation between the South and the North*' - which is commonly known as the '*Basic Agreement*' - was signed in December of 1991. This agreement consists of three main chapters, and one of them primarily had to do with exchanges and cooperation between North and South Korea. Article 15 in particular stated that "to promote the integrated and balanced development of the national economy and the welfare of the entire people, the South and the North shall

engage in economic exchanges and cooperation, including the joint development of resources, the trade of goods as intra-Korean commerce and joint venture" (MOU 1992: 464).

It means that "the two parties agreed that economic exchanges between the South and North should be considered as intra-Korean matters, and subsequently, intra-Korean trade would not be subjected to tariffs by either party"(Kim 2000: 4). Put another way, the South Korean government declared that "the inter-Korean trade is not a foreign trade" between states but "the trade within the boundary of a state, and shall not be regarded as the international trade" (Park 2005: 14). This concept was possible because both Koreas regarded the nature of the North-South relationship as a 'unification-oriented special relationship', not a relationship between states. Based on these reasons, the Basic Agreement concretized that the two parties respected each other's political system and agreed with the active promotion of inter-Korean cooperation and exchanges. It showed South Korea's commitment to engagement with the North through inter-Korean exchanges and cooperation for facilitating North Korea's opening. Armstrong (2005: 7) stated that the 'Basic Agreement' was "the most important declaration of North-South cooperation and coexistence since the 1972 Joint Communiqué, and was far more detailed than the 1972 agreement had been." Bluth (2011: 83) also pointed out the meaning of the agreement by saying that "this agreement codified a form of peaceful coexistence."

Despite its legal issue,¹⁴ the 1991 Basic Agreement was considered as the most comprehensive measure for dealing with all elements between the two Koreas in politics, military, economics and future unification (Sheen 2007). With regard to the common interest of inter-Korean exchanges and cooperation, it was further discussed and negotiated by the meeting of the Joint Exchanges and Cooperation Committee from 18 March 1992 onwards. The North and South finally agreed with the 'Resolution of Protocol of North-South Exchanges and Cooperation' to implement the agreement on 17 September 1992.

The prospect for the improvement of inter-Korean relations was fortified following the 'Joint Declaration on the Denuclearisation of Korean Peninsula' on 31 December 1991. The adoption of the Joint Declaration of Denuclearisation began with the commitment on the elimination of nonstrategic nuclear weapons between the United States and Soviet Union. As U.S. President George H. W. Bush announced that

¹⁴ The Basic Agreement has not been ratified by the National Assembly, and the South Korea's Supreme Court and the Constitutional Court ruled that the Basic Agreement is not a legally binding treaty or associate treaty between states.

the United States would withdraw all ground-launched tactical nuclear weapons from overseas bases on 27 September 1991, known as President Nuclear initiatives (PNIs), all tactical nuclear weapons were planned to withdraw from South Korea (Woolf 2012). This change in American nuclear policy, and the resultant removal of the nuclear weapons, was considered as an opportunity for the South Korean leadership to stop North Korea's nuclear programme and pressure North Korea to give up their nuclear reprocessing facilities. Shortly afterwards, President Roh announced the 'Declaration on the Denuclearisation and Peace Building on the Korean Peninsula' on 8 November 1991, specifying that "South Korea shall not manufacture, process or use nuclear, nor shall the ROK possess reprocessing or enrichment facilities" (Lim 2012: 119). From a different perspective, President Roh's denuclearisation declaration meant that South Korea had to even give up the right of using reprocessing facilities in the meaning of the peaceful use of nuclear energy. However, in compliance with the strong persuasion of the United States, the South accepted their suggestions, and both Roh and Bush administrations cooperated to urge North Korea to adopt a joint declaration of denuclearisation, to sign IAEA Safeguards Agreements and to accept IAEA inspections. As a result, in December 1991, both North and South Korea signed the Joint Declaration of Denuclearisation, and North Korea also pledged to accept international nuclear inspections. During this process, the withdrawal of all tactical nuclear weapons from South Korea played a decisive role in persuading the North to agree the 'Joint Declaration on the Denuclearisation of Korean Peninsula'. This was because, from the standpoint of the North Korean state, Bush's announcement of PNIs and the resultant Roh's declaration of denuclearisation partly relieved the North Korean security concerns that they faced.

However, the rising hope for a drastic change in the inter-Korean relations was unfulfilled again. North Korea suddenly halted high-level talks at the end of 1992. More importantly, the suspicion of North Korea's nuclear weapon programme caused conflict with the United States, and North Korea rejected the IAEA's request for special inspections on the ground of violation of sovereignty in February 1993. As a result, the mood of reconciliation could not last long and the two sides clashed over North Korea's nuclear development programme. It showed the dialogue and cooperation between the North and the South was subject to the progress in the North Korean nuclear issues. This feature was important because it began to determine the direction and nature of positive engagement of whether it would be linked to the resolution of nuclear issue or separated from the nuclear issue or run in parallel with the nuclear

issue. Afterwards, this debate led to a serious ‘South-South conflict’ amongst proponents and opponents of the engagement approach, forming a domestic obstacle for the promotion of inter-Korean economic cooperation in which the North had been interested (Paik 2002; Cho 2003; Kim 2006; Kim 2007).

5.2.2 The Kim Young-sam government, 1993-1998

The Kim Young-sam administration was the first elected South Korean civilian president against a succession of military-backed governments since 1961. The Kim government basically adhered to key components of Roh’s policy, especially in the first part of his presidency (Moon 1999). In his inaugural speech on 25 February 1993, President Kim endorsed the establishment of a new era of reconciliation and cooperation with North Korea by citing that “no ally can come before our fellow Korean people: neither ideology nor political belief can bring greater happiness than national kinship”.¹⁵ Kim went on to say, “If you really care about the Korean people and desire genuine reconciliation and unification between our brethren in the South and North, we can meet at any time and in any place to discuss this dream”.¹⁶ The following day, Han Wan-sang, Deputy Prime Minister and Minister of National Unification, stated at a press interview on his inauguration, “the unification, reconciliation and happiness of the same nation is more important than any thoughts or ideologies” (*Joongang Ilbo* 2006; Han 2013). President Kim also showed his determination on objections to either “unification by absorption” or seeing “the North isolated from the rest of the world” at his Liberation Day Speech in August 1994 (MOU 1994). These gestures emphasising *minjok* or national ties clearly indicated that President Kim had intended to improve long-frozen North-South relations from the beginning of his tenure (Hyun 2008). In fact, despite heavy criticism from South Korean conservatives, the Kim government decided to send a long-term prisoner, Lee In-mo who had refused to convert from communism, back to North Korea and to attempt a breakthrough in the deadlocked North-South relations.

Despite a series of friendly gestures towards Pyongyang, relations between the two Koreas worsened and security concern was heightened due to North Korea’s withdrawal from the Nuclear Non-proliferation Treaty (NPT) in March 1993, North Korean verbal threats at a negotiation table indicating ‘a sea of fire’ upon Seoul in

¹⁵ National Archives of Korea (www.archives.go.kr)

¹⁶ Ibid.

March 1994, and Kim Il-sung's sudden death in July 1994. The source of conflict came from North Korea's nuclear programme, called 'the first North Korean nuclear crisis'. During that time, the tension was seriously built up when North Korea had removed 8,000 fuel rods from the 5 MWe reactor at Yongbyon in May 1994. The behaviour of North Korea's unloading the reactor discouraged the American willingness and efforts to resolve this problem through negotiations, thereby causing the United States to consider stronger measures to react North Korea's provocations. At that time, the Clinton administration seriously discussed a possible strike on North Korea's nuclear facilities in June 1994 and even planned to evacuate the families of diplomats, the U.S. forces and American citizens from South Korea (Sigal 1999; Bluth 2008). Although President Clinton turned down the suggestion for military actions considering the latent risk and estimated casualties of armed conflict, Pyongyang's withdrawal from the NPT and its confrontation with Washington brought the Korean peninsula to the brink of a physical confrontation. Bill Clinton latter commented that "I was determined to stop North Korea from developing a nuclear arsenal, even at the risk of war. In order to make absolutely certain that the North Koreans knew we were serious, Perry continued the tough talk over the next three days, even saying that we would not rule out a pre-emptive military strike" (Clinton 2004: 591). Although the mounting crisis was eased with U.S. former president Jimmy Carter's visit to the North in June 1994, the first nuclear crisis led the Kim government to reverse the early years of engagement approach towards North Korea and to take a hardline stance (Han 2013).

However, this escalation of tension on the Korean peninsula not only resulted from Pyongyang's unpredictable and aggressive behaviour but also came from political confrontation between Seoul and Washington on a diplomatic solution to deal with North Korean nuclear issues. The Kim administration vehemently opposed the Clinton administration's intention to bomb the North Korean nuclear facilities and the U.S.'s plan to evacuate American citizens to provide for a surgical strike. President Kim even criticised Carter's visit as a mistake at an early stage. Kim Young-sam was particularly discontented with the process of 'the 1994 Agreed Framework' between North Korea and the United States since South Korea could not participate in negotiations as one of the key parties. Moreover, during this process, North Korea even proposed discussing the issue of replacing the 1953 Armistice Agreement into a peace treaty between the United States and North Korea. It meant South Korea had not been a direct party for the nuclear discussion and could even be excluded from such a 'key agenda' pertaining to a permanent peace mechanism on the Korean peninsula. To

make it worse, the Agreed Framework incurred a very substantial financial contribution to South Korea in terms of the construction of two 1,000 MW light-water reactors. This position from Seoul drew strong criticism from both the ruling and opposition parties because it was viewed as too passive and showed a lack of diplomatic capability managing the North Korean nuclear crisis that would seriously affect the country's future (Kihl 1998). It was revealed that not only was the Kim government drifting to balance its policies between Pyongyang and Washington, but also the administration's North Korean policy was fundamentally lacking in consistency.

In fact, the Kim Young-sam government's policy on North Korea was based on scenarios predicated on a sudden collapse of the North and inflexible linkage strategy between North Korean disarmament steps and the improvement of inter-Korean relations (Lim 2012). The latter clashed with American interests prioritising the resolution of the North Korean nuclear issue for preventing further proliferation of nuclear weapons and missiles (Paik 2012). Indeed, from 1993 to 1994, the Kim administration not only officially set out its objection to the settlement of the Agreed Framework, but also intentionally hindered and delayed negotiations (Koh 1994, Gurtov 1996, Kim and Winters 2004). For instance, in an interview with the *New York Times* on 7 October 1994, Kim Young-sam criticised that the United States' basic stance in the discussions with North Korea has been too soft, and "expressed deep doubts about whether the North Koreans could be trusted to live up to any agreements and whether the American negotiators understood that possibility". Depicting North Korea at the brink of economic and political collapse, he asserted, "any compromises might prolong the life of the North Korean Government and would send the wrong signal to its leaders...Time is on our side" (*New York Times* 1994). This diplomatic stance by the Kim government on the nuclear negotiations that were neither favourable to a diplomatic solution, nor to military confrontation, did not even bring with it other major powers' support from China, Russia and Japan. A chilling effect on inter-Korean relations still remained even after the sudden death of Kim Il-sung on 8 July 1994. Seoul's decision to ban any grieving for Kim's death thereafter caused a series of riots and demonstrations among students and civil groups. Amid of a series of disagreements between Seoul and Washington, the Kim administration changed its previously opposing stance and accepted the Agreed Framework as they came under the U.S. pressure to change discourse of South Korea's hard-line policy. Under the changed circumstances, the Kim government's policy toward Pyongyang shifted again

from a hawkish into a dovish stance and inter-Korean relations were consequently resumed. Furthermore, the Kim government agreed with the U.S. to suspend Team Spirit exercises and began to take an active measure on economic exchange and cooperation with the North (Park 2001). As Hyun (2008: 61) has noted that “the South Korean government was oscillating from a hard-line position to a moderate one, sending mixed messages to the North.”

However, Kim’s tentative engagement approach had come to another deadlock when Seoul had offered to supply rice and other goods in response to Pyongyang’s request. A South Korean cargo ship, *Sea Apex* carrying rice was forced to fly the North Korean flag when the ship entered the port of Chongjin in June 1995. Although South Korean food assistance was resumed again after an apology from North Korea, it caused another issue as a crewmember on the South Korean cargo ship, *Useongho* was detained, facing charges of espionage by taking pictures. A backlash against North Korea was intensified and in turn, inter-Korean relations deteriorated further due to the North Korean submarine infiltration in September 1996. These incidents led to a reduction in all levels of economic exchanges with Pyongyang. While it was true that the inter-Korean trade lasted for Kim’s term, progress toward inter-Korean cooperation had been inconsistent. The expansion of economic exchanges and cooperation had only increased by 4.3 percent from 186 million in 1993 to 194 million in 1994 when the nuclear issue began to take place on the Korean peninsula. Despite the Agreed Framework in October 1994, and following South Korea’s ‘Law of Promoting South-North Korean Economic Cooperation’ in November 1994, the fluctuations in the volume of inter-Korean trade had persisted until the end of his term. The volume of inter-Korean trade decreased by 12 percent in 1996, 252 million US dollars compared with the previous year in 1995, 287 million US dollars. After a North Korean apology for the submarine incident which was forced by the U.S. in December 1996, the volume of inter-Korean economic trade seemingly increased in 1997, to 308 million US dollars. However, the export from South Korea was mainly material for the Light-Water Reactor (LWR) construction rather than normal commercial trade between North and South Korea. As the South Korean economy was in trouble with the Asian financial crisis in 1997-1998, inter-Korean trade sharply reduced to 222 million US dollars in 1998 which was about a 28 percent decrease compared to 308 million US dollars in 1997. (See table 5.1)

Table 5.1 Overall trend of annual inter-Korean trade

(Unit: thousands of US current dollars)

Year	Import into South	Export from South	Total	Annual growth (%)
1989	18,655	65	18,724	-
1990	12,278	1,188	13,466	-28.1
1991	105,719	5,547	111,266	726.3
1992	162,863	10,563	173,426	55.9
1993	178,167	8,425	186,592	7.6
1994	176,298	18,249	194,547	4.3
1995	222,855	64,436	287,291	47.5
1996	182,400	69,639	252,039	-12.3
1997	193,069	115,270	308,339	22.3
1998	92,264	129,679	221,943	-28.0

Source: Inter-Korean Exchanges and Cooperation (MOU 1999)

Note: The aggregate volume of inter-Korean trade included export from the South and import into the South. The former included general exports, commission-based processing trade, investments, and humanitarian and other cooperation supports to the North while the latter included only purchases by the South.

What is notable is that, during his term in office between 1993 and 1997, the processing-on-commission (POC) trade played an important role for expanding inter-Korean trade. The POC was a form of business that involved South Korean firms supplying North Korea with raw or intermediate materials and then reimporting semi-finished or finished products or exporting them to third countries. As indicated in table 5.2, POC trade had increased continuously and the share of POC in the total amount of inter-Korean commercial trade increased from 0.5 percent in 1992, 3.8 percent in 1993 to 49.4 percent in 1997 (Choi 2010; Kim and Noh 2009).

Table 5.2 Inter-Korean trade and processing-on-commission trade, 1989-1997

(Unit: thousands of US current dollars)

Year	From North to South		From South to North		Total	
	Total trade ⁽¹⁾	POC	Total trade	POC	Total trade	POC (%)
1989	18,655	-	69	-	18,724	-
1990	12,278	-	1,188	-	13,466	-
1991	105,719	-	5,547	-	111,266	-
1992	162,863	638	10,562	200	173,425	838(0.5)
1993	178,167	2,985	8,425	4,023	186,592	7,008(3.8)
1994	176,298	14,321	18,249	11,343	194,547	25,664(13.2)
1995	222,855	21,174	53,440	24,718	276,295	45,892(16.6)
1996	182,400	36,238	55,384	38,164	237,784	74,402(31.3)
1997	190,281	42,894	60,020	36,175	250,301	79,069(49.4)

Source: KITA, *Inter-Korean Exchanges and Cooperation* (<http://www.kita.net>)

Note: (1) These number only included commercial transactions between the South and North that were inclusive of general trade and POC and excluded non-commercial transactions.

It is also noteworthy that with regard to non-commercial transactions, South Korea provided food and fertilizer to the North in the form of a grant or loans and the amount sharply increased since the mid-1990s. For instance, the Kim government officially provided 150,000 tons of rice to relieve Pyongyang's severe food shortage and donated 232 million US dollars through the government's North-South Cooperation Fund in 1995. This was the first direct South Korean assistance towards the North since they divided. However, providing food aid was not performed with humanitarian principles. A part from the fact that food aid was provided in the form of loans, the government had pursued the food assistance with deliberate political considerations, and the provision of humanitarian assistance was often linked to the condition of resuming inter-Korean dialogue.

During his term in office between 1993 and 1997, inter-Korean trade including commercial and non-commercial transactions continued to grow, but progress in inter-Korean cooperation had been disappointingly inconsistent. As North Korea's nuclear development programme raised tensions on the peninsula, an incentive-based strategy was not employed consistently in South Korea's policy on North Korea. The former was a major external obstacle to evolving South Korea's policy into positive engagement that had interdependent or transformative features. However, structural factors limiting the operation of economic incentives were also attributed to inherent structural vulnerabilities. Crucially, the level of economic ties was too weak to generate the conflict-inhibiting effects relating to peninsula stability and transformation.

5.3 The inception and frustration of South Korea's early economic statecraft

It is fair to say that since its formal inception, the trade volume between the two Koreas had expanded from 18.7 million US dollars in 1989 to 308 million US dollars in 1997. However, inter-Korean economic relations during the terms of the Roh Tae-woo and Kim Young-sam administrations were in many ways not at all about economics. Namely, the pursuit of economic statecraft under the South Korean government had been a strategic means to secure domestic political interests and to promote national reconciliation with North Korea. Even if South Korea's economic statecraft based on inter-Korean exchanges and cooperation became more visible and important in its North Korean policies, latent receptivity on the North Korean side was required for their effects. For this reason, the initial development of inter-Korean relations was related to the domestic political consequence of North Korea being threatened by their economic hardships and changes in geopolitical conditions between the late 1980s and the mid-1990s. In this vein, engagement through economic cooperation under the Roh and Kim administrations provided an important clue as to understand the interplay between politics and economics in inter-Korean relations. The questions that need to be addressed are: what were the motives and intentions that drove South Korea to initiate economic interaction with North Korea? Why did North Korea accept South Korea's economic incentives that resulted from trade and aid? Why did the early South Korea's positive economic statecraft fail to be centred in its policy on North Korea? These analyses ultimately show that the South Korean government policy on North Korea during the Roh and Kim era did not have the key aspects of positive engagement based on interdependent and transformational impact of economic incentives.

5.3.1 Stability and the status quo of inter-Korean relations

Firstly, the promotion of inter-Korean economic interaction was not designed to catalyse fundamental changes in the behaviour or the policies of North Korea, but rather, it was pursued for the stability and preservation of the status quo on the Korean peninsula. It was correct that economic exchanges and cooperation had been an element in South Korea's policy on North Korea under the administrations of Roh Tae-woo and Kim Young-sam. Nevertheless, it was not formulated and navigated with the goal of constructing interdependent relationship between the two Koreas, nor aimed at

encouraging the transformation of the North Korean system through economic opening and reform.

The inception of inter-Korean economic relations in the late 1980s matched both sides' political interests and economic needs. The Roh administration, having launched from the June Democratic Uprising in 1987 had to differentiate his regime from previous authoritarian regimes in South Korea. To consolidate his position, the Roh government needed certain levels of reconciliation and reduction of military tension to secure social stability and economic prosperity. Bringing about inter-Korean reconciliation was especially imperative to South Korea, ahead of summer Olympic Games in September 1988. The impetus also came from the outside. The end of the Cold War during the late 1980s opened a window of opportunity for the Roh government to change the course of inter-Korean political relations. By contrast, this transformation of the international situation during the 1988-1989 period and the growing economic strength of South Korea in the 1980s brought external security threats and domestic economic crisis to North Korea. The feat of President Roh's *Nordpolitik* in establishing diplomatic relations with the Eastern European countries and the Soviet Union between the years of 1989 and 1990 laid a burden upon the North to be isolated even by their critical allies (Yoon 2011; Lee 2011).¹⁷ Yet, the economic impact of diplomatic normalisation between Seoul and Moscow was more serious than the political impact on Pyongyang (Cha 2012). Since it caused a serious decline in capital and material support from both the Soviet Union and China, North Korea needed a breakthrough in dealing with their own economic constraints such as shortages of energy, food and machinery needs. Given this background, South Korea proposed a high-level North-South talk that included measures to implement inter-Korean exchanges and cooperation. Consequently, North Korea, considering inter-Korean economic cooperation as ways for securing foreign investment, currency and necessary commodities, accepted Seoul's proposal.

In fact, the promotion of inter-Korean economic exchange and cooperation was the most realistic policy measure that South Korean administrations could employ in practice. The context behind the promotion of exchanges and cooperation in North Korea policy under the Roh administration was, by achieving realistic results in the realm of economic cooperation in which the South can take the initiative based on superior position in economics, to have the potential leverage over the political and

¹⁷ Interview with Yoon Young-kwan in Seoul, 12 April 2011, and with Lee Kwan-se in Seoul, 30 May 2011.

military issues. To the Roh administration, promoting trust and expanding contact through inter-Korean exchanges and cooperation was a *sine qua none* of further progress in inter-Korean agreement of non-aggression, arms reduction, confidence-building measures, and North Korea's nuclear development programme. On this point, former Vice-Minister of Unification Kim Hyung-ki (2011) stated that "the agreement and development of economic cooperation between the North and South Korea was regarded as a litmus test of the Roh administration, with expectation that these achievements would pave the way of resolving the political and military areas."¹⁸ From Seoul's perspective, it was a realistic and safe way toward improving relations with Pyongyang. To put another way, the confidence on the disparity in economic power between the two Koreas and recognition of the rapidly changing international security order from the end of Cold War provided the motives and impetus for South Korea to engage with North Korea. Considering South Korea's limited policy options and weak leverage towards North Korea at that time, the promotion of inter-Korean economic exchanges and cooperation was the most viable policy measure that the administrations of Roh Tae-woo and Kim Young-sam could realistically employ.

Within its structural limitation, North Korea's nuclear programme provided the rationale for why South Korea's policy on North Korea and inter-Korean economic cooperation had to be focused on managing North Korea's risk and maintaining the status quo of inter-Korean relations. Compared with the previous South Korean administrations, it was true that there was a drastic change in the North Korea policy under the Roh government. *Nordpolitik* and '7.7 Declaration' were considered as the most forward-looking engagement approach in the history of South Korea's policy on North Korea. In effect, it led to important outcomes such as the 'Basic Agreement' and 'Joint Declaration on the Denuclearisation of Korean Peninsula'. Meanwhile a series of North-South high-level talks was an unprecedented event, a theatre of dialogue in which both sides first discussed and negotiated a wide-range of political, economic, and military issues since the end of the Korean War. Nevertheless, what both North Korea and South Korea had confirmed through the inter-Korean high-level talks were the different approaches to unification and the difficulty in determining priorities between the political and military issue and the exchange and cooperation issue. It was indeed problematic in the latter stage of Roh's presidency because it caused controversy between the proponents and opponents of engagement strategy, and raised a fundamental question of what the North and the South should discuss and

¹⁸ Interview with Kim Hyung-ki in Seoul, 14 June 2011.

resolve first between North Korea's development of nuclear weapons and inter-Korean economic cooperation issue. For instance, the Roh administration intentionally slowed down the progress of the pilot projects of the Nampo industrial complex which Chairman Kim Woo-jung of the Daewoo Group and North Korea had been discussing in 1992. Indeed, North Korea was determined to expand inter-Korean economic cooperation, but since the South adopted its policy of linking the nuclear issue to economic cooperation, "the North's request for the initiation of pilot projects had been virtually rejected" (Lim 2012: 141). It indicated that North Korea's suspected nuclear weapons programme has undermined the dynamics of economic cooperation as a means of leverage over the political and military area.

It happened particularly during the Kim Young-sam era, being a main reason as to why a policy instrument of inter-Korean economic cooperation could not be geared as a key strategy to generate vested interests in continued interdependence or encourage the desired transformation of the North's political economy and its belligerent behaviour. As the pursuit of nuclear weapons became a central element of North Korea's policies in conjunction with a decision to withdraw from the NPT, the South Korean leadership's will to develop inter-Korean relations was discouraged, and the growth of inter-Korean trade and humanitarian aid fluctuated with the political situation. The criticism from conservative parties and the media, alleging that the nuclear issue should be resolved first for the improvement of North-South relations, also helped to undermine the impetus for the promotion of economic cooperation between the North and South. Under these circumstances, South Korea's policy on North Korea under the Kim administration took on a character of stabilising the North Korean regime and maintaining the status quo of inter-Korean relations. The policy direction had accordingly converged towards the recognition of the state of division and political entity, the simultaneous entry of the North and the South into the United Nations, the prioritisation of denuclearisation over economic cooperation, the resumption of the Team Spirit exercise, and the augmentation of defensive capabilities against military provocation.

Indeed, both the Roh and Kim administrations reasoned that it was not possible, nor desirable, to bring down the North Korean regime from the outside. Faced with the collapse of the Soviet bloc countries, the disintegration of the Soviet Union and the unification of East and West Germany, there was an initial expectation that the North would follow the Chinese model and undertake a process of gradual opening and economic reform, thereby, Roh's policy directive would contribute to the gradual

change in the totalitarian dictatorship based on a command economy. But even at that time, Roh government's policy goals were not aimed at achieving unification through absorption or the demise of communism in North Korea or the radical reform of the Kim, Il-sung regime. Rather, the Roh administration's North Korea policy was based on a gradual approach toward transformation of North Korea. According to Lim Eul-chul (2011), this gradual transformation approach did not assume that increasing exchanges and cooperation between North and South Korea would lead to reform or liberalisation measures in North Korea.¹⁹ It meant that the promotion of economic cooperation was not designed to encourage North Korea's policy-makers to undertake reform and the opening of North Korea. With regard to North Korea policy under the Kim Young-sam government, although the Kim administration that came into power in 1993 officially stressed peace and cooperation with the North, they basically held the view that North Korean economic and political collapse was imminent, and adopted the linkage strategy between the progress in North Korean nuclear issue and the improvement of North-South relations (Lim 2012). Notwithstanding these features, it was not reasonable to judge that the Kim government pursued a containment policy with the aim of isolating or promoting a 'hard landing' in North Korea. This is because the Kim administration vehemently opposed the U.S. surgical attack towards North Korean nuclear site and abandoned its previous hard line policy in the latter stage of his presidency. As President Kim faced the mounting criticism due to the inconsistency of his North Korea policy, the Kim administration eventually reversed its previous position of 'strategy of nuclear linkage', providing food aid to North Korea.

In short, inter-Korean economic cooperation persisted as a part engagement strategy under the Roh and Kim administrations, but it was not driven as a policy instrument to facilitate the regime opening and reform within North Korea. In this sense, the rationale behind South Korea's economic approach to North Korea was not based on commercial liberalism, which claimed that the increased economic exchange and interdependence would promote peace (Chun 2012). Power politics prioritising military, economic and political dominance over North Korea was still considered significant in South Korea's foreign and North Korean policy. Considering the scale of inter-Korean economic cooperation and its leverage over inter-Korean security matters, it did not form an ever-greater part of South Korea's policy on North Korea, nor evolved into a form of positive engagement.

¹⁹ Interview with Lim Eul-chul in Seoul, 29 July 2013.

5.3.2 North Korean economic hardships and geopolitical changes

Secondly, the development in inter-Korean relations was highly associated with the deteriorating North Korean domestic economy and the changing geopolitical conditions. In principle, South Korea's engagement with North Korea required Pyongyang's response and reaction. Thus, it is critical to examine why North Korea accepted South Korea's positive incentives. Even though South Korea's vital interest had been stability on the Korean peninsula and inter-Korean trade had been made by President Roh's initiatives, these political interests and purposes of South Korea do not provide a sufficient explanation as to why North Korea started to engage in trade with the South. It means that endogenous and exogenous factors of the North Korean regime should be considered.

First, the receptivity of South Korea's positive economic statecraft had to do with North Korea's domestic economy. Considering the North Korean economic condition between the 1980s and the 1990s, it would have been difficult for Pyongyang to reject the opportunity of trade with South Korea as they had been faced with economic constraints such as the low level of technology, the decrease in labour productivity, and the high level of trade debts. After North Korea established its government in 1948, the political leadership adopted a centrally planned economy based on a socialist-style economy and pursued domestic-oriented industrialisation. It was advocated by Kim Il-sung's *juche* ideology which was a policy of keeping external influence at bay and seeking to meet demand entirely through domestic production (Armstrong 2002; Lankov 2002; Lee 2003). Despite the defeat in the Korean War in the early 1950s, North Korea had achieved a relatively sound growth in output between the 1960s and the early 1970s thanks to the popular mobilisation system and external assistance from the Soviet Union, China and other European socialist countries. In fact, South Korean GDP per capita, by several estimates, did not exceed North Korea's until the mid-1970s (Eberstadt 2007; Yang 2008; Park 2009). However, the early success of the high degree of industrialisation and labour mobilisation could not propel continuous economic growth. The North Korean economic hardship had become evident as the 1970s and 1980s progressed.

North Korea's security commitments were central to an understanding of the North Korean economy during those years. Kim Il-sung at that time had emphasised the development of heavy industrialisation for its self-reliant national defence (Kim 1996). For this reason, as seen in Table 5.3, the military build-up was initiated from the mid-1960s. The priority defence allocations within the state budget consequently led to

a decrease in the budget for non-defence sectors such as light industry and agriculture (Park 2009).

Table 5.3 Heavy and light industrial production: South and North Korea, 1960-1990

(Unit: percent)

	South Korea		North Korea	
	Heavy	Light	Heavy	Light
1960	-	-	55.6	44.1
1962	28.6	71.4	-	-
1965	31.4	68.6	51.2	48.8
1970	38.1	61.9	62.0	38.0
1975	45.9	54.1	63.7	36.1
1980	51.2	48.8	64.8	35.2
1985	56.7	43.3	-	-
1990	59.3	40.7	74.1	25.9

Source: Koo and Jo (1995: 27).

Although North Korea had been committed to developing its national economy through the implementation of the first Six-Year Plan (1971-76) and two Seven-Years Plans (1978-84 and 1987-93, respectively), its intensive growth strategies were limited to revitalise economic performance, and “per capita economic growth in North Korea may have come to a halt by the late 1980s” (Eberstadt 2010: 80).

During those years, North Korea’s domestic economic difficulties directly affected its external trade activities. In an effort to boost its economic plans and recognition of limitations of these policies, North Korea began to import plants and technology from Western industrial countries from the early 1970s (Yeon 1995). However, North Korea’s foreign trade had been shrinking because payments could not be made for the increased imports from Japan and European countries as well as the Soviet Union. To make it worse, the 1973 oil crisis aggravated this situation. This is because in the aftermath of the crisis, the Soviet bloc countries for which North Korea mainly relied on foreign trade reduced their economic assistance. As a result, as Pyongyang was not able to make repayments on schedule by the mid-1970s, the state’s credit rating collapsed and foreign trade was reduced by one-third between 1974 and 1976 (Eberstadt 2010). The fact that North Korea was not able to pay back its debt meant that it had to rely on foreign loans. Between 1970 and 1975, North Korea’s loans had already reached approximately 1.2 billion US dollars, even excluding the amount of debt repayment from Eastern bloc countries and China (Cha 2012). Under these

circumstances, as trade related debts accumulated with its repeated failure to meet payments, borrowing money via commercial loans to finance foreign debts consequently increased (Table 5.4).

Table 5.4 North Korea's grants and loans in the 1970s

(Unit: millions of US current dollars)

Year	USSR		China		Western loan ¹⁾	Total
	Grant	Loan	Grant	Loan		
1971	-	129	10	3	53	195
1972	-	110	50	-	205	365
1973	-	15	40	-	357	412
1974	-	6	60	-	491	557
1975	-	139	120	-	92	379
1976	-				28	
1977	-	-	-	-	8	8
1978	-	43	-	-	-	43
Total	-	442	280	3	1,234	1,959

Source: Yeon (1986: 73).

Note: Western countries refer to Japan, West Germany, France, Austria, Sweden, Denmark, U.K., Finland, Italy, Swiss, and Belgium.

The enormous trade debts and unpaid loans were beyond Pyongyang's repayment capacity, driving the country to default on its debt repayment. This vicious circle triggered by Pyongyang's approach to commercial and financial markets exacerbated the already dismal economic situation that had developed in the early 1970s.

To overcome this vulnerability, North Korea implemented tentative reform measures including a regional budget programme in the early 1970s and the '*Habyeongbeop*' (or the Law of Equity Joint Venture) in 1984 to increase domestic production and foreign trade and investment. However, these attempts undertaken in the 1970s and the 1980s turned out to be insufficient to overcome this innate economic hardship (Kim 2008). For instance, the *Habyeongbeop* failed to attract foreign investment except for economic assistance from the *jochongryeon*, the pro-North Korean residents in Japan. It was also revealed that only twenty contracts for venture projects were made until 1992 (Kim 2008). According to Jo (2009: 4), the *Habyeongbeop* was destined to fail because "it was not based on a solid and clear determination to open and reform the economy. The law also did not allow complete ownership by foreign companies." While it might be true that Pyongyang had certainly considered partial opening at the end of the 1980s, it was clear that these reform measures had been implemented within

the existing centralised and planned economy, failing “to improve its international creditworthiness or to attract international commercial contacts” (Eberstadt 2010: 89). Given that North Korea’s vital interest was to secure its regime survival, North Korea had to seek its own solution for revitalising its deteriorating economy.

From the North’s side, the most agonising problem was energy shortage. Although coal had been the most important source of energy in North Korea, an increasing militarisation of North Korea increasingly affected the entire structure of energy supply, demanding a large amount of crude oil to maintain military equipment. Even under the ideological commitment to *juche*, North Korea had to import most of its crude oil from the Soviet Union, China, and Iran from the early years, which means that North Korea has never reached self-sufficiency in energy and food supply even at the best of times (Smith and Huang 2000) (Table 5.5,5.6).

Table 5.5 North Korea’s crude oil imports

(Unit: US 1,000 tons)

	China	Libya	Yemen	Iran	Russia	Total
1991	110	-	-	75	4	189
1992	110	20	-	22	-	152
1993	105	10	-	21	-	136
1994	83	8	-	-	-	91
1995	102	8	-	-	-	110
1996	93.6	-	-	-	-	93.6
1997	50.3	-	60	-	-	110.6

Source: KOTRA, *North Korea's External Trade in 1997* (KOTRA 1998)

Table 5.6 North Korea’s grain imports

(Unit: 10,000 tons)

Year	China	Syria	Thailand	Canada	Japan	EU	Others	Total
1991	30	-	9	35	-	-	55	129
1992	62	-	2	8	-	-	11	83
1993	74	-	7.8	16	-	-	11.5	109.3
1994	30.5	-	5.2	-	-	-	13.3	49
1995	15.3	-	16.2	-	37	-	27.7	96.2
1996	54.7	14	3	-	13.2	-	20.1	105
1997	86.7	3.4	3.8	-	-	11.5	57.6	163

Source: KOTRA, *North Korea's External Trade in 1997* (KOTRA 1998)

On this point, Yang (2008: 62) argued that “the obsession with economic self-reliance brought about tremendous economic inefficiencies, including a low level of technology,

devastation of production facilities, and a decrease in overall labour productivity.” This economic downturn and stagnation in the 1980s led to the loss of North Korea’s fundamental capacity to obtain sufficient inputs to produce enough fertilizer, chemicals and electricity to satisfy agricultural needs. Along with huge natural catastrophes such as drought and floods from the early 1990s until 1998, severe food shortages made a difficult situation worse. Following from this, the context of the overall economic situation of North Korea in the 1980s and 1990s had driven the country to seek outside assistance, and thereby inter-Korea trade became attractive to North Korea as means of alleviating their own economic predicament.

Next, the changing international order significantly affected North Korea as well. As the Cold War waned, the United States reconciled its relationship with China in the early 1970s during the *détente* era. Considering that China made a diplomatic effort not to undermine its close ties with North Korea, the mood for rapprochement taking place during this time did not seriously threaten North Korea’s security and economic interests (Lee 2011). The reason was that both the Soviet Union and China still provided political and economic support and North Korea was able to maintain trade with other communist partners by the early 1980s. However, significant changes had occurred in the Eastern European socialist states between 1989 and 1990. In the wake of the collapse of communism in Eastern Europe, Hungary and Poland, which were former communist allies, established diplomatic relations with South Korea. Amid the changes of the time, the greatest challenge to North Korea was when the Soviet Union formally recognised South Korea and established diplomatic relations on 30 September, 1990. The Soviet Union’s recognition of South Korea was indeed a shock to North Korea because since the North Korean state was founded, the Soviet Union had not only been a key socialist allies providing security support via the provision of nuclear and missile technologies and a promise of military backing in wartime, but also the biggest backer of economic assistance such as energy, steel and food (Yeon 1986; Jo and Koo 1995; Cha 2012).

North Korea’s fear posed by the changes in the geopolitical situation was heightened when China made a decision to establish diplomatic relations with South Korea on 24 August 1992. The diplomatic recognition of South Korea by two major powers who had long been North Korean’s allies was a serious diplomatic defeat to North Korea in that they failed to prohibit the Soviet Union and China from establishing diplomatic relations with South Korea. At the same time, it was also a

political or ideological defeat due to the fact that it heightened North Korea's insecurity as it made the North Korean leadership agonise over their regime survival against external pressure for reform, thereby weakening their ideological superiority of communism over capitalism. Although North Korea stressed the *juche* ideology more firmly and resisted any influence from the political reform taking place in the East European countries, the Soviet Union, and China, the new international order led to increased pressure on every aspect of North Korea.

These geopolitical changes taking place in the international arena between the late 1980s and the early 1990s made a big impact on North Korean economic conditions. Considering that North Korea's trade with socialist markets at the time accounted for two-third of its trade, the collapse of the Communist bloc at the end of 1980s caused a considerable loss for the North Korean economy (Kim 2008; Lee 2005). Compared with political or ideological challenges, North Korea's economic impasse stemming from the loss of support from the Soviet Union and the failing socialist economy caused a more significant threat to the North Korean leadership. This was because economic benefits from cheap energy and grain supplies was directly linked to the general population whom North Korea had to feed and provide daily necessities (Paik 2008). The Soviet Union in particular had played a pivotal role in the establishment of North Korea after the Second World War. From the founding of the state in 1948 until the early 1980s, the Soviet Union had supported North Korea's current account deficits with heavily subsidised supplies of energy, fertilizer, manufactured goods and military technology (FAO/WFP 1998; Eberstadt 2003; Haggard and Noland 2007). By the late 1980s, the Soviet Union's support toward North Korea was responsible for 40 percent of electricity, 30 percent of coal, 30 percent of steel, and 40 percent of nitrogenous fertilizer, respectively (Starichkov and Kim 2008). However, facing economic constraints of its own, and frustrated by North Korean unwillingness to repay, the Soviet Union began to reduce aid and diverse support, beginning in 1987. The impact resulting from the decrease in Moscow's support became more distinct when the Yeltsin government cut off patron aid and began demanding that Pyongyang converted from the previous barter system to a currency payment system (Park 2009; Oh 2005). As a consequence of the collapse of the Soviet Union, China became North Korea's primary supplier of both oil and food in the early 1990s. However, when North Korea, due to a lack of foreign currency, was not able to meet payments, China consequently pulled back on crucial exports of corn and oil to North Korea (Oberdorfer 1999; Bluth 2008).

It was apparent that a significant decline in the support of energy supplies and raw materials from both the Soviet Union and China severely hit North Korea's production and sales of weapons. The military industry, called a second economy of the regime, had been the only lucrative business to bring in foreign capital during the 1980s, by exporting weapons and technology to Middle Eastern countries (Yang 2008). The critical point to be noted is that the revenue from arms exports was important to the North because it could be used to finance its enormous foreign debts. Yet, as shown in Table 5.7, the estimate of North Korean arms sales exports decreased from 166 million US dollars in 1991 to 12 million US dollars in 1997. The reduction in subsidised energy and food from the Soviet Union and China, coupled with the decline in North Korea's exports of weapon during 1990s worsened the deteriorating North Korean external debt situation. According to KOTRA, the external debt of North Korea in 1990 was estimated at 704 million US dollars, mostly owed to Russia and China (Young *et al.* 1998). The thing was, North Korea's trade deficit had been widening and lasted until the end of the 1990s (Table 5.8).

Table 5.7 Estimates of North Korean arms exports

(Unit: millions US dollars)

Year/To	Iran	Libya	Myanmar	Pakistan	Syria	Vietnam	Total
1990	4	-	-	-	-	-	4
1991	92	-	-	-	74	-	166
1992	109	-	-	-	74	-	183
1993	115	-	-	-	39	-	154
1994	6	-	-	-	35	-	41
1995	6	-	-	-	35	-	41
1996	4	-	-	4	18	4	29
1997	4	-	-	4	-	4	12
1998	2	-	-	-	-	44	46
1999	-	9	10	-	-	-	19

Source: SIPRI Arms Transfers Database

Note: Figures are SIPRI Trend Indicator Values (TIVs) expressed in US\$ m. at constant (1990) prices.

Table 5.8 North Korea's trade account

(Unit: millions US current dollars)

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Export	1,733	945	933	990	858	736	727	905	559	515
Import	2,347	1,639	1,622	1,656	1,242	1,316	1,250	1,272	883	965
Trade Account	-704	-694	-689	-666	-384	-580	-523	-367	-324	-450

Sources: KOTRA, *North Korea's External Trade in 1999* (Seoul: KOTRA, 2000)

Note: Inter-Korean Trade excluded

This dramatic decline of Soviet and Chinese support and the severe debt imbalance gave rise to a mega industrial shock, which was particularly felt in the agriculture sector. The lack of oil led to a decline in chemical fertilizers, and along with the electricity shortfall, the fertilizer shortages directly hurt North Korea's crop production (Cha 2012). Afterwards, deteriorating fertilizer and food shortages became a main cause in triggering the North Korean famine in the mid-1990s. As Phillip Park (2009: 36) highlighted, the energy shortage was "at the heart of the North Korean economic crisis". In this vein, the reduction in the supply of crude oil products, lumber, coal, and fertilizers from the Soviet Union and China precipitated the falling economy. It showed that external dynamics emanating from both Moscow and Beijing's shifting interest to normalise diplomatic relations with Seoul directly affected the North Korean domestic economy.

In accordance with these geopolitical changes, the successful hosting of the 1988 Olympic Games in Seoul and the implementation of *Nordpolitik* toward the communist-bloc countries during the early 1990s pressured Pyongyang to cope with external challenges. In essence, the diplomatic recognition of South Korea by two major powers was enough to shock North Korea, both politically and ideologically, but the disruptions in trade with the Soviet Union and China had a greater effect on the North Korean economic system. In this respect, given that North Korea had been facing economic difficulties and international isolation between the end of the 1980s and the mid-1990s, an opening for South Korea and inception of inter-Korean economic cooperation were viable alternatives to North Korea, prioritising the survival of its political system.

5.3.3 Structural vulnerabilities

Then, why did South Korea's use of economic statecraft under the Kim and Roh administrations fall short of causing positive changes in North Korea's behaviour? It meant that South Korea's strategic promotion of inter-Korean economic cooperation had limitations as an instrument of statecraft. Three factors are worthy of notice.

First, there was the trade imbalance between the two Koreas (Kim 2003). From 1988 to 1997, inter-Korean trade was dominated by import from the North to the South. It meant that whereas North Korea had earned a trade surplus in its economic exchanges with the South, South Korea had run a trade deficit in inter-Korean economic exchanges and cooperation (Kim 2005; Kim 2000). In particular, the increasing share of processing-on-commission (POC) trade in commercial transactions contributed to generating a trade surplus because it made it possible for North Korea to acquire foreign currency without other capital investment and foreign exchange transactions (Lee 2003: 190). Since the overall trade deficit of North Korea at that time had continually expanded from the early 1970s, those trade surpluses had been used as a means to earn foreign currency. Even though this trade surplus with South Korea was not large enough to reduce North Korea's high level of foreign debt during the 1980s and 1990s, it was obvious that inter-Korean trade was helpful to the North Korean economy.

Secondly, while inter-Korean trade might represent a significant share of the North Korean economy, North Korea's share in South Korea's total trade was meagre. From a strictly economic perspective, since the total amount of inter-Korean trade weighs little part in the South Korean economy, this trade deficit was not fiscally significant (Kim 2004). Even though inter-Korean economic cooperation, which officially began in 1988, had gradually expanded to 308 million US dollars in 1997, the overall volume of inter-Korean economic cooperation was still meagre and inter-Korean trade had remained in its early stages. Namely, it had not reached such a level that the North Korean economy was dependent on the South Korean economy. It was an important feature that since the Roh administration, South Korea's initial engagement through economic exchanges had been conducted with strategic objectives such as the improvement of inter-Korean political relations, reduction of military tension and balanced development of the national economy. Nevertheless, it was clear that the volume of inter-Korean trade was not large enough to create a bilateral interdependent relationship generating mutual benefits, fell short of the level of trade making conflict increasingly costly, nor something that was regarded as an instrument

to lead to a systemic transformation in North Korea such as economic reform or economic integration.

Thirdly, the legal and institutional framework to facilitate trade and investment could not lead to accelerate further expansion of inter-Korean economic cooperation. As discussed in the previous section, the fundamental problem, even putting aside institutional issues such as investment risk, transportation costs, insufficient infrastructure and the lack of communication channel, was stemming from North Korea's nuclear development. Although the South was able to generate agreements with the North and concrete measures for the implementation of economic exchange through the 7.7 Declaration, Basic Agreement, and Inter-Korean Exchange and Cooperation Act, security threats posed by Pyongyang's nuclear programme has been major impediments, discouraging the motivations and political will of the South Korean administrations. The North Korea's nuclear programme directly conflicted with international norms, the nuclear Non-proliferation Treaty (NPT) which they joined in 1985, and it was also a violation of the North-South 'Joint Declaration on the Denuclearisation of Korean Peninsula' of 1992. Consequently, North Korea's contradictory attitude made the willingness of the inter-Korean cooperation questionable.

Moreover, recurrent provocations and skirmishes with North Korea during the period of inter-Korean trade strengthened the political stance of South Korean conservatives who have emphasised South Korea's defensive needs and a direct linkage between economic incentives and North Korea's denuclearisation progress. While it was correct that the two sides might expect more mutual benefits from inter-Korean economic cooperation, the security concern stemming from the nuclear programme and North Korea's diplomatic and military confrontation with United States made it difficult to establish deep relations with North Korea and improve inter-Korean exchanges and cooperation. A systemic framework for inter-Korean economic cooperation leading to a stable and reasonable economic exchange was unlikely to be feasible as long as any of the resolutions regarding the North Korean nuclear problem were not made. It means that North Korea was approachable, but the signed agreements could not provide any momentum to propel the expansion of inter-Korean trade.

Lastly, North Korea's perception on a market economy and concern over allowing a partial opening posed a substantial obstacle to further develop inter-Korean economic cooperation. It is important to emphasise that, despite South Korea's

diplomatic efforts and North Korea's economic hardship, Pyongyang did not take up a positive attitude for market interaction with Seoul. Rather, North Korea maintained a reactive and even uncooperative attitude towards South Korean efforts to accelerate economic exchanges and cooperation between the two Koreas (Kim 2000). This lukewarm attitude had to do with Pyongyang's fear of the adverse effect of economic opening up, and the perception that its persistence and expansion of economic relations seemed to a 'Trojan Horse to liberalise the North'. To put it differently, North Korea held the view that any opening might cause the regime to collapse. On this point, Yeon (1995: 285) argued that

"Pyongyang's reluctance to commit to full economic cooperation with the South derived from its worries that such cooperation may awaken its people to the economic superiority of the South. This would be a detrimental blow to the North Korean regime."

In this respect, the South's willingness to expand inter-Korean economic cooperation was considered as a threat by the North, being contaminated by capitalist ideology. North Korea indeed needed a breakthrough to overcome the security and economic crisis, thereby beginning its economic relations with South Korea. Nevertheless, North Korea's opening toward South Korea should be limited to be the level of relieving its economic predicaments which would contribute to the survival and maintenance of the North Korean regime. Thus, the legal and institutional framework between North and South Korea could not guarantee the promotion of inter-Korean economic cooperation even if the North showed interests and willingness to abide by these measures. Considering that the development of economic relations based on the mutual benefits principles of interdependence could not occur through unilateral intention of either side, South Korea's strategy to generate a linkage effect from increased economic ties intrinsically required Pyongyang's resolute determination to receive South Korea's investment, capital and aid. However, from Pyongyang's perspective, South Korea's leverage and influence resulting from economic incentives might weaken the political and social cohesion of North Korea, undermining its own socialist economic system based on the self-reliant *juche* ideology. Thus, despite South Korea's desire to promote trade, inter-Korean economic cooperation could not expand without the change in the North Korean leadership's perceptions about a market economy. Even if North Korea had sought to overcome its economic difficulties through the inception of inter-Korean

economic exchange, it was doomed to fail unless Pyongyang adhered to the principle of economic growth without political reform.

5.4 Conclusion

The development of inter-Korean relations since the end of the Cold War has been remarkable and the volume of inter-Korean transactions gradually grew from 18.7 million US dollars in 1989 to 308 million US dollars in 1997, a 16.5-fold increase in just nine years. It was obvious that South Korea's efforts made it possible to initiate and diversify inter-Korean trade. However, the effects of the stagnant North Korean domestic economy and the influences of geopolitical conditions between the 1970s and 1980s also played an important role in the inception of inter-Korean economic relations. As the Cold War structure came to an end between the late 1980s and the early 1990s, it was undeniable that South Korea had an advantageous position in security with the collapse of communism in Eastern Europe, the normalisation of diplomatic relations with the Soviet Union and China, and the unification of West and East Germany. Whereas these changed dynamics around the Korean peninsula were enough to put significant pressure on North Korea undergoing economic predicament and international isolation, it was an opportunity for South Korea to engage and take lead in inter-Korean relations based on its achievements of economic modernisation and a relatively stable U.S.-ROK military alliance. However, as the wave of détente of international relations in the 1970s had not changed the dynamics of inter-Korean relations, the collapse of the Soviet empire and the fall of the communist camp during the late 1980s and early 1990s could not lead to a process for the dismantlement of the Cold War structure on the Korean peninsula.

Despite the dramatic shift in the correlation of force between the two Koreas, it became evident that the main motive of the Roh Tae-woo and Kim Young-sam administrations for promoting inter-Korean economic interactions was not aimed at changing the course of existing preferences and identities in North Korea. Rather, the implementation of exchanges and cooperation was more focused on maintaining the status quo of the Korean peninsula with domestic political considerations in attempting to promote peninsular stability. Certainly South Korea's policy on North Korea provided new momentum towards reconciliation and cooperation. Nevertheless, the aim of inter-Korean economic cooperation was not designed with the bigger purpose to encourage fundamental changes in North Korean political economy and

foreign policy. Rather, it had worked as a strategic tool for improving inter-Korean relations and preserving coexistence that were prerequisite for a more stable environment for sustainable development in South Korea. In this vein, engagement through economic cooperation has been an element of South Korea's policy on North Korea, as it expanded the scope of South Korea's interest in domestic policy areas, but it had not been advanced enough to be a central axis leading South Korea's North Korea policy or catalysing economic opening and reforms in North Korea.

Since the rationale behind inter-Korean economic relations was inseparable from political interests, South Korea's approach to commerce with the North has been largely state-driven and interlocked with each government's strategic considerations. This nature of trade was revealed with *sui generis* phenomenon that inter-Korean cooperation was subject to the whims of the political conditions between the North and the South. Fluctuating political relations made it impossible to deepen inter-Korean economic interactions, being an obstacle to transform the relations into an asymmetrical interdependent relationship. The main factors contributing to this feature were the Kim Young-sam government's inflexible linkage strategy and favoured belief in the imminent collapse of North Korea. However, a fundamental impediment to the South's drive to expand inter-Korean cooperation was Pyongyang's pursuit of nuclear weapons.

Given this situation, North Korea's nuclear programme seriously affected South Korea's core strategic choices and paradigms. At the level of the security policy of South Korea, according to the extent of the advancement of North Korea's nuclear technology, it could threaten the military balance between North and South Korea, and in this case, it fundamentally required South Korea to reframe its security discourse. With regard to South Korea's North Korea policy, it meant that regardless of the underlying objectives on North Korea's nuclear programme, the progress in inter-Korean relations was inevitably subject to progress in the North Korean nuclear issues. As South Korea's vital interest was considered to persuade Pyongyang to eliminate its nuclear capability, the South Korean leadership had to decide whether or not they would link the promotion of economic cooperation to the resolution of nuclear issue. In this sense, the advent of North Korea's nuclear programme in the early 1990s not only undermined the legitimacy for the expansion of inter-Korean economic cooperation, but also constituted a dilemma for South Korea and other countries to engage with North Korea. Thus, the nature of dual strategic interests in preventing North Korean military threats while working toward peaceful reunification caught South Korea

between the desire to engage with North Korea through diplomatic and economic measures and the responsibility of effectively deterring the North Korean nuclear arms development.

It was true that since official trade began with the South Korean government's '7.7 Declaration' in 1988, inter-Korean economic cooperation has continued to grow over the 1990s. It is also noteworthy that during the early period, the pursuit of inter-Korean economic relations brought greater contacts and interactions between the two Koreas and provided a limited experience of a market economy for Pyongyang. In some cases, it could be conceived that the South Korean administrations had some leverage toward North Korea. By linking economic cooperation to political and military issues, they indeed induced dialogue. However, despite these achievements, inter-Korean exchanges and cooperation during the initial phase had not led to significant improvements in inter-Korean political relations. Considering the economic weight and influence of inter-Korean trade on the North Korean economy, the leverage coming from trade and aid was not enough to revitalise the stagnant North Korean economy, or to lead to a rapprochement on the Korean peninsula. There was no doubt that Pyongyang seemed to be more interested in obtaining cash and goods from Seoul, and these inputs from South Korea helped to alleviate the trade deficit and food shortages of North Korea. From a North Korean standpoint, the improvement of relations with South Korea and inception of inter-Korean economic cooperation were likely to be considered as a channel of influx of foreign currency and aid.

However, the ties between the two Koreas were weak, and North Korea often hesitated to be too reliant on South Korea. It meant that absolute gains from inter-Korean transactions were not large enough to offer significant benefits to the North Korean economy. More importantly, military threats due to North Korea's nuclear programme made it more difficult to build a structural interdependent relationship. From Pyongyang's perspective, North Korea's economic opening towards the South had to be limited to being a means to obtain foreign capital and aid. Meanwhile, the effect of inter-Korean economic cooperation should not undermine its political system or awaken the people's awareness to the weakness of the self-reliant economic system and the superiority of South Korea's capitalism. Given this situation, it is inconceivable that economic incentives from trade and aid worked as leverage over the North Korean economic restructure or the political sphere in inter-Korean affairs. The bottom line is that while the past early stage of inter-Korean economic exchanges have grown continually between 1988 and 1997, profits from trade did not reach a level seriously

affecting a change in policies and behaviour within North Korea. Therefore, the early South Korean governments' tentative engagement through economic cooperation towards the North did not result in 'an influence effect' on the security matter on the Korean peninsula.

CHAPTER SIX

Positive Engagement towards North Korea in the Kim Dae-jung and Roh Moo-hyun era: Evolution and Limitations - Part one: Ideas and Interests

6.1 Introduction

This chapter examines the ideas and logic of the Sunshine Policy that underpinned the implementation of economic incentives towards North Korea. From a policy standpoint, there was an important shift in South Korea's policy on North Korea in the period between 1998 and 2007. It is because the progressive governments of Kim Dae-jung and Roh Moo-hyun were highly committed to the use of economic incentives in its North Korea policy and unprecedentedly adopted engagement through inter-Korean economic cooperation to advance political relations with North Korea. However, a mode of engagement through bilateral cooperation was nothing new in South Korea, because the previous South Korean administrations had also strived to resolve inter-Korean conflicts and develop economic relations with North Korea. This observation raises important questions on the underlying feature of Kim and Roh's policy on North Korea. What are the ideas and interests expressed in the Kim and Roh administration's statecraft, and what makes them different from the past administrations' policy on North Korea? Through investigating these issues, this chapter seeks to address the key research question of this thesis: to what extent the Kim Dae-jung and Roh Moo-hyun governments' Sunshine Policy can be identified with the frame of positive engagement. This chapter begins with a discussion of the principles and approaches of the Kim and Roh administrations' policy on North Korea. It then examines the policy directions of the Sunshine Policy. Next, based on the analytical framework presented in chapter 4, it elucidates how the Sunshine Policy can be understood within the framework of positive engagement.

6.2 Ideas of the Sunshine Policy

6.2.1 Kim Dae-jung administration, 1998-2003

South Korea's policy on North Korea had changed since the government of Kim Dae-jung was inaugurated as South Korea's 15th president on 25 February, 1998. The launching of the Kim Dae-jung administration was important in the history of South Korean politics, because it was the first peaceful democratic transfer of power from the ruling to the opposition party (Koh 1999). The inception of the government of Kim Dae-jung also implied that there was going to be a more fundamental shift in South Korea's policy on North Korea. This was because Kim, widely known as a pacifist, has maintained a progressive stance towards national reconciliation and reunification (Moon 2000; Paik 2011).

When Kim came to power, the administration presented a new policy of engagement towards North Korea called the 'Sunshine Policy'. Kim's Sunshine Policy heralded a profound change in the course of inter-Korean relations and South Korea's policy on North Korea. In his inaugural speech in February 1998, Kim Dae-jung strongly urged dialogue, reconciliation and cooperation between the two Koreas, laying out the three fundamental principles that were to form the basis for his new policy of engagement with North Korea.

"First, we will never tolerate armed provocation of any kind.

Second, we do not have any intention to harm or absorb North Korea.

Third, we will actively push reconciliation and cooperation between the South and North beginning with those areas which can be most easily agreed upon"

(Kim 1999: 65).

Strictly speaking, the declaration of non-tolerance of military threat, peaceful coexistence and economic cooperation were by no means new, because these agendas had been advocated by Kim's predecessors as well (Hoare 2008). The reason behind this was that, as Paik Haksoon (2009) noted, the core of the Korean peninsula issue was how to overcome the separation of the country and realise reunification. Given the realities of the national division, a common challenge and dilemma to all South Korean governments was that South Korea had to seek the goal of national unification while securing the status of co-existence. Hence, it was natural for the South Korean

presidents to emphasise 'peaceful' ways and means for reunification and a 'credible' military deterrence for self-preservation. Nevertheless, what differentiated the Kim Dae-jung administration from previous governments was its strong willingness and zeal to implement an engagement approach towards North Korea (Park 2001). In this sense, although it has been common to stress the improvement of inter-Korean relations, reduction of military tensions, and necessity of trust-building, Kim's new peace initiative was determined to change the nature of inter-Korean relations from hostility and confrontation to reconciliation and cooperation, with the aim of realising national unification.

The official title of the Kim Dae-jung administration's policy on North Korea was the 'Reconciliation and Cooperation policy' (*hwahaehyeopryeokjeongchaek*) (MOU 1998). However, President Kim preferred to call his policy the 'Sunshine Policy'. The analogy of 'Sunshine' originated from one of Aesop's fables, describing that it was not a cold north wind, but warm sunshine that makes a passerby take off his coat (Kim 1998). In the Korean political context, Kim's conception of the Sunshine Policy was based on the idea that positive incentives was deemed to be effective in encouraging the North to open its mind and its door to the outside world (Kim 1999). Recognising that "it was not the use of force or containment policy on the Cold War that could successfully change communism", Kim strongly believed that engagement approach through more contacts, exchanges and cooperation in a wide range of areas was more desirable than coercing or isolating North Korea (Kim 2008: 1). Namely, making the assumption that 'Sunshine' or engagement through positive incentives was more likely to reduce the North's fears and mitigate its mistrust and hostility towards the South, President Kim proposed a policy of reconciliation and cooperation as his administration's new policy on North Korea.

The conception of Kim's Sunshine Policy also originated from his ideas on Korean reunification. President Kim has proposed the 'Three Stages Unification' formula that consisted of the 'inter-Korean confederation', 'inter-Korean federation', and 'unification' (Kim 1997). Kim had long believed that the unification should proceed in a gradual and incremental integration process between the two Koreas, so it was critical to make a favourable environment for North Korea to change. To attain this goal, (neo-) functionalist approaches were significant (Koo 2000; Kim 2006). Under his three-stage approach to national unification, the dynamic process of economic exchanges and cooperation which would occur in the first stage was expected to promote mutual understanding and minimise conflict and hostility between the two

Koreas (Kim 1997). If the two Koreas could continue these efforts, inter-Korean economic cooperation would lead to deepen the structure of interdependence, being the catalyst for encouraging North Korea's opening and reform efforts (Kim 1997). Kim contemplated that, along with the process of building political confidence, these consequences of the stage of the South-North confederation would serve to manage the national division and create a climate for actual reunification or *de facto* unification (Kim 1997; MOU 1998). According to this line of reasoning, the active promotion of political and social exchanges and economic cooperation was a key activity under the stage of confederation and also a prerequisite for proceeding with inter-Korean federation. Therefore, it was regarded as the most realistic way to prepare for ultimate reunification while preventing the collapse of the North Korean regime and helping the restoration of national community.

Highlighting the validity of exchanges and cooperation did not, however, mean that the importance of military power for self-preservation was less emphasised. Kim made it clear that the Sunshine Policy was predicated on a strong security posture. Against a grave threat to South Korea's national security posed by North Korea's nuclear programme, Kim expected that, along with diplomatic efforts, the improvement of inter-Korean relations could contribute to the resolution of the nuclear issue as well. Hence, the parallel implementation of a strong security posture and an active effort at reconciliation and cooperation was regarded as relevant to his administration's policy toward North Korea (Kim 2000: 13). In this light, the aim of the Sunshine Policy was declared to "improve the inter-Korean relations through peace and reconciliation and cooperation" (MOU 1998; 2001: 24). To put it differently, Kim's Sunshine Policy was crystallized into the administration's determined goal to create a *de facto* unification situation in which the North and the South could exchange visits freely and help each other in peaceful coexistence, in advance of achieving an eventual *de jure* unification (Kim 1997; MOU 2001; Lim 2012). To implement the Sunshine Policy, the Kim administration set six policy objectives. They were: (1) promoting security and cooperation in parallel, (2) focusing on peaceful coexistence and peaceful exchanges, (3) establishing a favourable environment for North Korea to change through more contacts, dialogue, and cooperation, (4) generating mutual benefits, (5) securing international support, and (6) improving transparency and not rushing policy promotion (MOU 1998).

6.2.1.1 Three principles

The three fundamental principles of the Sunshine Policy offered by Kim deserve explicit emphasis. Kim's three principles strategically played an important role in signalling South Korea's clear willingness to engage with North Korea. However, the underlying significance stems from the fact that they formed a basis for the Sunshine Policy, guiding South Korea's strategies and policies on North Korea. Three factors that particularly influenced the formulation of the principles of the Sunshine Policy are the reality of military confrontation on the Korean peninsula, Kim's ideas on Korean reunification, and his judgement on realistic methods for the creation of peace.

First, the promulgation of the absolute rejection of any war or major military conflicts on the Korean peninsula was a reflection of the reality of inter-Korean military confrontation. Although the Sunshine Policy was aimed at reconciliation and cooperation between the two Koreas by all available means, Kim made it clear that Seoul would not tolerate any of Pyongyang's hostile actions or armed conflicts that would jeopardize stability on the Korean peninsula. In particular, North Korea's development and possession of nuclear weapons was a present and potential risk factor that posed a significant threat to South Korea's national security, and they could at any moment deteriorate inter-Korean relations. Given North Korea's nuclear ambitions and the resultant security environment, Kim clearly acknowledged that 'peaceful coexistence' would not be viable without a strong deterrent posture. Under these circumstances, it is noteworthy that Kim's first principle conveyed three different messages towards three different parties (Kim 1997: 47).

First, it was intended to be a warning to North Korea. Although Kim showed a willingness to engage with North Korea through dialogue, exchanges and cooperation, it would be difficult to implement his policy if the North would raise military tension or create a crisis situation on the Korean peninsula. Thus, it was a message to the North Korean leadership that they should refrain from military provocations towards the South if they were interested in improving inter-Korean relations (Kim 2000: 11).

Second, the first principle carried an important meaning considering the domestic opponents in South Korea who were suspicious of the Sunshine Policy. As noted earlier, regardless to the extent of the leadership's willingness and intentions to engage with North Korea, it was natural for South Korea's presidents to emphasise national security, placing a greater priority on the goal of deterring North Korea's military threat and armed provocations. Yet, Kim, being recognised as pro-North by conservatives in South Korea, had to eliminate doubts of the Sunshine Policy and the

suspicion of it being the 'Korean version of appeasement', emanating from speculation that the Sunshine Policy would weaken the South's security stance (Paik 2011).²⁰ To this end, Kim had to convince the domestic audience that, with the commitment on maintaining their deterrence and defence capabilities against North Korea's threat, the aim of promoting reconciliation and cooperation was to bring changes in North Korea for opening and reform, not unilaterally assisting the North or rewarding its bad behaviour.

Third, the first principle played a role in reassuring the major powers surrounding the Korean peninsula, especially the United States. Since Kim's Sunshine Policy had been devised in the midst of North Korea's nuclear issue, it was crucial for Kim to secure support from major actors around the Korean peninsula by underlining South Korea's commitment to cooperate in the resolution of the nuclear issue, particularly, the 1994 Agreed Framework. Although Kim has sought to win support from the international community, including the United States, Japan, China, and Russia, his idea of peace and reconciliation with North Korea particularly required close consultation and cooperation with the United States. For South Korea, the U.S. has been not only the most important ally to South Korea, but a key partner who could virtually support Kim Dae-jung in promoting an engagement approach towards North Korea. In fact, Washington reviewed the Kim administration's new policy, regarding Kim's Sunshine Policy as "the proper mixed deterrence, reciprocity and inducements", being compatible with their interests on the premise of robust deterrence and close cooperation between the United States and South Korea (Abramowitz *et al.* 1998: 5). After that, William Perry who was in an official position to review the United States policy toward North Korea evaluated that President Kim's North Korea policy was consistent with the national interests of the United States (Perry 1999). In this sense, Kim's emphasis on South Korea's firm security posture served to secure the foundation of support of South Korea's key ally, the United States, as it confirmed a determined attitude towards the North Korean threat, in particular nuclear and missile issues. Taken together, the Kim government needed to highlight that the Sunshine Policy was not the policy of appeasement, nor the policy of weakening South Korea's security posture. Rather, it was the strategy to induce voluntary changes in North Korea along with the persistence of the ROK-US alliance. For this, Kim's message on non-tolerance of military threat and armed provocation by North Korea played an important role in legitimising the Sunshine Policy.

²⁰ Interview with Paik Haksoon in Seoul, 15 June 2011.

Second, President Kim Dae-jung also officially confirmed that South Korea would not have any intention to harm or absorb North Korea whilst adopting the Sunshine Policy. The rationale behind the second principle of the Sunshine Policy was Kim's determination for 'peaceful unification' (Kihl 1998). Kim Dae-jung (1997: 48) elucidated that 'peaceful unification' referred to "the peaceful management of unification processes" and the prevention of "any possibility of unification through the Southern absorption of the North or the Northern Communisation of the South through conspiratorial scheming, coercion, or by military force". Both Kim's 'Three-Stage Approach to Unification' and South Korea's official unification formula, 'the National Community Unification' (NCU) posited that an immediate and full integration of the two Koreas into a single political unit was neither possible nor desirable. It indicated that South Korea's long-term goal for unification should be progressed in a gradual and peaceful manner rather than absorption or unification by force. To put it differently, it was widely accepted in South Korea that, in any circumstance, the government must prevent the possibility of either unification through the use of force or absorption that would inflict serious damage or impose unbearable economic costs to the both Koreas (Kim 1997). Thus, Kim's conception of 'peaceful unification' was predicated on the co-existence between the two Koreas, not requiring a prompt abandonment of their sovereign rights whilst moving forward to unification without violence. Given that Kim supported, in principle, peaceful co-existence and a gradual process to unification, the idea of absorption or unification by force was inconceivable to Kim Dae-jung.

However, considering that the mutual recognition of the existence of two different political entities and an incremental and step by step unification were the general consensus of South Korean politics, the declared principle of Kim's Sunshine Policy was hardly a new viewpoint. Thus, it is important to understand that the underlying causes of the abandonment of unification through absorption was influenced by four factors: the cognition of unification-oriented special relationship, a theory of gradual change, a prediction about North Korea's policy direction, and diplomatic message towards China and Russia.

First, from the viewpoint of the North-South institutional framework, Kim's declaration on the rejection of unification by absorption meant that his policy was predicated upon a non-aggression agreement which was a key component of 'the 1991 Basic Agreement'. However, the most important aspect of his principles was not attributed to a substance of an agreement itself, but to his perspective on the nature of

inter-Korean relations. Kim's second principle indicated that inter-Korean relations should be regulated as a special interim relationship stemming from the process towards unification, not viewing it as real state-to-state relations. In fact, the fundamental feature of the Basic Agreement of 1991 was to treat the North Korean regime as a legitimate government, viewing Pyongyang as a rational partner, recognising the North-South relationship as 'unification-oriented special relationship'. Thus, whilst both Koreas were committed to abide by the Basic Agreement, they should not consider the other side as the object of overthrow or absorption. Highlighting the assurance of non-aggression and the abandonment of the idea of unification by absorption did not, however mean that Kim was content with the continuation of the 'absence of war' or took the stance of merely opposing war on the Korean peninsula. Rather, it signified that, the agreement of non-aggression or non-threatening which had been penetrating the Joint Communiqué of 1972 and the Basic Agreement of 1991 should not be only a mechanism to maintain the existing status quo which might perpetuate national division. From the point of view of Kim's unification idea, this rule should promote reconciliation and cooperation, thus paving the foundation for establishing *nambugyeonhap* (literally South-North Confederation). To accomplish this, the policy of unification through absorption should be ruled out. The validity of this thinking was legitimised when considering the two divergent systems, the tremendous shock and confusion of the people, the unbearable economic costs, and the potential military conflict. In this context, the rejection of unification by absorption and force was not an option for Kim, but was viewed as an essential prerequisite for expediting inter-Korean reconciliation and cooperation, moving towards an incremental integration, and undertaking a task of an ultimate unification.

Second, it should be noted that the second principle of the Sunshine Policy was based on the premise that the North Korean regime would not collapse immediately. The Kim administration believed that the sudden collapse of the Kim Jong-il regime was wishful thinking and the chance of it was also very slim (MOU 2001; Kim 2001). The fact that North Korea did not collapse even under chronic economic downturn and severe food shortages in the mid-1990s deepened Kim's conviction on North Korea's capacity of maintaining the regime. The reasoning was also attributed to the indispensable role of China supporting North Korea with enormous material assistance and security alliance. On this point, Kim Dae-jung stated that "as long as Socialist China is able to maintain its power and supports North Korea's existence, and exerts its power and influence to block the sudden demise of North Korea, it would be

impossible to foresee a collapse of North Korea” (Kim 1997: 81). In this context, Kim Dae-jung and the Kim administration contemplated that the North Korean regime would more likely survive through a gradual reform and opening up measures, as was the case with China or Vietnam (MOU 2001). Hence, it was necessary and appropriate for South Korea to engage with North Korea so that it would encourage economic reform and the practice of cooperation, rather than keeping its focus on isolating Pyongyang or seeking a ‘hard-landing’ (Kwak 2000; Swenson-Wright 2012).

Third, this line of reasoning also had to do with Kim’s own judgement on the future direction that North Korea might choose. Given the three possible options to the North Korean regime which were summarised by armed provocation, self-imposed isolationism, and reform and opening, Kim Dae-jung predicted that North Korea would have no choice but to adopt economic reform and an open-door policy for the survival of the North Korean system (Kim 2011b: 71). Even if Pyongyang might seek economic development while adhering to ‘socialism with Korean characteristics’ or ‘socialism in our own style’ (*urisiksahoejuui*), the North would be most likely to take the road to the third way in the long run. Namely, faced with the collapse of the Communist Bloc and the reunification of East and West Germany in 1990, Kim anticipated that the changes in North Korea were inevitable, viewing that Pyongyang was certainly attempting to come out of isolation to overcome its economic predicament. Cognisant of the continuity of the North Korean regime destined for irreversible change for its survival, it was a logical conclusion for the Kim government to support the Korean incremental change that could control Pyongyang’s soft-landing and assure stable management of the national division. In fact, Kim Dae-jung contended that an abrupt and sudden integration of the two Koreas was unfeasible and undesirable, considering “the expected shocks and confusion from the integration of the two systems and their multifaceted difference” (Kim 1997: 33).

Lastly, the second principle underpinning the Sunshine Policy had a practical diplomatic purpose. Indeed, it played a role in reassuring Pyongyang that Seoul would not seek unification by absorption. However, the second principle had more to do with strategic manoeuvre to draw support from the major powers, particularly China and Russia by underlining that the Sunshine Policy would be in accord with their own strategic interests. To put it differently, Kim’s Sunshine Policy, especially its second principle was aimed at not only delivering Kim’s willingness of peaceful co-existence and peaceful unification to North Korea, but also relieving China and Russia’s conceivable concerns over whether or not the motives and intention of the South’s

policy of engagement were a rapid transition in North Korea with the goal of pushing for immediate unification. Considering that any cooperative move of Kim was unlikely to draw resistance from the United States and Japan, the second principle of the Sunshine Policy that the South would not undermine the North Korean regime or attempt unification by absorbing the North accorded with the positions of China and Russia whose primary national interests were to maintain stability on Korean peninsula (Kim 2000: 65; Kim 2004: 65).

Third, considering that the first and second principles of the Sunshine Policy had the characteristic of declaration and promises on what the Sunshine Policy was about, the third principle, the promotion of reconciliation and cooperation between the two Koreas, concerned substantive means on what it ought to do. From this perspective, whereas its first and second principles were based on the value of 'peace-keeping' through a strong security posture and the rejection of any hostile ideas of unification, the third principle was an 'instrument' on how to realise the goal of the Sunshine Policy, founded on the value of 'peace-making' (Moon 2012).

In principle, the promotion of reconciliation and cooperation was meant to resume and develop inter-Korean exchanges and cooperation in all areas, including political, economic, social and cultural areas as it was predicated on the 1991 Basic Agreement. For Kim, the validity of expanding inter-Korean exchanges and cooperation was not so much the necessity of the functional links but its value as a strategic means. This activation of exchanges and cooperation in various areas was expected to increase the level of inter-Korean interdependence, serving to build "the firm substructure that would facilitate peaceful and democratic unification" (Kim 1997: 18). The important fact was that the broadening and deepening of inter-Korean economic cooperation involved a 'process' under the framework of the Sunshine Policy, but the idea was, at the same time, a 'means' to the ends. In other words, the promotion of inter-Korean exchanges and cooperation was adopted as an instrument to achieve the ultimate goal of the Sunshine Policy, the creation of *de facto* unification, and to make the former process easier. Since Kim contemplated that the North Korean regime could not help taking a step towards economic reform and opening for its own survival, the administration believed that the North would accept economic incentives generating from the relationship with the South. In this way, as the two Koreas expanded economic interactions through trade, investment and aid, gradually constructing asymmetric interdependence relationships, they would not only help

Pyongyang to improve its economic condition, but also serve to form internal dynamics, leading to self-motivated changes within North Korea. From this perspective, inter-Korean exchanges and cooperation under the engagement and reconciliation policies involved not only economic motives, but also political interests. An important distinction and implication of the Sunshine Policy lies in the fact that inter-Korean economic cooperation was driven by a state primarily for these strategic reasons.

6.2.2 Roh Moo-Hyun administration, 2003-2008

Roh Moo-hyun came to power as the 16th President of Republic of Korea on 25 February 2003. In his presidential campaign, Roh who was the ruling Millennium Democratic Party (MDP) candidate made it clear that he would carry on President Kim's Sunshine Policy of pursuing peace and reconciliation with North Korea as well as his effort to expand inter-Korean economic cooperation (*Korea Times* 2002). Regarding North Korea's security concern, Roh pledged that the South would not allow the North to become a nuclear power, emphasising the need to induce changes through dialogue and economic incentives rather than containment pressure and sanctions. The official title of the Roh Moo-hyun government's policy towards North Korea was the 'Peace and Prosperity Policy' (*pyeonghwabeonyeongjeongchaek*). In essence, Roh Moo-hyun and his government were committed to continue the previous Kim government's Sunshine Policy and increased engagement towards North Korea (Kang 2003; NSC 2004). As with the former Kim's government, the Roh administration basically recognised North Korea as a legitimate counterpart for dialogue and negotiation, viewing the nature of inter-Korean relations as a 'unification-oriented special relationship' which had penetrated the Basic Agreement of 1991 and the Joint Declaration of 15 June, 2000 (Kim 2004). Believing that the North would not collapse immediately, and unification through absorption would not be desirable, a central plank of the Sunshine Policy-a step by step and negotiated approach to unification and the modality of the creation of *de facto* unification-was commonly shared with the Roh administration's North Korea policy. Accordingly, the path to expand exchanges and cooperation and build economic interdependence was consistently supported by the Roh government.

It should be noted that there were internal and external challenges that significantly influenced the course of inter-Korean relations and his administration's

North Korea policy. First, Roh had a responsibility to continue his predecessor, Kim's Sunshine Policy. Despite South Korea's commitment on engagement over the past five years, the process of inter-Korean reconciliation and cooperation fell far short of constructing interdependent relationship, and it still had a long way to form inter-Korean economic community. The first inter-Korean summit since the end of the Korean War was obviously a great achievement of Kim's Sunshine Policy and led to visible developments in inter-Korean relations, but the progress in reduction of military tensions and confidence-building between the two Koreas was too slow to bring about any meaningful changes. Namely, the Roh administration was given the task of realising the condition of *de facto* unification that had not been achieved despite Kim's efforts for deepening and expanding inter-Korean exchanges and economic cooperation (NSC 2004). Second, the Roh administration was launched with the so-called 'the second North Korean nuclear crisis' which was precipitated by North Korea's clandestine highly enriched uranium (HEU) programme. Irrespective of ascertaining whether an actual HEU programme existed or not, North Korea's HEU issue particularly caused Washington's desire to apply more containment pressure and sanctions to North Korea. In other words, from the beginning of his administration, Roh faced a complicated problem posed by North Korea's alleged uranium enrichment programme regarded as "Asia's gravest security crisis" (Kim 2005: 13). An important point to be notice here is that the external security challenges caused by the HEU issue acted as a major variable in undermining the impetus for driving the Sunshine Policy. To cope with these internal and external challenges, Roh emphasised that his administration would not only continue and expand inter-Korean economic cooperation, but would also seek a peaceful resolution of the North Korean nuclear issue (MOU 2003a). It showed that the Roh Moo-hyun administration had been placed in the position which inherited the legacy of the Sunshine Policy and the crisis over the North Korean nuclear weapons (Kim 2004). In this sense, these major challenges formed a new circumstance of inter-Korean relations, making the Roh administration devise a strategy that could contribute to both the advancement of inter-Korean relations and progress in the North Korean nuclear issue.

To address this twofold task, President Roh set 'peace' and 'prosperity' as the two important pillars of his national strategy (MOU 2003b). Roh regarded the North Korean nuclear issue as the root of conflicts, disputes and instability to both South Korea and the entire international community. The Roh administration more specifically perceived that the pursuit of nuclear weapons by North Korea had been a

major barrier to carry out mutual tension reduction and military confidence building, thereby making it unable to transform the military armistice agreement into a peace treaty. Thus, the establishment of a peace regime that would be viable only after the resolution of the North Korean nuclear issue constituted a *sine qua non* for the stability and prosperity on the Korean peninsula and in Northeast Asia. This point of view was formalised with the two goals of the Policy of Peace and Prosperity: 1) “the promotion of peace on the Korean Peninsula” and 2) “the pursuit of mutual prosperity for North and South Korea and contribution to prosperity in Northeast Asia” (MOU 2003a).

The first goal represented that South Korea would place the priority on dissolving the complex and long lasting confrontation between North and South Korea by seeking a resolution of the nuclear issue and establishment of a peace regime on the Korean peninsula. One important policy direction regarding the first goal was Roh’s parallel approach, which determined to tackle the resolution of the North Korean nuclear issue in tandem with improvement of inter-Korean relations (NSC 2004: 47). In align with the Bush’s administration’s North Korea policy, it was true that President Roh earlier indicated a more resolute attitude towards North Korea’s nuclear weapon and missile related programme. For instance, at the meeting with President Bush in May 2003, he stated that “future inter-Korean exchanges and cooperation will be conducted in light of developments on the North Korean nuclear issue” (White House 2003). It did not mean, however, that the activation of inter-Korean economic cooperation was contingent on the progress made on the nuclear issues. During his presidency between 2003 and 2008, the overall economic incentives through humanitarian aid and internal trade were provided to North Korea without being tied to a progress in nuclear negotiations. Considering that Pyongyang’s continued pursuit of nuclear weapons caused a direct threat to South Korea’s security, the resolution of North Korea’s issues was a prerequisite for the establishment of a durable peace regime on the Korean peninsula. The nuclear issue itself, however, did not preclude the South from engaging economically towards North Korea.

The second goal meant that the Roh administration would pursue a common regional prosperity in Northeast Asia by constructing interdependent relations among South and North Korea and Northeast Asia. The Roh government believed that if the two Koreas could institutionalise inter-Korean reconciliation and cooperation, moving toward a *de facto* unification situation, it could bring mutual benefits to the Northeast Asian region. The underlying assumption of the Roh administration was that the former process would lead to tension reduction and confidence building between the

North and the South, thereby contributing to peace and prosperity in Northeast Asia. In Roh's Peace and Prosperity Policy, the idea of growing ties and the creation of a North-South economic community was interlinked with the government's strategy of making Korea into a Northeast Asian business hub. For instance, Roh envisioned multilateral economic cooperation in the Northeast Asian region by connecting the Trans-Korean Railway (TKR) with the Trans-Siberian Railway (TSR) (MOU 2005). This cooperation project, the so-called "Iron Silk Road" symbolised that Roh contrived to link the promotion of inter-Korea economic cooperation with the common interest and regional dynamics of cooperation such as trade, industrial and energy among the countries in Northeast Asia. Such conception of Roh was what made it different from the former Kim's administration's policy on North Korea. On this point, Kang In-duk (2003: 4) claimed that "while the Sunshine Policy focused on the methodology of North Korea policy, the Peace and Prosperity Policy goes beyond the Korean peninsula and places emphasis on achieving peace and prosperity in Northeast Asia."

Against this backdrop, two points deserve emphasis with regard to the Roh government's policy on North Korea. First, as with the Sunshine Policy's central assumption, the Roh administration believed that progress in the inter-Korean economic area which was relatively easy and practical to cooperate would facilitate more cooperation in the political and military areas which were difficult to settle (Huh *et al.* 2007). Strategically, it demonstrated that South Korea wanted to utilise economic incentives through inter-Korean economic cooperation or the North Korean economic dependence on the South as leverage to influence North Korea's attitude and behaviour. Second, compared with Kim's Sunshine Policy, the Roh government combined the expansion of inter-Korean economic exchanges and cooperation with regional cooperation and prosperity in Northeast Asia. Whereas the Kim Dae-jung administration primarily focused on inter-Korean reconciliation and development of national economy with the belief that greater interaction and cooperation would create peace between the two Koreas, the Roh administration linked it with ongoing dialogue, interaction, and economic cooperation between the two Koreas to security and relations in Northeast Asia.

Under the conception of North Korea's policy, Roh promulgated three strategies in pursuing the Peace and Prosperity Policy that included: peaceful resolution of the North Korean nuclear issue in the short term, the establishment of a durable peace regime on the Korean peninsula in the mid-term, and building a Northeast Asian economic hub in the long-term (MOU 2003a). To continue to the

Sunshine Policy and achieve two policy goals, the Roh administration set four policy guidelines. They were: (1) resolving all conflicts and disputes through dialogue, (2) seeking mutual understanding and reciprocity, (3) promoting international cooperation based on the principle of 'parties directly concerned', and (4) carrying out policies reflecting the will of the people (NSC 2004: 24; MOU 2005: 17).

6.3 Strategies of the Sunshine Policy

On the base of the ideas and principles of the Sunshine Policy, there were important strategies penetrating South Korea's positive engagement between 1998 and 2007. They were mainly devised by the Kim Dae-jung administration, and persistently implemented throughout the Roh's presidency. The three vital components in the strategy of the Sunshine Policy were: (1) the use of positive economic statecraft; (2) the separation of politics from economics; and (3) the adoption of diffuse reciprocity.

6.3.1 Positive economic statecraft

First, positive engagement relying on economic incentives was adopted as a key strategy under the Kim and Roh administrations. Along with more dialogue and negotiation, the promotion of inter-Korean economic cooperation was highly significant for Seoul because it was regarded as a desirable policy instrument to expedite the process of an inter-Korean economic community and to foster a gradual and incremental integration process between the two Koreas. It meant that between 1998 and 2007 the activation of inter-Korean economic cooperation was centred on South Korea's policy towards North Korea, and the former became a mode of engagement in the two previous governments (Kang 2006). Then, the question was why it was important for Kim and Roh to employ positive economic statecraft towards North Korea. The Kim Dae-jung and Roh Moo-hyun administrations advocated engagement through inter-Korean economic cooperation with the following three main reasons.

First, Kim and Roh commonly believed that inter-Korean exchanges and cooperation was a useful means to bring mutual benefits to both Koreas (Yoon and Lee 2009). President Kim foresaw that if the two Koreas could expand trade and investment, the economic benefits would be generated for both states, and those positive incentives would consequently impact on reciprocal dependency (Kim 1997).

Kim's recognition of the need for cooperation could be understood as the role of economic incentives in interstate conflict. Within the discourse of strengths and drawbacks of economic statecraft, economic incentives that might come with increased trade, investment and aid would tend to foster mutual interests between the two states, and increasingly promote the level of asymmetrical interdependence. By contrast, the use of negative economic statecraft would not only threaten the opportunity of trade, but also weaken the incentive for political cooperation. These consequences of the use of economic statecraft provided a clue as to why Kim and Roh supported positive engagement characterised by the provision of economic incentives, and they ought to have opposed a containment policy or coercive diplomacy towards North Korea. In the Korean political context, President Kim viewed that whereas the North had an advantage of natural resources and labour pool, the South gained an advantage over capital and technology. Based on this fact, if both Koreas upgrade the scope and scale of economic cooperation, the South can benefit from cheap industrial site, a quality labour force, relatively rich natural resources, and the North can derive benefit from capital investment, technology transfer, and attraction of foreign capital. In fact, such a thought on the utility of inter-Korean economic cooperation was not something new to South Korea. Rather, it has been repeatedly asserted as the logical basis by those who supported an engagement approach with North Korea. With this reason, the two Koreas have initiated and developed the processing on commission (POC) trade since the early 1990s. Nevertheless, inter-Korean economic cooperation as a means to enhance the mutual gains of both Koreas seemed particularly appropriate to the Kim administration. They firmly believed that "combining South Korea's capital and technology with North Korea's labour" would "generate benefits for both Koreas and, thereby, promote balanced growth of the national economy" (MOU 2001: 44). This was corroborated by the rapid growth of POC trade under the Kim government. The share of POC as a percentage of total commercial transactions remained at 31 percent between 1996 and 1997, but it rose by nearly 50 percent in 2001.

Second, the promotion of inter-Korean exchanges and cooperation was regarded as important by the governments of Kim and Roh, because it would contribute to economic recovery in North Korea, thereby serving to reduce the ultimate cost of reunification. On this point, by giving the example of German unification, Kim Dae-jung asserted that "if unification were to occur with the current enormous economic gap between the two Koreas, even if that were to occur gradually, it would create a host of extremely difficult economic and social problems for us all" (Kim 1997:

129). In other words, the insurmountable gap between the two Koreas or the increasing vulnerability of the North Korean economy was not of great advantage to South Korea's national interests, even if it would bring with it an unexpected political and economic integration process. Rather, Kim contemplated that the increased economic difficulties of North Korea would amplify political instability and public concern over the nation's leadership, thereby becoming a potential danger to cause Kim Jong-il's regime to collapse. Thus, all these consequences would threaten peaceful co-existence between the two Koreas. The fact that Kim had supported the prevention of a collapse of the North and balanced development of the national economy provided a rationale for government policies to adopt engagement toward North Korea. On this point, Paik Haksoon (2011) stated that "Kim believed that a disengagement policy was inappropriate to South Korea. This was not only because a choice of non-involvement did not necessarily bring the probable change in North Korea, but also because it prohibited the growth of functional linkages between North and South Korea."²¹ Kwak Tae-hwan (2011) also mentioned that "a policy of malign neglect would not be an option for Kim's policy on North Korea because it only served to expand the economic, social, and cultural gap that had grown over the past half century."²² In a similar vein, a confrontation policy or coercive diplomacy could not be considered as a policy on North Korea, because they were likely to be implemented with the anticipation of the regime's collapse in North Korea. In Kim's view, these options were far from helping the recovery of the North Korean economy and building a better relationship with the North. Looking at it this way, engagement through inter-Korean economic cooperation was seen as the only viable option to induce gradual changes and improvement of the North Korean economy while reducing the current economic disparity between North and South Korea.

Third, for President Kim and Roh, and their administrations, inter-Korean economic cooperation was a realistic means available to develop the level of trust between the two Koreas. Considering the ingrained animosity and hostility formed for more than a half century, the restoration of different social identity under different systems was a prerequisite for proceeding to the stage of a union of states or confederation. As a supporter of the functionalist approach, Kim Dae-jung and Roh Moo-hyun commonly believed that the intensification of inter-Korean exchanges and cooperation would not only expand the flow of exchanges of commercial goods, but

²¹ Interview with Paik Haksoon in Seoul, 15 June 2011.

²² Interview with Kwak Tae-hwan in Seoul, 11 May 2011.

also promote more contacts and communication, the exchange of information, and even social and cultural relations between the North and the South. From the Kim Dae-jung and Roh Moo-hyun administrations' standpoint, positive engagement through inter-Korean economic cooperation seemed desirable to South Korea because the influence inherent in economic ties between the North and the South was believed to be the best possible way of signalling the South's intentions and willingness to promote welfare and understanding. If such interaction process between the two states could be persisted in the long term, a repeated pattern of transaction behaviour was expected to heighten trust by bilateral cooperation in various areas between the two Koreas. Such development could contribute to bridging the socio-economic gap between the two Koreas, laying a foundation for national unity in the long-term perspective. It was with this understanding that Kim and Roh regarded the growth of functional linkages resulting from inter-Korean economic relations as a practicable pathway to facilitate the process of reconciliation between the two Koreas. Viewed in this context, Kim stressed that "such economic exchanges and cooperation will have significance far above and beyond mere economics: it should portend the integration of the whole society" (Kim: 1997: 131). In other words, inter-Korean economic cooperation was a means not only to bring about the mutual gains of both Koreas "contributing to an integrated development of the Korean national economy", but also to generate social-psychological processes that would lead to "the recovery of national homogeneity" (MOU 2001: 48).

6.3.2 Separation of politics and economics

Second, the administrations of Kim Dae-jung and Roh Moo-hyun adopted the separation of politics and economics to facilitate economic exchanges and cooperation between the two Koreas. South Korea's operating principle of the separation of politics and economics (the Korean phrase '*jeonggyeongbunri*') technically meant that the Kim administration did not attempt to link the promotion of economic cooperation to political and security issues and situations. Kim made clear that "the government sustained the Sunshine policy, despite the existence of what some see as obstacles to the strategy, on the assumption that the steady implementation of the engagement policy will work out in the long run" (Kim 1999: 14). Once the Sunshine Policy was undertaken, this principle became a vital component of South Korea's policy on North Korea, being a mechanism for upholding Seoul's constant aid practice towards

Pyongyang, and lasting inter-Korean economic cooperation in the face of military provocations by North Korea. From the theoretical perspective, the idea of decoupling politics from economics was based on the expectation of a 'spillover' effect which was developed by functionalists (and neo-functionalists), claiming that increased cooperation in a specific area leads to increased cooperation in other areas (Yoon 2002). In this sense, the Kim and Roh administrations commonly expected that if the separation principle of economy and politics was kept, it would help the scope of economic cooperation to remain unaffected by political turmoil between the two Koreas, accordingly leading to facilitate increased exchanges and cooperation between the South and the North in various areas. On the assumption that it may have a ripple effect on the whole inter-Korean relations, these concrete achievements and economic and cultural ties in inter-Korean relations would serve to resolve other political and security matters, "eventually leading to an easing of military tension and recovery of national homogeneity" (MOU 2001: 44).

It is worth noting that the principle of economics-political separation had been consistently carried out despite the existence of North Korea's military provocations. Although a North Korean submarine infiltrated into the South Korean eastern coast in June 1998, the principle of separating politics from business had not been discarded and the Sunshine Policy was not swayed by Pyongyang's provocative acts (Kim 1999). Even after North Korea's missile test on 31 August, 1998, the Kim government endorsed the outset of Hyundai Group's Mt. Geumgang tour. In addition, the strategic directions of the separation of politics and economics served as momentum for private business and NGOs to become key coalition partners in the implantation of the Sunshine Policy. Under the Kim government, civilian exchanges between the two Koreas were stepped up and the activity of non-governmental organisations was also noticeable in North Korea. The principle separating political negotiation from economic interaction had persistently worked during the Roh presidency, playing an important role in the continuation of the Mt. Geumgang tourism project and the inception of GIC project. Despite Pyongyang's nuclear test in October 2006, South Korea's Sunshine Policy had been maintained, and the merchandise trade from the GIC has increased dramatically until the end of Roh's term in office.

6.3.3 Diffuse reciprocity

Third, the Sunshine Policy adopted a diffuse reciprocity in the course of engaging with North Korea. The Kim Dae-jung administration contemplated that in order to encourage exchanges and cooperation on a sustained basis, 'an-eye-for-an-eye strategy' or 'a strict reciprocity' was not suitable in government-to-government negotiations with the North.

Before the shift to the Sunshine Policy, South Korea had a rather strict concept of reciprocity towards North Korea. With the North-South Basic Agreement of 1991, the concept of 'reciprocity' in South Korea was understood as the recognition of other's position as a political entity and the pursuit of mutual gains of both Koreas (Kim 1999). From this perspective, functional links in economic interaction and socio-cultural exchanges between two different systems were able to be formed and expanded steadily under the Roh Tae-woo and Kim Young-sam administrations. However, it does not necessarily mean that the South adopted a 'diffuse reciprocity' in dealing with the North. Strictly speaking, the past South Korean governments adhered to its position that "North Korea should show a certain level of corresponding efforts or reaction to South Korea's aid to the North, and other efforts to improve inter-Korean relations" (Chae 2002: 5). This position was particularly noticeable when the Kim Young-sam administration began to provide humanitarian assistance to North Korea in 1995. The South's provision of economic incentives only occurred when the North responded something in return and showed an effort to accommodate the South's demands.

It is worth noticing that the conventional concept of reciprocity in inter-Korean relations changed with the inauguration of the Kim Dae-jung administration. What distinguished the Kim Dae-jung administration from other past administrations was that Kim basically thought that a dialogue with the North was possible although North Korea had shown abnormal behaviours, even being recognised as an enemy or the 'axis of evil' (Park 2011). However, it was not only the Kim Dae-jung government that had regarded the North as a dialogue partner, not a hostile enemy. In principle, the recognition of the North as a partner for negotiation and cooperation stemmed from the '7.7 Declaration' of 1988, the Basic Agreement of 1991 during the Roh Tae-woo administration. South Korea's official unification formula, 'the National Community Unification (NCU) Formula' laid out by the Kim Young-sam government in 1994 was also predicated upon the mutual recognition and respect of the two separated political identities. Nevertheless, President Kim, unlike his predecessors, believed that, no

matter how deviant North Korea's action might look, the efforts to communicate through reciprocal recognition could help to understand the motives and intentions driving North Korea's behaviour, leading to a more and deeper communication (Han 2011). In his view, the South ought to communicate with the North Korean "not because we trust them, but because it was essential to build mutual confidence" (Lim 2012: 270). In a similar vein, Kim contended that "while it is easy to have dialogue with a friend, it is difficult to have dialogue with somebody you don't like. But for the sake of national interest or necessity, sometimes you have to engage that party" (Lim 2012: 295; Kim 2011b: 446). Hence, to (re)start dialogue, even if it was not expected to bring out promising results, was logically viable to Kim and the Sunshine Policy, being necessary to search for common ground (Han 2011; Paik 2011). Within the Sunshine Policy framework, Kim's conception of reciprocity was concretized with the attitude that the South could expand trade, and provide aid to North even if these incentives could not guarantee reciprocal process of exchange and dialogue with the South. In other words, Kim Dae-jung's political philosophy towards reciprocity made acceptable the North's inadequate compliance with agreements, the risk of economic interaction with a treacherous partner, and Pyongyang's begrudging response to Seoul's pursuit of reconciliation and cooperation.

Against this backdrop, the adoption of a diffuse reciprocity towards North Korea had two strategic reasons. First, in the short run, considering the lack of trust on both sides of government and Pyongyang's doubt on the intentions of the Sunshine Policy, a relatively loose form of reciprocity was regarded as a relevant strategy in coaxing the North to dialogue and cooperation. Interestingly, when President Kim Dae-jung began his term, the administration implied that all inter-Korean bargaining and negotiation should be based on a give and take or a strict reciprocity. This position was technically necessary to avoid any doubt of the Sunshine Policy from right-wing conservatives, labelling it as appeasement or unilateral provision of incentives (Kihl 1998: 25). However, the frustration to apply 'specific reciprocity' to government level assistance of food or fertilizer in the early stages of the Kim administration decisively affected the change of Seoul's position in the principle of reciprocity. South Korea failed to elicit Pyongyang's reciprocal actions when they attempted to link the provision of fertilizer to the reunion of separated families at a vice-minister level meeting in April 1998. Since 1999, an initial approach of 'give and take' began to change into 'give first and take later', and the Kim government did not insist on a strict or specific reciprocity when dealing with North Korea (Park 2003). On this matter, the

South's approach could be elucidated as three distinct positions: 'giving' and 'taking' did not necessarily have to occur at the same time (asynchronous); 'giving' and 'taking' did not have to be the same price (non-equivalent); and 'giving' could be returned with a different form (asymmetric) (Kim 2008).

Second, in the medium to long run, a flexible reciprocity made it possible to continue its implementation of the Sunshine Policy despite the unsatisfactory achievement in political and military areas. According to Lim Dong-won, an approach of the Sunshine Policy could be summarised with: (1) Easy tasks first, difficult tasks later; (2) Non-government channel first, government channel later; (3) Economic approach first, politics later; (4) Give first, and take later (Moon 2000: 8). From this point of view, the government of Kim Dae-jung expected that North Korea was likely to be receptive and responsive to the Sunshine Policy, because the South made the decision not to require an immediate reciprocation and a precise equivalent (Kim 2013). This strategic position of South Korea actually made it possible to expedite inter-Korean economic cooperation in the face of various military provocations by North Korea. South Korea was committed to continue the Sunshine Policy and increased economic interactions even though the negotiation for resolving North Korea's nuclear weapons and missile had made no visible progress. Kim's eagerness to reconcile with the North and its determination to push trade forward was not dampened despite North Korea's crisis escalation through the submarine infiltration in 1998 and naval intrusion in the West Sea in 1999. From the North Korean perspective, Pyongyang's preference and priority on economic issues, rather than military and political matters was one of the reasons behind the active participation in economic cooperation with Seoul. In fact, the improvement of relations between the two Koreas had been primarily made up in non-political areas, such as economic cooperation and socio-cultural exchanges during the period of the Sunshine Policy (Kwak 2000). Notwithstanding, considering Pyongyang's passive demeanour towards inter-Korean talks and its doubt on the Sunshine Policy, the principle of a flexible reciprocity not only induced the North for dialogue and further cooperation, but also played an indispensable role in sustaining inter-Korean economic relations in the face of the development of a nuclear crisis and several naval provocations by North Korea (Kim and Winters 2004).

As inter-Korean economic cooperation continued to expand and diversify, economic gains from continuing interaction was expected to be an active drive for the progress in difficult political and military issues. A flexible reciprocity theoretically

made it possible for the Kim administration to strive for a resolution to the North Korean nuclear and missile issues in parallel with the promotion of inter-Korean economic cooperation and exchanges (Lim 2012: 99). For instance, faced with the Taepodong-I missile launch and the suspicion of underground nuclear facilities at Kumchangni in August 1998, the Kim administration maintained the Sunshine Policy whilst constructing trilateral cooperation with the United States and Japan for dealing with North Korea's development of nuclear weapons and missile programmes. The Yeongyepong naval clash in June 1999²³ particularly marked a watershed in South Korea's principle of reciprocity. At that time the South Korean government was considering providing fertilizer aid to North Korea. Although the navy battle, the so-called first Battle of Yeonpyeng aroused domestic concerns and criticisms of South Korea's engagement policy, the operation of the cruise ship to Mount Guemgang and the delivery of fertilizer aid were not suspended. In his speech for the 49th anniversary of the Korean War, 25 June 1999, after ten days of the occurrence of the naval incident, Kim made it clear that "we will consistently push our engagement policy towards North Korea with the close cooperation and assistance of friendly nations, inducing the United States. Thus, we will realize peace and stability on the Korean peninsula and lay the foundation for the long-cherished unification" (Kim 2000: 108). It demonstrated that the Kim administration sustained the Sunshine Policy on the assumption that a consistent implementation of engagement based on a diffuse reciprocity would help to build trust and facilitate cooperation in the long run. South Korea's pursuit of a flexible reciprocity with North Korea was clearly observable under the Roh administration as well. Despite the crisis caused by North Korea's clandestine uranium enrichment programme and its decision to withdraw from the NPT in 2003, inter-Korean commercial and non-commercial transactions did not shrink. The 2006 North Korea's nuclear test did not have a dampening effect on inter-Korean economic relations. As Roh Moo-hyun and his administration remained firmly committed to the Sunshine Policy of positive engagement towards Pyongyang, a flexible reciprocity played an important role in expanding the overall scale of inter-Korean economic cooperation.

²³ On 15 June, 1999, the South Korean naval vessels engaged in the exchange of fire with a North Korean torpedo boat in the area of the Northern Limit Line (NLL), resulting in the sinking of two North Korean vessels and more than thirty casualties.

6.4 The Sunshine Policy as positive engagement

Then, the question is how South Korea's Sunshine Policy can be understood within the analytical perspective of positive engagement. The underlying logic and causal mechanism of Kim Dae-jung and Roh Moo-hyun's policies on North Korea can be elucidated within the concept of the interdependence model relating economic interdependence to the reduction of the likelihood of war. In order to draw this conclusion, three things should be considered: what the theoretical premises were on which the Sunshine Policy was based on; whether it primarily adopts positive economic statecraft in its foreign policy; and if so, for what purposes and interests it was pursued.

First, South Korea's policy towards North Korea during the Kim and Roh administrations was framed on the liberal's perspectives on the relationship between economics and security and the probability for using positive incentives as an instrument of achieving a state's policy goals. Presidents Kim Dae-jung and Roh Moo-hyun, having progressive perspectives on political relations with North Korea and optimistic about prospects for reunification, basically assumed that North Korean behaviour could be changed if proper external incentives were granted (Moon 1999; Park 2001; Sheen 2002). Kim and Roh's perspective, viewing North Korea as a rational actor and partner for dialogue and negotiation, served to form the government's position that cooperation with North Korea would be possible despite its nature of security seeking and resultant military threats. In line with commercial liberals' logic advocating that interdependence promotes peace, Kim and Roh commonly believed that the most effective way to influence North Korea is not to isolate, restrict or threaten them, but to engage through more contacts, exchanges and cooperation. For this, the persistence and expansion of inter-Korean economic relations was particularly important to the Sunshine Policy, because it was believed to be a feasible and desirable way of constructing interdependent relationship between the two Koreas, being the catalyst for North Korea's policy changes and economic reforms in the long run. The underlying logic of Kim and Roh's Sunshine Policy is similar to a general liberal proposition arguing that positive economic incentives can be powerful instruments to help turn conflict to cooperation by providing economic *quid pro quo* to target states or creating the structure of interdependence. The liberal school of thought argues that, looking beyond the recognition of economic power for its national security, economic incentives can be used as an instrument of statecraft to promote their own national interests in the context of a foreign policy. This idea is deeply rooted in the belief that

the roles of economy and economic measures is not limited to the domain of 'low politics' but it can be expanded to the 'high politics' on security matters. This liberal thinking elucidates why a steady stream of economic benefits from trade, investment, and aid was deemed critical for the administrations of Kim Dae-jung and Roh Moo-hyun, because it was a means to bring about a rapprochement with North Korea, and a way to reduce the North Korea's fears and mitigate its mistrust and hostility towards the South that were a precondition for a more peaceful relationship and the ultimate goal of creating *de facto* unification.

Second, South Korea utilised inter-Korean economic cooperation as a main channel for providing economic incentives to North Korea. Given the low-level of trust and long-standing hostility, the biggest challenge and dilemma to the Sunshine Policy was that the process of building interdependence required a long period of the pursuit of reconciliation, exchanges and cooperation while deterring North Korea's military threats. Thus, the political leadership in South Korea should be able to continue to implement the Sunshine Policy and to apply economic incentives to North Korea even when their relationship was worsening due to the recurrent North Korea's armed provocations. This is the reason why South Korea's positive engagement needed the strategies of the separation of politics and economics and the adoption of a diffuse reciprocity in dealing with North Korea. These strategies were significant in the sense that they not only characterised the Sunshine Policy during the ten years of the Kim and Roh administrations, but also made a mode of engagement sustainable in the face of rising criticisms, lack of progress, and military standoff. In this light, the necessities for the promotion of inter-Korean economic cooperation are predicated upon its validity as a policy instrument for developing commercial relations while influencing political relations between the North and the South. Under the framework of Kim and Roh's Sunshine Policy, positive economic statecraft was a means to enhance the mutual gains of both Koreas, a way to boost the North Korean economy, and a medium to promote mutual understanding and trust-building. Strictly speaking, the evolution of South Korea's policy on North Korea was not attributed to the declared principles of Kim's Sunshine Policy, but the centrality of positive economic statecraft in its policy as a means to materialise the ideas and interests of the Sunshine Policy. Thus, the strategic use of economic incentives in the South's Sunshine Policy was consistent with the framework of positive engagement.

Third, the underlying logic and causal mechanism of South Korea's positive engagement was fitted to the concept of the interdependence model. Under the

interdependence model of positive engagement, a steady stream of economic gains from trade might help to not only facilitate bilateral cooperation and broaden contacts in various areas, but also prevent or mitigate future armed conflict on the part of the target states and establish improved relations. The causal mechanism of underpinning this type of positive engagement was based on the constraining effects that came with the political effects of the high level of economic interdependence. According to commercial liberals' theories, since a set of economic interdependencies tends to generate an economic opportunity cost for both parties, the anticipation that interstate conflicts will lead to a loss of gains from trade helps to deter state leaders from waging wars or conflicts against trading partners (Polachek 1980; Russett and Oneal 2001).

This line of liberal arguments illuminates the purpose of South Korea's positive engagement and how it works. The Kim and Roh administrations contemplated that increased gains from trade, investment and aid would serve to construct an interdependent relationship, so that both Koreas would be inclined to maintain the relationship by deepening ties in the realms of economic, political and socio-cultural areas. To put it differently, it was designed so that as North Korea increasingly relied on economic exchanges and cooperation with the South, it would be more costly for North Korea to carry out armed aggressions that might interrupt these flows (Kim and Winters 2004: 59). Hence, the interests of both sides, which would be only attainable under a stable interdependent relationship, led to discourage its motives for military provocations that would rupture inter-Korean relations, thereby depriving them of possible trade benefits. For this reason, South Korea anticipated that engagement through inter-Korean economic cooperation would lead to a reduction in military tensions between the two Koreas, bringing positive effects on alleviating conflict, especially arising from the nuclear and missile issues. Taking these insights into account, South Korea's Sunshine Policy has the clear characteristic of positive engagement considering that it primarily employs inter-Korean economic cooperation as an instrument to ease military tensions and reset relationship by constructing mutual/asymmetric interdependent relationship between the two Koreas.

In relation to conceptualise the Sunshine Policy within the concept and practice of positive engagement, one remaining issue is its connectivity between the interdependence model and the transformative model. While the underlying logic of the Sunshine Policy could be elucidated with the interdependence model, it did not necessarily mean that it was irrelevant to the framework of the transformative model. This is because South Korea's positive engagement was also expected to help the North

to understand the values and merits of a market economy through inter-Korean commercial interaction. As noted earlier, the Sunshine Policy was aimed at inducing North Korea to accept the idea of opening up and reform, so that it would contribute to the economic integration of the two Koreas in the medium and long term. In doing so, Kim and Roh hoped that these consequences of the engagement could accelerate the path towards a peaceful reunification. These long-term goals of the Sunshine Policy implied that South Korea's positive engagement had an inherent characteristic that was intended for causing transformative effects on inter-Korean relations and within North Korea. However, considering that this transformative effect was not likely to generate without the cultivation of economic ties and creation of a group benefiting from bilateral economic ties within the target state, the underlying motives and intentions guiding the Sunshine Policy was more fitted within the interdependence model. In fact, the primary purpose of the Sunshine Policy was more focused on the advancement of inter-Korean relations, the cultivation of economic ties, the realisation of an improved security situation for both Koreas, the creation of a favourable environment for North Korea, and the incremental and voluntary changes in North Korea's institutions and behaviour. More importantly, the final goal, the realisation of *de facto* unification was inconceivable if it could not succeed in constructing a bilateral interdependent relationship that would be a prerequisite for bringing about a systemic transformation of the North's preference and values. Therefore, although South Korea's policy on North Korea during the past ten years had ingredients of the transformative model, the ideas and interests underpinning the Sunshine Policy is more likely to be clear when it is linked to the influence and effects inherent in the interdependence model.

6.5 Conclusion

This chapter discussed the ideas and approaches of the Sunshine Policy implemented during the past Kim and Roh administrations. The Sunshine Policy was predicated on three fundamental principles: non-tolerance of armed aggression, rejection of unification by absorption, and promotion of exchange and cooperation. To materialise these principles of the Sunshine Policy, the Kim and Roh administrations commonly adopted three strategies including the use of positive economic statecraft, the separation of politics from economics, and the adoption of a diffuse reciprocity. This chapter demonstrated that these strategies were the key components of the Kim and Roh administration's North Korea policy as well as the essentials that characterised

inter-Korean relations throughout the past ten years of the progressive governments. The important finding is that the underlying logic and causal mechanism of the South's policy on North Korea could be identified within the framework of positive engagement and its concept of the interdependence model. This line of reasoning stemmed from the liberal school of thought relating economic interdependence to the reduction of the danger of war and its assumption that economic inducements could be effective as an instrument of statecraft. This chapter investigated that the Sunshine Policy under the Kim and Roh administrations was centred upon positive engagement. South Korea consistently expanded and deepened inter-Korean exchanges and economic cooperation, and attempted to use its ties as leverage to influence North Korea's political behaviour. Under Kim and Roh' strategic thinking towards North Korea, engagement through inter-Korean economic cooperation was believed to be the best possible way to enhance absolute economic gains of both Koreas, to ease military tensions and to promote confidence-building between the two Koreas. Meanwhile, in the course of constructing interdependent relationships, Kim and Roh commonly anticipated that North Korea would embark on a path to opening and reforms for reasons of regime survival. By examining the ideas of the Sunshine Policy and its characteristic of positive engagement, this analysis illuminates the two important implications on inter-Korean relations. These are the nature of continuation and evolution of South Korea's statecraft towards North Korea.

First, it is undeniable that the principles of the Sunshine Policy had common ground with South Korea's conventional wisdom for managing national division and achieving national unification. Critically, the principles of non-tolerance of armed provocations and peaceful co-existence and unification were by no means new. While Kim emphasised the validity of the incremental unification and the rejection of unification by absorption, it did not necessarily mean the Sunshine Policy solely posited these principles in South Korea. There was no South Korean government that did not stipulate the preservation of national security, the maintenance of peace, and the necessity of a peaceful and gradual unification in their policy objectives on North Korea. In a similar vein, the pursuit of bilateral rapprochement through economic cooperation was not an innovative idea that had begun to emerge with the inauguration of the Kim Dae-jung government. Rather, in the history of South Korea's policy toward North Korea, it was a consistent pattern occurring in inter-Korean relations from 1989 in which the two Koreas initiated intra-Korean trade for the first time (Choi 1995). The concept of inter-Korean 'exchanges and cooperation' can even be

traced back to North-South economic talks of 1985. Thus, considering that South Korea's policy on North Korea has been inseparable from its discourse of foreign and unification policy and the trajectory of the development of inter-Korean economic relations, the underlying idea behind the Sunshine Policy was a reflection of the notion of unification and the ways for the creation of peace that has been gradually formed since the late 1980s.

Second, Kim Dae-jung's Sunshine Policy had unique features that differentiate it from the former administration's policy on North Korea. It was true that the idea of rapprochement through economic exchanges was adopted by the former administrations as well. Nevertheless, at that time, inter-Korean economic cooperation was not centred on South Korea's policy towards North Korea. Although it was pursued by the government with the goal of influencing 'high politics', it was not the centrepiece of South Korea's North Korea policy. However, since the Kim Dae-jung government proclaimed the Sunshine Policy as a way and means of approaching North Korea and crafting peace on the peninsula, the nature of South Korea's policy on North Korea has shifted its focus from containment or carrot-sum stick into positive engagement. The most noticeable change in the dyadic relations on the Korean peninsula was in its gravity of inter-Korean economic cooperation. Whereas inter-Korean economic cooperation was as a subsidiary component of the government's policy on North Korea, or a concomitant of the political relationship between the two Koreas, it became a key instrument in South Korea's policy on North Korea, and a main driver of inter-Korean relations starting from the late 1990s.

These changes and evolutions of South Korea's policy on North Korea were possible because the political leadership recognised the North as a rational partner, viewing the North-South relationship as 'unification-oriented special relationship'. It was also attributed to the belief that North Korea would not collapse immediately, and the policy options such as coercion and isolation were not likely to change North Korea's behaviour. Along with this, the most important aspect of this evolution was the fact that the progressive administrations of Kim Dae-jung and Roh Moo-hyun paid their attentions to the influence inherent in the practice of economic interactions and its possibility of strategic means for improving inter-Korean political relations. Kim and Roh commonly contemplated that engagement relying on positive incentives could only induce North Korea's voluntary changes in policy and behaviour. In tandem with this, engagement through more contacts, exchanges, and cooperation not only secures the stable co-existence between North and South Korea, but also hastens the path of

peaceful reunification. The crucial point is that inter-Korean economic cooperation was employed as a key instrument in inter-Korean relations. This hallmark which was clearly observable during the Kim and Roh administrations signifies that South Korea's practice of economic statecraft that was based on commercial and political interests was aimed at influencing North Korea's behaviour. The political and strategic standpoints start from here. From this perspective, not only an economic interpretation of inter-Korean economic cooperation, but also political aspects of South Korea's positive engagement will be tackled in following chapter.

CHAPTER SEVEN

Positive Engagement towards North Korea in the Kim Dae-jung and Roh Moo-hyun era: Evolution and Limitations - Part two: Practice and Dynamics

7.1 Introduction

The aim of this chapter is to investigate the practice of inter-Korean economic cooperation under the administrations of Kim Dae-jung and Roh Moo-hyun and then to elaborate on the dynamics that influenced the outcomes and limitations of South Korea's positive engagement. The Sunshine Policy under Kim and Roh marked a dramatic shift in South Korea's policy on North Korea. As the mode of engagement was centred on positive economic statecraft, South Korea deepened its economic ties with North Korea and attempted to influence its political behaviour. However, the effectiveness of South Korea's positive engagement was highly controversial. Crucially, Kim and Roh's Sunshine Policy did not receive public support as the newly elected Lee Myung-bak government criticised the predecessors' Sunshine Policy as a failed appeasement policy. The Lee government backed by South Korean conservatives denounced that the unilateral and unconditional incentives under the progressive regime over the past 10 years did not elicit a reciprocal change in Pyongyang. This phenomenon raises important questions on how the ideas of the Sunshine policy were implemented and how they impacted inter-Korean relations. These debates and evaluation are instrumental in examining whether economic incentives through positive engagement achieve its policy objectives. The purpose of this chapter is three-fold. First, it deals with the definition of inter-Korean economic cooperation. Second, it presents the achievements and limitations of South Korea's positive engagement towards North Korea. Finally, the focus is on the dynamics that impose constraints on the effective functions of positive engagement.

7.2 Definition of inter-Korean economic cooperation

To assess the practice of positive engagement in South Korea's policy on North Korea, this thesis primarily examines inter-Korean economic cooperation between 1998 and 2007. This is because South Korea's use of economic incentives towards North Korea occurs in the form of inter-Korean economic cooperation including trade, investment and aid. Thus, the concept of inter-Korean economic cooperation is significant to understand the mode and practice of engagement in South Korea.

Then, to what extent did both North and South Korea begin to agree with the concept of inter-Korean economic cooperation? With regard to the exchange of goods between the two Koreas, the terms 'economic exchange' (*gyeongjegyoryu*) and 'economic cooperation' (*gyeongjehyeopryeok*) have been more frequently used than trade and investment. This tendency meant that both North and South Korea did not regard their trade or investment as 'foreign trade' or 'foreign investment' per se (Kim 2003). It is attributed to the fact that the two Koreas agreed through the Basic Agreement of 1991 to recognise the exchange of goods between North and South Korea as 'domestic commerce' or 'intra-Korean trade' between our own people, not a cross-border trade meaning an international exchange between two different countries.²⁴ It was later confirmed again by the 'Development of Inter-Korean relations Act' in December 2005. This act stipulated that "inter-Korean trade shall not be regarded as international trade but as intra-national trade[exchange]." (Article 3.2) For these reasons, the South Korean government used the term 'exchange' (*gyoyeok*) rather than 'trade' (*muyeok*). In a similar vein, inter-Korean trade was not understood as exports or imports but the 'taking out' (*banchul*) or 'brining in' (*banip*) of goods and services between South Korea and North Korea via any third countries.

In the history of inter-Korean relations, the origin of the term inter-Korean 'exchanges and cooperation' (*gyoryuhyeopryeok*) can be traced back to North-South economic talks in 1985. With regard to this terminology, the South insisted on using 'exchanges and cooperation' (*gyoyeokgwa hyeopryeok*), but the North contended that it should be called 'joint ventures and exchanges' (*hapjakgwa gyoryu*). After prolonged negotiations, the two sides agreed to use 'exchanges and cooperation' as the official term at the third round of North-South economic talks which was held in June 1985 (Kim 2005: 70). Although it was not until 1989 that the official economic exchanges

²⁴ Article 15 of Chapter 3 in the Basic Agreement stipulated that "the two sides shall engage in economic exchanges and cooperation, including the joint development of resources, the trade of goods as domestic commerce and joint ventures" (MOU 1992: 464).

between the two Koreas began, this agreement served as a momentum to conceptualise inter-Korean economic relations given the situation of the division of states.

As commercial interactions have increased steadily since then, the role of inter-Korean trade became instrumental in forging new functional links between the two countries. In fact, along with 'reconciliation' and 'non-aggression', 'exchanges and cooperation' was one of the key components of the 1991 North-South Basic Agreement. From the viewpoint of South Korea, the purpose and meaning of inter-Korean exchanges and cooperation were stipulated at the 'Inter-Korean Exchanges and Cooperation Act' which was first enacted in August 1990. According to this law, amended in January 2009, inter-Korean exchanges and cooperation meant "activities to promote reciprocal exchanges and cooperation between the area south and north of the Military Demarcation Line" with the aiming of peace and unification on the Korean peninsula (Article 1). The term inter-Korean 'exchanges' (*gyoyeok*) referred to "taking out or bringing in goods, services and intangible articles in electronic form between South Korea and North Korea for purpose of sale, exchange, lease, loan for use, donation, use, etc." (Article 2.2) When it comes to the 'cooperative project' (*hyeopryeoksaeop*), it was defined as "all activities jointly carried out by residents of South and North Korea with respect to culture, tourism, health and medical services, sports, art, economy, etc." (Article 2.4) It indicated that the scope of inter-Korean exchanges and cooperation encompassed not only economic interaction, referring to movements of all goods including aids and donations between the North and the South, but also human exchanges between the two sides such as meetings of separated families, personal visits for economic social and cultural purposes.

From this perspective, the term inter-Korean 'exchanges and cooperation' (*gyoryuhyeopryeok*) was a rather broad and comprehensive concept. The term inter-Korean 'economic cooperation' (*gyeongjehyeopryeok* or simply *gyeonghyeop*), by contrast, gave more weight to economic implications that excluded the social and political sphere. Nevertheless, it should be noted that the original meaning of economic cooperation was more close to investment. To use this term accurately, an additional understanding of this terminology is needed. On this point, Jo Dong-ho (1998: 2) argued that "in general, inter-Korean economic exchange was referred to as trade between the two Koreas, and inter-Korean economic cooperation was referred to as investment between the two Koreas. However, inter-Korean economic cooperation was customarily used as the term covering trade and investment." With a similar logic, Kim Dae-jung also mentioned that whereas economic exchange refers to "the simple

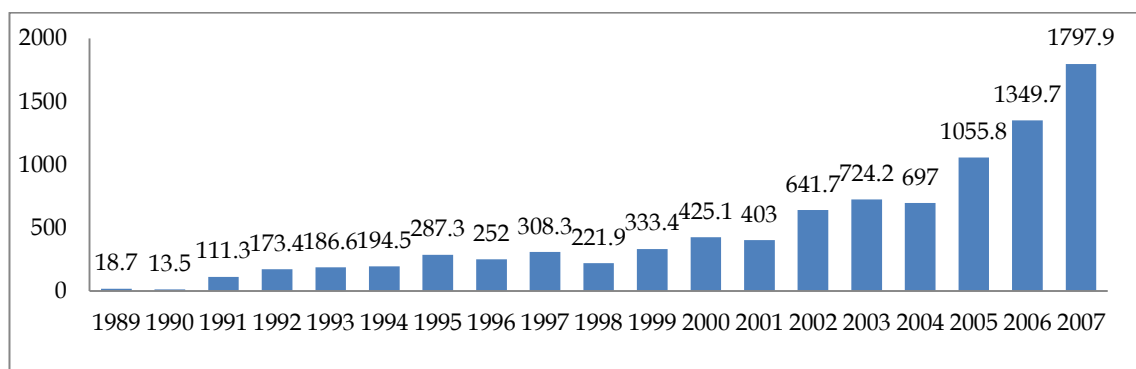
movement of goods and services”, economic cooperation means “not only the movement of capital and labour”, but also “the joint investment that accompanies the movement of goods” (Kim 1997: 127). In this sense, this thesis primarily used the term ‘inter-Korean economic cooperation’ (*nambukgyeonghyeop*) to conceptualise and assess the mode of South Korea’s positive engagement. Here it refers to all the public and civilian economic transactions that include bilateral commercial trade, economic cooperative projects, and economic assistance. This thesis, however, pays more attention to the practice of inter-Korean economic cooperation that was implemented by the government from the policy standpoint.

7.3 Practice of South Korea’s positive engagement

Since the Sunshine Policy was adopted by the Kim Dae-jung administration and consistently supported by the Roh Moo-hyun administration, a strategy of rapprochement through economic statecraft has become the heart of South Korea’s policy on North Korea. The large rise in trade and aid was primarily due to the persistence and expansion of inter-Korean economic cooperation between 1998 and 2007. The total amount of inter-Korean trade was a mere 18.7 million US dollars in 1989, but it steadily increased to 221 million US dollars in 1998 and reached 1,797 million US dollars in 2007. As depicted in Figure 7.1, compared with the pre-Sunshine Policy era between 1989 and 1997, both commercial and non-commercial transactions between North and South Korea had remarkably increased under the Kim and Roh governments.

Figure 7.1 Inter-Korean economic cooperation, 1989-2007

(Unit: millions of US current dollars)



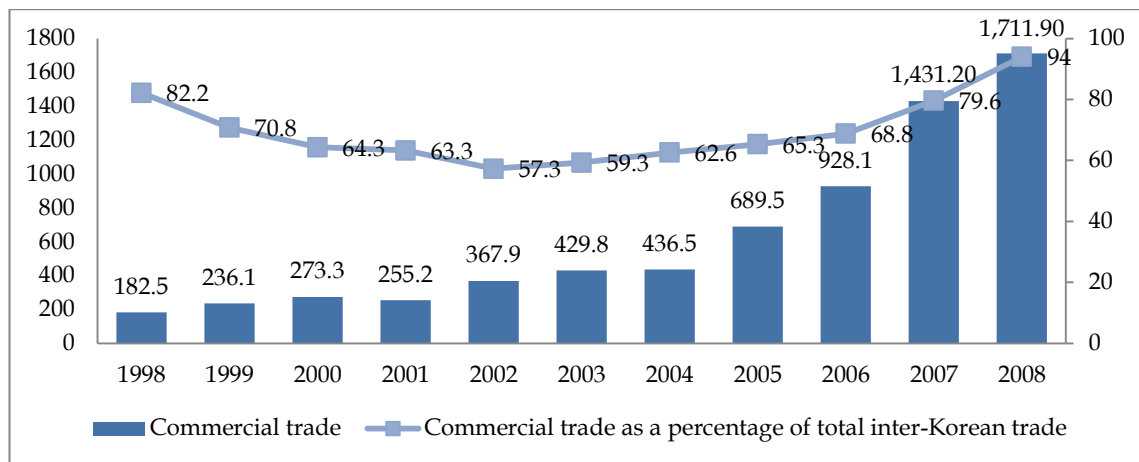
Source: MOU

7.3.1 Commercial transactions

Despite the pending North Korean nuclear issues and missile launches, inter-Korean economic relations continued to evolve and expand between 1998 and 2007. It was primarily attributed to President Kim and Roh's efforts to increase market interactions with North Korea. The volume of inter-Korean commercial trade expanded from 182 million US dollars in 1998 to 1.4 billion US dollars in 2007, increasing eight-fold between 1998 and 2007. Although the share of commercial transactions as a percentage of total inter-Korean trade dropped from 82.2 percent in 1998 to 57.3 percent in 2002, this trend was reversed by the Roh government. As a result, its share of total inter-Korean trade rose from 59.3 percent in 2003 to 79.6 percent in 2007. (Figure 7.2) It meant that South Korea's commercial transactions with North Korea, particularly economic cooperation projects, were instrumental in deepening economic ties between North and South Korea. The development in inter-Korean commercial trade centred on general trade, POC trade and economic cooperation projects, notably the Gaeseong Industrial Complex and Mt. Geumgang tours.

Figure 7.2 Commercial trade and its weight in total inter-Korean trade

(Unit: millions of US current dollars/percentage)



Source: MOU

7.3.1.1 General trade

One of the types of inter-Korean commercial transactions, general trade (GT), has been the oldest form of market activities between the two Koreas. The notable change was that, general trade that had relied on an indirect trade via a foreign mediator and country had gradually changed into a direct trade between the North and the South

since the mid-1990s. General trade was a typical trade between developed and underdeveloped countries. It occurred through “the interchange of North Korean raw materials and South Korean industrial merchandise” (Kim 2005: 9).

Between 1989 and 1997 the materials that South Korea brought in from North Korea were mainly dominated with minerals and metal products. Since 1998, the composition of general trade, however, has continued to diversify with textiles, agricultural and aquatic products, minerals, steel and metal products. With increased flows of goods through POC trade, textiles became the most important items imported from North Korea. Indeed, during the Sunshine Policy era, imports of agricultural and aquatic products and textiles accounted for the most part of inter-Korean general trade (MOU 2008c; Choi 2010). In regards to goods to North Korea, South Korea had initially exported chemical products such as vinyl, but export items gradually diversified with textiles and chemical industry products, machinery, and electric and electronic products. The fact was, under the form of general trade, there were few merchandise exports towards North Korea. Most trade items that the North imported from the South were limited on the flows goods associated with POC trade and equipment-supplying for economic cooperation projects. It meant that general trade, especially exports to the North had not been made through transactions based on the principle of comparative advantages. Instead, it was primarily driven by the necessity of South Korea’s businesses that used the construction of LWR and machine equipment of GIC for apparel production (MOU 2008c; Choi 2010).

It should be noted that, from a strictly economic standpoint, general trade has been more beneficial to North Korea than South Korea. The reason for an unfavourable condition to South Korea was attributed in part to the structure of inter-Korean general trade. South Korea's general trade has so far occurred in a biased direction in that the South unilaterally purchased agricultural, marine, minerals, metals and steel products from the North. Its feature made inter-Korean general trade to form a typical inter-industry trade that the two Koreas’ exports and imports occurred in different industries. Although these imported items were critical and cost competitive in the South, the South Korean firm’s options to purchase in the North were relatively limited in the current situation. The underlying problem stemmed from not just trade structure, but the flow of capital. Beyond the fact that general trade was genuinely economically beneficial to North Korea, it had been a source of hard currency for the North due to the nature of inter-Korean economic relations (Hwang 2008). Choi (2010: 41) pointed out that general trade was typically carried out through South Korea’s one-sided

imports from North Korea that the flow of goods simultaneously occurred with price settlement. It meant that South Korea's trade deficits converted to trade surpluses, bringing foreign exchange earning with North Korea. As depicted in Table 7.1, South Korea's trade balance in general trade has been in deficit for the entire Sunshine period between 1998 and 2007. Besides, this deficit status has been maintained since general trade was launched in 1989. Considering that North Korea has not resolved its serious shortages of foreign exchanges, the benefits arising from inter-Korean general trade became an important source of earning foreign currency for North Korea.

Table 7.1 Scale and trend of general trade, 1998-2007

(Unit: millions of US current dollars)

General trade	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Imports	50.8	67.7	78.6	100.9	167.4	177.4	150.1	188.9	282.0	441.2
Exports	21.9	21.7	32.0	10.5	4.4	46.2	21.2	20.9	22.2	20.2
Total	72.7	89.4	110.5	111.4	171.8	223.7	171.3	209.8	304.1	461.4
Trade balance	-28.9	-46.1	-46.6	-90.4	-163.0	-131.2	-128.9	-168.1	-259.8	-421.1

Sources: MOU

7.3.1.2 POC trade

Along with the growth in general trade, the volume of processing-on-commission (POC) trade continued to expand during the Sunshine Policy era. The total amount of POC trade between the North and the South increased from 71 million US dollars in 1998 to 185 million US dollars in 2003 under the Kim Dae-jung administration, and it amounted to 329 million US dollars during the Roh Moo-hyun government. Although it showed a temporary decrease in 2001 and 2004, the volume of POC trade increased steadily over the period, recovering to the amount of 171 million US dollars and 210 million US dollars in 2002 and 2005 respectively, and jumping to 330 million US dollars in 2007. This pattern indicated that POC trade, which had led to the growth of the early stages of inter-Korean trade, was still useful to inter-Korean economic relations and continued to produce mutual gains to both Koreas.

From the viewpoint of South Korea, once the South Korean firms set up their production facilities in North Korea's factories, without further sizable investment and labour management, they could reimport quality and standardised merchandise while reducing the production cost. For North Korea, POC trade not only created business

opportunities for involved factories, bringing with them new experience and technology, but also constantly provided hard currency as payment that North Korea obtained for processing. These respective advantages driving the continuation of POC trade led to a steady growth in its proportion of total commercial trade. POC trade represented 3.8 percent of total trade in 1993, but, it amounted to 43 percent of total commercial trade and 25.5 percent of total trade in 2003. (Table 7.2) After South Korea's adoption of the Sunshine Policy, the average share of POC trade accounted for more than 38.8 percent in total of commercial trade and 25.7 percent in the total inter-Korean trade. Considering that POC trade was made by North-South business agreements and cooperation, it has been regarded as the most important inter-Korean commercial transactions since it was launched in 1992 (Kim 2009). However, there has been significant change to this number in the past several years. Compared with the previous year's figure, its proportion of total trade and commercial trade has relatively decreased by 18.3 percent and 23.1 percent respectively in 2007. (Table 7.2)

Table 7.2 POC trade and inter-Korean trade, 1998-2007

(Unit: thousands of US current dollars; percentage)

Year	Total trade (A)	Total commercial trade (B) ¹	POC	POC/A (%)	POC/B (%)
1992	173,426	173,426	839	0.5	0.5
1993	186,592	186,592	7,008	3.8	3.8
1994	194,547	194,547	25,663	13.2	13.2
1995	287,291	276,295	45,892	16.0	16.6
1996	252,039	237,784	74,402	29.5	31.3
1997	308,339	250,302	79,069	25.6	31.6
1998	221,943	182,542	70,988	32.0	38.9
1999	333,437	236,064	99,620	29.9	42.2
2000	425,148	273,349	129,190	30.4	47.3
2001	402,957	255,168	124,924	31.0	49.0
2002	641,730	367,926	171,177	26.7	46.5
2003	724,217	429,800	185,009	25.5	43.0
2004	697,040	436,492	175,959	25.2	40.3
2005	1,055,754	689,542	209,729	19.9	30.4
2006	1,349,739	928,068	252,958	18.7	27.3
2007	1,797,896	1,431,173	329,912	18.3	23.1

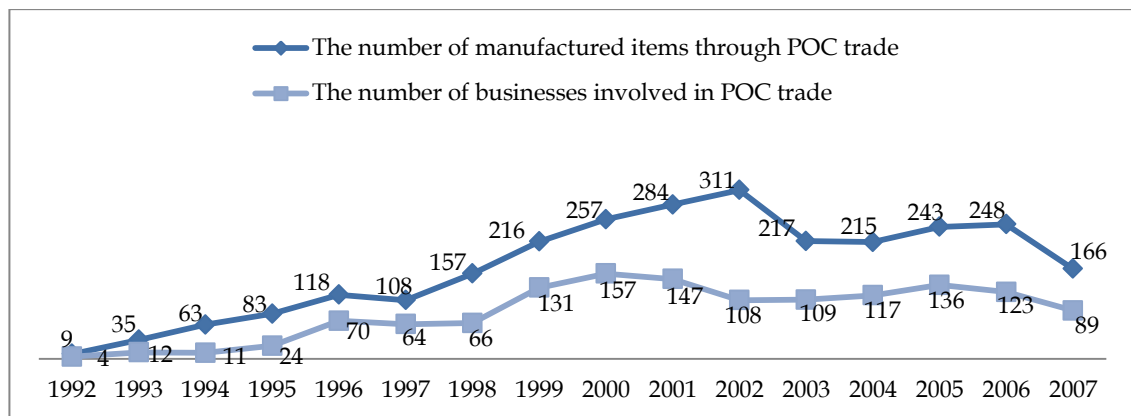
Source: MOU

Note: (1) These numbers represent total commercial transactions between the South and the North and exclude non-commercial transactions. Between 1992 and 1997 these number combined GT and POC trade, but from 1998, they included other economic cooperation projects.

Although these changes were associated with the inception of the GIC trade, POC trade was clearly shrinking in the late 2000s. For instance, the number of businesses involved in inter-Korean POC trade fell by 68 from 157 in 2000 to 89 in 2007, and that of manufactured items, by 145 from 311 in 2002 to 166 in 2007. (Figure 7.3)

Figure 7.3 Trend of POC trade

(Unit: numbers of items and businesses)



Source: MOU

Despite its significant portion of inter-Korean trade, POC trade had fundamental issues that prohibited the businesses involved in processing trade from advancing their production structure. Under the current system, most of inter-Korean POC trade was carried out on a small scale that had to do with processing textiles or electronic products such as TVs and speakers (Kim 2005). On this point, Lim Kang-taek (2011) stated that “considering North Korea’s lack of detailed technology and insufficient infrastructure, it had a limitation in regards to expanding their processing facilities or diversifying the processing items.”²⁵ In other words, the eighty nine South Korean firms were too few to create a synergy effects with North Korean partner firms, and the one hundred sixty six items involved in POC trade were too small to have a significant impact on intra-industry or inter-industry trade within North Korea. Besides, the processing and manufacturing of goods only occurred in specific factories that were mainly located in Pyongyang and Nampo, and they were executed under the control of North Korean authorities. Hence, it was difficult to expect a ripple effect of POC trade that would affect the heart of the North Korean economy. Kwon Young-kyong (2011) pointed out that to advance POC trade “it was imperative for factories to be able to secure local supplies or to use local components. However, the current North

²⁵ Interview with Lim Kang-taek in Seoul, 28 June 2011.

Korea's processing was primarily to assemble the products with materials supplied from the South." ²⁶ It meant that unless North Korea's firms could secure further capital, and raw and intermediate materials by themselves, it was unlikely to generate the possible linkage effect with other local related industries (Kim 2005).

7.3.1.3 Gaeseong Industrial Complex

Whilst South Korea's policy on North Korea embarked on a course of positive engagement, the structure of inter-Korean economic cooperation changed drastically with the inception of the Gaeseong Industrial Complex (GIC). As discussed later, the GIC was virtually the key strategy for South Korea's economic engagement with North Korea. Considering that GT and POC trade occurred before the Kim Dae-jung administration, the GIC was a new initiative taken by the Sunshine Policy.

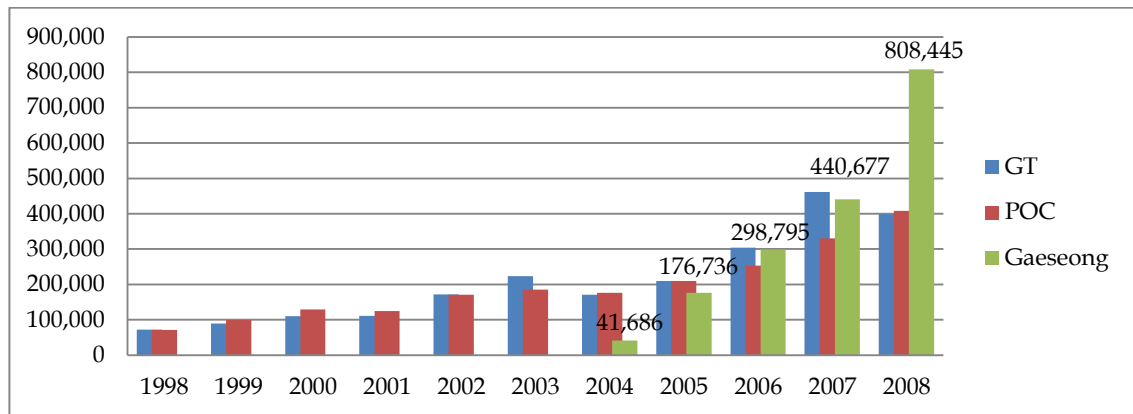
The idea of the construction of a large-scale industrial park in North Korea was initially proposed by Chung Ju-young, the founder of Hyundai conglomerate during his visits to Pyongyang in October 1998 and February 1999. Afterwards, Chung Mong-hun, the chairman of Hyundai Group, and Kim Yoon-kyu, the president of Hyundai Asan, visited North Korea and made an agreement, the so-called 'seven business projects' with Kim Jong-il in 2000.²⁷ With the momentum of the June 2000 summit, Hyundai Group made an announcement that Kim Jong-il acceded to its proposals to build an industrial complex in the city of Gaeseong, and its agreement was officially signed between Hyundai Asan and North Korea's Asia-Pacific Peace Committee in August, 2000. With the beginning of the GIC, the nature of commercial transactions between the two Koreas changed remarkably, because the pivot of inter-Korean economic cooperation that centred primarily in general and POC trade had moved to the realm of inter-Korean economic cooperation projects. Whereas general and POC trade has shown its modest growth over the period of Sunshine Policy, the merchandise trade from the GIC has increased dramatically since 2004. (Figure 7.4)

²⁶ Interview with Kwon Young-kyong in Seoul, 25 May 2011.

²⁷ In return for the provision of land and the exclusive business rights for the potential business projects including the construction of an industrial park by the North, Hyundai made a secret deal to pay 450 million US dollars to the North.

Figure 7.4 GT, POC and Gaeseong trade, 1998-2008

(Unit: thousands of US current dollars)



Source: MOU

The total transactions made by the GIC started at 41.7 million US dollars in 2004, reached 298.8 million US dollars in 2006, and soared to 808.4 million US dollars in 2008, which rose nineteenth times larger over four years. The trade through the GIC even recorded 1,442.8 million US dollars in 2010 in which South Korea was confronted with the sinking of the warship *Cheonan* in March and North Korea's shelling of Yeonpyeong Island in November. The GIC indeed led the expansion of inter-Korean commercial transactions during the Roh Moo-hyun government. The GIC's relative importance could be calculated by its weight in total trade between the two Koreas. As seen in Table 7.3, the share of the GIC trade out of total commercial trade was 9.6 percent in 2004, increased to 32.2 percent in 2006 and jumped to 47.2 percent in 2008. The single total volume of transactions through the GIC, 808.4 million US dollars actually outstripped the total volume of commercial transactions through the GT, 399.4 million US dollars and POC, 408.3 million US dollars in 2008. It demonstrated that along with the Mt. Geumgang tourism project, the imports and exports through the GIC hold an important position in inter-Korean commercial transactions during the latter Sunshine era.

Table 7.3 GIC and inter-Korean trade, 2004-2008

(Unit: millions of US current dollars; percentage)

	2004	2005	2006	2007	2008
Total trade (A)	697.0	1,055.8	1,349.7	1,797.9	1,820.4
Total commercial trade (B)	436.5	689.5	928.1	1,431.2	1,711.9
Trade through the GIC (C)	41.7	176.7	298.8	440.7	808.4
GIC trade as a percentage of total trade (C/A)	6.0	16.7	22.1	24.5	44.4
GIC trade as a percentage of total commercial trade (C/B)	9.6	25.6	32.2	30.8	47.2

Source: MOU

The growth of its share of total inter-Korean trade was linked to an expansion of productive capacity in the GIC. The number of companies in the GIC was eighteen and the value of its production was a mere 14 million US dollars in 2005. However, the number of companies rose by seventy five between 2005 and 2008, and the amount of production in the GIC exceeded 251 million US dollars in 2008. Its accumulated amount of production reached 524 million US dollars within the period of four years. As of December, 2012, one hundred twenty three enterprises were operating, and its accumulated volume of GIC production totalled 1.98 billion US dollars. (Table 7.4) Meanwhile, the growth of production output in the GIC led naturally to the increase in the employment of GIC workers. Since South Korean companies first employed fifty five North Korean workers in October 2004, the total number of North Korean workers exceeded 10,000 in November 2006 and 30,000 in July 2008.²⁸

Table 7.4 Numbers of companies operating in the GIC and production volume

(Unit: number and ten thousand of US current dollars)

	2005	2006	2007	2008	2009	2010	2011	2012
Number of companies	18	30	65	93	117	121	123	123 ²⁹
Production volume	1,491	7,373	18,478	25,142	25,648	32,332	40,185	46,950
Accumulated production volume	1,491	8,864	27,342	52,484	78,131	110,463	150,648	197,599

Source: MOU and Kaesong Industrial District Management Committee (KIDMC)

²⁸ As of October 2013, the number of North Korean workers at the GIC was 45,000.²⁹ As of October 2013, it dropped from 123 in 2012 to 120.

Lee Jong-seok and Kim Keun-sik commonly pointed out that the GIC project was a central component of South Korea's engagement strategy (Lee 2011; Kim 2011).³⁰ President Roh, in his address on the 59th Anniversary of National Liberation on 15 August, 2004, stated that if the GIC project could develop as planned, "it will bring with three results at a time: both Koreas will have substantial economic benefits; the danger of war will be reduced on the Korean peninsula; and the international credibility will go up for both the South and the North" (Roh 2005: 260). In fact, the GIC project played an important role in expanding economic ties while easing tensions between the two Koreas. From this perspective, it is important to understand the economic and political reasons that lay behind this fastest-growing production in the GIC.

To put it simply, why was the GIC project important for South Korea? In what way could it be understood as a strategy for positive engagement? First, the development of the GIC was driven by significantly commercial factors, reflecting the economic interests of South Korean enterprises and government. The reasons for the South's interest in the GIC were attributed to its validity of South Korea's short-term and mid and long term strategy. With regard to the former, the significance of the GIC stemmed from its positive impact on inter-Korean economic environment. Yang (2013: 63) argued that the GIC contributed to the establishment of a "win-win economic cooperation model" in inter-Korean economic relation. The GIC combined South Korea's capital and technology with North Korea's land and labour. Indeed, it was a good opportunity for South Korean small-and medium-sized enterprises (SMEs) that were struggling with rising wages and high rent, and to those who faced a difficulty to extend its business abroad. The GIC was literally an industrial complex that was primarily designated for South Korean business ventures, and it was situated only sixty kilometres from Seoul. Along with its basic feature and geographic proximity, the competitive minimum wages and the high quality labour were also critical factors attracting South Korean manufacturing businesses.

From a longer perspective, the development of the GIC was a meaningful step towards laying the foundations of a South-North economic community. The GIC has been the biggest joint venture project since inter-Korean economic relations began in 1989 (Kim and Noh 2009). With the increase in economic interaction, policymakers in South Korea anticipated that if the GIC could be a successful model of mutually

³⁰ Interview with Lee Jong-seok in Seoul, 20 June 2011, and with Kim Keun-sik in Seoul, 26 May 2011.

beneficial cooperation, it would serve to transform the place into an economic common market in which a common currency would circulate or single price would be applied to one commodity (Hong 2004). Lim Dong-won, serving as Director of the South Korean National Intelligence Service in 2000 claimed that “with the Kaesong project underway, we were in a position to promote our long-term strategy to build a North-South economic community” (Lim 2012: 233). In this sense, South Korea’s pursuit of the GIC project was closely related with a strategic long-term goal pertaining to reunification, effectively paving the way for the creation of an inter-Korean economic community.

Second, the significance of the GIC was also associated with its expected ripple effect on the political and security realm. This strategic thinking elucidated why the GIC was an important part of South Korea’s positive engagement. Politically, Seoul pursued the GIC project in the hope that it could improve the security environment on the Korean peninsula. It was, looking beyond the positive occurrences of inter-Korean economic cooperation that came with more contacts, dialogue, and interaction, expected to help stabilise the security situation, such as tension reduction and the restoration of mutual trust in inter-Korean relations. The rationale behind positive economic statecraft through the GIC was its prospect for the structural effect on tension reduction that resulted from the high level of economic interdependence. If the South could successfully make the GIC into a sustainable industrial site generating mutual gains to both Koreas, it was believed to bring with it the constraining effects of economic interdependence, leading to a reduction in the likelihood of military conflict. Namely, a steady stream of economic benefits from the GIC might help to prevent or mitigate future aggression between the two Koreas, because the opportunity costs of potentially lost gains from the GIC would deter any fatal provocations. Ko Kyung-bin (2011), former Director of the Social and Cultural Exchanges Bureau of the Ministry of Unification stated that “whilst the GIC was operating, it virtually played the role of a buffer zone preventing armed conflict between the North and the South.”³¹

From a longer perspective, the reason behind driving the GIC project, however, was not confined to the conflict-inhibiting effects relating to peninsula stability. Strategically, the GIC was regarded as an appropriate means to produce desirable changes within North Korea. To Kim Dae-jung and his successor Roh Moo-hyun, the development of the GIC was believed to be the best possible way not only to deepen economic ties that were mutually beneficial, but also to encourage North Korea’s

³¹ Interview with Ko Kyung-bin in Seoul, 8 June 2011.

gradual reform in that the experience of a market economy could be the catalyst for North Korea's partial marketisation and further structural changes. While it might not be correct that the political leadership in the South primarily pursued the GIC project with the aim of achieving this transformative effect as an imminent goal, the government did not hide its expectation in terms of its prospects for opening and reform in North Korea. The 'socialising (or psychological) effect' at the GIC in which tens thousands of North Korean employees could interact daily with South Korean managers and staffs at the modernised facilities was believed to expedite the transformative effects within North Korea (Lankov 2008). Lim Eul-chul (2011) pointed out that "this positive and structural effect of the GIC on inter-Korean relations was what South Korea's economic engagement had ultimately aimed at in the long term."³² Taken together, the inception and development of the GIC was driven not only by economic reasons, but also by political ones, reflecting strategic interests of South Korea's positive engagement.

Despite the great economic advantages for both Koreas and strategic interests of the South, the GIC project faced a serious challenge. First, the two Koreas had not resolved three procedural issues - passage, communications, and customs clearance in spite of frequent requests and negotiations (Kim and Lim 2009; Cho 2011; Stangarone 2013). One of the main difficulties was caused by the restricted border crossings. The invitation from the North was required for entry to GIC, and the incomings and outgoings at the GIC were only possible within a limited time. The communications at the complex were also restrictive. The firms in the GIC could not use internet and mobile in their plants. The process of customs clearance was also complicated and inefficient. Inspection was often applied to all goods rather than selected items, so it took a long time. The tenant companies experienced inconvenience as well because the North Korean custom office was closed for about eighty days a year. Besides, if it involved any machinery, it had to go through a more complicated procedure at customs.

Second, the GIC project has caused the status of goods from the GIC. The underlying problem was attributed to the barrier to export products made at the GIC. In the United States products manufactured in the GIC were subject to 'Column 2' tax category.³³ Under this condition, North Korea was not eligible for special trade treatment such as preferential duty-free entry or lower tariffs. By a similar logic, the GIC products were not recognised as South Korean in origin, but treated as North

³² Interview with Lim Eul-chul in Seoul, 29 July 2011.

³³ The United States applied 'Column 1' tax category to WTO member states and Normal Trade Relation (NTR) countries. As of 2013, only Cuba and North Korea were subject to 'Column 2' in the United States.

Korean goods. As a consequence, they were subject to high tariffs or required importation permission under the U.S. Trading with the Enemy Act (Cho 2011). It meant products made in the GIC were unlikely to be exported to the United States, considered as the biggest potential market.

This legal status of the GIC-produced goods had to do with the rules of origin of whether products from the GIC could be acceptable as goods made in South Korea. If goods manufactured at the GIC were considered as South Korean in origin, they were subject to treatment of most-favoured-nation (MFN) status applied to goods from WTO member states, granted with preferential tariff by countries that have bilateral trade agreements with South Korea. It also meant that, when the GIC products were exported abroad, through negotiation with its trading partners, the GIC could be designated as 'outward processing zones' (OPZ) in the free-trade agreement (FTA). Otherwise, goods made in the GIC were regarded as North Korean products, losing duty free status and price competitiveness. Accordingly, as long as trading partners did not treat the GIC-made goods as South Korean, export of the GIC products was unlikely to be increased under this condition. It indicated that GIC would lose an important opportunity to be internationalised, discouraging further investment in Gaeseong by other South Korean businesses or potential foreign investors. Yoo Ho-yeal (2011) claimed that "without market access for goods from the GIC, it might be nothing more than South Korea's large processing complex in North Korea."³⁴

Third, the GIC has raised human rights issues on North Korean workers. The primary concern was whether or not North Korean workers in the GIC were being exploited with the low wages. As seen in Table 7.5, the average wage per North Korean worker in the complex was 68.1 US dollars in 2006, and went up every year. In the end of Sunshine period, the wages was 71 dollars in 2007, and it increased 80.3 US dollars in 2009, 109.3 US dollars in 2011. The minimum wages has been 50 US dollars since a complex opened in 2004, but rose to 52.5 US dollars in 2007, 57.9 US dollars in 2009, 67 US dollars in 2011.

³⁴ Interview with Yoo Ho-yeal in Seoul, 11 April 2011.

Table 7.5 Average and minimum wages for North Korean workers at the GIC

(Unit: US current dollars)

	2005	2006	2007	2008	2009	2010	2011	2012.8
Average wages	57.5	68.1	71.0	74.1	80.3	93.7	109.3	128.3
Minimum wages	50.0	50.0	52.5	55.1	57.9	60.8	63.8	67.0

Source: MOU

The problem regarding wages stemmed from two major facts that (1) South Korean enterprises could not pay workers individually in the complex; (2) The North Korean government took a portion of the wages paid by the South Korean companies. Under the current wages system, North Korean authorities deducted 30 percent of the Society and Culture taxes (*sahoemunhwasichaekgeum*) from the wages of North Korean workers and received 15 percent of the minimum wages for the social insurance fee (*sahoehoheomryo*) from the South Korean firms. It meant, the only remaining 55 percent was given to North Korean workers in either North Korean currency or coupons. On this point, Yang (2007) contended that although the exact wages that North Korean workers actually received were unclear, the wages at the GIC were relatively higher than other North Korean regions. However, Haggard (2012) asserted that given North Korea's 'high inflation and rapid depreciation of the exchange rate', the value of their wages and coupons they received was very small. Jo (2012) argued that considering the wages of North Korean workers at the GIC remained only 5 percent of the average South Korean employees, the current wages at the GIC were too low. In this sense, if working at the GIC could be still a 'dream' for the North Korean workers, the measures for guaranteeing relevant wage increase and good fringe benefits should be considered by South Korean managers. While it is true that South Korean enterprises do not have independent labour management rights, the South's Kaesong Industrial District Management Committee (KIDMAC) should continually demand a transparent wage distribution system to the North Korean authorities. The concern over better working conditions and welfare system for North Korean employees has to be preceded before the interest in the further expansion or investment of the GIC or the requests of South Korean firms for more manpower supply.

7.3.1.4 Mount Geumgang tourism project

While it is correct that the GIC played an important role in expanding economic cooperation and ties with North Korea, inter-Korean economic cooperative projects started in earnest with the Mount Geumgang tourism project, which commenced in November 1998.

The outset of Mt. Geumgang tourism project originated from Honorary Hyundai Chairman Chung, Ju-young's visit to Pyongyang to discuss economic projects including a tourism business in January 1989. However, his proposal was not materialised at that time. Along with the historical event of crossing the Demilitarised Zone (DMZ) with five hundred cattle in June 1998, Chung visited North Korea again, being granted permission to develop the Mt. Geumgang area and carry out tourism business. After receiving South Korean government approval, Chung paid another visit to Kim Jong-il in October, 1998, and the Mt. Geumgang tourism project was finally signed between the North's Asia-Pacific Peace Committee and Hyundai Group.

Since the first cruise boat left, carrying 826 tourists on 18 November 1998, the number of Mt. Geumgang tourists rapidly increased to 148,074 in 1999 and 213,009 in 2000. As it was expected to continually make profits to both Hyundai Group and North Korea, the project was regarded as the most prominent symbols of inter-Korean reconciliation and cooperation. However, the project was confronted with difficult challenges from Hyundai Asan's financial crisis in 2002 and the government's budget reduction allocated to the project in 2003. Meanwhile, a rapid decline in the number of tourists aggravated its financial crisis. The monthly average for tourists was 15,000 in 2000, but it sharply decreased to 3,000 in 2001. As a result, three of four tourist cruise boats, the *Geumgang*, the *Bongrae* and the *Pungak* suspended its operation between April and July, 2001. It is noteworthy that Hyundai Asan's financial troubles served to transform the nature of the business from a purely private venture into a government' involved business project. The Kim Dae-jung government supported 90 billion won (about 83 million US dollars) from the Inter-Korean Cooperation Fund (IKCF), and the Korea Tourism Organisation (KTO) began working on the Mt. Geumgang tourism project. The problem also stemmed from the nature of tour. According to the survey on the actual condition of the Mt. Geumgang tour in 2003, the respondents cited the complicated immigration and customs formalities as the most unsatisfactory factor (KTO 2003).³⁵ A high cost, a monotonous programme of sightseeing and insufficient

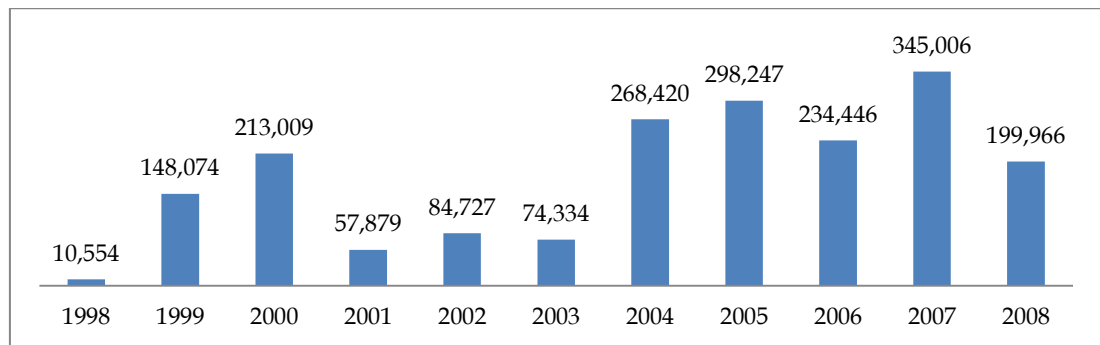
³⁵ Fifteen point six of the respondents who did not want to revisit Mt. Geumgang answered that (1) there are many restrictions on the trip, and (2) it took a long time to reach to Mt. Geumgang.

infrastructure also led to a decrease in South Korean tourists to the North (Jo 2012: 116). The tourist cruise ship via sea routes was eventually terminated with 449 visitors in January 2004.

However, after the government’s financial support and the opening of tours via overland routes, the Mt. Geumgang tourism project was revitalised from 2004. As depicted in Figure 7.5, the number of tourists was mere 74,334 in 2003, but it rapidly increased to 268,420 in 2004 and soared to 345,006 in 2007.

Figure 7.5 Number of the Mt. Geumgang tourists

(Unit: number of tourists)



Source: MOU

Consequently, North Korea’s revenue from the Mt. Geumgang tourism project also increased during this period. (Table 7.6) However, the tours were unexpectedly suspended after a South Korean female tourist was shot to death by a North Korean soldier at Mt. Geumgang in July 2008. Since then, the high standard measures to guarantee personal safety and prevent a recurrence have been a key issue to restart the tours. However, the negotiation between North and South Korea has been slow for the past four years, and as a result Mt. Geumgang’s inactivity continues today.

Table 7.6 Amount of revenue of the Mt. Geumgang tourism project

(Unit: millions of US current dollars)

1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	Total
206.0	136.0	37.2	21.5	13.1	15.3	13.5	12.0	20.0	20.0	494.6

Source: MOU

Note: The numbers from 1999 to 2005 cited in a document prepared for parliamentary inspections of Ministry of Unification in 2006 (MOU 2006). Data from 2006 to 2008 cited in Choi (2010: 140)

Then, what were the political and economic drivers that made South Korea pursue the Mt. Geumgang tourism project? First, for Kim and his administration, it was an ideal means to advertise a new policy of engagement towards North Korea called the 'Sunshine Policy' that emphasised reconciliation and cooperation with Pyongyang. Lee Kwan-se, former Vice Minister of Unification stated that "the promotion of the Mt. Geumgang tourism project was a good opportunity to show the government's active stance toward inter-Korean economic relations and to affirm its commitment on the path of engagement not of isolation and confrontation toward North Korea."³⁶ Kim Dae-jung anticipated early that the tourist industry was desirable for the joint venture between the two Koreas, and that the Mt. Geumgang region would be a candidate for investment in the tourist industry (Kim 1997: 172). Although the project was primarily motivated by Hyundai's interest, it was undeniable that the Kim government's willingness to support this project played an important part in starting and maintaining the Geumgang tourism. Despite external unstable factors caused by the suspicion of underground nuclear facilities at Kumchangni and the Taepodong-I missile launch in August 1998, the government granted a permit for the Mt. Geumgang tourism project. Considering that the Mt. Geumgang project was promoted whilst Kim Dae-jung's Sunshine Policy has not received a positive response from the North, the private sector's initiative was deemed a litmus test of the prospects for future success on the Sunshine policy.

Second, the rationale behind its inception was also related to the consideration of a domestic economy. The Mt. Geumgang project was not only a symbol of cooperation between Seoul and Pyongyang, but also a proof of political stability on the Korean peninsula. At the time Seoul was desperate to secure domestic stability to overcome the 1997 Asian financial crisis, confronted with the challenge of convincing investors and credit rating agencies that South Korea was suited for foreign direct investment. According to Lim Dong-won serving as Senior Presidential Secretary of National Security and Foreign Affairs at the time, for South Korea, it was imperative to resolve the concerns of the foreign investor who hesitated to do business for a fear of the possibility of war that originated from North Korea's nuclear crisis (Lim 2008: 373). Thus, the significance of the Mt. Geumgang tourism project was attributed to both political reasons and economic value. Meantime, the Mt. Geumgang tourism project was considered as the confidence building measures that could promote reconciliation and tension reduction on the Korean peninsula. Whereas Kim's Sunshine Policy

³⁶ Interview with Lee, Kwan-se in Seoul, 30 May 2011.

provided a momentum to start off Hyundai's idea of tourism, Roh's commitment on the principles of positive engagement such as the separation of politics and economy and a diffuse reciprocity enabled the project to continue in the face of security concerns and other interruptions. Taken together, these combined security and economic considerations drove the administrations of Kim Dae-jung and Roh Moo-hyun to get involved in this project and provided legal and financial support despite its low profitability.

Notwithstanding, the assessment of the Mt. Geumgang tourism project was different between supporters and critics of the Sunshine Policy. The proponent appraised that the Mt. Geumgang tourism project was the first result of a policy of separating economic matters from politics and that it was a meaningful economic cooperation project when it considered the poor business and investment environment in North Korea. They commonly stressed that it made a contribution to tension reduction during the early years of the Kim Dae-jung administration (Lee 2011; Kim 2011; Ko 2011).³⁷ President Kim has been a big supporter of this project, believing that tourism could contribute to the resolution of regional conflicts and to peace. In his address at the Asia-Pacific Economic Cooperation (APEC) Tourism Ministers' Meeting in June 2000, Kim (2001: 181) stated that "South and North Korea began tours to Kumgangsan, the Diamond Mountains, in the North in November 1998. This began to foster an atmosphere of reconciliation on the peninsula, promoted exchanges and became an important turning point for the settlement of peace." In this light, the proponent of engagement claimed that the Mt. Geumgang tourism project made it possible to open the Jangjeon port in North Korea, a Military Demarcation Line (MDL) and a demilitarised zone (DMZ) by beginning overland tour. Thus they argued that it played an important role in reducing tension between the two Koreas (Lim 2011; Paik 2011).³⁸ In addition, the advocates of the Mt. Geumgang tourism project contended that it had a positive influence on inter-Korean trade and official cooperation by promoting dialogue and discussions between Seoul and Pyongyang (Kwon 2011)³⁹.

Conservative South Koreans did not deny that the Mt. Geumgang tourism project contributed in part to making a favourable environment for the advancement of inter-Korean relations. However, they have long argued that its effect on tension reduction was limited. Critics highly emphasised it was corroborated by the detention

³⁷ Interview with Lee Kwan-se in Seoul, 30 May 2011, with Kim Keun-sik in Seoul, 26 May 2011, with Ko Kyung-bin in Seoul, 8 June 2011.

³⁸ Interview with Lim Dong-won on 28 May 2011 and with Paik Haksoon on 15 June 2011.

³⁹ Interview with Kwon Young-kyong in Seoul, 25 May 2011.

of a tourist in 1999⁴⁰ and its final suspension of the cross-border tour project in 2008. According to their account, these negative occurrences demonstrated that 'détente through tourism' had a limitation as a means of easing tensions and building trust between the two Koreas. In contrast with the proponent, they were pessimistic on its role in expanding functional linkages between North and South Korea. Yoo Ho-yeal (2011) made the point that "the effects on people-to-people contacts were unlikely to happen in the Mt. Geumgang tour zone. This was because the North did not permit South Korean tourists talk to North Korean people including North Korean employees in hotels, shops, and restaurants, and the tour occurred under a strictly controlled condition."⁴¹

More fundamental criticism stemmed from its precarious financial situation. According to the initial contract made in October 1998, Hyundai promised to pay 942 million US dollars to the North, 12 million US dollars over six years and three months, until March 2005 in return for its thirty-year exclusive business rights to Mt. Geumgang development. It meant, in order to maintain this project, the Hyundai had to attract more than 350,000 tourists annually. However, the actual number of visitors to the mountain between 1999 and 2001 fell short of their expectations. This excessive contract drove the Hyundai to the verge of bankruptcy, making the project unsustainable without the government's financial support. Hence, the opposition Grand National party and conservative media asserted that the project only brought significant benefits to North Korea, providing an opportunity to earn foreign currency. According to Jo (2011),⁴² they were particularly concerned that North Korea's revenue, that was directly obtained in cash from the number of tourists coming to Mt. Geumgang could be used for other purposes such as the personal asset of Kim Jong-il for the purchase of luxury items or the development of North Korea's missile and nuclear weapons, allowing the leadership to stay in power. Although the initial contract of Hyundai's monthly payment of 12 million US dollars irrespective of the number of tourists was revised to pay 1.3~1.5 million US dollars to North Korea according to the number of tourists, the condition of 'the debt-ridden project' virtually continued, being a target for criticism in South Korea.

⁴⁰ While on a cruise ship tour to Mount Geumgang in June 1999, the South Korean tourist was arrested by North Korean authorities on suspicion of acting as a South Korean agent.

⁴¹ Interview with Yoo Ho-yeal in Seoul, 11 April 2011.

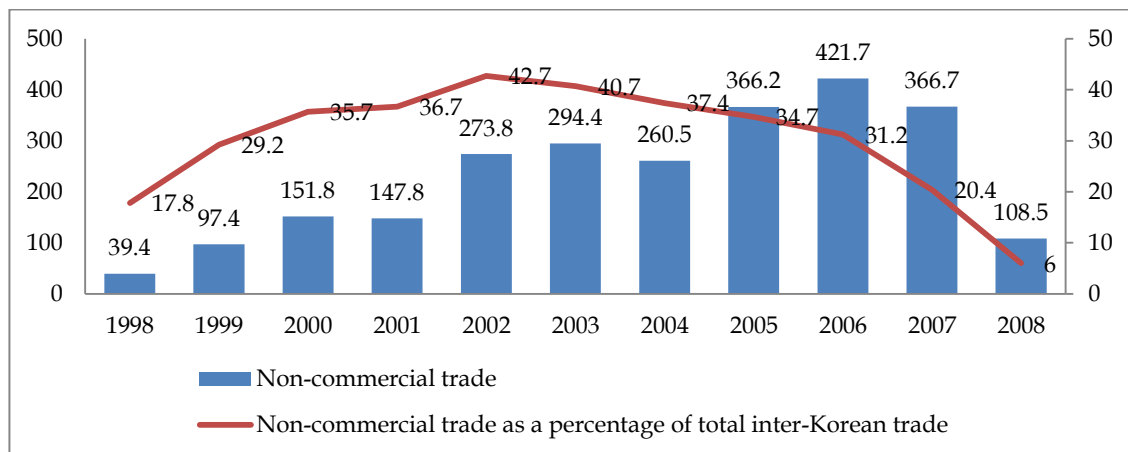
⁴² Interview with Jo Dong-ho in Seoul, 21 April 2011.

7.3.2 Non-commercial transactions

Economic incentives through non-commercial transactions were one of the two most important pillars of South Korea’s positive engagement. As shown in Figure 7. 6, the weight of non-commercial transactions in trade between the two Koreas rose from 17.8 percent in 1998 to 42.7 percent in 2002. Although its relative share of total inter-Korean trade continued to decrease throughout the Roh administration, falling from 40.7 percent in 2003 to 20.4 percent in 2007, the amount of non-commercial transactions increased in absolute terms except for in 2004 and 2007. It showed that non-commercial transactions represented a significant part of inter-Korean trade during the Kim and Roh administrations. As noted earlier, non-commercial transactions consisted of South Korea’s involvement in KEDO activities, humanitarian assistance to North Korea and social cultural projects. However, the analysis in this thesis primarily focused on humanitarian assistance in line with the concept of positive engagement.

Figure 7.6 Non-commercial trade and its weight in total inter-Korean trade

(Unit: millions of US current dollars/percentage)



Source: MOU

7.3.2.1 Humanitarian Assistance

Since the Sunshine Policy started by the Kim Dae-jung administration, humanitarian assistance became one of the central tenets of South Korea’s positive engagement with North Korea. Recognising that North Korea had undergone chronic food shortages with the continuing deterioration of the North Korean economy, the Kim government made the decision to provide food and fertilizer aid to North Korea. Although South Korea encouraged NGOs’ activities on delivering aid to North Korea, South Korea’s humanitarian assistance has been largely driven by the state. To the Sunshine Policy of

President Kim and Roh, aid operation was considered as a practical pathway to improve inter-Korean relations while relieving the suffering of North Koreans caused by the chronic food crisis. In this sense, in order to understand South Korea's aid policy and its dynamics, it is important to examine what the government had offered, how it was delivered, why it caused controversy.

President Kim's Sunshine Policy resulted in the changes in the South's aid to the North. The most prominent change was observed in the leading role of the government in humanitarian operation (Lee 2011).⁴³ From 1999, the way of the provision of aid which had been channelled through multilateral organisations changed to state-led bilateral assistance. The inception of direct support by the government made it possible for Seoul to provide large-scale assistance to Pyongyang for its own strategic interests. As shown in Table 7.7, between 1998 and 2007, South Korea provided a total of 2,730 billion South Korean (hereafter SK) won (2.40 billion US dollars) in humanitarian assistance to North Korea. Of this, 2,034 billion SK won (1.78 billion US dollars) was government assistance, and the rest, 696 billion SK won (617 million US dollars) was assistance through non-governmental organisations.

Table 7.7 South Korea's humanitarian assistance to North Korea, 1998-2007

(Unit: one hundred million SK current won/ten thousand US current dollars)

	Government (a)			Private (b)	Total (a+b) (won)	Total (a+b) (dollar)
	Grant ⁽¹⁾	Food loans	Sub-total			
1998	154	-	154	275	429	3,185
1999	339	-	339	223	562	4,688
2000	978	1,057	2,035	387	2,422	20,213
2001	975	-	975	782	1,757	13,539
2002	1,140	1,510	2,650	576	3,226	24,092
2003	1,097	1,510	2,607	766	3,373	26,363
2004	1,313	1,359	2,672	1,558	4,230	36,590
2005	1,360	1,787	3,147	779	3,926	36,254
2006	2,273	-	2,273	709	2,982	29,828
2007	1,983	1,505	3,488	909	4,397	45,631
Total	11,612	8,728	20,340	6,964	27,304	240,383

Source: MOU

Note: (1) Grants from the government consisted of three main categories: a direct assistance, assistance through NGOs, and assistance through international organisations. The government's direct assistance mainly comprised of food aid, fertilizer aid, and emergency relief aid.

⁴³ Interview with Lee Jong-moo in Seoul, 21 July 2011.

Most items in the government-level assistance were provided in the form of grants. Fertilizer aid and emergency relief aid were typical cases. By contrast, food aid took a form of a long-term loan. In fact, two of the most important supply items for the government's humanitarian assistance were food and fertilizer. From 1998 until 2007, food loans made up the largest volume in the government-level assistance with 872 billion SK won (720 million US dollars). The South Korean government's food aid towards North Korea continued except in 2001 and 2006, and its annual average food shipments including a form of loans and grants was 320,000 tons. As for fertilizer assistance, beginning with 150,000 tons in 1999, South Korea provided the North with an average 200,000 tons a year until 2007.

South Korea's government-level food assistance was carried out in three main ways (Kim 2010; Lim 2011). First, it was delivered directly to the North through the South's Red Cross which was entrusted by the government. Second, food aid was provided through the United Nations World Food Programme (WFP). Third, it was delivered to North in the form of loans. In South Korea, the second and third way was mostly used for delivering food aid to North Korea whereas there were only two cases of the first type of food aid. With regard to the latter, the South Korean government provided the North with 150,000 tons of rice and 100,000 tons of rice in 1995 and 2006 respectively. As seen in Table 7.8, during the Kim and Roh administrations 1998-2007, food aid through the three ways totalled at 3.27 million tons, worth nearly 864.6 million US dollars (1,035 billion SK won).

Table 7.8 South Korea's food assistance to North Korea, 1998-2007
(Unit: one hundred million SK current won/ten thousand US current dollars)

	Descriptions	Volume ^(a)	Amount (won)	Amount (dollar)	Note
1998	30,000 tons of corn 10,000 tons of wheat	4	154	1,100	WFP
1999	-	-	-	-	-
2000	300,000 tons of foreign rice 200,000 of foreign corn	50	1,057	8,836	Loan
2001	100,000 tons of corn	10	223	1,725	WFP
2002	400,000 tons of Korean rice	50	1,510	10,600	Loan
	100,000 tons of corn		234	1,739	WFP
2003	400,000 tons of Korean rice	50	1,510	10,600	Loan
	100,000 tons of corn		191	1,619	WFP
2004	100,000 tons of Korean rice 300,000 tons of foreign rice	50	1,359	11,799	Loan
	100,000 tons of corn		240	2,334	WFP
2005	400,000 tons of Korean rice 100,000 tons of foreign rice	50	1,787	15,000	Loan
2006	100,000 tons of Korean rice	10	394	3,938	Grant
2007	150,000 tons of Korean rice 250,000 tons of foreign rice	53.8	1,505	15,170	Loan
	120,000 tons of corn 12,000 tons of bean 5,000 tons of wheat 1,000 tons of dry milk		190	2,000	WFP
Total		327.8	10,354	86,460	

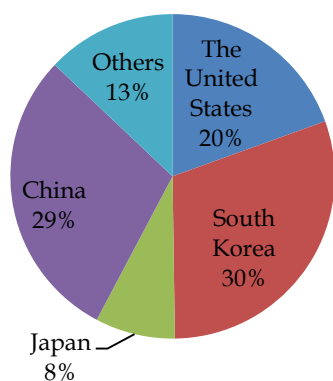
Source: MOU

Note: (a) ten thousand tons

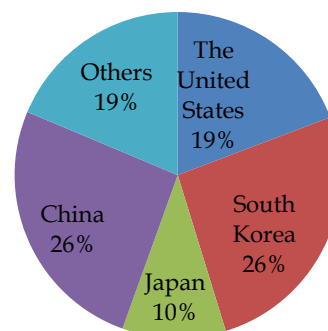
This total food aid by the South Korean government was larger than the United States' 1.89 million tons of food aid, at an estimated value of 545 million US dollars during the same period (U.S. Congressional Research Service 2013). Considering that two countries have been the principal donors to North Korea so far, the continuous provision of South Korea's large-scale of food assistance was believed to significantly help North Korea alleviate its food shortages (Kim 2008; Cho 2005). As shown in Figure 7.7, South Korea was the largest provider of food aid to North Korea between 1998 and 2007, and the share of South Korea's food assistance as a percentage of total international food assistance to North Korea reached 30 percent.

Figure 7.7 International food assistance to North Korea

Major Food Donors to North Korea, 1998 to 2007



Major Food Donors to North Korea, 1995 to 2011



Source: The database of the International Food Aid Information System (INTERFAIS), WFP
 Notes: Basis: Grain Equivalent; Optional filters: Food Aid Type (all), Commodity (all), Delivery Mode (all); accessed 21 October 2013.

After food aid, fertilizer represented the second largest share of government level assistance. Between the mid-1990s and 2000, North Korea had faced serious fertilizer shortages. Such an insufficient fertilizer supply led to a decrease in the overall agricultural production including food in the 1990s (Kim 2001). According to the estimation of Kwon and Kim (2003: 29), over 73 percent of fertilizer availability was supplemented by assistance from the international aid community between 1998 and 2002. In fact, nutrient applications through fertilizer were indispensable for producing grain, leading to the improvement of crop yield. The Kim government was well aware of this fact, beginning to deliver fertilizer in North Korea with the aim of relieving widespread fertilizer shortages. It seemed particularly appropriate to South Korea because it was expected to assist the North's efforts for increasing food production while dispelling domestic concerns over its reliance on food aid. Since the Kim administration first sent 155,000 tons of fertilizers in 1999, fertilizer aid has been sent to the North consecutively until 2007. In contrast with food aid, all fertilizers were provided in a form of grants, and the cost of fertilizer aid was funded by the government's Inter-Korean Cooperation Fund. After the summit in 2000, an average of 300,000 tons of fertilizer was delivered to the North. From 1999 until 2007 the South Korean government has sent over 2.5 million tons of fertilizers, worth 798 billion SK won to the North. (Table 7.9)

Table 7.9 South Korea's fertilizer assistance to North Korea, 1998-2007

(Unit: ten thousand tons, one hundred million SK won, ten thousand US dollars)

	Volume	Amount (won)	Amount (dollar)	Date
1998	-	-	-	-
1999	15.5	339	2,853	5.5: 3.30~6.5 10: 6.8~6.25
2000	30	943	8,342	20: 5.18~6.28 10: 8.1~8.28
2001	20	639	4,947	5.2~6.9
2002	30	833	6,660	20: 4.25~6.11 10: 9.13~10.26
2003	30	836	7,013	20: 5.29~7.30 10: 11.1~12.1
2004	30	972	8,446	20: 4.16~6.23 10: 11.16~12.21
2005	35	1,258	12,344	20: 5.21~6.21 15: 6.29~7.25
2006	35	1,200	12,566	15: 2.28~4.10 20: 5.15~7.10
2007	30	962	10,349	3.27~6.23
Total	255.5	7,982	73,520	

Source: MOU

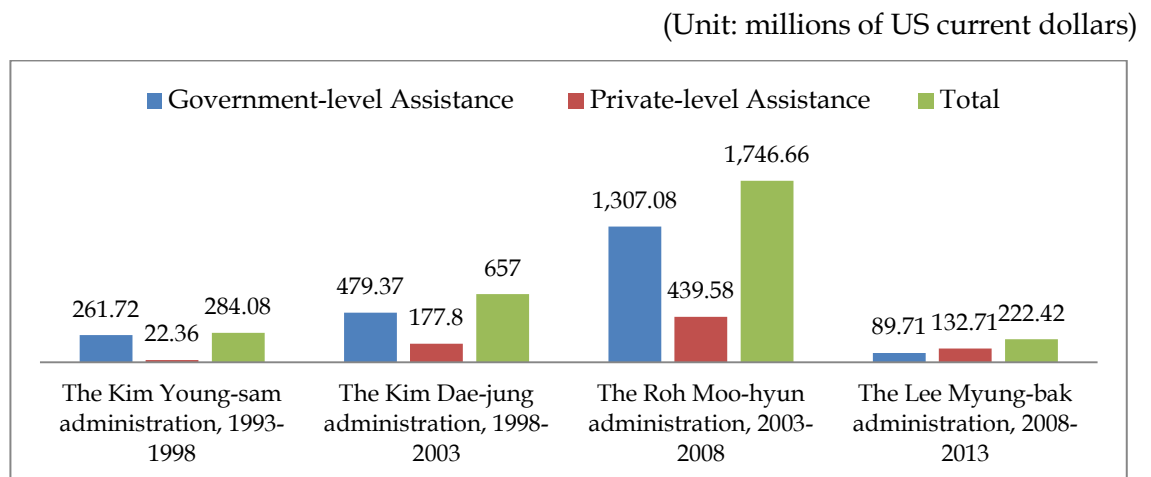
Understanding South Korea's inception and expansion of humanitarian aid to North Korea requires the identification of each of Kim and Roh's motives and each administration's objectives on aid provision. This is because, in the context of South Korean politics, dealing with humanitarian concerns in North Korea was also a political matter of how to engage with North Korea. To be sure, South Korea's food and fertilizer shipments were initiated to meet humanitarian conditions in North Korea, but, at the same time, aid was utilised to serve political and diplomatic ends for South Korea. From this perspective, it is critical to identify the drivers of South Korea's humanitarian aid and its political and non-political elements of aid.

What was the main impetus to South Korea's humanitarian assistance to North Korea? It was in part attributed to individual causes revolving around identity. Namely, President Kim and Roh's personal perceptions over North Korea, seeing it as a partner, not an enemy, and the two governments' consistent perspective on inter-Korean relations, regarding it as 'unification-oriented special relationship', not viewing it as real state-to-state relations influenced its decision to begin humanitarian actions of delivering food aid to North Korea. In common with inter-Korean economic cooperation, aid to North Korea was not considered as 'foreign assistance'. Rather it

was 'inter-state assistance' driven by a moral obligation to help vulnerable fellow Koreans living at the northern part of Korea.

However, considering that food aid also was observable in the former conservative government of Kim Young-sam, the more crucial question is how it could continue in the face of the dangers of a North Korean threat. Viewed in this light, the underlying factor propping up South Korea's aid policy stemmed from the structural cause, the dynamics of positive engagement that both progressive administrations commonly adopted to deal with North Korea. The Sunshine Policy, which had been operated by the principle of the separation principle of economy and politics, and the diffuse reciprocity created the structural environment in which aid operation to North Korea could be sustained even though inter-Korean relations became rather strained. Accordingly, the provision of humanitarian assistance to North Korea was less affected by the political situation in inter-Korean relations, so South Korea's aid policy was able to last throughout the governments of Kim Dae-jung and Roh Moo-hyun. For instance, fertilizer shipments were not suspended despite the first and second Yeonpyeong Naval Clash in June 1999 and June 2002. It was not seriously affected by North Korea's nuclear test in October 2006. While it is correct that the Roh administration temporarily shelved its food aid shipments due to North Korea's nuclear test, it was resumed in March 2007. Compared with the pre-to-post Sunshine era, the total volume of South Korea's humanitarian assistance showed dramatic differences. (Figure 7.8) It demonstrated how much Kim and his successor, Roh were committed to aid operation during their terms in office.

Figure 7.8 South Korea's humanitarian assistance during the pre-to-post-Sunshine era



Source: MOU

Another important question is why the South provided humanitarian aid to North Korea. Of course, it was caused by the moral imperative that South Korea ought to help North Koreans who were suffering from insufficient food, chronic malnutrition, and dire economic conditions. However, the motives for South Korea to deliver food and fertilizer aid to North Korea were not all simple and straightforward. Rather, they were complex, and not entirely driven by moral obligations, but mixed with political interests and long-term gains. The Kim Dae-jung administration basically contemplated that the provision of aid to North Korea would not only relieve the North Korean hardship, but also contribute to the improvement of inter-Korean relations, paving the way for the establishment of an ethnic community by inspiring a one nation sentiment (MOU 2001: 145). Furthermore, the Roh Moo-hyun government publicly indicated that South Korea's aid would promote North Korea's reform and openness in the medium to longer term, and encourage a change in North Korea's behaviour in nuclear negotiations (Park 2009). On this point, Park Hyeong-jung (2011) pointed out that "the provision of South Korea's aid to North Korea was carried out under the belief that the South could achieve political objectives in the course of giving aid."⁴⁴ Lee Jong-moo (2011) also stated that "South Korea's humanitarian aid was a part of the engagement policy, playing the role as a means to create incentives for trust and cooperation between the two Koreas."⁴⁵ Strategically, Kim and Roh commonly recognised humanitarian aid as positive incentives, expecting that the North, who was in dire need of aid, would show a cooperative attitude towards South Korea (Hong 2001; Park 2011). In this context, South Korea's aid had humanitarian purposes, but at the same time its food and fertilizer shipments were considered as a political and diplomatic tool for a new political and economic relationship. Both were vital to shaping South Korea's consistent policy of aid between 1998 and 2007.

Under these circumstances, humanitarian aid under the progressive governments of Kim Dae-jung and Roh Moo-hyun had two roles in inter-Korean relations. First, aid served as a communicative tool. To Kim, the provision of rice and fertilizer in the early phase of his term had the role of delivering his earnest message to Kim Jong-il that Seoul was ready to actively seek a reconciliation policy towards Pyongyang. Kim, in his speech on the 51st Armed Forces Day on 1 October, 1999, said that

⁴⁴ Interview with Park Hyeong-jung in Seoul, 13 June 2011.

⁴⁵ Interview with Lee Jong-moo in Seoul, 21 July 2011.

“We do not want to fight a war with North Korea. We want to coexist and cooperate with it. We want to help it. We want to help North Korea feed our hungry brothers and sisters as well as improve their standard of living. We want to help it reinvigorate its devastated economy” (Kim 2000: 183).

Considering that Pyongyang did not show any significant response to Seoul’s engagement initiatives, President Kim’s repeated message⁴⁶ on humanitarian aid conveyed his sincerity on rapprochement and trust-building with North Korea. Under the Roh administration, aid was instrumental in delivering a message to the North pertaining to security matters. Faced with the North’s missile test in July 2006, the Roh government temporally shelved the remaining shipment of fertilizer in the fall, and suspended food aid delivery against Pyongyang’s nuclear test in October 2006. It did not mean, however, that the Roh administration directly linked humanitarian assistance with the nuclear issue. In fact, fertilizer aid was shipped as originally planned, and food aid to North Korea also resumed after the ‘13 February agreement’ in 2007. Nevertheless, what is important to note is the fact that the South’s decisions to continue and halt aid delivery was used as a means to show Seoul’s diplomatic stance regarding North Korea’s nuclear issues.

Second, aid served as a *quid pro quo* for political negotiations. The South Korean government took for granted that aid involved an element of ‘exchange’. Over the course of implementing positive engagement, the Kim administration did not evade the linkage strategy between the provision of humanitarian aid and the pursuit of his political agenda. For instance, from 1998 to 1999, the South attempted to resolve the issue of separated families by offering fertilizer aid to the North, although it ended in failure. Along with two large-scale food aid in 2000 and 2002, the Kim administration linked fertilizer aid to a negotiation of the holding of defence ministerial military talks and the reunion of separated families in 2002. The feature of offering aid in exchange for political goals was still apparent during the Roh government. In response to the North’s request for 500,000 tons of fertilizer in 2005, the South tried to simultaneously resolve the resumption of the North-South Ministerial talks and other exchanges and cooperation in sociocultural area. These hallmarks showed that the South Korean government’s decision to initiate, halt and resume food and fertilizer aid was made considering domestic political circumstances and the impacts of its aid on the North’s political behaviour.

⁴⁶ President Kim’s speech at the Free University of Berlin in March, 2000 (Kim 2001: 54).

Nevertheless, it is important to emphasise that the South's humanitarian assistance to the North was not based on a specific or strict reciprocity. In other words, highlighting South Korea's tendency of 'food for talk' or 'food for meeting' did not mean that the Kim and Roh's aid policies were based on a conditional engagement. Kim and Roh's humanitarian engagement with North Korea was more focused on the improvement of inter-Korean relations. Namely, they used aid as a quid pro quo to resolve domestic humanitarian concerns, and to make a favourable environment for inter-Korean economic cooperation. Although the Roh administration particularly emphasised a change in North Korean behaviour in the course of direct food and fertilizer supply, its provision of aid was not contingent on the progress in North Korea's denuclearisation. In relation to correlations between humanitarian and security objectives, it is correct that the government used it as a diplomatic tool to reveal Seoul's concern about Pyongyang's hostile behaviour pertaining to the nuclear and missile issues, but the South Korean leadership did not employ it as a means to persuade North Korea to give up its nuclear weapons.

South Korea's combined interests in delivering aid to North Korea between humanitarian and political intension was considered as inevitable or even accepted by opponents of the Sunshine Policy. Then, why has South Korea's aid to North Korea been at the centre of controversy? The most substantive concerns and criticism stemmed from the issues of restricted monitoring and aid diversion.

First, humanitarian assistance including South Korea's food and fertilizer shipments was faced with the dilemma of whether or not they had to continue the provision of aid without monitoring food deliveries in North Korea. In any shape or form, if the donor provided aid for humanitarian purposes, aid delivery should be transparent, enabling agencies to confirm what is distributed to the intended beneficiaries (Riddell 2007). However, under the current system, the South Korean government had no way to confirm whether its food aid was delivered to the target beneficiaries or its designated delivery locations. The former Minister of Foreign Affairs and Trade, Yoon Young-kwan pointed out that "The biggest mistake in South Korea's aid policy during the Roh Moo-hyun administration was to allow large-scale food aid without a serious progress in adequate monitoring."⁴⁷

Contestation on South Korea's offer of aid whilst North Korea was reluctant to implement humanitarian norms and principles posed two questions: first, why the

⁴⁷ Interview with Yoon Young-kwan in Seoul, 15 April 2011.

North Korean government consistently prohibited the aid agencies monitoring food aid distributions; second, in such a situation, why the South Korean government was willing to provide humanitarian aid to North Korea. Considering the latter issue was addressed earlier, the dispute surrounding the monitoring deficits was associated with the former. In fact, the restricted monitoring and the lack of free access were intentional actions of the North Korean political leadership. Given that political stability and autonomy were vital interests of the North Korean regime, they basically did not want to reveal the reality to the outside world of what they were doing (Schloms 2004; Haggard and Noland 2007). Hence, this political setting in the North Korean regime was the main cause of the issues of restricted monitoring, consequently making it difficult for the South Korean government to negotiate the conditions of aid including improvements in monitoring frequencies and capacities.

However, this first problem of implementing humanitarian principles arose from the way that South Korea handled humanitarian aid. Yoo Ho-yeal (2011) commented that “the problem was attributed to South Korea’s modality of humanitarian assistance. In retrospect, the Roh government provided massive food aid directly to North Korea with the form of loans, and this large-scale food aid was not channelled through multilateral UN agencies such as WFP or Food and Agriculture Organisation (FAO). Hence, the South Korean government was not in a position to request a strict monitoring towards North Korea in the first place.”⁴⁸ Namely, the methods in which South Korea delivered aid to North Korea courted controversy. These arguments lead to the following question on why South Korea did not primarily use these multilateral channels that had relatively high standards of monitoring and evaluation of its effects.

The crucial point is that South Korea provided humanitarian aid to North Korea with political purposes and tactical considerations. Such dual nature of South Korea’s humanitarian aid between the ‘moral imperative’ and ‘political interest’ undermined Seoul’s justification to call for an appropriate monitoring to North Korea. From Pyongyang’s perspective, they did not have to seriously consider humanitarian norms regarding South Korea’s aid because Seoul’s conditionality on aid has already been paid by their reciprocal actions through the reunion of separated families and the arrangement of ministerial-level talks. For this reason, Pyongyang, considering aid as a quid pro quo on their concessions, did not feel the need to implement a monitoring protocol. Ironically, Seoul, despite the belief that its food and fertilizer aid to the North

⁴⁸ Interview with Yoo Ho-yeal in Seoul, 11 April 2011.

was humanitarian assistance, could not push North Korea to comply with international standards of monitoring. Although it might be inevitable for the South Korean government to add its political interests to aid operations, so they had to legitimise such type of aid for larger diplomatic goals, Seoul's bilateral food aid to the North without an agreement for monitoring food aid distributions was enough to evoke domestic criticisms and ethical issues among the opposition party and the conservative media. Cho Seong-ryoul (2011)⁴⁹ and Park Hyung-jung (2011)⁵⁰ claimed that it was not wrong that South Korea provided large-scale aid to North Korea, but that its aid was delivered to the North without appropriate assessments about the scale of need and a negotiation of monitoring on the distribution of food.

Interestingly, the Roh government kept emphasising that since the fund for food aid was financed by taxpayers' money, they would push through the reciprocity and invent a more comprehensive approach that included a minimum level of a monitoring. The reality, however, was that the series of meetings had made little advance. Far from end-user monitoring through household level visits and interviews or commodity tracking, inspections of city and town-level ration distribution points have not been permitted yet. More critically, the South Korean government publicly indicated that the food aid has been provided as a form of loan, so that it was not an unconditional aid, nor a unilateral give away with nothing in return. However, despite Seoul's notification of the due date and first payment for the food loan, Pyongyang has not implemented the repayment so far. This result showed that South Korea's food and fertilizer aid had an intrinsic factor not to be fully recognised as 'humanitarian' assistance despite claiming to 'purely humanitarian'. It might not be wrong that South Korea adhered to a 'principle of reciprocity', linking the provision of rice and fertilizer to a matter of mutual interest of both Koreas. However, the problem was that South Korea's conditionality, in particular its food loan, did not include the measure for improvements in monitoring capacities. This is the reason why South Korea's food and fertilizer aid to North Korea was caught in a dilemma between humanitarian intention based on a moral obligation to help compatriots across the border on one hand, and political purposes that attempted to utilise aid as an instrument to influence political agendas and the North's behaviour on the other.

Second, aid to North Korea also evoked disputes and criticism due to aid diversion. Various sources pointed out that not all the food assistance going to North

⁴⁹ Interview with Cho Seong-ryoul in Seoul, 2 June 2011.

⁵⁰ Interview with Park Hyung-jung in Seoul, 13 June 2011.

Korea was reaching its intended recipients such as infants, children, pregnant and nursing women, hospital patients and elderly people, and claimed that food aid was systematically diverted to support North Korea's party elites and the military (Haggard and Noland 2005; Smith 1999; CRS 2005). Haggard and Noland (2007) estimated that the magnitude of diversion was most likely to be large, with perhaps as much as 30 percent or more of total aid diverted. In this light, critics contended that South Korea's humanitarian assistance, particularly food aid was highly likely to not be delivered to North Korean in need, but to North Korean authorities and military. Further, some sceptics asserted that humanitarian assistance only helped Pyongyang to save time and money needed to advance its nuclear and missile technology because it made it possible to divert its budget planned to purchase or import food to the investment of military industries (Yoo Ho-yeol 2009).⁵¹ The culmination of these criticism arouse when the North carried out its nuclear test in October 2006 in which the South's humanitarian aid reached a zenith in terms of quantity. Since the South Korean government did not hide its political purposes of aid, serving to ameliorate inter-Korean relations, the North's nuclear test of 2006 not only discouraged the South's humanitarian efforts, causing aid fatigue, but also precipitated deep scepticism over the utility of aid. Indeed, the opposite party and conservative media insisted that South Korea's aid returned with a nuclear arsenal.

A major source of criticism raised by the South Korean conservatives centred on the link between the provision of aid and the development of the nuclear weapons. In fact, the possibility that aid would be misused and diverted by the ruling elites has long been a serious challenge for aid operations, particularly, in fragile countries (Dollar and Pritchett 1998; Riddell 2007). In the case of North Korea, an accusation of the vulnerability of aid emerging from irresponsible misuse of food aid entailed its own logical basis. To those regimes struggling with the scarcity of capital or general market imperfections, the use of an additional resource made possible by foreign aid was likely to be determined by the priorities of political power. This pattern led to the misuse of aid by the vested interests and 'the rising profitability of capacity' for the ruling regime (Elsenhans 1994, 2004). Namely, a source of finance that resulted from saving the government's budget due to the input of foreign aid was not used for the marginal population, but for the privilege and less deserving groups such as the military and political elites. This is the reason why there has been a growing concern with aid operation in North Korea, and why the opponents of the Sunshine Policy

⁵¹ In interview with Yoo Ho-yeol in Seoul, 11 April 2011.

casted doubt on the probability that the North's available budget from food aid has been utilised for the on-going development of North Korea's nuclear and missile capability.

However, there are counterarguments which might indicate that it is not persuasive to link South Korea's humanitarian aid to North Korea's nuclear development. Philo Kim commented that "humanitarian assistance including South Korea's food aid was more likely to allow the North Korean elites to free up resources for other purposes, and the possible reallocation of North Korea's budget could be used for the development of its nuclear programme. However, linking the fungibility of South Korea's aid to the North Korean nuclear issue was wrong because North Korea would continue to develop its nuclear programme without South Korea's aid."⁵² Cho Seong-ryoul contended that "North Korea's development of nuclear weapons was initiated even before the onset of the food crisis and the inception of humanitarian aid. Thus, the question of whether aid was used as intended should be considered with the question of what the top policy priority for North Korean elites is."⁵³ In other words, because the North Korean authorities' priority on the military, the so-called 'military-first' policy was not likely to be changed or abandoned, North Korea's development of nuclear weapons would continue regardless of South Korea's food aid.

Needless to say, it is imperative to examine how food aid impacted on the North's financial management, and whether food aid was used for intended purposes. However, the problem was largely attributed to the autocratic nature of the North Korean regime in which the leadership could use their resources for their own purposes and priorities. The process to maximise their budgets and allocate foreign aid would be determined by their own desires and decisions. More importantly, the underlying motives and intentions for developing nuclear weapons fundamentally stemmed from the security dilemma that was constructed by a complicated and multi-layered political and economic setting in North Korea. Hence, given the lack of sufficient information on the effect of food aid, it would be illogical to link budget allocations resulted from aid to its effects on the development of nuclear weapons.

Finally, it is important to emphasise that these constraints, which the South Korean government faced, were caused by its mode of aid operation. Under the current circumstance, setting a strong measure to clearly monitor the end-use and track their deliveries that would prevent food from diverting to the ruling elite and military

⁵² Interview with Philo Kim in Seoul, 19 May 2011.

⁵³ Interview with Cho Seong-ryoul in Seoul, 2 June 2011.

was hardly feasible. Even acknowledging that South Korea's virtually unconditional food and fertilizer aid is more likely to be fungible, the South Korean government was in a weak position to pose the issue of resource allocation towards the North Korean authorities. This is because South Korea, as a single donor country, did not have an enough bargaining power to make the North to change their aid distribution system, and had no political or diplomatic leverage to intervene in North Korea's budget allocation. Unless the South uses UN multilateral organisations such as WFP or FAO as a main channel for delivering food assistance, allegations of diversion on the South's food aid and concern over the indirect effect of aid on resource reallocation would likely be continued. The vital point is that South Korea's modality of food aid and its hallmark of giving humanitarian aid as a quid pro quo on political agendas made it difficult to persuade Pyongyang to adopt international standards of monitoring that would prevent further diversion of food aid.

7.4 Results of South Korea's positive engagement

Over the course of Kim Dae Jung's and Roh Moo-hyun's presidencies, South Korea's engagement policy towards North Korea produced tangible outcomes within the economic sphere. It was clear that the Sunshine Policy brought about discernible changes in the level of economic ties between the two Koreas. The effectiveness of the engagement policy on the political realm, however, remained highly controversial between the supporters of the Sunshine Policy and its opponents. It meant that South Korea's engagement strategy resulted in both positive and negative occurrences.

7.4.1 Economic interdependence

Then, what are the consequences of South Korea's strategy of economic statecraft? A close assessment of the Kim and Roh administrations' positive engagement towards North Korea must begin with the investigation of how much the use of economic incentives as part of engagement strategies contributed to the development of economic interdependence between the two Koreas. This examination - central to an understanding of the driver of positive engagement - provides a clue as to test the causality between commercial ties and interstate conflict and the potential role of economic power and relations for its national security.

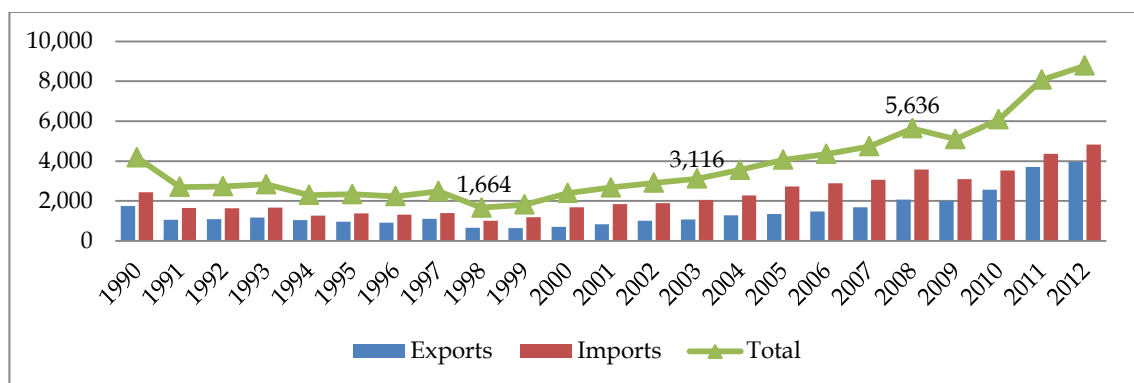
Over the past decade, South Korea's positive engagement through commercial

and non-commercial transactions has brought about a significant change in the nature of North Korea's foreign trade. The increase in economic incentives through inter-Korean economic cooperation has influenced the course of economic interdependence between North and South Korea, but its economic outcomes had different implications in the North and the South respectively. The most significant result of South Korea's positive engagement was an asymmetrical interdependence structure in inter-Korean economic relations. Namely, inter-Korean economic cooperation has been of great importance in North Korea's foreign trade in terms of both quantity and quality, whereas its proportion of the total South Korean trade has been relatively meagre.

As seen in Figure 7.9, despite its isolation and economic sanctions North Korea's economic activities have not hindered between 1998 and 2008. Rather, North Korea's international trade continued to expand during the entire era of the Sunshine Policy. According to trade statistics compiled by KOTRA,⁵⁴ the total North Korean trade was 1,664 million US dollars in 1998, but it surpassed 3.1 billion in 2003, exceeding 5.6 billion US dollars in 2008 with exports of 2.0 billion and imports of 3.5 billion. The core issue here is behind the increase in North Korea's foreign trade, to what extent did inter-Korean economic cooperation influence the North Korean economy and the level of economic ties between the two Koreas.

Figure 7.9 Trend of North Korea's exports and imports, 1990-2012

(Unit: millions of US current dollars)



Source: KOTRA, "Foreign Trade of North Korea," each vol.; MOU, "Monthly Movement of Inter-Korean Exchanges & Cooperation," each vol.

Note: North Korea's export and import volume was compiled by KOTRA figures plus inter-Korean trade.

⁵⁴ The author primarily used KOTRA's data on North Korea's foreign trade, but North Korea's export and import volume was compiled by adding inter-Korean trade to the original KOTRA data. This is because KOTRA regarded it as intra-transactions between the two Koreas, omitting the trade volume of inter-Korean trade from the total North Korean trade.

In fact, in terms of quantity, the volume of inter-Korean economic cooperation has not made a significant impact on the South Korean economy. Whilst inter-Korean trade continued to expand from 222 million US dollars in 1998 to 1,798 million in 2007, having grown eight-fold in ten years, its proportion of the total South Korea's foreign trade increased by only zero point one five percent during the same period. (Table 7.10)

Table 7.10 Inter-Korean trade and the proportion of trade with North Korea, 1998-2007
(Unit: millions of US current dollars)

	South Korea's foreign trade (A)	Inter-Korean trade (B)	South Korea's total trade (A+B)	Inter-Korean trade as a percentage of the total South Korean trade
1998	225,595	222	225,817	0.10
1999	263,438	333	263,771	0.13
2000	332,749	425	333,174	0.13
2001	291,537	403	291,940	0.14
2002	314,597	642	315,239	0.20
2003	372,644	724	373,368	0.19
2004	478,307	697	479,004	0.15
2005	545,657	1,056	546,713	0.19
2006	634,847	1,350	636,197	0.21
2007	728,335	1,798	730,133	0.25

Source: Korea International Trade Association (KITA) statistics Database (<http://stat.kita.net/>) (A); MOU (B).

Although North Korea's meagre share of South Korea's total trade was attributed to the relative sizable trade volume of South Korea and an increase in South Korea's commercial exchanges with other trading partners, inter-Korean trade itself has been given too little weight in overall South Korean trade. In other words, despite the quantitative growth in inter-Korean economic cooperation, the relative costs of changing or forgoing the structure of a system of interdependence were minimal or negligible in South Korea. It meant that in theory, despite the anticipated negative consequence such as political tension and economic loss, a cessation of trade relations with the North would more likely to be offset by finding other trading partners or realigning its private commercial interests. It did not mean, however, that inter-Korean economic cooperation had little impact on inter-Korean relations. Rather, in terms of quality, South Korea's economic ties with North Korea has been increasingly significant in the sense that the extent and asymmetry of interdependence had the potential to be exercised as a leverage or a means to influence inter-Korean diplomatic and security realms. Thus, Kim and Roh's efforts to expand economic interactions with

North Korea, and to make inter-Korean relations be costly to break involved a strategic aspect of positive economic statecraft. In fact, the patterns of inter-Korean economic cooperation under the Kim Dae-jung and Roh Moo-hyun governments have brought about a different implication to the North Korean economy.

In terms of size, inter-Korean economic cooperation has been more significant to North Korea (Jo 2003). As Table 7.11 demonstrates, the weight on the trade with South Korea within North Korea's economy took 13.3 percent in 1998, but it continually increased under the administrations of Kim Dae-jung and Roh Moo-hyun, accounting for 37.9 percent in 2007. In fact, inter-Korean trade as a percentage of the total North Korean trade would be slightly different depending on which figures it used. Nevertheless, the data commonly pointed out that the proportion of trade with South Korea represented more than one third of the entire North Korea trade volume by the early late 2000s.

Table 7.11 Share of trade with South Korea on North Korea's total trade

(Unit: millions of US current dollars / percentage)

	North Korea's total trade (KOTRA) (A)	North Korea's total trade (KDI) (B)	Inter-Korean trade (C)	The proportion of trade with South Korea (C/A)	The proportion of trade with South Korea (C/B)
1998	1,664	1,339	222	13.3	16.6
1999	1,813	1,359	333	18.4	24.5
2000	2,394	1,824	425	17.8	23.3
2001	2,673	2,850	403	15.1	14.1
2002	2,902	2,251	642	22.1	28.5
2003	3,115	2,421	724	23.2	29.9
2004	3,554	2,863	697	19.6	24.3
2005	4,058	3,241	1,056	26.0	32.6
2006	4,346	3,619	1,350	31.1	37.3
2007	4,739	4,195	1,798	37.9	42.9
2008	5,636	5,072	1,820	32.3	35.9

Source: KOTRA, "Foreign Trade of North Korea," each vol.; MOU; Lee *et al.* (2010).

Note: North Korea's export and import volume was compiled by KOTRA figures plus inter-Korean trade.

For Pyongyang, the importance of inter-Korean trade was even more obvious when it compared with other North Korea's trading partners. Although Pyongyang caused military tensions with its nuclear and missile programme, being branded as the 'axis of evil', North Korea has maintained its trade relations with many other countries over the years. Above all, China, Japan and South Korea have been the three major

trading partners to North Korea throughout the 1990s. The combined trade volume of these three countries accounted for an average of 65 percent of the entire North Korea trade between 1998 and 2007. (Table 7.12) Considering that China has been the largest trading partner to North Korea so far, it was apparent that North Korea's economic dependence on China simultaneously increased since the late 1990s. Interestingly, there has been a noticeable change in the status of Japan and South Korea as North Korea's trading partners during this period. Since 2002, South Korea (22.1 percent) has ranked the second largest North Korea's trading partner surpassing Japan (12.7 percent). This trend continued until the end of the Roh government.

Table 7.12 North Korea's foreign trade: Share of China, South Korea, Japan and EU

(Unit: percentage)

	China (A)	South Korea (B)	Japan (C)	Combined (A+B+C)	Combined (A+B)	EU
1998	24.8	13.3	23.7	61.8	38.1	21.3
1999	20.4	18.4	19.3	58.1	38.8	16.3
2000	20.4	17.8	19.4	57.6	38.2	10.6
2001	27.6	15.1	17.8	60.5	42.7	11.6
2002	25.4	22.1	12.7	60.2	47.5	12.0
2003	32.8	23.2	8.5	64.5	56.0	10.9
2004	39.0	19.6	7.1	65.7	58.6	7.3
2005	38.9	26.0	4.8	69.7	64.9	7.2
2006	39.1	31.1	2.8	73.0	70.2	5.4
2007	41.7	37.9	0.2	79.8	79.6	3.0
2008	49.4	32.3	0.1	81.8	81.7	2.8
2009	52.6	33.0	0.1	85.7	85.6	3.0
2010	57.0	31.4	0	88.4	88.4	2.3
2011	69.7	21.2	0	90.0	90.9	1.8
2012	68.5	22.4	0	90.9	90.9	0.9

Source: KOTRA, "Foreign Trade of North Korea," each vol.; MOU.

Note: North Korea's total trade volume was compiled by adding KOTRA figures on North Korea and inter-Korean trade volumes.

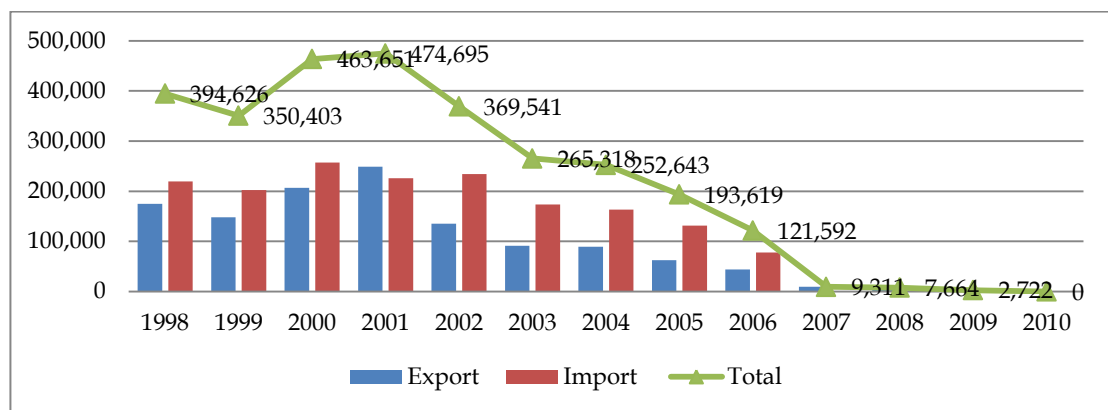
The change in the status of the trading position was largely attributed to different reactions between the two countries against North Korea's hostile behaviour in the 2000s. Japan's trade with North Korea dropped due to the onset of North Korea's nuclear crisis and other pending issues,⁵⁵ whereas inter-Korean trade rapidly rose after the 2000 summit meeting. In the case of Japan, its absolute amount of trade with North

⁵⁵ It primarily referred to the abductee issue that Japan had long demanded to be resolved.

Korea sharply decreased from 2002 in which the North Korean nuclear threat became an urgent problem caused by the clandestine development of a uranium enrichment programme in October 2002. (Figure 7.10) This steep decline in trade continued along with Japan's economic sanctions towards North Korea in 2006, and the ongoing nuclear standoff. It showed that Japan's economic relations with North Korea seriously deteriorated throughout the 2000s.

Figure 7.10 Japan's trade with North Korea, 1998-2007

(Unit: thousands US current dollars)

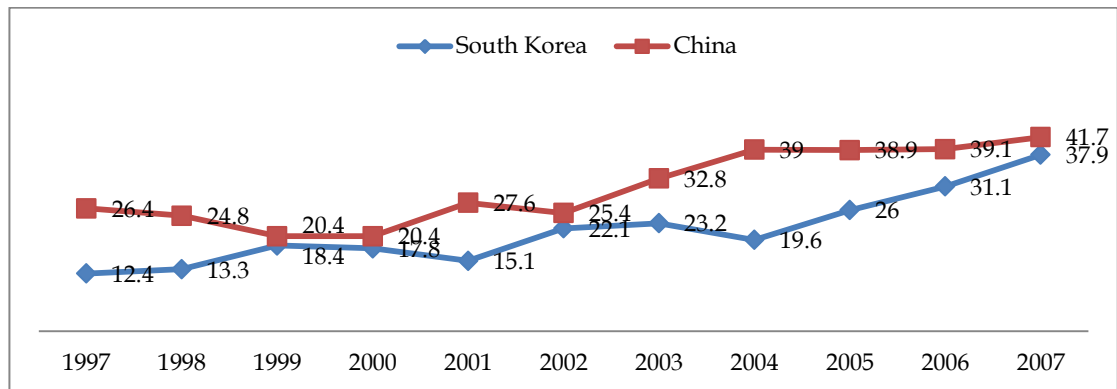


Source: KOTRA, "Foreign Trade of North Korea," each vol.; MOU

By contrast, the volume of inter-Korean trade increased in the midst of the second nuclear crisis, and South Korea's economic relations with North Korea remained intact even after North Korea's nuclear test in 2006. The quantitative expansion in inter-Korean economic cooperation continued until the end of the 2000s. As a consequence, Japan's proposition of North Korea's total trade decreased from 17.8 percent in 2001 to 12.7 percent in 2002, falling sharply to 0.2 percent in 2007, whereas South Korea's proposition increased from 15.1 percent in 2001 to 22.1 percent in 2002, rising to nearly 38 percent in 2007.

The growth in inter-Korean trade was clearly observable even when compared with the North's most influential trading partner, China. The gap of the share of trade with South Korea and China in North Korea's total trade constantly narrowed during the Sunshine Policy era. As seen in Figure 7.11, China and South Korea accounted for 41.7 percent and 37.9 percent of North Korea's total trade respectively in 2007, showing only a 3.8 percent difference.

Figure 7.11 Share of trade with South Korea and China of the total North Korean trade
(Unit: percentage)



Source: KOTRA, "Foreign Trade of North Korea," each vol.; MOU.

Note: North Korea's total trade volume was compiled by adding KOTRA figures on North Korea and inter-Korean trade volumes.

These results demonstrated that since the mid-2000s, North Korea's foreign trade has centred on South Korea and China, which together accounted for more than two third of the North's foreign trade (Lee 2012). In fact, a combined share of these two countries in North Korea's total trade rose from 64.9 in 2005 to 79.6 percent in 2007, and to 90.9 percent 2012. This phenomenon had an important meaning to both Koreas. To South Korea, the data, most notably, underpinned that with the beginning of the Sunshine Policy inter-Korean economic cooperation played a vital role in expanding North Korean trade. A rapid growth of trade with South Korea within North Korea's economy caused an increase in the rate of trade dependence on Seoul. This increased dependence on South Korea necessitated a continuous flow of commercial and non-commercial transactions and a room for stable inter-Korean relations, creating an opportunity for Seoul to exercise it as leverage to induce Pyongyang's cooperative behaviour. From North Korea's point of view, the significance of inter-Korean economic cooperation stemmed from its usefulness in maintaining its trade relations with China. Considering that North Korea's trade with China has run cumulative trade deficits, inter-Korean economic cooperation that has been an important channel for a substantial inflow of hard currency became indispensable to hold out its trade structure that was characterised by its growing trade dependence on Beijing.

Taken together, South Korea's positive economic statecraft between 1998 and 2008 has succeeded in structuring economic asymmetries between North and South Korea. In comparison with South Korea, the absolute amount of inter-Korean trade has become more significant to the North Korean economy in the 2000s. Considering the share of inter-Korean cooperation in North Korea's total trade and a sizeable amount of

South Korea's investment and aid to North Korea, the vulnerability of interdependence was more observable in North Korea in the sense that its commercial and non-commercial flows were not easily substituted by other sources of supply. It demonstrated that the relative costs of changing or forgoing its economic ties had been high in North Korea. Strategically, this structure made it possible for Seoul to expect conflict-inhibiting effects of interdependence, because it was believed to create the motivation for Pyongyang to avoid military conflict that would jeopardize the gains from inter-Korean economic relations. Even assuming that the extent of economic exchange between the two Koreas does not lead to change in North Korea's behaviour, there is little reason for Pyongyang to abandon the increased benefits in economic trade, investment and aid that the regime needed to maintain. It meant that North Korea would be likely to lean towards a policy of engagement, thereby eschewing the escalation of militarised disputes. The consequences indicated that as South Korea had taken the place as North Korea's principal trading partner after China, Seoul could look for 'interdependence effects' associated with the framework of positive engagement.

7.4.2 Positive consequences

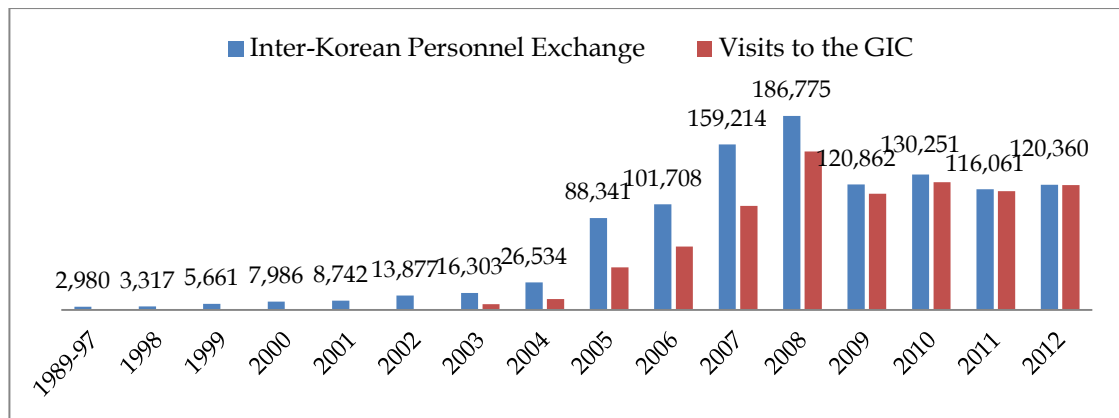
There were certain areas in which Seoul's strategy of economic statecraft had a positive impact on inter-Korean relations. Between 1998 and 2007, it resulted in increased people exchanges and numbers of talks and agreements between the two Koreas.

First, South Korea's positive engagement caused a significant increase in exchanges of people between North and South Korea. Whilst the Sunshine Policy was implemented, the number of people visiting another part of Korea expanded from 3,317 in 1998 to 159,214 in 2007, increasing in about a forty eight-fold during this period. The number of South Korean visitors to the North, 3,317 in a single year, 1998 was even larger than the total number of people exchanges, 2,980 made between 1989 and 1997. An important point to notice here was that there was an obvious reason leading to its quantitative increases. The visits to North and South Korea were made with various purposes, but the main reason behind the sharp increase in the number of people visiting the North from 2004 was due to economic related visits such as the GIC project and tourism consultations. In particular, the share of the visitors to the North for the GIC project as a percentage of total inter-Korean personal exchanges accounted for 32.8 percent in 2003, but it gradually increased under the Roh administration, rising from

46.3 percent in 2005 to 62.9 percent by 2007. (Figure 7.12)

Figure 7.12 People exchanges between South and North Korea

(Unit: person)



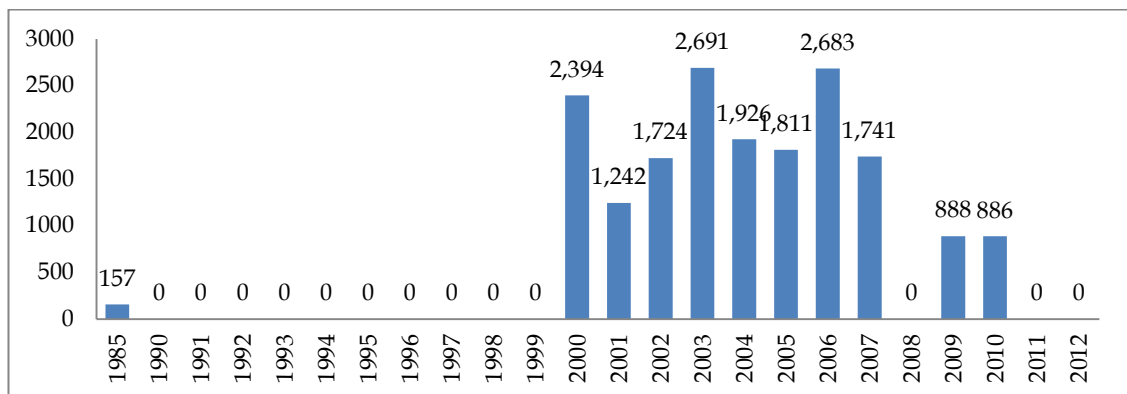
Source: MOU

Note: People exchanges did not include sightseeing visits to the Mt. Geumgang and city of Gaeseong.

It is also noteworthy that South Korea's economic incentives especially through humanitarian aid led to an increase in the exchanges of separated families. As seen in Figure 7.13, since the meeting of the separated families in the South and the North first occurred in September 1985, most of exchanges of visits by separated families took place during the presidency of Kim and Roh. From this perspective, South Korea's strategic use of economic incentives was instrumental in increasing personal contacts between the two Koreas.

Figure 7.13 Number of exchanges of separated families

(Unit: person)



Source: MOU

Note: The number is based on the government level's exchanges of separated families. It includes the number of reunions in North and South Korea but excludes the number of video reunions that occurred from 2005 to 2007.

Second, South Korea's engagement policy led to an increase in inter-Korean military talks. As shown in Table 7.13, out of a total of forty eight inter-Korean military talks between 1971 and 2012, forty four inter-Korean military talks were held between 1998 and 2007. It could be inferred that the frequent military dialogue under Kim and Roh was attributed to its interrelation between military affairs and economic cooperation. Given inter-Korean relations regulated by the armistice agreement, military assurance was a prerequisite for carrying out inter-Korean economic cooperative projects. The development of the GIC inevitably involved the construction of railways and roads between the two Koreas, mine sweeping, and cross-border passages. The Mt. Geumgang tourism project also required an agreement regarding passage by land and sea, and the safety of South Korean tourists. For this reason, the issues pertaining to military support were one of the key agendas in the South-North military talks. Clearly, Kim and Roh's drive for positive economic statecraft created a need for military dialogue and cooperation with North Korea, and it served to promote inter-Korean economic cooperation and vice versa. In this sense, the expansion of inter-Korean economic cooperation appeared to bring about 'spill over' effects on the active inter-Korean military talks.

Third, the effectiveness of South Korea's positive engagement was clearly observable in a marked increase in inter-Korean agreements. Between 1998 and 2007, the two Korean governments made one hundred and fourteen inter-Korean agreements, including sixteen on political matters, ten on military affairs, and seventy on economic cooperation. (Table 7.13) Considering that a total of one hundred fifty seven inter-Korean agreements were made between 1971 and 2012, about 73 percent of South and North Korea agreements were made during the period of the Sunshine Policy. The respective proportions of agreements in the realm of politics, military, and economy over the period as a whole were 48.5 percent, 100 percent, and 98.6 percent. In other words, nearly half of the total number of inter-Korean agreements on politics and all inter-Korean agreements on military were produced under the Kim Dae-jung and Roh Moo-hyun governments. These facts demonstrated that virtually all of the increases in inter-Korean military dialogue and agreements from the early 1970s through the early 2010s occurred whilst South Korea employed positive economic statecraft towards North Korea for the period between 1998 and 2007.

Table 7.13 Inter-Korean talks and agreements, 1998-2007 and 1971-2012

(Unit: times/ numbers/ percentage)

	Inter-Korean Talks, 1998-2007 (a)	Inter-Korean Talks, 1971-2012 (b)	a/b (%)	Inter-Korean Agreements, 1998-2007 (a)	Inter-Korean Agreements, 1971-2012 (b)	a/b (%)
Politics	71	248	28.6	16	33	48.5
Military	44	48	91.7	10	10	100
Economy	91	106	85.8	70	71	98.6
Humanitarian	26	150	17.3	12	24	50
Sociocultural	19	54	35.2	5	13	38.5
Others	-	-	-	1	6	16.7
Total	251	606	41.4	114	157	72.6

Source: MOU; <http://dialogue.unikorea.go.kr/home/talk/statistics/list>

Note: An author reconstructed the statistics provided by Special Office for Inter-Korean Dialogue Ministry of Unification.

7.4.3 Limitations

Notwithstanding, the impact of South Korea's positive engagement on the security area has been highly controversial both at home and abroad. The following three factors could be considered.

First, from the late 1990s until the late 2000s, inter-Korean security circumstance became precarious with a continued North Korean nuclear programme. Despite Seoul's persistent efforts to promote reconciliation and resolve North Korea's nuclear issues, Pyongyang conducted a nuclear test in October 2006 and again in May 2009.⁵⁶ Although the North Korean nuclear crisis was caused by many other reasons, particularly, the drive of Kim Jong-il's 'military-first politics' and the long North Korea-US conflict, the 2006 North Korea's nuclear test served to unleash the uselessness of economic incentives and thus reinforced criticism of South Korea's positive engagement towards North Korea. While North Korea's development of weapons of mass destruction and missiles were the gravest challenge ever in the history of inter-Korean relations, North Korea's build-up of its nuclear capabilities in the mid-2000s posed a serious challenge to the Roh administration. This was partly because President Roh commenced his term with North Korea's clandestine high enriched uranium (HEU) programme, precipitating the so-called 'second nuclear crisis'. However, the underlying predicament was largely attributed to the fact that North Korea's nuclear test occurred whilst South Korea's positive economic statecraft had

⁵⁶ North Korea conducted the third nuclear test in February, 2013.

reached a peak in the history of inter-Korean relations. It virtually demonstrated that 'the promotion of peace on the Korean Peninsula,' placed as the top priority for the Roh administration turned out to be an unrealistic and unattainable goal. Without the fundamental resolution of the North Korean nuclear crisis, it was unlikely to receive public support for further expansion of inter-Korean economic cooperation, and it was hardly feasible to build the peace regime that South Korea aimed to achieve. The dilemma for South Korea stemmed from its intrinsic limited role or leverage in the nuclear negotiation process. North Korea's decision to cooperate in the denuclearisation process was contingent on the satisfaction of North Korea during the bilateral or multilateral nuclear negotiations.

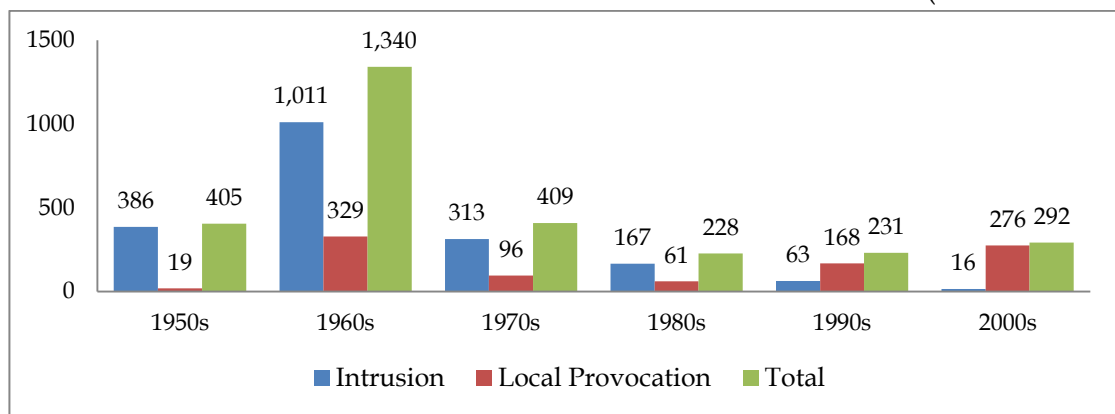
More critically, Pyongyang's growing demands such as the removal of economic sanctions, normalisation of relations with the United States, and economic and energy assistance were not affordable for South Korea solely. It was apparent that South Korea did not have any political and security incentives to induce or trade with North Korea's nuclear disarmament within the framework of the Six-Party talks⁵⁷ or bilateral relations. Simply, since the onset of North Korea's nuclear crisis, South Korea's capacity of diplomatic and economic incentives fell far short of meeting North Korea's requirements for halting or eradicating its nuclear programme including highly enriched uranium and missile systems. The South Korean government indeed made efforts to find a diplomatic solution to achieve the denuclearisation of North Korea. Beyond South Korea's role as a facilitator in the Six-Party talks or an honest broker between the United States and North Korea, President Roh initiated the discussion of the nuclear issue at the 2007 summit and urged Kim Jong-il to comply with the 'Joint Declaration on the Denuclearisation of the Korean Peninsula' (Moon 2007). Notwithstanding, the 2007 declaration failed to specifically state North Korea's willingness to discard its nuclear weapons. These facts showed that, North Korea's hostility in using the nuclear threat had not changed despite the South's tireless efforts for reconciliation and cooperation with the North. To put it differently, although Kim and Roh's Sunshine Policy and South Korea's positive engagement successfully led to the North's growing dependence on the South economically, this structure of asymmetrical interdependence could not alter the direction of North Korea's nuclear weapons development.

⁵⁷ It referred to a series of talks beginning in 2003, which have included China, Russia, Japan, and the United States, in addition to the Koreas.

Second, North Korea's local provocations towards South Korea and its violations in crossing the Northern Limit Line (NLL)⁵⁸ in the West Sea were not reduced during the 2000s. As seen in Figure 7.14, the North Korean provocations including intrusions and local provocations have been significantly reduced since 1970s. The fact was that the record of North Korean local provocations against South Korea had not decreased since 1980s. Rather, it has steadily increased during the 2000s in which positive engagement was actively implemented throughout the Kim and Roh administrations. According to the Ministry of National Defence (MND), the total number of the North Korean local provocations in the 2000s was 276, increased by 64.3 percent from 168 in 1990s.

Figure 7.14 North Korean intrusions and local provocations to South Korea

(Unit: numbers)



Source: MND

Note: The statistics of the North Korean provocations were based on '2012 Defence White Paper' published by South Korea's Ministry of National Defence. According to its classification, 'intrusion' included intrusion through ground, river, sea and overseas routes, and activities of spy agent. 'Local provocation' referred to different types of North Korea's provocative behaviour including the crossing Military Demarcation Line (MDL), rifling, artillery firing, provocations to U.S. military, NLL violations, naval skirmishes, kidnapping, and others.

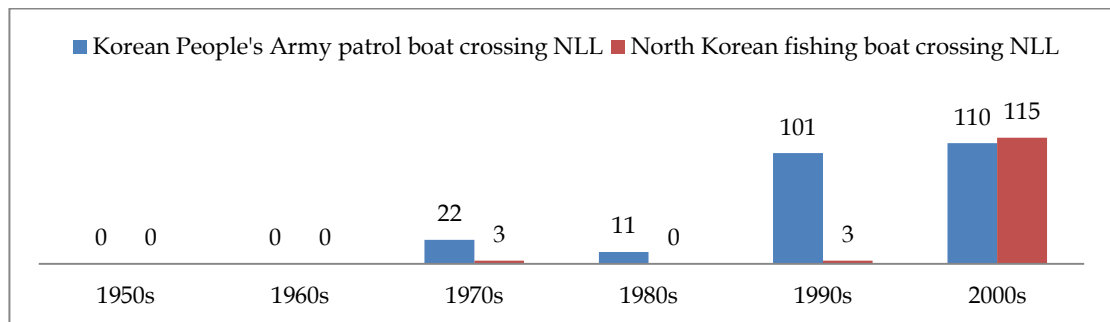
Next, statistics indicated that North Korea's provocative posture in the West Sea has not mitigated over the period of the Sunshine Policy. It is important to investigate the trend of North Korea's provocations around the NLL in the West Sea. This is because the area of the NLL has been at the centre of intense naval skirmishes, battles and local provocations, causing sensitive political and security issues between the two Koreas

⁵⁸ The Northern Limit Line (NLL) is the de facto maritime boundary between North and South Korea. The problem was attributed to the different way of recognising the NLL between the two Koreas. South Korea regarded the NLL as an effective maritime border, but North Korea did not officially recognise the line.

over the last half century (Roehrig 2009; Chang 2013). In essence, military provocations in the West Sea near the NLL have not reduced in the past decade. According to Figure 7.15, the number of North Korea’s NLL violations by Korean People’s Army (KPA) patrol boats increased from eleven in the 1980s, to one hundred one in the 1990s, reaching one hundred ten in the 2000s. With regard to North Korean fishing boats, the number of crossing NLL rose remarkably from three in the 1970s to one hundred fifteen in the 2000s.

Figure 7.15 North Korea’s NLL violations

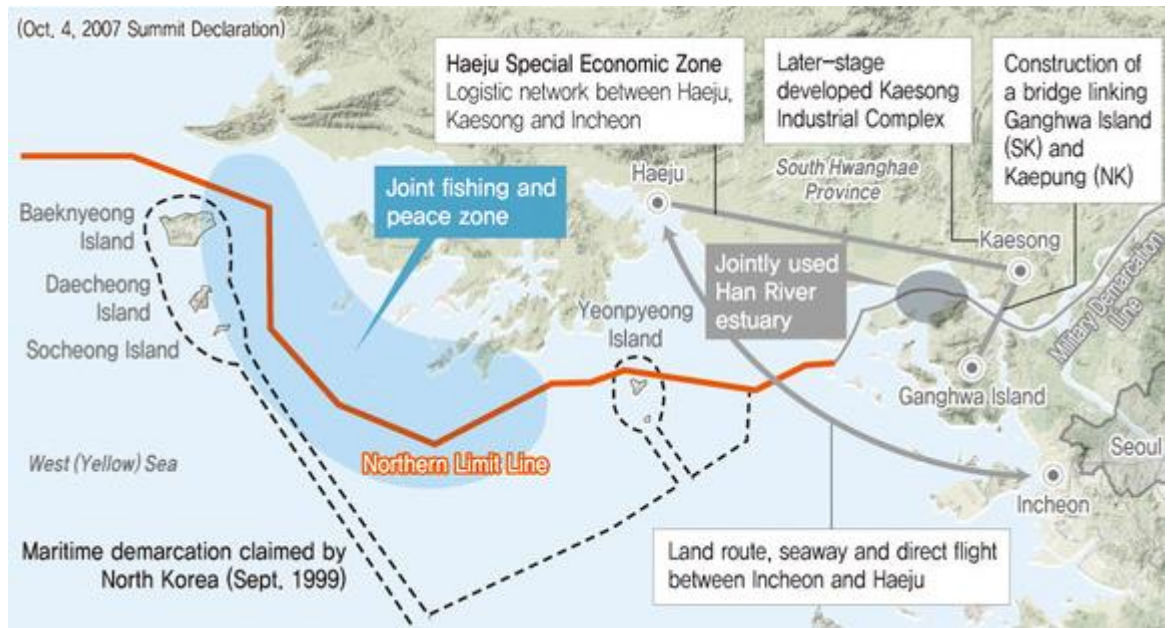
(Unit: times)



Source: MND

It was true that there was no major naval incident in the West Sea during Roh’s five-year term of office in comparison with the two naval skirmishes which occurred in 1999 and 2002 during Kim’s presidency. In fact, inter-Korean military talks were most frequent during the Roh administration, and the main agenda for inter-Korean dialogue between 2004 and 2006 was virtually about measures to prevent accidental naval clashes in the West Sea. It was particularly notable that President Roh Moo-hyun and Chairman Kim Jong-il reached an agreement on the designation of a ‘Special Area for Peace and Cooperation in West Sea’ (*seohaepyeonghwahyeopryeokteukbyeoljidae*) during the 2007 summit. (Image 7.1)

Image 7.1 Planned West Sea Special Peace and Cooperation Zone



Source: *The Hankyoreh* (2013)

Note: Accessed on 26 Nov 2013, (www.hani.co.kr/arti/english_edition/e_national/593174.html)

The Roh administration claimed that the agreement on the establishment of a joint fishing area and peace zone in the West Sea was ‘the key achievement in the 2007 summit declaration’, and, by transforming a ‘sea of tension and conflict’ into a ‘peace zone’, it would prevent accidental clashes in the disputed inter-Korean maritime border area in the West Sea (MOU 2008). However, the two Koreas have so far been unable to come to a detailed agreement on a joint fishing and peace zone (MOU 2008). It showed that although President Roh’s ‘economic’ approach to ease military confrontation succeed in attracting North Korea’s interests and receiving some confirmation from Chairman Kim, it fell short of resolving the maritime dispute surrounding the NLL.

North Korea’s belligerent behaviour that repeated military provocations while carrying on dialogue and economic cooperation raised fundamental questions regarding North Korea’s motives and intentions as well as the role of positive economic statecraft in ‘high politics’. On this point, Lee (2011) argued that given that North Korea’s vital interest in regime survival was not able to be altered, although its policy priority between military negotiations and military provocations would be placed differently in each situation, its path dependency in combining the two strategies continued between the early 1990s and the mid-2000s. Kim and Lee (2013) claimed that a rise or fall in North Korea’s NLL violations was not influenced by South Korea’s policy orientation in engagement or containment towards North Korea. In this

vein, the results on North Korea's local provocations and its violations in crossing the NLL at least showed that positive engagement under the Kim and Roh administrations did not have conflict-inhibiting effects on the Korean peninsula. Taken together, Seoul's Sunshine Policy of positive engagement succeeded in arranging military talks with Pyongyang, and changing the nature of dialogue from dealing with symbolic or declaratory agreements into concrete and specific substance. Nevertheless, it could not discernibly influence North Korea's repeated provocative behaviours, nor seriously weaken its inclination towards military provocation towards South Korea.

Third, South Korea's defence spending was also a critical indicator to assess the effectiveness of economic engagement in the political sphere under the Kim and Roh administrations. In essence, South Korea's military spending had not decreased during the past decade. As seen in Table 7.14, South Korea's defence budget has steadily increased since 1998 from 13,800 billion SK won (approximately 9.87 billion US dollars) to 24,497 billion SK won (26.36 billion US dollars) in 2007.

Table 7.14 Defence spending in South Korea, 1998-2007

(Unit: one billion of SK current won / percentage)

	Defence budget	% of GDP	% of public spending	Defence budget increased rate (%)
1998	13,800	2.75	18.3	0.1
1999	13,749	2.50	16.4	-0.4
2000	14,477	2.30	16.3	5.3
2001	15,388	2.36	15.5	6.3
2002	16,364	2.27	14.9	6.0
2003	17,515	2.28	14.8	7.0
2004	18,941	2.29	15.8	8.1
2005	21,103	2.44	15.6	11.4
2006	22,513	2.48	15.3	6.7
2007	24,497	2.51	15.7	8.8

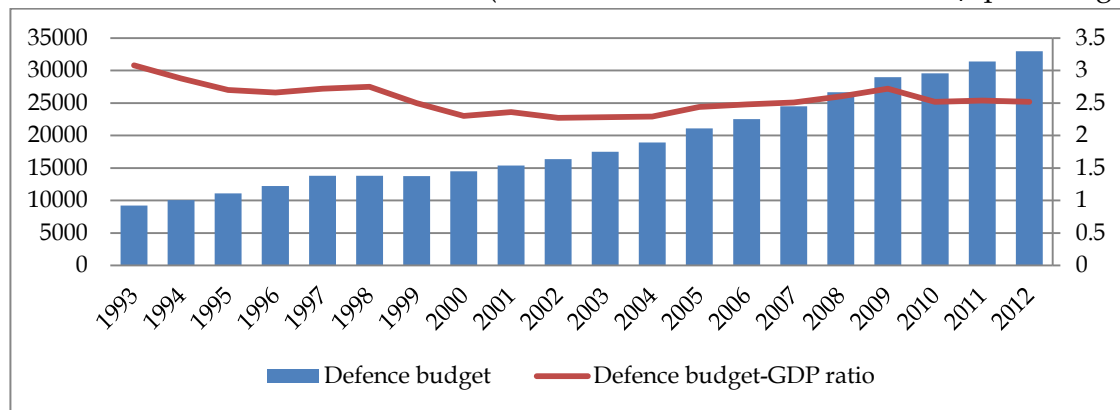
Source: MND

During this period, South Korea's defence spending has been managed within 3 percent of its GDP, and its share of total public spending has been maintained between 15 and 16 percent except for 1998. Nevertheless, the rate of increase in defence budget continued to go up during the period of the Sunshine Policy except for 1999. Arguably, South Korea's defence spending also continued to rise during the pre-to-post Sunshine

era, from 1993 to 1997 and from 2008 to 2012. This fact demonstrated that the trend of defence spending has been unaffected by South Korea's engagement policy towards North Korea. (Figure 7. 16) Rather, it has been a consistent pattern over the past two decades in South Korea.

Figure 7.16 Annual defence budgets, 1993-2012

(Unit: one billion of SK current won / percentage)



Source: MND

In fact, the rise or fall in defence spending itself did not indicate the shadow of war and conflict or the prospects for peace and stability on the Korean peninsula. Realistically speaking, both Koreas were unlikely to decrease their military spending or start arms control without beginning the process of a peace agreement (Park 2011).⁵⁹ Within the framework of South Korea's official unification formula, 'the National Community Unification' and Kim Dae-jung's 'three-stage approach to Korean reunification', the presence of the American forces in the South and the ROK-U.S. combined deterrence strategy would be maintained until the two Koreas enter the stage of complete unification. Given North Korea's possession of nuclear weapons and ballistic missiles, irrespective of domestic ideological inclinations and the leadership's perspective on North Korea, there was a common perception that South Korea had to maintain a certain level of defence capability not only to secure a stable coexistence, but also to prepare for a peaceful unification. In other words, since the end of the Korean War, it has been a vital interest for South Korea to prevent North Korea from launching any armed provocation. Even to Kim and Roh, implementing the most forward-looking engagement approach towards North Korea, the government's foremost duty was to protect the country against the potential threats against North Korea (MND 2000, 2004). To this end, South Korea's spending on military was

⁵⁹ Interview with Park Min-hyung on 17 July 2011.

imperative and was regarded as a prerequisite for enhancing defence capabilities. It meant that the gravity of the first obligation was not swayed by the South Korean government's ideological grounds between liberal or conservative, or its policy orientation between engagement and containment.

Then, the central issue was what caused South Korea's defence spending and to what extent these causes affected the dynamics of positive engagement. An important point to note here is that a driver of military spending also came from the transformation of the ROK-U.S. security alliance. The Roh government legitimised South Korea's spending on the military for the goal of its own self-reliant defence (NSC 2004). Despite the controversy over the motives and intentions behind Roh's goal of 'cooperative and self-reliant national defence' (*hyeopryeokjeok jajugukbang*), it signified that South Korea took more responsibility for its own defence posture while becoming less dependent on the United States (Sheen 2008). This readjustment of national defence policy not only caused a reallocation of defence budget, but also required an increase in absolute defence spending in South Korea. In fact, the task for the improvement of defence capability became a pressing matter as the Roh government began to discuss the issues of the withdrawal of 12,000 U.S. forces from South Korea in 2003 and the transfer of wartime operational control with the Bush administration in 2005. In this vein, South Korea's increase in military spending under the Roh presidency was caused by complex reasons that stemmed from not only the ongoing military confrontation and competition on the Korean peninsula, but also recent alliance arrangement between South Korea and the United States.

Nevertheless, the underlying cause, which has determined the trend of South Korea's military spending over the past two decades, arose from the military confrontation between the two Koreas. Regardless of Pyongyang's intentions on whether they were for offensive or defensive purposes, North Korea's augmentation on asymmetrical force including the development of nuclear and biological weapons, diversified medium- and long-range ballistic missiles, and submarines posed a serious threat to the security of South Korea and neighbouring countries as well. While it was not correct that the Kim and Roh administrations used the North Korean threat to legitimise its military spending, it was clear that the nature of threat posed by North Korea's asymmetric capabilities was the principal drivers of defence spending in South Korea. In this sense, although both Koreas' decreases in defence spending were not the determinant of the success or failure in positive engagement, nor a necessary condition that it must occur during the stage of reconciliation and cooperation, the patterns of the

increases in the military budget undermined the prospects for lowering tension and building confidence on the Korean peninsula that the Sunshine Policy aimed for.

7.5 Dynamics of South Korea's positive engagement

Despite the positive influence on inter-Korean relations under the governments of Kim Dea-jung and Roh Moo-hyun, the security situation between North and South Korea remained tense. The threat posed by North Korean nuclear weapons and ballistic missiles continued on the Korean peninsula, imposing serious constraints on South Korea's employment of positive engagement. Along with this, North Korea was reluctant to take the direction of economic reforms and opening. However, the factors determining Pyongyang's receptivity of positive economic statecraft and credibility of Seoul's Sunshine Policy were also attributed to other structural constraints.

7.5.1 Dual strategic goals of positive engagement

First, the constraints on South Korea's positive engagement stemmed from its dual strategic objectives between the development of an interdependent relationship and the realisation of structural changes. From a theoretical perspective, positive economic statecraft which involved a long-term interaction process between the sender and acceptant states could be employed with two different frames included (1) the interdependence model, and (2) the transformative model.

In the South Korean political context, if the policy goal of positive engagement placed more priority on the interdependence effect, it would primarily focus on the expansion of functional linkages, the management of unstable division, the prevention of the outbreak of war or military provocations, and the continuation of the status quo and stability on the peninsula. By contrast, when the policy was designed to bringing about the transformative effect, it would be more concerned with the pursuit for national unification, the transformation of the 1953 armistice agreement into a peace treaty, the inducement of opening and reform in North Korea. Whereas the former was aimed at building a cooperative political relationship by a set of economic interdependence between the two Koreas, the latter concentrated on reconfiguring North Korea's preferences and interests through structural impact of economic ties. Despite these differences, both directions were based on the appropriateness of a gradual and manageable unification and the rejection of unification by absorption or

force. They were also similar in the sense that both approaches were not intended to seek the destruction or toppling of the North Korean regime. They were commonly rooted in the belief that positive incentives could influence and elicit positive changes in North Korea's behaviour. However, the former gave more weight on incremental and voluntary changes in North Korea, thereby paying more attention to the improvement of inter-Korean relations and the creation of an external environment for the North to change. The latter favoured intentional efforts to induce an underlying change in domestic politics, focusing on the development of vested interests or a new interest group within North Korea.

In this sense, the challenges and dilemmas arose from the fact that the ultimate goal of South Korea's Sunshine Policy should be beyond the achievement of the status of asymmetrical interdependence relationship between North and South Korea and be linked to the process of integration between the two Koreas. In other words, the Kim and Roh governments' stated goal of a '*de facto* unification' was premised on the transformative effects in North Korea and the role of positive economic statecraft on structural changes on the Korean peninsula. It meant that South Korea albeit emphasised an incremental and step by step unification by mutual consensus between the two Koreas, South Korea's policy on North Korea had an intrinsic attribute that entailed fundamental changes in North Korea, even if it was regarded as dangerous or fatal for the North Korean leadership. This feature was more observable under the progressive governments of Kim Dae-jung and Roh Moo-hyun that had the aspiration not only to engage with North Korea, but also to steer the process of unification. In a broader theoretical and historical perspective, clear evidence to verify the realisation of a *de facto* unification was to ascertain whether the two Koreas achieved an economic community in the narrow sense or both Koreas moved on the stage of a union of states or *nambugyeonhap* (literally South-North confederation) in a broad sense.

Under the concept of South Korea's policy towards North Korea or the standpoint of its unification plans, the broadening and deepening of inter-Korean commercial relationship was regarded as a key task to build an economic community. The rationale of 'an economic community' was laid out in the NCU formula and Kim Dae-jung's three-stage approach to national unification. Under South Korea's unification plan, an economic community was considered as the general characteristics and status of the second phase of the NCU, *nambugyeonhap* on which the two Koreas were actively involved in inter-Korean exchanges and cooperation to increase economic interdependence. Indeed, an economic community was 'a key element of the

Korean Commonwealth' or *nambugyeonhap* (Jo 2012: 20). The logic posited that if the two Koreas proceeded to build the North-South economic community along with other social and cultural areas during the stage of South-North Confederation, it would accelerate the establishment of a national community (*minjokgongdongche*), eventually leading to political integration in the process of unification. According to Kim's three-stage unification formula, the pursuit of inter-Korean economic exchanges and cooperation was also one of the essential activities in the stage of the South-North Confederation. Along with a minimum political confidence-building such as a satisfactory settlement of North Korea's nuclear issue, inter-Korean economic community must be established during the first stage of his three-stage approach, being a prerequisite for entering the stage of federation (*nambugyeonbang*) (Kim 1997; MOU 2001).

From the framework of the Sunshine Policy, 'establishing the inter-Korean economic community and its development' was a core condition to achieve a *de facto* reunification (MOU 2001; NSC 2004). A principle architect of the Sunshine Policy, Lim Dong-won made it clear that the state of *de facto* unification would be only realised when the two Koreas could achieve arms control and a North-South economic community (Lim 2008: 401). Taking these insights into account, the ultimate success of the Sunshine Policy was only viable when it brought about structural changes in North Korea. It meant that North Korea should make the transition from the *juche* economic system towards a market economy through economic opening and structural reforms. Although the former process did not require simultaneous changes in the political system and policy reforms in North Korea, in order to enter the stage of federation, it required North Korea to be democratised through a multi-party system and free elections (Kim 1997: 24; Moon 2012).

However, as demonstrated earlier, the positive occurrences in 'high politics' between 1998 and 2007 was meagre, and there were no palpable changes in the strategic military situation between the two Koreas. More importantly, the unsolved North Korean nuclear programme reinforced South Korea's military readiness capability to counter North Korea's asymmetric threat, being the reason for increasing defence spending in South Korea. From a theoretical perspective, even though Kim and Roh's Sunshine Policy was aimed to achieve not only mutually interdependent relationships between the two Koreas, but also structural changes in North Korea, the latter was not attainable. This is because economic interdependence between the two Koreas did not sustain until it created an environment for inducing behavioural change

in North Korea. In principle, the existence and persistence of a bilateral interdependent relationship was a minimum condition for positive engagement of the transformative model to be successful. Further, the relations required the existence of internal groups benefiting from bilateral economic ties that would be much more likely to support external economic incentives. More critically, it should be able to form a new coalition supported by outward-looking internationalists that could put pressure on their regime to accede the sender's demands and pro-incentive policies. From this perspective, the necessary conditions for the transformative effects of economic incentives were not formed within North Korea.

The limited impact of South Korea's positive engagement on North Korea's reform and opening was clearly corroborated in the case of the GIC project. Although supporters of the Sunshine Policy claimed that the GIC could contribute to the navigation towards North Korea's economic reform and the spread of information about the outside world, it is undeniable that the significance of the GIC to the North is limited as a means of acquiring foreign currency they desperately need. The GIC project might increase North Korea's exposure to the outside world and awaken the North Korean workers' desire for a better life, but North Korean leadership was under the pressure to avoid 'capitalist-liberalising influences', the so-called 'yellow wind' (*hwangsaekbaram*)⁶⁰ that might occur while running in the GIC (Kelly 2013; Yang *et al.* 2013: 149). Acknowledging such potential socialising effect through the GIC, North Korean authorities paid special attention 'to eliminate any ideological contamination' while being "fenced off from the rest of the North Korean economy" (Stangarone 2013: 38; Haggard and Noland 2008: 243). The challenges to the North Korean leadership were that the potential positive and negative occurrences through the GIC should be controlled in accordance with the interest of their own regime. In this sense, although the North Korean government ostensibly permitted the benefits of low wages and employment of its good quality labour at the GIC, which has been highly favourable to South Korean enterprises, the leadership exerted itself to limit it as a means to access to foreign funds, revenue and technology that were deemed essential for regime survival. Accordingly, the North tried to minimise "the political and social impact of economic investment" and prohibit it from propagating a desire for capitalism over North Korea (Cronin 2012: 22). While it was correct that, as supporters of economic engagement claimed, North Korea could learn the basic business norm and practice 'a limited open economy' through the GIC, these positive effects only occurred in a controlled

⁶⁰ It refers to capitalistic ideology or culture in North Korean.

environment. Contrast to the supporters' expectation on the role of GIC, encouraging the spread of reform and market mechanisms, North Korea had succeeded in avoiding substantive changes in the economic system while operating the GIC that would serve to sustain their own regime.

To set structural changes in the system level as a policy goal - whether it was premised on the continuation of the current Kim's regime or not - would be inevitable in South Korea's policy on North Korea especially when it considered the domestic conservatives and opponents of the Sunshine Policy. However, this goal was virtually unattainable and unfeasible to the Kim and Roh administrations that have only managed to build asymmetrical interdependence with the North for a few years. The declared goal of a *de facto* unification albeit connoted the motives and intentions of inducing economic and political transformation in North Korea, the reality was the concentration on the process of constructing interdependent relationships that at least served to guarantee peaceful coexistence between North and South Korea while refraining serious hostile acts from North Korea.

7.5.2 Different interpretations of North Korea's nuclear programme

Second, the North Korean nuclear weapon programme was one of the most important factors in determining the dynamics of positive engagement on the Korea peninsula. This is because the pace and density of engagement through positive incentives were seriously affected by North Korea's aggressive behaviour pivoting around the development and test of a nuclear capability. The focus here was not Pyongyang's nuclear pursuits itself. Rather, it paid its attention to the significance of an interpretation of North Korean nuclear programme and the gravity of the negative effects on the exercise of positive engagement in South Korea. This argument required an understanding of how Kim and Roh perceived the threat posed by the North Korean nuclear programme and how their governments' positions affected the way of coping with this issue.

In South Korea, academics and policy-makers have long debated North Korea's motives and intentions that led to the development of a nuclear programme. Two different interpretations were articulated. First, North Korea attempted to develop nuclear weapons and their means of delivery, using its nuclear programmes as leverage or a bargaining chip to obtain rewards from other countries and to improve its relations with the United States. Second, North Korea sought to develop nuclear

weapons for possession with the aim of threatening or attacking South Korea and neighbouring countries including Japan and the United States. In South Korea, the group inclined to the former position tended to view North Korea's nuclear pursuits through North Korea's nuclear diplomacy, stressing the significance of a diplomatic resolution, favouring engagement strategy in dealing with the dismantling of nuclear weapon programmes. They were of the view that the nuclear weapons programme could be exchanged for political and economic incentives. By contrast, the group in the latter paid more attention to the nature of North Korea's military threat, favouring coercion or isolation strategies. They in part admitted the role of the nuclear programme as a tactical bargaining tool to apply pressure on the international community to get what they wanted. However, they were sceptical about Pyongyang's renunciation of its nuclear weapons because its strategic role as a deterrent was predominant. Namely, they were of the view that the nuclear programme is tied to North Korea's regime survival strategy (Byman and Lind 2010). By a similar logic, while the former group advocated the denuclearisation of North Korea, they argued that the measures for achieving this goal should be linked to North Korea's interest, "but not at the price of threatening war on the peninsula" (Allison 2006: 10). In contrast, the latter placed the highest priority on the North's denuclearisation and proliferation problems. Those in this position did not object the idea of diplomatic efforts or negotiations. However, they contemplated that unilateral positive incentives only enabled North Korea to further develop its military capabilities, encouraging its misbehaviour. Thus, all possible options including economic sanctions and the use of military threat or force should be considered for an end to the development of weapons of mass destruction and the North Korean missile threat. Proponents of this position asserted that "regime changes in North Korea might be inevitable unless Pyongyang voluntarily denuclearized" (Park 2011).⁶¹

Within the framework of positive engagement, different views on the motives of and solutions to North Korea's nuclear development also meant different approaches in inter-Korean economic cooperation. Supporters of the Sunshine Policy preferred a 'parallel strategy', believing that inter-Korean economic cooperation could proceed with the nuclear issue, whereas South Korea's conservatives including opponents of the Sunshine Policy advocated a 'strategy of nuclear linkage', insisting that the expansion of inter-Korean economic cooperation should be contingent on the progress in the overall denuclearisation process. The Kim and Roh administrations

⁶¹ Interview with Park Se-il on 24 June 2011.

basically believed that North Korean intentions were reformable and the North Korean nuclear issue was negotiable. In this vein, they emphasised a diplomatic resolution through dialogue and negotiations, consistently adopting a 'parallel strategy' that separated the nuclear issue from inter-Korean economic cooperation (Lim 2011; Lee 2011).⁶²

A key aspect of the North Korean nuclear problem was its negative influence on the credibility and continuity of engagement strategies towards North Korea. Although the interpretation and position of the progressive governments of Kim and Roh enabled them to pursue positive engagement towards North Korea during the nuclear crisis, the challenge arose from the fact that its nuclear threats made it difficult to sustain a steady stream of economic incentives towards North Korea. Indeed, the receptiveness of positive incentives was contingent upon the North Korean leadership's desire and choice. However, given that North Korea's development and possession of nuclear weapons and missiles posed a serious threat to South Korea's security, the availability and continuity of the provision of economic incentives essentially required a long-standing domestic support and robust defence capabilities. Even though South Korea attempted to seek 'structural linkage' or 'unconditional engagement' so these frames facilitated a steady stream of incentives even in the absence of sufficient change in North Korea's behaviour, the continuation of North Korea's nuclear programme and the resultant patterns of the risk of escalations imposed constraints on speeding up the engagement process. This is because such confrontational behaviour from Pyongyang caused concerns about the lack of reciprocity and precipitated the controversy over an appeasement policy and the likelihood of a moral hazard, rewarding Pyongyang's wrong behaviour. In this vein, the unsolved nuclear issue and the resultant North Korea's nuclear threat undermined the driving force of the South's positive engagement towards North Korea even though it was consistently operated by diffuse reciprocity and the principle of the separation of politics and economy.

7.5.3 Divergent forces between incentives and sanctions

Third, the dynamics of South Korea's positive engagement were also determined and constructed by the external milieu. The immanent constraints on South Korea's use of positive economic statecraft certainly originated from North Korea's nuclear ambitions.

⁶² Interview with Lim Dong-won in Seoul, 28 May 2011, Lee Jong-seok in Seoul, 20 June 2011.

However, the external dimension determining the effectiveness of South Korea's positive engagement was not entirely caused by the 'North Korean nuclear problem'. Rather, it also stemmed from the 'coordination problem' between the United States and South Korea. The latter was particularly important in understanding the limitations of South Korea's strategic use of positive incentives towards North Korea.

South Korea's political position on the issue of North Korea's nuclear development created discord and friction with the United States. The underlying problem arose from a political disagreement between the Roh and Bush administration over how to deal with the North Korean nuclear programme. Although Roh affirmed the principle of intolerance of the North's nuclear programme, his government emphasised that the North Korean nuclear issue should be resolved peacefully through dialogue and negotiations (NSC 2004). Roh, considering that the American hardliners' approach of rejecting to engage with North Korea in bilateral negotiation only gave more time to develop nuclear weapons and ballistic missile technology, demanded a more active role of the U.S in dialogue and persuasion to prevent a further deterioration of the situation. However, President Bush was sceptical of Kim Jong-il and had doubts about North Korea's compliance with past agreements (White House 2001; Mazarr 2007; Pritchard 2007). Bush designated North Korea as an 'axis of evil' in his State of the Union address in 2002, and did not hesitate to vilify Kim Jong-il as a 'pigmy' and 'tyrant' in 2002, 2005 (*New York Times* 2007). In particular, he strongly believed that the 1994 Agreed Framework during the Clinton administration turned out to be a failure that rewarded Pyongyang's bad behaviour while letting it breach the international obligation (Bluth 2011). Thus, Bush's dissatisfaction with the previous agreements with North Korea made the government and his cohort of neo-conservatives contemplate that further negotiations should not reiterate the patterns of 'freeze for compensation', but seek the complete elimination of all nuclear programmes in North Korea. Taken together, Bush's personal dislike of Kim, and the hard-liners' preference for sanctions, and the Bush administration's dismantlement first approach were based on their conviction of North Korea's commitment to obtaining nuclear weapons with the goal of becoming a nuclear weapon state rather than its intent on using it as a bargaining chip. From this point of view, although the United States publicly showed no intentions of invading North Korea and participated in multilateral formal negotiations, Washington's policy towards Pyongyang shifted its focus from rewarding in return for its freeze of nuclear activities to putting 'pressure' for the end of the nuclear programme and to achieving the goal of a complete,

verifiable, and irreversible disarmament (CVID). As Graham Allison (2006: 8) described, Bush's North Korea policy virtually "proposed a regime change as the solution."

The strategic point was that America's central objective was in conflict with South Korea's vital interest in North Korea. Kim and Roh commonly declared that the Sunshine Policy was based on the principle of non-tolerance of military threat and a non-nuclear North Korea. However, its policy goal was predicated upon a soft-landing in the North and a gradual integration between the two Koreas, but not on the prospect of the North Korean regime's collapse, clash-landing of Pyongyang, and the absorption of the North. While it was clear that the Bush administration's policy toward North Korea eventually pivoted around 'unpalatable engagement'⁶³ in his second term, Washington's goal for CVID was problematic in the nuclear negotiations. During the course of the Six-Party talks, the United States and Japan placing the highest priority on the North's denuclearisation strived to push CVID, while South Korea and China, primarily concerned with the viability of North Korea's system, tried to link nuclear issues with system survival (Ha and Chun 2010). Lee Jong-seok, the former Deputy Head of the ROK National Security Council argued that "the intention of the Bush administration's initiation of the Six-Party talks was not to resolve North Korea's nuclear issue through 'give-and-take' negotiations, but to put pressure on the North by making a 'five (the U.S., China, South Korea, Japan, and Russia) versus one (North Korea) structure'".⁶⁴ From this perspective, although the U.S. wanted to coerce North Korea into submission by constructing coalitions among the 'five countries', South Korea and China paid more attention to finding common interests of the six countries than unilaterally putting pressure on North Korea.

The dissonance in the North Korean policy between Seoul and Washington seriously emerged when the United States imposed financial sanctions against North Korea after reaching an agreement on North Korea's nuclear programme, the so-called 'September 19 Joint Statement' in 2005. After designating Banco Delta Asia (BDA), a bank in Macao as a 'primary money laundering concern' by the U.S. Department of Treasury, Pyongyang's 24 million US dollars was deprived of access to funds. An accusation of North Korea's illicit foreign exchange earnings and the resultant U.S. government's BDA actions propelled Pyongyang's acts of brinkmanship and led to negate the agreement of the September 19 Joint Statement. Lee Jong-seok

⁶³ Campbell (2004: 27).

⁶⁴ Interview with Lee, Jong-seok in Seoul, 20 June 2009.

stated that “Washington should have dealt with the BDA issue after the implementation process of the September 19 Joint Statement of principles. The sanctioning of North Korea while the negotiations were in progress contradicted each other. The sudden BDA actions and later Washington’s rejection of bilateral talks demonstrated that not only was Bush’s North Korea policy not coordinated within his administration, but also the North Korean nuclear programme was not a top priority for the foreign policy of the United States.”⁶⁵

In the meantime, there were some policy coordination regarding the North Korean issues between Seoul and Washington. In response to North Korea’s missile launch in July 2006, the Roh administration temporarily halted its delivery of rice and fertilizer, and, after North Korea’s nuclear test in October 2006, the Roh administration supported the UN sanctions under Security Council Resolution 1718. Nevertheless, it was obvious that U.S. ties with South Korea became weaker and its incongruity between Seoul’s positive engagement run by unconditional incentives and Washington’s ‘hawk engagement’ mixing negative pressure and positive inducements became evident. The friction between the Roh and Bush administration over how to deal with North Korea’s nuclear issue was largely attributed to the different understanding on the intent on developing nuclear weapons, to the divergent priority between improvement of inter-Korean relations and abandonment of the North’s nuclear weapons programme and to the different tools between incentives and sanctions to change course. Important to note is the fact that the discordance of the two governments’ interests and positions pertaining to the nuclear problem became a salient cause of constraining each side’s use of incentives and sanctions, thereby mutually weakening its impetus driven by Seoul’s positive engagement and Washington’s incentives-cum sanctions approaches towards North Korea (Haggard and Noland 2011). It consequently verified that the effectiveness of positive engagement would decrease when it exposed a coordination issue between the sender states.

7.5.4 The dual nature of South Korea’s aid

Lastly, it is important to emphasise that the polarity of South Korea’s positive inducements between non-political purposes and political purposes affected the credibility and success of positive economic statecraft towards North Korea. This

⁶⁵ Interview with Lee, Jong-seok in Seoul, 20 June 2009.

problem particularly arose as the administrations of Kim Dea-jung and Roh Moo-hyun utilised the delivery of humanitarian aid as a strategic instrument for their own political objectives.

It was true that the Kim administration provided food and fertilizer with humanitarian concerns and moral obligations to help North Korea tackle their food shortage problems. However, South Korea's handling of humanitarian assistance entangled with political considerations constructed an important feature in the course of the Sunshine Policy, causing controversy and criticism over the political aid. The crucial point was that the Kim and Roh administrations provided humanitarian aid to North Korea as part of its engagement policy to advance inter-Korean relations. It meant humanitarian assistance was delivered to North Korea with not only the humanitarian aim of relieving the North Korean people's hardships, but also with security objectives to supplement the underlying goal of the Sunshine Policy. By taking opportunity of North Korea's unexpected appeal for emergency relief assistances, Seoul began to provide Pyongyang with food and fertilizer aid in the hope of creating incentives for reconciliation and cooperation. Taking a broad view, Kim and Roh considered that the provision of food and fertilizer aid from South Korea might have contributed positively to momentum for the summit and on-going inter-Korean economic cooperation. Namely, in addition to helping the North Korean people, to Kim and Roh the provision of humanitarian aid was a means to forge links and engage in political dialogue and cooperation between North and South Korea. By doing so, they hoped that these efforts would in turn build common identity and encourage a change in North Korean behaviour.

Although it was correct that South Korea's humanitarian aid was instrumental in alleviating North Korean's suffering and its linkage strategy succeeded in achieving their political objectives, it is also undeniable that it posed dilemma and criticism. South Korea's aid approach caused a serious issue of monitoring and aid diversion. Indeed, North Korea's willingness and capacity to use aid for the right purpose was the most important factor to determine the efficiency of food aid in North Korea. However, the point is that the dilemma of humanitarian aid also arose out of South Korea's *modus operandi*. The direct food aid to North Korea undermined Seoul's position to persuade transparent and frequent monitoring, and made it easy to divert food to North Korea's political elite and the military. In addition, the use of aid as a *quid pro quo* in negotiations and its form of food loans diluted the South's humanitarian purposes, causing controversy of whether or not South's course of action

accorded with humanitarian standards and principles. The South's advocacy of using aid as a means to improve inter-Korean relations, in turn, was discredited by the unchanging North Korea's aggressive behaviour on testing nuclear weapons or long-range ballistic missiles. To summarise, although the South Korea's 'humanitarian-plus-political' assistance achieved a short-term goal, aid effects on inter-Korean relations were not sustainable and North Korea's chronic food shortages have continued until now.

7.6 Conclusion

This chapter demonstrated that despite the frequent flare-ups of tension on the peninsula, inter-Korean economic cooperation was the most active under the governments of Kim Dae-jung and Roh Moo-hyun. Compared with the pre-Sunshine era, both commercial and non-commercial transactions between the two Koreas were incrementally expanded as the Kim administration was launched in 1998, remarkably rising throughout Roh's five-year term of office. This persistence and expansion of inter-Korean economic cooperation was largely attributed to Kim and Roh's commitment on the Sunshine Policy and their governments' adoptions of positive engagement towards North Korea. Three points should be emphasised with regard to the practice of inter-Korean economic cooperation.

First, despite its external development, South Korea's general and POC trade with North Korea has shown its limitation in influencing the North Korean domestic industry. Between 1998 and 2007, North Korea primarily limited inter-Korean general and POC trade as a means to acquire foreign currency while preventing its trade from making synergy effects with intra-industry or inter-industry trade. This result indicated that unless the North Korean authorities change its policy and lift its restrictions, the South's general trade would be constantly in deficit with the North, and its POC trade would be unlikely to expand enough to make a ripple effect on the heart of the North Korean economy. Second, over the course of Roh's presidency, the GIC has shown the conflict-inhibiting effects of economic interdependence, deterring North Korea from showing any fatal military provocations against South Korea. It signified that along with North Korea's revenue from the Mt. Geumgang tourism project, the economic gains arising from the GIC became indispensable for North Korea's economy. However, South Korea's economic engagement fell short of encouraging the spread of reform and the introduction of market mechanism in North

Korea. During the decade of positive engagement, the North Korean authorities paid special attention not to let the impact of capitalism permeate their people. Although the GIC and Mt. Geumgang tourism projects were instrumental in deepening economic interdependence between the two Koreas, its effect on the political and security realm turned out to be minimal, failing to bring about transformative effects within North Korea. Third, it was certain that the provision of a large-scale of assistance from South Korea significantly helped North Korea alleviate its chronic and massive food shortages. Notwithstanding, South Korea's strategic interest in humanitarian aid and its modality of the delivery process not only attenuated good-faith efforts and humanitarian intentions by Seoul, but also weakened South Korea's bargaining position for a strict and frequent monitoring of North Korea. Considering the continued reliance on external food supplies without fundamental agricultural reform and development of weapons of mass destruction during the North Korean food crisis, the vulnerability of aid emerging from the irresponsible misuse of food aid was largely attributed to North Korea. Under these circumstances, aid efforts inevitably caused concerns over the fungibility of aid, enabling the regime elites to benefit from the aid financially. However, South Korea's handling of humanitarian aid under the Kim and Roh administrations provided the cause for the issues of restricted monitoring and aid diversion, thereby diminishing the ultimate effectiveness of aid operation in North Korea.

Key findings of this chapter are as follows. First, from a theoretical perspective, South Korea's policy on North Korea under the governments of Kim Dae-jung and Roh Moo-hyun had evolved into positive engagement in the sense that it showed the centrality of inter-Korean economic cooperation to the development of interdependent relationship and its patterns of employing economic statecraft for political changes in North Korea. In comparison with the past governments, a policy differentiation under the Kim and Roh administrations was not just because of quantitative expansion of the volume of economic interactions, but because of the greater concentration on engagement relying on positive incentives for advanced inter-Korean relations and further structural changes within North Korea. As discussed earlier, since the Sunshine Policy was adopted by the Kim administration, a strategy of rapprochement through trade and aid had become the heart of South Korea's engagement strategy. Namely, economic incentives through commercial and non-commercial transactions were the two most important pillars that consisted of South Korea's positive engagement towards North Korea. It is worth noting that the significance of inter-Korean economic

cooperation stemmed from not only its 'economic' role in expanding commercial and non-commercial interactions between the two Koreas, but also its 'political' role in fostering cooperative inter-Korean relations and eliciting a positive change in North Korea's behaviour. It meant that, for South Korea, inter-Korean trade was not only recognised as commercial activities with North Korea driven by 'economic interests', but also involved strategic purposes to achieve political objectives with the aim of enhancing 'national interests' in South Korea.

Second, the impact of positive engagement on inter-Korean relations was clearly corroborated by the changes in the level of economic ties between the two Koreas. The close examination of inter-Korean economic cooperation and North Korea's foreign economic relations with its principle trading partners revealed that South Korea's positive economic statecraft between 1998 and 2007 led to the construction of asymmetrical interdependence between North and South Korea. This finding indicates that the relative costs of changing or forgoing the structure of economic interdependence became high in North Korea between the mid and the late 2000s. Third, South Korea's positive engagement towards North Korea resulted in the significant increase in the exchanges of people, numbers of talks and agreements between the two Koreas. In particular, a marked increase in inter-Korean military dialogue and agreements showed that there was a positive impact in South Korea's positive engagement on inter-Korean relations. Fourth, this chapter demonstrated that the limitations were clearly observable in the security area. Arguably, an increased level of North Korea's economic dependence on South Korea did not curb North Korea's pursuit of security interests pertaining to the North Korean nuclear and missile programme. It was also correct that North Korea's provocative posture in the area of NLL in the West Sea was not mitigated during the period of the Sunshine Policy. In addition, the empirical evidence of South Korea's defence spending increases and North Korea's augmentation on asymmetrical force substantiated that intense competition in military build-up on the Korean peninsula continued, and that it was far from the reduction of military tensions and confidence-building between the two Koreas.

The most serious challenge to the Sunshine Policy and the practice of positive engagement arose from North Korea's pursuit of nuclear weapons. This is because North Korea's unrestrained ambition for the development of nuclear weapons and missiles significantly undermined the driving force of the South's positive engagement towards North Korea due to domestic disputes and concerns about moral hazard and

the likelihood of appeasement. However, from a different angle, the determinants of the effectiveness of positive engagement also existed outside North Korea. The problem was also caused by South Korea's positive engagement itself. South Korea's underlying goal of a *de facto* unification was premised on economic and political transformation that involved changes in power structure, reformation of economic system, posing changes in the status quo on the peninsula. However, theoretically speaking, it was unlikely to occur without a solid and sustainable interdependent relationship and the creation of pro-incentive domestic coalitions within North Korea. For this reason, although South Korea's attempt to achieve a twofold goal – fostering ties between the two Koreas while inducing structural changes seemed to be ideal, but it was neither realistic nor feasible. Next, North Korea's nuclear programme imposed another serious constraint on implementing positive economic statecraft in South Korea. The different interpretations of the motives and intentions on North Korea's development of nuclear weapons between South Korea and the United States resulted in contradicting approaches as to how to cope with North Korea's nuclear issue. These divergent forces generated by each state's concentration on incentives and sanctions policy caused a serious coordination issue between the two countries, consequently weakening the impetus of South Korea's positive engagement towards North Korea.

South Korea's positive engagement seemed to promise a new possibility for peaceful unification and reconciliation on the Korean peninsula. The increased inter-Korean economic cooperation and the resultant economic ties instilled the prospect for a spill over effect to the political arena and structural changes in the North Korean regime in the South Korean public. However, its influence on 'high politics' on security matters turned out to be minimal. Despite the North's growing dependence on the South economically, the structure of asymmetrical interdependence did not alter the direction of North Korea's nuclear weapons development. This result shows that the premise and beliefs of the liberal idea that economic incentives and the resultant expansion of economic ties tends to reduce the likelihood of military conflict was not corroborated by the Sunshine Policy and the implementation of positive engagement in South Korea.

CHAPTER EIGHT

Conclusion

“Every political judgment helps to modify the facts on which it is passed. Political thought is itself a form of political action. Political science is the science not only of what is, but of what ought to be” (Carr 1946: 223).

In this thesis the development and evolution of positive economic statecraft in South Korea’s North Korea policy has been explored and the impact of positive engagement on inter-Korean relations between 1998 and 2007 has been examined using different indicators. To address whether South Korea’s positive engagement induced cooperation in inter-Korean relations and changes in North Korea’s behaviour, this thesis made a historical and empirical analysis of South Korea’s policy on North Korea between 1988 and 2007. This conclusion discusses the major features of this thesis, summarises the key findings and finally suggests policy implications and further areas for research. These arguments and indicators of South Korea’s positive engagement are expected to validate the practise of positive economic statecraft in South Korea’s policy on North Korea and the causality between economic benefits and political changes in the domain of international politics and economics.

8.1 Features of the thesis

Methodologically, this thesis investigated inter-Korean relations and the practice of South Korea’s positive engagement towards North Korea by combining historical context and numerical data analysis. This thesis was based primarily on qualitative research, and it utilised a mixed methods approach including intensive interviewing techniques and document analysis. To deal with research questions that required an understanding of inter-Korean political and economic relations, and of the economic and security nexus, this thesis placed a focus on reviewing the history of inter-Korean relations and the role of inter-Korean economic cooperation in South Korea’s policy on

North Korea. For the latter, this thesis invested its effort in examining inter-Korean economic relations from its inception in 1989 to 2007, and looked at North Korea's foreign trade during this period. The thesis first looked into the historical background of inter-Korean relations, and then presented the influence of South Korea's North Korea policy on inter-Korean relations. Through this investigation, the thesis revisited the ideas and interests of the Sunshine Policy, and then moved onto a closer examination of the interplay between inter-Korean economic cooperation and inter-Korean relations, and between economic benefits and political changes on the Korean peninsula. There is existing literature which has examined North Korea's foreign trade, inter-Korean economic cooperation, and South Korea's policy on North Korea respectively. However, a study adopting an integrated approach is relatively limited, and there were only a handful of studies that examined South Korea's policy on North Korea in the form of economic statecraft.⁶⁶

Second, from a theoretical perspective, the wider significance of this study is that it clarified the underlying logic and course by which positive economic statecraft works in international relations, and suggested that the concept and framework for examining positive engagement was helpful when South Korea devises a strategy for dealing with North Korea. Despite a sharp increase in scholarly attention to the use of positive inducements for dealing with recalcitrant regimes, there is little attention in identifying the ways in which economic incentives have worked.⁶⁷ By redefining positive engagement and establishing theoretical frameworks that include the transactional, interdependence, and transformative models, this thesis contributed to understanding the casual mechanism through which positive engagement works, and identified the sequential stages which could lead to the modification of policies or abandonment of objectionable behaviour.

Third, from an empirical perspective, this thesis clarified and illustrated the underlying logic of South Korea's Sunshine Policy under the Kim Dae-jung and Roh Moo-hyun's administrations. With a closer examination on positive engagement, this thesis elucidated how the idea of engagement through economic incentives has evolved over the past two decades. In addition, the thesis explored how the development path chosen by Kim and Roh for the expansion of inter-Korean economic cooperation and its ties have been understood within the established frameworks, and why their efforts have not brought about desired policy changes in North Korea.

⁶⁶ An exception is Haggard and Noland (2011), Nincic (2011), and Solingen (2012).

⁶⁷ An exception is Crumm (1995), Kahler and Kastner (2006) and Nincic (2010).

Within the South Korean political context, while it is correct that the implementation of inter-Korean economic cooperation and its role in shaping the political relations between the two Koreas has been investigated by several studies, the existing literature falls short in elucidating the causal link between economic incentives and policy changes (Jo 2008; Lee 2010, 2012; Yoon and Yang 2005; Hwang 2008; Kim 2005; Choi 2010). Much has been written about engagement policy in international relations with the case of South Korea's Sunshine policy,⁶⁸ but modes of engagement were understood as one-dimensional, failing to explain multi-dimensional characteristics in the sense that different types of incentives-based strategies may be operated with different strategic goals.

8.2 Findings

Positive engagement in the context of foreign policy

Research question 1: To what extent can the strategies using economic incentives be understood within the context of international relations and foreign policy?

This thesis argued that the concept and models of positive engagement were relevant in understanding the foreign-policy strategy that primarily utilised economic incentives to influence the target state's behaviour.

This thesis redefined the term 'positive engagement', referring to a strategy which primarily employs positive economic statecraft as an instrument to influence or modify the behaviour of a target state. There are two reasons behind the re-conceptualisation of positive engagement in this thesis. First, the centrality of the conventional tools of foreign policy that pivots around military force and coercion creates the necessity of crafting a non-military and non-punitive tool to advance a state's national interests. As discussed earlier, economic statecraft was primarily focused on negative economic statecraft that has been used as a coercive policy tool for persuasion, pressures and punishments. While there has been considerable academic debate and empirical research on the use of economic sanctions, the study on theorising and practicing economic incentives to attain foreign policy objectives has been relatively sparse. Second, the ambiguity of the term engagement requires a better conceptualisation of engagement activities which primarily employ economic measures to produce the desired outcome. In general, the use of economic incentives

⁶⁸ Kihl (1998), Park (2001), Paik (2002), Moon (2000, 2012), Kim (2008), and Kim (2010).

tends to be understood in the context of engagement policies. However, the term 'engagement' is rather a broad and loose concept in the sense that it includes a wide variety of means to interact with other states and does not rule out the use of economic sanctions and the threat of military force. The concept of engagement also has fundamental flaws because it is unlikely to account for how it leads to altering the behaviour of other states. In addition, the notion of engagement is problematic because it is obscure whether it refers to a means of 'interacting' with other states or the 'ends' which it achieves.

From a theoretical perspective, positive engagement is predicated on the two underlying beliefs that (1) the roles of economy and economic measures are not limited to the realm of 'low politics' but it can be expanded to the 'high politics' of national security, and (2) positive economic statecraft causing high economic benefits and the asymmetries of interdependence can be used as a tool for changing a target state's behaviour. The relevance of the term positive engagement largely stems from the fact that it serves to clarify the different purposes a state might have in employing economic statecraft with a target state, and illustrates the underlying logic and causal mechanisms in which positive economic statecraft works. Activities pursuing positive engagement can be implemented for producing political concessions on a specific issue from a target state, or they can be employed with the aim of influencing the long-term political behaviour of a target regime. Whereas the former is more likely to be characterised by 'tactical linkage', 'conditional engagement' and 'specific reciprocity' in the course of action, the latter is more likely to be run by a structural and unconditional mode of engagement and a 'diffuse reciprocity'. The granting of political or economic incentives to a target state is more likely to be a one-off thing in the case of the former. By contrast, with regard to the latter, the practice and policy of positive engagement is most likely to occur consistently through increased and deepened economic exchanges, as a stimulus or encouragement for action. Under this framework, the increase or manipulation of economic interdependence is regarded as the primary method to influence the attitude and behaviour of another state. Crucially, all activities pursuing positive engagement that involve their own dynamics and process of giving incentives to a target state, are driven for political and strategic objectives.

This thesis was particularly devoted to presenting two different approaches to account for a state's attempt to shape the behaviour of another state. In the realm of foreign policy, positive economic statecraft, which involves a long-term interaction process between sender and target states, could be employed with two different

models: the 'interdependence model' and the 'transformative model'. First, positive economic statecraft was utilised by sender states with the aim of fostering cooperative political relations with target states. To this end, positive engagement at the bilateral level primarily focused on developing a relationship of increasing interdependence that created and distributed mutual benefits between the two states. The most important aspect of this interdependence model was its conflict-inhibiting effects, that is, that the benefits from bilateral economic ties would constrain states from taking the risk of militarised disputes. Under the interdependence model, the practice of positive engagement would be more likely to be effective when it could utilise economic strength from the sender, adequate domestic political support, and the capacity of political leadership to sustain an incentive based strategy. Second, positive economic statecraft could be undertaken strategically not just to promote economic ties for improved bilateral relations, but ultimately to reconfigure the political interests and priorities of a target state. A key dimension of this transformative model is that positive engagement was aimed at eliciting a transformation of regime policies and behaviour in a target state. To enhance its likelihood of success, it should be able to cultivate vested interests, or a new interest group, favouring the continuation of cooperation and external incentives, thereby creating an impetus for a target regime to be rooted in outward-oriented political economies that would be more inclined toward policy changes, economic openness and market-friendly economic growth and development. In this vein, the transformative effects would be more likely to occur when high levels of economic interdependence were established between states, and the sender states' economic incentives precisely targeted pro-internationalist or pro-incentive groups within the targeted states.

Causes of inter-Korean economic relations

Research question 2: How has the concept of positive engagement evolved in South Korea's policy toward North Korea? In particular, why did the two Koreas initiate economic relations in 1989?

This thesis demonstrated that the inception of inter-Korean economic relations was driven not just by economic motives, but significantly by political ones. Along with this the early development of inter-Korean relations was determined not only by South Korea's policy initiatives towards North Korea itself, but also by North Korea's economic hardship and geopolitical changes between the late 1980s and the mid-1990s.

This thesis emphasised that it is important to explore South Korea's policy on North Korea during the administrations of Roh Tae-woo and Kim Young-sam. The significance is attributed to the fact that political and economic relations between North and South Korea broke new ground under Roh and Kim, and South Korea's tentative engagement towards North Korea was first initiated during this period.

Three findings deserve emphasis with regard to inter-Korean political and economic relations between 1988 and 1998. First, the inception of inter-Korean economic interactions was not designed to bring about fundamental changes in the behaviour or the policies of North Korea. Rather, it was pursued for the stability and the preservation of the status quo on the Korean peninsula. It showed that domestic factors of both North and South were considered significant enough to commence inter-Korean relations. For South Korea, the Roh government needed to differentiate his regime from previous authoritarian regimes in South Korea and needed certain levels of reconciliation and reduction of military tension to secure social stability and economic prosperity. Bringing about inter-Korean reconciliation and tension reductions were especially important to South Korea, in order to stabilise its political position and to succeed in hosting the Olympic Games.

Second, one of the most important findings of Chapter 4 is that the new shift in inter-Korean relations and the inception of inter-Korean economic exchanges was not solely driven by the Roh administration's new policy on North Korea, called *Nordpolitik* and following the '7.7 Declaration', but also by North Korea's economic hardship and geopolitical changes between the late 1980s and mid-1990s. To be sure, the Roh Tae-woo government's North Korea policy provided new momentum towards reconciliation and cooperation, making it possible to commence official economic exchanges with North Korea. However, the development in inter-Korean relations was highly associated with the deteriorating North Korean domestic economy and changing geopolitical conditions. With the end of the Cold War and the growing economic strength of South Korea, North Korea was faced with its domestic economic turmoil and external security threats. Given the serious decline in capital and material support from both the Soviet Union and China, North Korea needed a breakthrough to cope with their own economic constraints such as shortages of energy, food and machinery needs. In particular, the diplomatic recognition of South Korea by the Soviet Union and China, North Korea's traditional allies, heightened North Korea's insecurity in the early 1990s. The underlying challenge came from inside as well. When considering the North Korean economic condition between the 1980s and the 1990s, it

would be difficult for Pyongyang to reject the opportunity of trade with South Korea. Despite the North's intensive growth strategy in 1971 until the early 1980s, North Korea has been faced with economic constraints such as the low level of technology, the decrease in labour productivity, and the high level of trade deficits. Meantime, Pyongyang's excessive concentration on military build-up while sacrificing domestic agriculture and light industry deteriorated its stagnant domestic economy during this period. This economic downturn and stagnation in the 1980s led to reduction in the capacity to produce enough fertilizer and chemicals, causing chronic food shortages in North Korea in 1990s. Following from this, the overall economic situation of North Korea in the 1980s and 1990s, and Pyongyang's fear posed by the changes in the geopolitical situation seriously, affected the behaviour of North Korea, propelling its regime into accommodation with the South's engagement approach. In other words, it is correct that the initial development of inter-Korean relations was driven by Seoul's confidence on the disparity in economic power between two Koreas, the Roh Tae-woo government's necessity to engage with the North, and its recognition of the rapidly changing international security order from the end of Cold War. Nevertheless, North Korea's internal and external challenges, and its reaction in coping with international isolation and economic difficulties, had a decisive effect on the inception of inter-Korean economic relations and the receptivity of South Korea's economic incentives.

Third, despite the growth in inter-Korean commercial and non-commercial transactions, South Korea's engagement approach under the governments of Roh Tae-woo and Kim Young-sam did not evolve into 'positive engagement' towards North Korea. Indeed, engagement through economic cooperation had been an element of South Korea's policy on North Korea, as it gradually expanded during the period between 1989 and 1997. However, it has not been advanced enough to be a central axis in South Korea's North Korea policy and its policy instrument in determining the course of inter-Korean relations. When considering the economic weight of inter-Korean trade and its influence on the North Korean economy, South Korea's leverage that might be derived from trade and aid was not strong enough to revitalise the stagnant North Korean economy, to build trust between the two Koreas, or to lead to a rapprochement on the Korean peninsula. In reality, economic ties between North and South Korea were weak, and North Korea often hesitated to be too reliant on South Korea. This meant that absolute gains from inter-Korean transactions were not large enough to offer significant benefits to the North Korean economy or to influence changes in North Korea's behaviour. Crucially, the aim of inter-Korean economic

cooperation was not designed with the strategic objectives of encouraging structural changes in the North Korean political economy and foreign policy, or to accelerate the integration process between the two Koreas. Rather, the implementation of exchanges and cooperation was more focused on maintaining the status quo of the Korean peninsula with domestic political considerations attempting to promote peninsular stability. In particular, the process of employing economic incentives under the Kim Young-sam government was not consistent, and it was often disrupted by political and security issues. This observation demonstrates that although the initial activity of engaging with North Korea through economic exchanges existed at that time, it failed to develop actual positive engagement by South Korea. Nevertheless, the North Korean policies under the Roh and Kim administrations were significant in that it established the foundation for positive engagement towards North Korea.

Logic of the economic incentives of the Sunshine Policy

Research question 3: To what extent can the Kim Dae-jung and Roh Moo-hyun governments' 'Sunshine Policy' be identified within the frames of positive engagement?

This thesis recast the underlying ideas and interests of Kim and Roh's Sunshine Policy as the concept of positive engagement. It highlighted that despite the similarities with former South Korean North Korea policies, the Sunshine Policy had significant differences in its policy means and goals. The thesis argued that the underlying logic and causal mechanism of the South's policy on North Korea could be identified within the framework of positive engagement and its concept of the interdependence model. This line of reasoning stemmed from the liberal school of thought relating economic interdependence to the reduction of the danger of war, and its assumption that economic inducements could be effective as an instrument of statecraft. Under Kim and Roh's strategic thinking towards North Korea, engagement through increased and deepened inter-Korean economic cooperation was believed to be the best possible way to enhance absolute gains for both Koreas, to ease military tensions and to promote confidence-building between the two Koreas. Meanwhile, in the course of constructing interdependent relationships, Kim and Roh commonly anticipated that North Korea would embark on a path to opening and reforms for reasons of regime survival.

However, this thesis pointed out that the promotion of personal exchanges and trade flows between the North and the South was not an innovative idea to South Korea. In fact, this idea was discussed during the Park Chung-hee era. Indeed,

promoting peace through inter-Korean economic cooperation had been a hallmark of inter-Korean relations since the Roh Tae-woo administration. Although inter-Korean economic cooperation experienced many ups and downs, it has not been suspended since 1989. External factors could not prohibit the two Koreas from engaging economically with each other. Despite North Korea's nuclear ambition, American pressure and expanded UN sanctions, inter-Korean exchanges and cooperation have grown considerably both in terms of quantity and quality. Irrespective of the South Korean government's ideological orientation, the development of inter-Korean economic relations has been an abiding interest and a common policy goal over the past two decades.

Notwithstanding, this thesis claimed that the reason for considering the Sunshine Policy as full-fledged positive engagement was South Korea's strategic shift to expanding economic incentives for eliciting cooperative political relations and positive changes in North Korea's behaviour. With the inception of Kim Dae-jung's Sunshine Policy, inter-Korean relations entered a new phase, and in this new phase inter-Korean economic cooperation played a pivotal role in South Korea's engagement policy on North Korea. Whereas past inter-Korean economic cooperation was as a subsidiary component of the government's policy on North Korea, or a concomitant of the political relationship between the two Koreas, it became a key instrument in South Korea's policy on North Korea, and a main driver of inter-Korean relations starting from the late 1990s. Although there were subtle differences in emphasising inter-Korean economic cooperation between Kim and Roh, the two administrations commonly adopted it as its key instrument in South Korea's policy on North Korea, pursuing solidly the course of interdependence with North Korea. The ultimate objective of Kim and Roh's Sunshine Policy was to create a state of *de facto* unification, and to achieve this, the establishment of inter-Korean economic community for economic integration should precede political integration between the two Koreas. This line of reasoning was predicated on the belief that North Korea would not collapse immediately and a functional approach through the expansion of economic interactions and deepening of interdependence was desirable for the long-term goal for peaceful reunification. In the face of the threat posed by the incessant development of nuclear weapons and missiles, both administrations' underlying belief that North Korea's nuclear issue could be resolved through political and economic inducements made it possible for South Korea to pursue a sustained positive engagement towards North Korea. The fact is that with the beginning of the Sunshine Policy South Korea

placed great importance on the process of constructing interdependent relationships, and cooperation through incentives was central to South Korea's policy on North Korea.

Effects of positive engagement on economic interdependence

Research question 4: How and to what extent did the Sunshine Policy affect economic interdependence between North and South Korea?

This thesis tested how and to what extent the Sunshine Policy between 1998 and 2007 affected economic interdependence between the two Koreas. Through a close examination of the effects of positive engagement, this thesis claimed that inter-Korean economic cooperation led by the governments of Kim Dae-jung and Roh Moo-hyun brought about an increase in economic interdependence between the two Koreas.

As argued earlier, the most crucial aspect of the strategies of Kim and Roh's administrations on North Korea was the employment of positive economic statecraft, focusing on trade, investment and aid, all of which were essential means for fostering cooperative political relations while eliciting a positive change in North Korea's behaviour. This thesis showed that between 1998 and 2007 South Korea's positive engagement had succeeded in constructing an economically asymmetrical structure between North and South Korea. Whereas in terms of quantity, the volume of inter-Korean economic cooperation had not made a significant impact on the South Korean economy, the absolute amount of inter-Korean trade had become more significant to the North Korean economy in the 2000s. This thesis demonstrated that, in comparison with South Korea, the relative costs of changing or forgoing the structure of a system of interdependence has been high in North Korea. Strategically, this asymmetrical structure made it possible for Seoul to expect conflict-inhibiting effects of interdependence because it was believed to make it more difficult for Pyongyang to take confrontational action that would disrupt economic relations with Seoul and jeopardize its gains from trade, investment, and aid.

Results of positive engagement

Research question 5: Has South Korea's employment of positive economic statecraft between 1998 and 2007 achieved a reduction in military tensions between the two Koreas and a de facto unification?

This thesis demonstrated that despite the increased economic exchanges and the resultant asymmetries of economic interdependence between the two Koreas, South Korea's employment of positive economic statecraft between 1998 and 2007 did not achieve its desired policy goals, and its effects on high politics of national security was relatively limited. Thus, the thesis argued that high economic benefits under the Sunshine Policy were not strongly associated with changes in North Korea's behaviour, and, there was a weak correlation between the provision of economic incentives and the effect on tension reduction on the Korean Peninsula.

The hallmark of South Korea's Sunshine Policy was its commitment to engagement through positive economic statecraft that aimed at realising *de facto* unification and eliciting North Korea's voluntary changes in behaviour. It is correct that Kim Dae-jung and Roh Moo-hyun's consistent efforts to engage with the North through political dialogue and economic cooperation had shown its achievements on improving inter-Korean relations. The outcomes in increased personal exchanges and numbers of talks and agreements between the two Koreas in this time were significant in the history of inter-Korean relations. In particular, the Sunshine Policy brought about most of the inter-Korean talks and agreements in the realm of the military over the past sixty years. However, this thesis demonstrated that its limited success were clearly observable in the security area. As chapter 7 showed, North Korea's provocative posture in the area of NLL in the West Sea was not mitigated during the period of the Sunshine Policy. The empirical evidence of South Korea's defence spending increases and North Korea's augmentation on asymmetrical force substantiates that intense competition in military build-up between North and South Korea continued. These negative consequences were far from the reduction of military tensions and confidence-building between the two Koreas envisaged by the Sunshine Policy. Despite increased economic interdependence, the two summit meetings, and the frequent high-level official talks that led to numerous inter-Korean agreements, the two Koreas failed to enter into a state of a *de facto* unification: an inter-Korean economic community was not established; meaningful political confidence-building and arms control was not realised; and the North Korean acceptance of a market economy did not occurred during the ten years of the Kim Dae-jung and Roh Moo-hyun administrations. It is obvious that in spite of Kim and Roh's efforts and expectations, South Korea's positive engagement fell far short of the inducement of structural changes in North Korea. Although President Kim and Roh's Sunshine Policy and South Korea's positive engagement successfully led to the North's growing dependence on

the South economically, this structure of asymmetrical interdependence did not alter the direction of North Korea's nuclear development and anti-reform. To summarise, contrary to Kim and Roh's promises and public expectations, there had not been much change in high politics, and the Sunshine Policy did not bring about a *de facto* unification on the Korean peninsula.

Dynamics of positive engagement

Research question 6: Which factors facilitated or hindered the success of engagement policy objectives, and how did these determinants affect the implementation of economic incentives to North Korea?

This thesis argued that the constraints on South Korea's positive engagement were not only associated with North Korea's pursuit of nuclear weapons, but also South Korea's positive engagement itself and the international environment.

The thesis traced that behind the limited success of South Korea's positive engagement, there were structural factors determining North Korea's receptivity of positive economic statecraft. The first of these structural factors is a constraint on South Korea's positive engagement, attributed to South Korea's dual strategic goals: the development of an interdependent relationship, and the realisation of structural changes. The second structural factor was the different interpretations of North Korea's nuclear problem by Washington and Seoul, and the different strategies used by them leading to an issue in coordination which significantly undermined the pace and density of engagement with North Korea. The third structural factor was the polarity of South Korea's aid between political and humanitarian purposes. This polarity seriously affected the credibility of positive economic statecraft towards North Korea, causing unsatisfactory monitoring and aid diversion, while making North Korean leaders the main beneficiaries of humanitarian assistance.

These findings indicate that although a serious impediment to the economic incentives of the Sunshine Policy arose from North Korea's pursuit of nuclear weapons and its reluctance to initiate economic reforms and opening, the determinants of the effectiveness of positive engagement also stem from outside North Korea. South Korea's positive engagement itself had an inherent nature that made it difficult to achieve its strategic goal towards North Korea. These constraints were also constructed by the external environment that was made by two important players, the United States and South Korea. The structural weaknesses of positive engagement was caused

by the different interpretations of the North Korea nuclear problem, and the different tolerances shown to North Korea's unreciprocated actions, and the divergent forces formed by Seoul-led incentive strategies and Washington-led sanctions strategies.

8.3 Policy implications and further research

Since the end of the 1980s, the use of economic incentives to influence North Korean behaviour has been a consistent pattern and a common policy instrument for South Korea. In particular, the progressive governments of Kim Dae-jung and Roh Moo-hyun were highly committed to the use of economic incentives in their North Korea policies. This thesis demonstrated that as South Korea became North Korea's second largest trading partner after China, economic interactions with the South became an indispensable part of the North Korean economy. This increased level of asymmetrical interdependence between North and South Korea was expected to impose a structural constraint, dissuading Pyongyang from provocative behaviour, while assisting North Korea's opening and reform efforts. In fact, inter-Korean economic cooperation led to an increase in inter-Korean talks and agreements in the domain of the military and politics. Considering the fact that there was no major naval incident in the West Sea during the Roh presidency, South Korea's positive engagement succeeded in making military conflict a less appealing option for North Korea. Whilst positive engagement towards North Korea was implemented between 1998 and 2007, the mechanism of economic opportunity cost - the fear of the loss of gains from trade deterring states from to military conflict - partly worked between the two Koreas.

However, it did not necessarily mean that the strategic situation in Korea had changed during the period of the Sunshine Policy. This thesis has shown that the promised *de facto* unification of the Sunshine Policy, in which the two Koreas could travel freely across the border and recover national homogeneity, had not been realised during the term of Kim Dae-jung and Roh Moo-hyun presidencies. The quantity of inter-Korean economic transactions and the intensity of economic ties fell far short of a construction of a North-South economic community, nor was enough for Pyongyang to transform its economy towards a market-oriented economy. As long as North Korea did not abandon its nuclear and missile development programmes, the Sunshine Policy's ultimate goal, peaceful unification would be an unthinkable hope and possibility. The dilemma stemmed from the fact that South Korea did not have sufficient leverage and incentives to persuade North Korea to abandon its nuclear

programmes. Thus, it is imperative for South Korea to accept limited means for changing North Korea's behaviour, while maximising the beneficial influence of interdependence between the two Koreas.

The challenge to South Korea is that in order to induce structural changes in North Korea, not only should South Korea be willing and able to sustain an incentives-based strategy, while avoiding the accusation of appeasement, but also this course of economic interdependence should be able to continue until reaching a tipping point to achieve transformative effects. The former requires sustained domestic support from constituencies, and the latter requires the existence of domestic groups within North Korea favouring external incentives to relations with South Korea. In this vein, further study shall be focused on how South Korea's positive engagement can influence domestic politics within North Korea. This research must ask, in particular, what type or combination of incentives can lead the North Korean regime to adopt elements of a market economy, and whether such incentive-based engagement can help to create and bolster alternative groups that are more likely to press established elites for changes in security and economic policies. It is correct that a path of economic reforms and opening is largely contingent on the North Korean leadership's willingness. These meaningful changes in North Korea may not likely occur whilst the ruling regime adheres to the *juche* ideology and 'military-first politics'. Structurally, North Korea's closed command economy operated by centralized political control makes it more difficult to create independent economic actors or reformist groups. However, unless South Korea alters its strategic goals that centre on the mere satisfaction (or continuation) of the conflict-reducing effects of interdependence, the transformative effects of positive engagement is no more than Seoul's wishful thinking.

Considering the costs of war, the use of military force is inconceivable irrespective of the chance of winning (Bluth 2011; Lankov 2013; Kang 2013). A strategy of negative pressure and economic sanctions failed to dissuade North Korea from carrying out nuclear or missile tests (Kim 2007; Kim and Chang 2007; Noland 2008; Yoon 2010; Elliott 2010; Haggard and Noland 2010; Yang and Ha 2012). Even though the use of targeted financial sanctions partly succeeded in bringing North Korea back to the negotiation table, economic pressure neither curbed the country's nuclear weapons and long-range missile programmes nor did it impede the flows and performance of its economic activities. South Korea's strategic use of the mix of incentives and sanctions to achieve the goals of denuclearisation and reform of North Korea seems to be idealistic (Kim 2012). However, the mix of sanctions and incentives

is more likely to provide the wrong-signal to North Korea and undermine South Korea's credibility for engagement. As Robert Jervis (2013: 107) noted, in the history of coercive diplomacy, "all too often, threats and promises undercut, rather than complement, each other." Simply, North Korea is not an easy target state that can be manipulated by the simultaneous use of 'carrots and sticks'. Cha (2011) asserted that in the face of military provocations from the North such as the *Cheonan* and Yeonpyeong attacks, it would be unavoidable for South Korea and the United States to intensify sanctions and military exercises. Nevertheless, these coercive and punitive pressures have failed to compel policy changes in North Korea while serving to legitimise the ruling elites' decision to develop and maintain nuclear weapons. More critically, all these means are unlikely to assist North Korea to embark upon the path to economic reforms and opening, and a political transformation. In this sense, although positive engagement may not be a strategy devised to achieve a denuclearized North Korea, its mechanism is designed to induce a reduction in security tension, improvement of the North's economy, and changes in the strategic calculus of political leaders in Pyongyang, by affecting the state's reward structure through Seoul's efforts in building an interdependent relationship. It is also important to note that interdependence can indirectly bring about increased inter-Korean personal exchanges and information dissemination. These intentional and unintentional effects are not attainable through coercive and punitive measures. Thus, what it needed is a more powerful and smarter incentive that can stimulate the growth of the market and the emergence of independent actors within North Korea.

Given the continuation of the North Korean nuclear programme, South Korea's goal of management of the national division is not a sufficient condition for peaceful coexistence or durable peace on the Korean peninsula. Therefore, South Korea's positive engagement should evolve into a strategy of supporting and inducing structural changes within North Korea. To this end, South Korea needs to maintain an engagement strategy despite the lack of palpable changes in North Korea's behaviour or unpredictable military provocations. More importantly, South Korea has to devise a strategy so that the benefits from trade, investment, and aid can be distributed to other sectors of the North's society i.e., North Korean citizens, economic technocrats, and pragmatic political groups within North Korea. As Nincic (2011) and Solingen (2012) noted, the emergence of the latter group is imperative for the success of an inducement-based strategy, so South Korea's positive engagement should play a role in enhancing the domestic position of those who are more likely to be supportive of

dialogue and trade within North Korea. It is correct that North Korean leaders resist economic reform, and such an advantageous condition for structural change is not likely to be cultivated soon. Nevertheless, unless South Korea makes the incumbent regime or the potential elites in North Korea account for the benefits of inter-Korean economic cooperation, the impact of positive economic statecraft on North Korea's domestic politics will be limited. Considering that few external measures can actually affect North Korea's strategic calculus towards South Korea, it is significant to acknowledge that the existence and persistence of a bilateral interdependent relationship is a minimum condition for the transformative effects of positive engagement. As this thesis demonstrated, North Korea's increasing asymmetrical dependence on South Korea - regardless of how long it lasted - does not necessarily bring about reconfiguration of the political coalitions within North Korea, nor does asymmetrical interdependence lead to a path of behaviour modification and reform. However, without constructing this asymmetrical interdependent relationship between the two Koreas, South Korea cannot retain the potential leverage that is practically attainable from inter-Korean economic interactions, losing the conditions that may make South Korea's positive engagement effective.

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List of Abbreviations

APEC: Asia-Pacific Economic Cooperation
COMTRADE: United Nations Commodity Trade Statistics Database
CRS: Congressional Research Service
CVID: Complete, Verifiable, and Irreversible Disarmament
DMZ: Demilitarised Zone
DOTS: IMF's Direction of Trade Statistics
DPRK: Democratic People's Republic of Korea
FAO: Food and Agriculture Organisation
FRUS: Foreign Relations of the United States
FYEDP: Five-Year Economic Development Plans
GATT: General Agreement on Trade and Tariffs
GDP: Gross Domestic Product
GIC: Gaeseong Industrial Complex
GNP: Gross National Product
GT: General Trade
HEU: Highly Enriched Uranium
HFO: Heavy Fuel Oil
IAEA: International Atomic Energy Agency
IBRD: International Bank for Reconstruction and Development
IMF: International Monetary Fund
KCIA: Korea Central Intelligence Agency
KEDO: Korean Peninsula Energy Development Organisation
KITA: Korea International Trade Association
KOTRA: Korea Trade and Investment Promotion Agency
KTO: Korea Tourism Organisation
LWR: Light-Water Reactor
MDL: Military Demarcation Line
MND: Ministry of National Defence
MOFAT: Ministry of Foreign Affairs and Trade
MOU: Ministry of Unification
NCU: National Community Unification
NGO: Non-governmental Organisation
NLL: Northern Limit Line

NPT: Non-Proliferation Treaty
ODA: Official Development Assistance
OPZ: Outward Processing Zone
PNIs: President Nuclear Initiatives
POC: Processing-On-Commission
ROK: Republic of Korea
UN: United Nations
US: United States
WFP: World Food Programme
WMD: Weapons of Mass Destruction
WTO: World Trade Organisation

Appendix A Interviewee lists

Name	Position	Date
Lim Dong-won	Former Minister of Unification Former Director of the National Intelligence Service	2011.05.28
Lee Jong-seok	Former Minister of Unification Former chairman of the National Security Council	2011.06.20
Yoon Young-kwan	Former Minister of Foreign Affairs and Trade Professor of Seoul National University	2011.04.15
Ma Min-ho	Professor of Handong University	2013.01.30
Kim Joon-hyung	Professor of Handong University	2011.06.29
Kim Keun-sik	Professor of Kyungnam University	2011.05.26
Lim Eul-chul	Research Professor of Kyungnam University	2011.07.29
Yoo Ho-yeol	Professor of Korea University	2011.04.11
Park Kun-young	Professor of Catholic University	2011.04.18
Paik Hak-soon	Research fellow at the Sejong Institute	2011.06.15
Park Hyeong-jung	Senior Research Fellow, Korean Institute for National Unification	2011.06.13
Lim Kang-taek	Senior Research Fellow, Korean Institute for National Unification	2011.06.28
Oh Il-whan	CEO of VHS Education and Research Institute	2011.05.17
Joo Do-hong	Professor of Baekseok University	2011.06.16
Kim Philo	Research Professor at the Institute for Peace and Unification Studies at Seoul National University	2011.05.19
Ha Sang-sik	Professor of Changwon University	2011.02.18
Park Min-hyoung	Professor of Korea National Defense University	2011.08.03
Jo Dong-ho	Professor of Ewha Womans University	2011.04.21
Kwak Tae-hwan	Professor Emeritus of Eastern Kentucky University	2011.05.11
Ko Kyung-bin	Former Director of the Social and Cultural Exchanges Bureau of the Ministry of Unification	2011.06.08
Lee Kwan-se	Former Vice Minister of Unification	2011.05.30
Kwon Young-kyong	Professor of Institute for Unification Education	2011.05.25
Cho Seong-ryoul	Research fellow at Institute for National Security Strategy	2011.06.02
Lee Jong-moo	Director of Korean Sharing Movement	2011.07.21
Huh Sung-up	Pastor	2011.08.06
Park Se-il	Chairman of the Hansun Foundation	2011.06.24
Kim Hyung-ki	Former Vice Minister of Unification	2011.06.14
Won Yoo-chul	Member of the National Assembly	2011.04.26
Park Myoung-Kyu	Director of at the Institute for Peace and Unification Studies at Seoul National University	2011.05.31