



# SPECIAL REPORT

## **ABOUT THE WORKING GROUP**

The United States Institute of Peace has held an ongoing series of working group meetings on U.S. policy toward the Korean peninsula since fall 1993, when a group was convened to examine policy options for dealing with the North Korean nuclear challenge.

Two Special Reports were issued in 1994. The first report, *North Korea's Nuclear Program: Challenge and Opportunity for American Policy*, addressed strategic and organizational aspects of an effort to achieve a negotiated solution to problems posed by North Korea's nuclear program. The second, *The North Korean Nuclear Challenge: The Post-Kim Il Sung Phase Begins*, provided a preliminary analysis of the Geneva Agreed Framework and examined the challenges posed by the political situation on the Korean peninsula following the death of Kim Il Sung.

*A Coming Crisis on the Korean Peninsula?: The Food Crisis, Economic Decline, and Political Considerations*, published in October 1996, explored prospective challenges to the coordination of U.S., South Korean, Japanese, and Chinese policies in the context of the difficult circumstances and circumscribed options currently faced by North Korea. *North Korea's Decline and China's Strategic Dilemmas*, an October 1997 report based on a research trip to the northeast China border with North Korea, analyzed Chinese perspectives on the two Koreas. *Beyond the Financial Crisis: Challenges and Opportunities for U.S. Leadership*, published in April 1998, detailed political and security implications of the Asian financial crisis.

This Special Report, authored by Program Officer Scott Snyder, is based on meetings of the working group that focused on political, economic, and security developments in North and South Korea. The meetings were held at the United States Institute of Peace in November and December 1997 and March 1998. For more information about the meeting series or this report, please contact Scott Snyder at (202) 429-3808 or visit our Web site at [www.usip.org](http://www.usip.org).

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## **Challenges of Building a Korean Peace Process Political and Economic Transition on the Korean Peninsula**

### **Key Points**

- Political and economic transitions in both South and North Korea have dramatically changed the context and prospects for initiating a Korean peace process. The South Korean financial crisis and the election of Kim Dae Jung have led to a more conciliatory South Korean policy toward North Korea, while North Korea's economic distress and the extended process of political transition from Kim Il Sung to his son, Kim Jong Il, have increased North Korea's dependence on international negotiations to gain resources necessary for the regime to survive.
- Resolving South Korea's financial crisis and restoring economic stability will take priority for the time being over improving relations with North Korea. The financial crisis has broadened public support in South Korea for a policy of gradual integration with North Korea while dampening desires for near-term Korean reunification. All parties surrounding the two Koreas support the near-term perpetuation of the status quo rather than facing the potentially destabilizing changes and financial and political burdens that would likely accompany an early reunification.
- Current developments on the Korean peninsula will require closer policy coordination between the United States and the Republic of Korea (ROK) on a broader range of issues than has previously existed. President Kim Dae Jung has shown his ability to take the lead in mapping out a strategic vision for reducing tension on the Korean peninsula through expanded dialogue, exchange, and cooperation with Pyongyang. Because he faces considerable domestic economic and political constraints, his policy is unlikely to succeed without full backing from the United States. The United States and the ROK should implement parallel policies designed to encourage economic and political cooperation with the Democratic People's Republic of Korea (DPRK) in order to gradually integrate the DPRK into the international community. Such a policy might require eliminating certain economic sanctions and supporting U.S.-South Korean cooperation in joint economic ventures with the DPRK. In addition, the United States

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and South Korea should begin to develop a joint policy regarding the long-term future of U.S.-ROK security relations.

- With deepened U.S.-ROK security coordination as the foundation for managing policy toward the DPRK, the United States should expand consultations with other regional partners and neighbors in Asia—including Japan and China—regarding cooperation to reduce tensions on the Korean peninsula. Such consultations might enhance understanding of the roles and objectives of U.S. troops in the Asia-Pacific region as a stabilizing force that may help to dampen the emergence of regional rivalries following Korean reunification.
- As an exercise in multilateral cooperation to implement the terms of the Geneva Agreed Framework and as an institution that helps prevent proliferation of weapons of mass destruction, the Korean Peninsula Energy Development Organization (KEDO) has proved itself an effective organization with a positive track record in its dealings with the DPRK. To maintain the credibility of U.S. commitments under the Geneva Agreed Framework, the U.S. Congress should authorize funding for heavy fuel oil delivered through KEDO, particularly since Japan and the ROK are committed to funding the costs of construction of light water reactors in the DPRK, the lion's share of the project. Congress should also be willing to invest in a Korean peace process through financial support for inter-Korean tension reduction measures on the model of the Nunn-Lugar initiative to support Russian nuclear drawdowns.
- While the initiative for driving the reconciliation process has shifted increasingly to the two Koreas themselves, assistance from international financial institutions will be necessary to provide political and financial support for economic integration, reconstruction, and reduction of military tensions, particularly if any sudden changes occur that destabilize the status quo. It is necessary to define and coordinate the respective roles and subjects of the various channels of dialogue with the DPRK, including the relationship between inter-Korean dialogue, U.S.-DPRK talks, Japan-DPRK dialogue on normalization of relations, and the Four Party Talks.
- The South Korean financial crisis has provided psychological balance to the atmosphere surrounding inter-Korean negotiations by diluting to a degree feelings of superiority by Seoul over Pyongyang while broadening South Korean public support for a policy of gradual integration with North Korea. President Kim Dae Jung's domestic political position and policy toward North Korea remain constrained in the absence of practical North Korean steps toward conciliation in response to Kim Dae Jung's "Sunshine Policy" of reconciliation.
- North Korea's economic distress has increased its dependence on China and the international community; however, its political structure—and the power of Kim Jong Il as its ultimate authority—remains intact in spite of the emergence of public differences among its bureaucratic organs and the rise of corruption among North Korean cadres at the highest levels. North Korea's food crisis has allowed the spread of private black markets at the expense of the central government's public distribution system.

## Introduction

The South Korean financial crisis and the election of Kim Dae Jung as president of the ROK are dramatic new developments that may—in combination with the more gradual political and economic changes under way in the DPRK in the years since the death of Kim Il Sung—open the way for progress in bringing peace to the Korean peninsula. However, the legacy of more than five decades of mutual mistrust and division persists. The confrontation between the two Koreas has perpetuated a status quo that is widely perceived among neighboring countries and the two Koreas themselves as desirable but perhaps unsustainable without the stabilization of the DPRK's economic situation and the emergence of Kim Jong Il as an effective international leader.

Parallel political and economic transitions provide a new context for examining prospects for peace building on the Korean peninsula. The settlement of conflict between the two Koreas presumably will allow for greater cross-border trade and investment in Northeast Asia, expanding economic prosperity and enhancing regional cohesion and cooperation in the region. Do these changes increase prospects for inter-Korean reconciliation that might lead to a lasting peace? To what extent do the risks of instability that might accompany change in the status quo prevent all sides from supporting a process of reconciliation or reunification? Is the time ripe for the initiation of a Korean peace process, and what will be required of leaders in the two Koreas and the international community? Is "peaceful reunification" of the Korean peninsula achievable under the new circumstances? If so, at what cost, and to whose benefit?

### *South Korean Economic Transition: The Asian Financial Crisis*

The election of long-time oppositionist and democracy activist Kim Dae Jung as president of the ROK has set the stage for the consolidation of South Korean democracy and initiated the first-ever democratic transition of power between political parties in South Korea. The election occurred in the midst of a severe and unexpected psychological jolt to the South Korean public: The economic "miracle on the Han" that had driven South Korea's remarkable industrial take-off of the past three decades had been victimized by a national pyramid scheme financed by unsustainable foreign borrowing. This triangle of unsound financial deals among businessmen, bureaucrats, and bankers suddenly came crashing down as international currency speculators realized in November 1997 that the Bank of Korea did not have enough money on hand to pay its own bills and that South Korea was careening dangerously toward national default.

Korean corporate debt in December 1997 amounted to more than \$120 billion, most of which was due in less than a year. The unavoidable reality was that the government of the ROK—which had engineered growth in South Korean per capita income from \$100 in the 1950s to more than \$10,000 in 1996—was broke, and the mighty industrial giants—the chaebols—were overleveraged to a remarkable degree: The average debt to equity ratios of the top thirty chaebols was over 500 percent in early 1998. The financial health of Korea's banking system could be restored only through what were perceived as humiliating appeals for assistance to the International Monetary Fund (IMF), a situation that contributed to the election by an angry South Korean public of Kim Dae Jung. In an ironic historical twist,

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Kim has traveled full circle from government enemy number one—surviving an assassination attempt in 1972 and intermittent house arrest through 1987 to head of state in 1998—from house arrest to the Blue House in just over a decade.

Kim Dae Jung's candidacy was assisted directly by South Korea's economic and political crisis of leadership, and the crisis provided him with an unprecedented challenge and opportunity to exhibit leadership immediately upon his election on December 18, 1997, even before he was sworn into office on February 25. Although President Kim Young Sam remained the official head of state, everyone—South Korean government officials and international visitors alike—came to Kim Dae Jung for key decisions even before his inauguration. On Christmas Eve, only days after his election, Kim authorized a deal with the IMF and the U.S. Treasury through which the South Korean government—which was losing close to \$1 billion per day through capital flight—could narrowly avert default on its international debts. The terms of the deal allowed South Korea to rely on expanded financial assistance through the IMF's "second line of defense" and to participate in a negotiation process between international bank creditors and the ROK government to support the roll-over of short-term bank loans that would allow South Korea to get back on its feet.

While the loan roll-over negotiations contained the immediate damage of the national financial crisis, the real economic effects of South Korea's financial dislocation were only beginning to ripple through the economy by the time Kim Dae Jung formally took office. The number of bankruptcies skyrocketed and 11,000 people per day lost jobs in the first quarter of 1998, with unemployment expected to triple to almost 2 million in a workforce of more than 20 million people. Estimates for Korean economic growth range from zero growth to a contraction of 5 percent of Gross Domestic Product for 1998, with a return to positive growth of 3 to 4 percent projected for 1999. As a result, managing the fallout from the financial crisis and implementing reforms that will restore South Korea's economic competitiveness will remain Kim Dae Jung's highest priority through 1998 and perhaps well into 1999.

Kim Dae Jung created an advisory committee composed of representatives from labor, management, and government that forged a fragile consensus in favor of reform measures that gave companies greater flexibility to allow layoffs in return for government measures to extend a partial social safety net to workers. Kim's greatest challenge in managing Korea's economic recovery is to ensure that structural reforms—including fundamental reform of the chaebol organizational structure—are implemented fairly, distributing sacrifices equitably across all sectors of society.

Changes in South Korea's economic structure are now possible as a result of these financial woes, which some analysts have described as a blessing in disguise. Many international economists consider reform necessary to enhance South Korea's long-term global competitiveness, as it may augment Seoul's ability to take on the economic challenges associated with economic integration with the North. In addition, international economic assistance for Korean reunification is likely to be channeled through the World Bank and IMF, so experience in dealing with those organizations' management practices may be useful preparation for international financial cooperation to support North Korea's economic reconstruction.

The financial crisis has ended for the time being the South Korean policy debate over whether to "squeeze" or "please" North Korea, as South Korea is currently in no position to finance the economic or political absorption of the North. And the

crisis has created a more balanced atmosphere for inter-Korean negotiations, as South Korean officials can no longer gloat about North Korea's economic difficulties, while North Korean officials may feel less intimidated by South Korea's heretofore unqualified record of economic accomplishment. One result of the crisis has been to convince most South Koreans that they have no choice but to support Kim Dae Jung's progressive policies of opening toward the North. Finally, the crisis diminished Seoul's ability to provide financial support for economic exchanges and cooperation with North Korea, including providing the food supplies and agricultural and fertilizer inputs that authorities in Pyongyang have requested.

*South Korean Political Transition:  
Kim Dae Jung's Election and the Transition of Power*

Kim Dae Jung's election marked a dramatic shift to a less threatening and more cooperative tone toward the North compared with that of his predecessor Kim Young Sam, whose public remarks often suggested a policy of containment and isolation of the DPRK. Kim Young Sam also initially sought dialogue with the DPRK, both through a proposal for exchange of special envoys in spring 1993 and through plans to hold an historic presidential summit meeting with DPRK President Kim Il Sung scheduled for July 27, 1994, but those plans were cut short by Kim Il Sung's untimely death on July 8 of that year. Kim Young Sam severely criticized the founder and Great Leader of the DPRK for starting the Korean War and for contributing to Korea's division; in turn, the North Korean press vilified Kim Young Sam endlessly in the starkest and basest terms. Such public exchanges ended all prospects for unmediated official inter-Korean dialogue during the Kim Young Sam administration.

Kim Dae Jung comes to office widely known as a leading expert on Korean reunification and with well-defined public positions on reconciliation formulated over several decades. In his inaugural address, Kim put forward three new principles for dealing with Pyongyang that may be interpreted as a sea change in the declaratory policy of the South Korean government: that the South will not tolerate armed provocation, that the South has no intention of undermining or absorbing North Korea, and that the South would actively pursue a policy of reconciliation and cooperation. Within days of his election, Kim had proposed an exchange of special envoys and declared his willingness to hold an inter-Korean presidential summit meeting, while resisting feelers from Pyongyang for an informal, unofficial channel of communication with top-level leadership. Instead, Kim has called for improved official dialogue, including renewed implementation of the 1992 Agreement on Reconciliation, Nonaggression, Exchanges and Cooperation (widely known as the Basic Agreement). This agreement—implementation of which was suspended in 1992 in the context of pressure to resolve growing doubts concerning North Korea's nuclear program—set out broad areas of potential cooperation and created a joint committee structure for implementing political cooperation, a joint military commission, and economic and cultural exchanges and cooperation.

As part of Kim Dae Jung's "Sunshine Policy" toward North Korea, his administration has sought to delink private economic exchanges from political considerations in policy toward the North—the first major substantive change from the policy of previous administrations. The administration has eliminated restrictions on the allowable amount of investment by South Korean companies in North Korea, has proposed to work with North Korean authorities to resolve the issue of

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reuniting divided families, and has considered lifting a ban on broadcast of North Korean radio and television programs in South Korea. The North Korean press has initially refrained from directly criticizing Kim Dae Jung, and in early April the DPRK proposed initiation of the first direct, official dialogue between North and South Korea since Kim Il Sung's death, on fertilizer assistance to North Korea and reunification of divided families. That dialogue was held in Beijing less than two weeks following the DPRK's proposal.

Many American observers hold an optimistic view of Kim Dae Jung's leadership in responding to the early stages of South Korea's economic crisis and in setting out a clear and consistent vision for dealing with North Korea. But it would be a mistake to overlook the formidable domestic political constraints on Kim's leadership and ability to fully implement either his economic agenda or his policies toward the North. First, Kim Dae Jung's popular support and public mandate are shallow. With just over 40 percent of the popular vote, he eked out a 1 percent margin of victory over ruling party candidate Lee Hoe Chang. Kim garnered more than 50 percent of the popular vote only in the Cholla region, his traditional stronghold.

Second, Kim Dae Jung owes his victory in part to the unlikely coalition he formed two months before the election with conservative chairman of the United Liberal Democratic Party Kim Jong Pil. Kim Dae Jung's support from Kim Jong Pil's stronghold in the Chungchong provincial region may have made the difference between victory and defeat in the presidential election. Lack of cooperation within Kim Dae Jung's ruling coalition is likely to constrain his ability to implement a more progressive policy toward North Korea.

Third, the former ruling party remains the largest party in the ROK National Assembly, and it is not likely to give Kim Dae Jung any easy victories. It has thus far cooperated with him only on the most pressing issues related to South Korea's financial crisis. Even the appointment of Kim Dae Jung's coalition partner Kim Jong Pil as prime minister was thwarted by the majority Grand National Party hours after President Kim's inauguration, and the constitutionality of Kim Jong Pil's appointment as acting prime minister has been referred to the courts. In his inauguration address, President Kim requested a year-long honeymoon to address the Korean financial crisis; he received less than a day.

Fourth, many career bureaucrats in the ROK government remain skeptical of President Kim, an outsider long under suspicion for his oppositionist activities and deep ties to South Korea's most disaffected Cholla region. Attempts by his supporters to root out opposition to his policies may create political enemies, while career bureaucrats may obstruct or slow the implementation of any policies viewed as too progressive. The fallout from the "North Wind" election scandal—in which South Korea's Agency of National Security Planning contacted North Korean government representatives to request help in smearing Kim Dae Jung before the presidential election—is the most public manifestation of the difficulties he faces.

Finally, Kim Dae Jung must temper impulses for political revenge among long-time supporters within his own party, since such measures would polarize and paralyze South Korea's fragile political environment. Despite the ephemeral high approval ratings traditionally enjoyed by incoming South Korean presidents, the foundation of Kim Dae Jung's leadership remains fragile, and it will take considerable political skill for him to expand the consensus in support of his policies.

Fortunately, a limited consensus in favor of attempts to engage North Korea in dialogue and exchange has emerged from South Korean policy debates during the

presidential election. However, the South Korean public expects North Korea to respond with positive and conciliatory steps of its own before such dialogue and exchange can proceed far. Past North Korean patterns of pocketing South Korean concessions without offering anything in return have hardened South Korean public attitudes and dampened generosity. In turn, the ROK government has offered public promises of unconditional assistance to the DPRK that turned out to have political strings attached when both sides sat down at the negotiating table.

The recent record of inter-Korean exchange and cooperation offers a clear political standard by which the efforts of the Kim Dae Jung administration will be judged. For instance, Kim Young Sam's failure to gain anything from North Korea in return for 150,000 tons of rice (supplied in 1995 as an attempt to influence public support for the ruling party in South Korea's local elections) has established symbolic limits on the generosity of the Kim Dae Jung administration in 1998 and has influenced South Korean tactics in managing the renewed inter-Korean dialogue in Beijing.

The election of Kim Dae Jung has already led to the first official dialogue in almost four years. Both sides have acknowledged the importance of the Basic Agreement as a starting point for developing inter-Korean exchanges and cooperation, and Kim Dae Jung is poised to take a leading role in dialogue with North Korea. However, he is operating under political constraints that severely limit and could undermine his flexibility in implementing a more progressive policy toward Pyongyang. Changes in South Korean policy toward the North will continue to be dependent primarily on public support, which will be influenced by judgments of whether North Korea is reciprocating South Korea's conciliatory efforts with a less hostile and more accommodating policy of its own.

*North Korean Economic Decline:  
From "Self-Reliance" to Economic Dependency*

The primary constraint on an accurate assessment of North Korea's economic and political situation remains the limited flow of reliable empirical data. However, available data and anecdotal evidence do provide a snapshot of broad economic trends and their possible influence on the policies of the DPRK. Perhaps the most significant economic developments in North Korea since the death of Kim Il Sung are the de facto devolution of economic authority and responsibility from the central government to local authorities, the economic penetration of the DPRK by outside forces, and the transformation by default of the DPRK's economic structure from one that relies on central planning to regulate supply and demand to one in which market mechanisms—albeit distorted by corruption and special privileges—play a key role. The result of these trends is that the DPRK cannot afford to live in "splendid isolation" from the outside world, but neither can it afford to open up without risking possible subversion.

Under Kim Il Sung's rule, the central government overshadowed local authorities, and the state was the purchaser and provider of most goods and services. Procurement of goods outside the state distribution system was relatively rare and was based more on privileges granted by the state than on price. In addition, the state delivered on its ration commitments with relative regularity, diminishing economic pressures that might otherwise have led to illicit transactions. And the punishment for illegal activity was high—a loss of life or of economic and social privileges. The procurement of goods beyond normal rations was limited, and authorities actively suppressed private commercial transactions and other forms of "corruption."

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*As a result of its economic decline, the DPRK cannot afford to live in "splendid isolation" from the outside world, but neither can it afford to open up without risking possible subversion.*

*The socialist political structure has remained in withered form . . . but that structure has been largely overshadowed by a highly distorted form of "crony" capitalism in which rent-seeking, collusive relationships, and the black market provide most of what people need to survive.*

*The financial crisis in the South may limit the prospects for large-scale economic cooperation between the two Koreas; however, the amount of viable trade and investment inputs that is available to North Korea may continue to exceed Pyongyang's capacity to absorb them.*

With the emergence of the food crisis in 1995—initially caused by a loss of inputs resulting from the fall of communism and exacerbated by a series of natural disasters and poor agricultural planning decisions—the central government was forced to give more leeway to provincial and local authorities to provide for the needs of their communities. This form of "self-reliance" resulted in a proliferation of trading representatives on the China-North Korea border who sought barter opportunities on behalf of their respective communities. It also resulted in the establishment of relationships on the basis of economic interest instead of political ties and led to heightened competition for resources among organizational units in North Korea.

For the first time, outside forces were able to break through the wall of isolation surrounding the DPRK. Perhaps the best example of this penetration is the gradual expansion of humanitarian nongovernment organization (NGO) representatives into the DPRK in 1996, first through regular site visits and subsequently through on-the-ground monitoring of food delivery. In addition, the DPRK government attempted to expand the presence of international investors through promotion of the Rajin-Sonbong Free Economic and Trade Zone via an unprecedented international conference held with assistance from the United Nations Development Program in September 1996.

Although a North Korean submarine incursion into South Korean territory dampened the enthusiasm of international investors, there was some investment activity and in 1997 it became possible for investors to visit Rajin-Sonbong without applying for a visa. The establishment of the KEDO and the groundbreaking for the light water reactor project in August 1997 represent another breakthrough in cooperation with North Korea, in which authorities traded space for energy resources that may contribute to their survival. Overflight of international flights began in April 1998. And prisoner-of-war/missing-in-action (POW/MIA) missions with the U.S. military initiated in 1996 have been expanded, allowing the U.S. military to see more and more of the North Korean countryside in areas where large numbers of casualties occurred during the Korean War in return for the prospect of enhanced political and security relations with the United States. There have also been steadily increasing exchanges between North Korea and northeastern China via Korean-Chinese living near the border who supply food to their relatives. The traffic has been two-way, including a continuing flow of refugees and defectors from North Korea to northeastern China and the extension of activity into North Korea by South Korean and Korean-American NGOs and humanitarian organizations, as well as South Korean intelligence operatives.

The increase in cross-border interactions during this period has resulted primarily from the decreasing ability of the state to provide the expected amounts of food through the public distribution system. This phenomenon began in the early 1990s but did not become critical until after the 1995 floods that destroyed much of the DPRK's crop production. Although a black market in currency exchange and trade of other goods did exist, the opportunity to engage in such trade was relatively rare. Even so, by the early 1990s there were reports that North Korea's currency on black markets was trading at 70 to 80 won per dollar. Foreign aid workers in Pyongyang in early 1996 observed the emergence of a barter trade born of economic desperation and no longer prosecuted by central government authorities, even though it was still illegal.

As the food crisis has continued, reports suggest the spread of market activity within North Korea, and the won's value in such markets dropped to around 200 won per U.S. dollar. By late 1996, it was increasingly apparent that state-provided



salaries and rations were no longer sufficient to meet the average person's needs and that most North Koreans were forced to seek alternative mechanisms to meet their needs. As desperation and corruption increased, personal relationship networks were increasingly exploited to gain the provisions to survive. The public distribution network, no longer able to meet the needs of the people, was replaced by markets and barter of goods for food. This breakdown encouraged corruption and disinvestment, as well as deforestation and dismantling of industrial plants to sell as scrap metal in exchange for food. The socialist political structure has remained in withered form, with an increasingly limited supply of goods available first for the highest ranking cadres whose support is necessary to the regime, but that structure has been largely overshadowed by a highly distorted form of "crony" capitalism in which rent-seeking, collusive relationships, and the black market provide most of what people need to survive.

The end of the Cold War has revealed North Korean claims of self-reliance to be a myth. North Korea's dependence on China for its economic and political survival—in the absence of inputs from the Soviet Union—has grown increasingly apparent. Customs figures suggest that at least 1.2 million tons of grain crossed the China-DPRK border in 1997, and uncounted grain supplies may push the total to well over 1.5 million tons. Likewise, China has continued to supply more than 1 million tons of oil per year to North Korea despite efforts in the early 1990s to convince authorities in Pyongyang to pay market prices for such deliveries. If anything, the DPRK economic strategy appears to be to expand and diversify its dependence on the international community through appeals for humanitarian food assistance, reliance on free economic inputs from South Korea, and large-scale joint projects with the United States, such as the light water reactor project with KEDO and the joint POW/MIA operations.

The financial crisis in the South may limit the prospects for large-scale economic cooperation between the two Koreas; however, the amount of viable trade and investment inputs that is available to North Korea may continue to exceed Pyongyang's capacity to absorb them. The flow of cash from South Korean tourism and business activities through the northeastern China border area and into North Korea may also dry up, making it harder to finance private barter and exchange activities in North Korea. In addition, the collapse of the Hong Kong-based Peregrine Consulting firm, a major source for venture capital for the few efforts to invest in the Rajin-Sonbong Free Trade Zone, eliminates a source of capital financing for investment. North Korea's international competitiveness as a site of foreign investment has been undermined by the crisis.

The effects of North Korea's economic decline have increasingly taken center stage as a component of inter-Korean dialogue. Although the DPRK chose not to engage in official dialogue with Kim Young Sam from 1994, it had no choice but to resume unofficial talks aimed at securing economic assistance from South Korea. Forms of inter-Korean dialogue stimulated by North Korean economic constraints include the KEDO process, Red Cross talks, unofficial private sector contacts related to inter-Korean trade and investment, North Korean participation in the Four Party Talks, and the resumption of official inter-Korean dialogue over fertilizer assistance in April 1998. Although economic issues have stimulated inter-Korean dialogue, North Korea's economic constraints pose an obstacle to dialogue on core political issues that must be addressed before broadened exchanges and political cooperation can develop between the two Koreas.

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***North Korean Political Transition:  
From Great Leader to Dear Leader***

The death of Great Leader Kim Il Sung, the founder of the DPRK, marked a significant turning point for inter-Korean dialogue. It robbed both sides of an opportunity to edge toward reconciliation through a meeting of the two presidents and turned South and North back to a cycle of mutual vituperation during the remainder of the Kim Young Sam presidency.

Predictions upon Kim Il Sung's death of the imminent collapse of the North Korean system proved unfounded. Maintaining the title of Supreme Commander of the Korean People's Army (KPA), Kim Jong Il—the Dear Leader—has gradually taken over his father's roles. After observing a three-year mourning period, Kim Jong Il took the title of General Secretary of the Korean Workers Party in October 1997. However, his father's post of President of the DPRK remains unfilled. Despite the sizable leadership void created by the death of Kim Il Sung, the DPRK has managed to implement foreign policy decisions during this transition period and maintained its social and political structure in the face of extraordinary stresses caused by its economic problems.

Indeed, periodic efforts have been made to reinforce Kim Jong Il's leadership position through loyalty petitions within the military and society at large and through endless propaganda in the North Korean press. During this transition phase, the military appears to have expanded its public role and remains the only institution capable of carrying out replacement or promotion functions. The party and the government have remained relatively inactive and have not received much attention from the top leadership, even following Kim Jong Il's assumption of the title of General Secretary of the Korean Workers Party. The expansion of the military's role may result partly from the fact that for more than three years Kim Jong Il's only official title was Supreme Commander of the KPA. As the role of the military has expanded and other parts of the DPRK organizational structure have withered, the military has also become the central vehicle for managing critical activities to meet core economic needs, including sensitive procurement and distribution functions to political elites. However, the Ministry of Foreign Affairs has continued to play a key role in managing international affairs, appearing able to overrule military views on certain policy issues, including acceptance of international humanitarian assistance and implementation of the Geneva Agreed Framework.

Although Kim Jong Il is reputed to provide guidance on most important policy decisions, his decision-making style appears to be much more hands off and his influence more constrained than his father's. This situation leads to much lengthier and more overt competition among rival bureaucratic interests within the North Korean system for a steadily decreasing share of resources. The rise of bureaucratic competition under Kim Jong Il has contributed to external perceptions of infighting and chaos in North Korea, yet the center still appears capable of imposing decisions or policy directives once they are made. The decision-making model of the DPRK remains that of democratic centralism; once the top leader provides guidance on the basis of input received from below, the directive is no longer subject to question. However, in the absence of direction from the top on all but the most important policy questions, factionalism along bureaucratic lines has been on the rise.

Another factor that appears to have weakened the consolidation of authority within the DPRK is the rise of corruption and sensitivity to possible high-level defections among the North Korean leadership. Certainly, the defection of the long-time head

of the Juche Academy of Social Sciences, Hwang Jang Yop, must have had repercussions for North Korea's political leadership. And the "North Wind" election scandal may have affected Pyongyang's political leadership even more than it rocked Seoul.

The "North Wind" incident is an example of how North Korea's leadership may be increasingly vulnerable to charges of corruption, particularly as market activity now dominates North Korea's economy. Reports that the DPRK Minister of Agriculture So Kwan-hui and other high-ranking officials may have been executed for agricultural policy mismanagement, and significantly, for alleged ties with ROK intelligence agency representatives, suggest that corruption may have reached the highest levels. North Korean officials who have contacts with South Korean counterparts—for instance, former Chairman of the External Economic Affairs Commission Kim Jong U, who has recently disappeared from the public eye—may be particularly vulnerable to charges of pocketing South Korean bribes. Reports of such dealings with South Korean security agency operatives swirled around Hwang Jang Yop following his defection to Seoul in 1997. And there are unconfirmed reports that in late 1997 suspicions of corruption reached as high as Kim Jong Il's brother-in-law Chang Song-taek—who has been widely seen as holding real power in support of Kim Jong Il's authority—through the Kim Il Sung Socialist Youth League.

Whether or not such scandals have inhibited Kim Jong Il's exercise of authority, the political transition from father to son has gradually moved forward but remains unconsolidated. Key positions are unfilled, including that of president. The prime minister continues to hold the title of "acting." And there have been no elections to appoint a new Supreme People's Assembly of the DPRK. The DPRK Constitution provides few clues to the current structure or balance of power. Some analysts have argued that the consolidation of political power under Kim Jong Il will not be complete until Kim Il Sung's contemporaries among the top leadership have all died, leaving Kim Jong Il as the senior leader, unchallenged by his peers.

Meanwhile, Kim Jong Il must respond to the economic and political changes in South Korea without allowing the foundations of his own leadership to erode. He may need improved relations with South Korea to gain critical economic support for his regime, but only under terms that underscore the sovereignty of the DPRK. Before Kim Dae Jung's election North Korea had already signaled its willingness in private discussions to take up the issue of divided families, and the resumption of official inter-Korean dialogue in Beijing marks a significant change on the part of Pyongyang, yet the severity of the dilemma facing the North Korean leadership in managing its relationship with Seoul means that any progress is likely to be slow and hard-won. South Korean flexibility may facilitate certain types of exchange, but it may also sharpen the debate over the fundamental trade-offs of economic dependence versus national sovereignty that will continue to challenge Pyongyang. North Korea may also attempt to use its apparent political vulnerability to its advantage in the international arena, playing off competitors for influence in North Korea against each other in order to gain additional resources, and even using its own potential instability to extract resources from neighbors such as China.

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*The fate of the Korean peninsula lies primarily in the hands of North and South Korean leaders themselves, and the current positive international environment limits the likelihood that any outside party might interfere with a gradual process of tension reduction. Nonetheless, neighboring countries may still influence any reconciliation process in important ways.*

***Regional Attitudes and Implications for Inter-Korean Dialogue:  
Prospects for Establishing a Korean Peace Process***

As regional relationships among the major powers have improved with the end of the Cold War, so has the environment for dialogue between the two Koreas. At the end of the nineteenth century, Yi Dynasty Korea was the battleground for several wars among major powers fighting for regional supremacy, but at the end of the twentieth century the interest of Korea's neighbors is in stability and maintenance of the status quo. In fact, the fear that instability or violence on the Korean peninsula might lead to a violent upheaval or Korean reunification has been a factor in favor of regional cooperation on Korean peninsular issues, including proposals for dialogue such as the Four Party Talks, the proposed Northeast Asia dialogue, and the Russian proposal for an international conference on Korea. Continued improvement in regional bilateral relationships, including good Sino-U.S. and Sino-Japanese relationships, enhance the environment for inter-Korean dialogue.

At the same time, no party is in a position to oppose the development of an inter-Korean dialogue that may lead to eventual reunification. The fate of the Korean peninsula lies primarily in the hands of North and South Korean leaders themselves, and the current positive international environment limits the likelihood that any outside party might interfere with a gradual process of tension reduction. Nonetheless, neighboring countries may still influence any reconciliation process in important ways.

The United States—with direct security interests represented by the presence of 37,000 troops on the Korean peninsula—must support a reconciliation process for it to be effective. As with other peace negotiations in the post-Cold War period—including the Dayton Agreement in Bosnia and the Middle East peace process—U.S. participation is essential. The major challenge for the United States is the need to maintain close security relations with the ROK while facilitating involvement by the DPRK in a balanced negotiating process. In addition, the U.S. role will be complicated by its involvement in aspects of the current security structure between the two Koreas, including the presence of U.S. forces on the Korean peninsula. Since such arrangements are governed by the U.S.-ROK Mutual Defense Treaty, U.S. deployments may be the subject of consultations with the ROK rather than part of any formal negotiation with the DPRK.

The primary U.S. roles in negotiating and implementing a settlement might include verification and compliance with implementation of military reduction measures or other inspections. The United States may play a leading role in providing guarantees and shaping a verification regime that gains the trust of both Koreas. The arrangements might include peacekeeping roles for third parties along the demilitarized zone (DMZ) and human and technical monitoring of compliance with arms control agreements.

Chinese involvement in the Four Party Talks recognizes China's involvement in the Korean War as a cosigner of the armistice treaty and its close relationship with the DPRK. It also underscores the fact that Chinese security interests are affected by negotiations between the two Koreas. China's role is likely to be a passive one aimed at ensuring that arrangements do not adversely affect its own interests, rather than an active facilitating role. Nonetheless, China's opinions and support matter—arrangements unacceptable to China are unlikely to be viable. China's primary role will most likely be to ratify and guarantee arrangements that are negotiated.

Japan's role is likely to be relatively passive; however, Japanese political and particularly financial cooperation may have a definitive influence on the non-security aspects of a peace implementation process. One example is Japan's active support of the KEDO effort to build light water reactors in the DPRK in exchange for the DPRK's compliance with international commitments to nuclear nonproliferation.

Russia has historical relationships with and residual influence on North Korea, although it no longer exerts the economic or military leverage it once did. However, some in Russia maintain close personal relationships with DPRK leaders, and Russia's seat on the UN Security Council, historical relations with the Korean peninsula, and developing economic relationships with the ROK give it some political clout that it can use to support or oppose Korean reunification.

Two primary dilemmas to a peace-building process must be overcome. First, although inter-Korean negotiations are the most efficient channel for paving the way toward implementation of a normalized relationship between Seoul and Pyongyang, the major pattern of such negotiations has been to pursue a zero-sum, no-compromise approach that almost inevitably leads to deadlock and breakdown without the involvement of a third party to mediate between the two sides. Yet nationalist attitudes in both Seoul and Pyongyang opposing foreign involvement in negotiations limits the possibility that third parties might mediate in peace negotiations, as they have in the Middle East negotiations, the Dayton Peace Accords in Bosnia, and the Northern Ireland peace agreement.

Second, despite the leading roles of the two Koreas in pursuing a process of tension-reduction and reconciliation, the effect of the Asian financial crisis and North Korea's own economic difficulties is that international financial and political assistance to support implementation of an inter-Korean peace process will be even more necessary than before. International roles in support of inter-Korean dialogue, exchange, and cooperation may include international monitoring to ensure implementation of inter-Korean agreements. International financial support will be necessary to cover certain costs associated with a Korean arms reduction process, including mutual troop and equipment reductions and repositioning, similar to the support provided under Nunn-Lugar for strategic arms reduction and financial incentives provided by the United States as part of the Irish peace accords. The process will also require dismantling of the current UN command structure designed to maintain the Korean armistice and its possible replacement with a UN peacekeeping structure designed to oversee implementation of and compliance with confidence-building measures.

One step toward resolving these dilemmas would be for North and South Korea to determine which of the outstanding issues might be most effectively addressed as part of an inter-Korean dialogue process and which require involvement by members of the international community. The Council on Foreign Relations Korea Task Force report delineates the various dialogue channels and their contribution as vehicles for consultation on Korean issues. The two Koreas must first agree on the relationship between the various channels of negotiation (for instance, inter-Korean dialogue versus Four Party Talks) and the sequence of issues to be dealt with; if they cannot agree on their own—even on issues that belong solely in an inter-Korean dialogue—a third party may have to step in and facilitate the negotiating process.

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*The most pressing challenge for the United States will be to ensure effective policy coordination with Seoul as the latter takes the lead in managing a more generous and inclusive policy toward North Korea without being perceived as either obstructionist or irrelevant.*

*It is in the U.S. interest to maintain its credibility by fulfilling financial obligations in support of the Agreed Framework by paying the bill for heavy fuel oil (including debt incurred for past deliveries) that the United States agreed to provide to the DPRK as part of that project. [Hoever] South Korean calls for an additional U.S. contribution to finance the light water reactor are politically unsustainable in Washington.*

### ***Consolidation of Korea's Parallel Economic and Political Transitions: Implications for U.S. Policy***

The parallel Korean political and economic transitions have created a new environment, requiring fresh examination of aspects of U.S. policy toward the Korean peninsula. Although the overall goals of the United States are maintaining stability and supporting a peaceful process of tension reduction and eventual reunification according to the will of the Korean people, the new situation may require tactical adjustments by the U.S. government. The emphasis should be on broadening policy coordination with South Korea while also working with Seoul to expand opportunities for cooperation and influence with counterparts in Pyongyang. The most pressing challenge for the United States will be to ensure effective policy coordination with Seoul as the latter takes the lead in managing a more generous and inclusive policy toward North Korea without being perceived as either obstructionist or irrelevant.

Specifically, U.S. and South Korean policy makers must coordinate the purposes and channels of dialogue with North Korea—including the relationship between inter-Korean dialogue and other channels. The key principle to be observed is parallelism: The United States should not get ahead of South Korea in relations with Pyongyang, nor should the United States fall behind the pace of improvement of relations between Seoul and Pyongyang. By agreeing to coordinate their policies, the United States and the ROK should be able to avoid the confusion and tensions that have arisen in the past over such issues as food assistance to North Korea or perceptions that either government is developing relations with Pyongyang at the expense of the other. In addition, managing the long-term future of a U.S. security relationship with a reunified Korea requires concrete advance planning.

During the South Korean financial crisis, the U.S. government has played a critical role, intervening to forestall its financial collapse and supporting the difficult reform process initiated under President Kim Dae Jung. This assistance is consistent with South Korea's strategic position and the long-standing security relationship between Seoul and Washington, which should remain unchanged for the foreseeable future. Management of the economic crisis will remain a priority for Kim Dae Jung for at least the next year, and the U.S. government may offer encouragement and support for his leadership. The American private sector and financial markets will be eager to support Kim Dae Jung's agenda for reform of questionable business practices by the chaebol, including the introduction of standardized accounting practices and elimination of cross-holdings between business groups. And President Kim may also use his visit to the United States in June to appeal directly to the international financial markets for support of his economic stabilization efforts, as well as to underscore the need for continued cooperation between labor and management in confronting the economic restructuring challenges that face South Korea.

Additional political and financial support for South Korea's efforts to pursue a dialogue with North Korea may be required from Washington as part of a broadened and well-coordinated approach to North Korea. South Korea's economic difficulties have reduced its capacity to finance peace-building with North Korea, including its ability to absorb the economic shocks that would accompany any sudden change in North Korea's economic or political status.

Despite Seoul's economic difficulties, Kim Dae Jung has stated his intention to honor South Korea's obligations to maintain strong political and financial support

for the Geneva Agreed Framework, negotiated between the United States and the DPRK in 1994. South Korea will finance the bulk of costs associated with construction of a light water reactor project in North Korea, which benefits South Korea by employing South Korean construction workers. It is in the U.S. interest to maintain its credibility by fulfilling financial obligations in support of the Agreed Framework by paying the bill for heavy fuel oil (including debt incurred for past deliveries) that the United States agreed to provide to the DPRK as part of that project. South Korean calls for an additional U.S. contribution to finance the light water reactor are politically unsustainable in Washington. However, Congress should be willing to consider near-term financial support for heavy fuel obligations under the Geneva Agreed Framework as well as for an inter-Korean tension reduction process on the model of the Nunn-Lugar initiative to support Russian nuclear draw-downs. The United States should be willing to invest in a Korean peace process since it would neutralize the North Korean threat, reducing the future costs of the U.S. military investment in the region (estimated at a minimum of \$3 billion/year).

Although Kim Dae Jung has provided impressive leadership in the midst of South Korea's financial crisis, the many constraints on his political flexibility noted above may increase as the crisis subsides, with the risk that a return to business as usual may be accompanied in Seoul by political paralysis. Solid international coordination and mutual support between Washington and Seoul is one means of expanding Kim Dae Jung's political maneuverability in managing policy toward North Korea. A mutually reinforcing policy approach by Seoul and Washington in dealing with North Korea may provide needed political flexibility to both presidents, particularly in dealing with their respective legislative bodies.

Comprehensive U.S.-ROK policy coordination might include expansion and reaffirmation of cooperation in dealing with North Korea, going beyond the joint Four Party Talks proposal made by Presidents Clinton and Kim Young Sam to endorse a shared vision of engagement with North Korea between President Clinton and Kim Dae Jung. American policies parallel to Kim Dae Jung's "Sunshine Policy" might include issuing of licenses for U.S.-ROK joint ventures in North Korea and other steps toward removing the economic sanctions imposed by Congress on North Korea.

The DPRK's economic difficulties have provided the United States and the ROK with apparent leverage to encourage a political dialogue process in both Four Party Talks and inter-Korean dialogue, but with little success. The dilemma of linking economic inducements to political dialogue is that unconditional assistance without reciprocal steps by the DPRK is politically unsustainable; on the other hand, the linkage has achieved few substantive results. Even in the context of a humanitarian response to North Korea's manifest food and agricultural needs, donations will eventually be limited by the onset of donor fatigue among the international community. Despite the fact that economic difficulties have driven Pyongyang's leadership to the negotiation table in an attempt to squeeze assistance from the international community, the North's economic distress and attempts to link economic assistance to political dialogue have on balance blocked rather than facilitated political negotiations.

However, the combined economic distress of North and South Korea may arguably contribute to potential future progress in reducing military tension by limiting procurement budgets and capacity on both sides of the DMZ. As the DPRK's military equipment continues to degrade as a result of failure to modernize, South Ko-

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*As the DPRK's military equipment continues to degrade as a result of failure to modernize, South Korea may be able to consider military downsizing measures for the sake of efficiency without becoming vulnerable to North Korea. In principle, such measures might be used to stimulate an inter-Korean arms control and arms reduction process.*

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Finally, the DPRK's political leadership must be consolidated before a Korean peace process can be established. To the extent that North Korea's leadership is unclear or in disarray, progress in pursuing a lasting peace will remain limited. Presidents Kim Dae Jung and Bill Clinton must be able to sit down with the highest political authorities in Pyongyang before it is possible to conceive of progress toward a fully normalized relationship with North Korea. A Korean peace process cannot move forward without the direct participation of the top leadership of both North and South Korea.

Fifty years after the establishment of separate states on the Korean peninsula, political and economic transitions in both North and South Korea have begun to soften the lines of division and to ease the legacy of hostility. This moment brings the most hopeful prospects for peace since the hardening of boundaries between North and South Korea following Korea's liberation from Japanese colonial rule. However, many obstacles remain to the achievement of a sustained process of relaxation and reconciliation that are the first steps to a lasting peace process. After a lengthy absence from the stage, all the players have returned to the negotiating table and have begun to rehearse their positions. Perhaps it will soon be possible to raise the curtain again on negotiations that may lead to real peace on the Korean peninsula.