

Moral Hazard Alert: U.S. Perspectives on Inter-Korean Relations

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The concept of moral hazard is hard to define, but relatively easy to recognize. Moral hazard is generally understood to be the risk that one party to a contract or agreement can change their behavior to the detriment of the other party once the contract has been concluded, or of greater concern, that the conclusion of the contract or action itself will lead to such a change in behavior. Examples of moral hazard can be found in fire insurance giving people an incentive to commit arson or encouraging sloppy fire prevention, the risk that a social safety net might discourage personal responsibility, or the possibility that subsidies may discourage needed reforms.

While primarily applied to economics and law, moral hazard can also apply to foreign policy. Inter-Korean relations are certainly not the only, or even the most appropriate, test for examples of moral hazard. However, over seven years after President Kim Dae Jung's inaugural speech in which he boldly proclaimed a policy of peaceful co-existence with North Korea and launched a policy of engagement, it is a fair time to assess Inter-Korean relations and in particular North Korea's response to South Korean initiatives.

To attempt such an assessment as an American is to admit that a truly balanced or unbiased approach to the questions is impossible. Inter-Korean relations cannot be viewed in a vacuum as they are integral to the U.S.-Korean relationship. After all, it was in the fires of the Korean War that U.S.-ROK alliance was forged and for the better part of the past five decades it was the common North Korean threat that further cemented the relationship. U.S. views and this assessment of the various aspects of

inter-Korean relations are seen through the prism of the U.S.-ROK alliance and U.S. concerns about North Korea.

Economics: Market Mechanisms Need Not Apply

When even prior to the elections of 1997 then candidate Kim Dae Jung began espousing his "Sunshine Policy" toward North Korea, his views were very much welcome in Washington D.C. The United States had already embarked on an engagement policy of its own toward North Korea and was in many respects being held back by opposition from a deeply suspicious Kim Young Sam Administration in Korea and its allies in the U.S. Congress. While there were significant changes in inter-Korean economic relations during the Kim Young Sam era, economic ties were fragile and closely linked to political and security developments. Provocative North Korean statements or actions routinely led to the suspension of economic activities. Kim Dae Jung's promise to separate politics from economics seemed to offer a genuine hope of progress in engaging North Korea economically and encouraging what at the time appeared to be a nascent move toward a greater degree of reform and opening in North Korea.

The South Korean "Sunshine Policy" of engaging the North however, quickly changed from the transforming rays envisioned in Aesop's fable of the North Wind and the Sun, to a policy driven much more by domestic developments in South Korea. These changes were not necessarily bad or unwarranted, but should be clearly understood.

Following the Asian financial crisis in 1997, South Korea's first priority was of a necessity reducing tensions on the peninsula and coaxing back the foreign capital that had fled Korea. The growing tensions on the Peninsula in the early days of the Kim Dae Jung Administration, which culminated with the test firing of a North Korean long range missile in August of 1998, not only nearly led to the collapse of the 1994 Geneva Agreed Framework, but were also a direct threat to South Korean domestic economic stability and its attempts to attract more foreign direct investment. In this respect, the first fruits of the historic June 2000 meeting between Kim Dae Jung and Kim Jong Il in Pyongyang were not changes in North Korea, but in international assessment of the risk faced by the South Korean economy. Viewed in the context of returning stability to Korean financial markets, the bribes

to North Korea that have tainted President Kim Dae Jung's Nobel Peace Prize, were probably well worth it. However, such results likely came at the expense of sacrificing the original intent and efficacy of the sunshine policy.

Rather than heap too much blame on Kim Dae Jung, who will likely be remembered as a rare visionary politician in Asia, it is also important to recognize the role of domestic opposition in the transformation of South Korea's engagement policy. President Kim Dae Jung continually faced pressure to "sell" his policy at home and to demonstrate that it was working. The traveler in Aesop's fable did not need to recognize or accept the role of the sun; he was merely subjected to its warming rays. Likewise, the original concept of the Sunshine policy was not one that required North Korean acceptance or even acquiescence. They merely had to be subjected to the long-term effects of increased contact, trade, investment, tourism, etc. Just two years into his administration, however, President Kim Dae Jung, perhaps driven by personal ambitions and concern for his legacy, but also by domestic pressures, attempted to garner short term results from what was essentially a long-term policy. For this he needed some form of North Korean acceptance of or at least acquiescence to his policy. Not only did this requirement lead to the curtailment of criticism of the North out of the Blue House in deference to North Korean sensitivities, but it placed South Korea in the sometimes awkward position of being North Korea's advocate and agent. For example, following the June 2000 meeting in Pyongyang, President Kim apparently felt obliged to speak on behalf of Kim Jong Il to say that North Korea was not opposed to the presence of U.S. troops on the peninsula, only to be later contradicted by Kim Jong Il himself.

This drive for short-term results most clearly manifested itself in the economic arena. In principle, the most effective agent of change in North Korea should have been market mechanisms. In other words, private enterprises saying to Pyongyang "I would invest in North Korea, but...." would have had just as much influence on North Korean behavior as those who actually invested. The determining factor would of course be the profitability of any action. In practice, however, the pendulum swung too far, from the close linkage of politics and economics under Kim Young Sam to a point where politics and economics were tied together in a very different and much more proactive way under Kim Dae Jung and today. The degree to which the South Korean government has been involved in and supportive of inter-Korean economic activity means that this is one case where moral hazard has come into play. Strong South Korean government support for select inter-Korean interactions effectively removed

market principles from the equation. Not only were many official exchanges essentially "bought and paid for," but indirect support for certain enterprises has also meant that those operating on a strictly for profit basis could not compete, and more importantly, North Korea had no incentive to make adjustments to its own system.

However understandable the South Korean government's actions may have been from the point of view of the objective of reducing tensions on the peninsula, the case can also be made that the Sunshine Policy significantly slowed the nascent North Korean reforms of the early and mid 1990s. Put simply, why would North Korea continue to invest time and resources in free trade zones such as Najin-Sonbong, when they produced so little in comparison to the revenue coming in from South Korea and particularly when revenue from South Korea came with so few demands or strings attached? In engaging North Korea, it would ideally be market principles and contacts of ever increasing scope and depth that play the role of the Aesopian sun and affect change. Yet with unmonitored resource transfers and transactions motivated more by politics than by profits, South Korea's engagement policy as implemented has often taken more the form of sun-shade or parasol than sun shine.

A careful examination of most inter-Korean ventures to date will likely reveal that in most cases not only were market incentives distorted, but that the South Korean side also accepted restrictions and conditions that would have been unacceptable in any other context. It is against this acquiescence that other interlocutors are ultimately judged and by which North Korea learns all the wrong lessons. Equally importantly the capitals flows from South to North during this period, while small by any international standard, are almost certainly significant in a North Korean context and may have enabled the regime in Pyongyang to put of the stark choices they might have otherwise faced.

This is not to say that South Korean engagement of North Korea has been without affect. Clearly North Korea is more economically dependent on the South than ever before. While South Korean willingness to wield such influence has recently come into question, Seoul has likely gained some leverage in the process. Furthermore, there does indeed appear to be signs of real change afoot in North Korea and such change should not be underestimated. Still there is likely far less going on in North Korea than meets the eye. A careful examination of all inter-Korean interaction to date would likely find few profit making enterprises and reveal that South Korean parties have done the lion's

share of the compromising. In the final analysis, despite such drawbacks the broader political, economic, and security gains for South Korea obtained from the Sunshine Policy may be deemed worthwhile. However, in the inter-Korean context, the impact of the policy on the much needed process of reform and opening of North Korea's economy should be honestly assessed.

Security: What a difference a decade makes.

In 1994, the average South Korean was deeply skeptical of U.S. engagement of North Korea. Many South Korean opinion leaders sharply criticized the fact that South Korea was cut out of the negotiations leading up to the October 1994 Geneva Agreed Framework and South Korean government diplomatic initiatives of the time (two plus two, the four party talks, etc.) were designed to ensure South Korea had a seat at the table. Many in the South Korean media and other opinion leaders worried openly about the U.S. throwing away its old wife (South Korea) and courting a new bride (North Korea.) The U.S. was frequently warned about North Korean intentions and told that North Korea could not be trusted. South Korean academics and government experts asserted that the U.S. was naïve and, lacking the experience the South had in negotiations with the North, would be taken advantage of by North Korean negotiators at South Korea's expense. South Korean officials were particularly sensitive to any bilateral contacts between with U.S. and South Korea.

In relation to its views a decade earlier, the South Korean position today is almost unrecognizable. The primary objective of South Korean diplomacy now seems to be to convince the United States to take North Korean at face value and to engage in bilateral talks, as Pyongyang has demanded. One might correctly observe that the greatest transformative effect of the Sunshine Policy was wrought not in the North, but below the thirty-eighth parallel. Of course this change was not brought about by the Sunshine Policy alone. It is also a natural result of South Korea's own economic and diplomatic success, its increasing national confidence, and the South Korean public's declining threat perception of North Korea. In some respects this change has been very positive, the South Korean body politic has left behind the zero-sum mentality that governed South-North relations for decades and with that change, South Korea has a much broader range of policy options for dealing with its Northern kin, including engagement. One cause for concern, however, is that that the changes in South Korean perceptions of the North Korean threat may not reflect actual changes on the ground in North Korea.

To be sure, for decades the regime in North Korea served as a bogeyman and as a justification for all types of repression and control in South. Following the Korean War, public views of North Korea were so heavily propagandized and North Korea so demonized that a zero-sum view of North Korea was to be expected. However, as South Korean society democratized and particularly as the press became increasingly free, the South Korean public began to regard with deep suspicion all the propaganda that it had been fed under previous military and non-democratic governments. This included views of North Korea that, while likely exaggerated, were not altogether baseless. In dismissing past views of the North Korea threat, many South Koreans have in effect thrown out the proverbial baby with the bath water.

Corresponding with the increasing suspicion about past government claims of the North Korean threat, came a perhaps unintended consequence of the South Korean government's decision to engage North Korea. The need to demonstrate some progress in inter-Korean relations has led the South Korean government, particularly the Blue House and the Ministry of Unification to be extremely sensitive of North Korean perceptions. The South Korean government has effectually made a decision to strongly emphasize the positive in North Korea and inter-Korean relations and to all but ignore or at least downplay the negative. Combined with public suspicion of past propaganda against North Korea and South Korea's own justified confidence following its economic and diplomatic success this has led to a dramatic decline in South Korean threat perception of the North. Compared to the eerily quiet streets of Seoul during civil defense drills of the 1980s when the North Korean threat felt very real and very close, walking the Streets of Seoul today one feels almost no sense of the proximity or potential danger posed by North Korea. It is almost as if North Korea has gone from being a "clear and present danger" to a poor cousin in need of help, who lives somewhere far away, in Africa perhaps.

As with economic issues, this is a case where the pendulum may have swung too far. The North Korean threat was doubtless over-exaggerated in years past, but is likely far underestimated today. Of course, South Koreans have lived under this same threat for over 50 years and cannot be expected to walk around like Chicken Little every day thinking the sky is falling. For decades, South Koreans have incorporated the North Korean threat into their daily lives. Now, however, from an outsider's perspective they seem dangerously close to ignoring rather than incorporating that threat. This is particularly true of the younger generations who seem to broadly discount any possible ill intent on

North Korea's part and any real risk of North Korean aggression targeting the South. After all, are not the two Koreas blood brothers? Surely any North Korean aggression would target Japan or the U.S. and not their Southern relatives who have been providing them so much aid as of late.

The dramatic transformation in average South Korean views of North Korea seems particularly stark when juxtaposed against the change in American and Japanese views over a similar time period. The 1998 missile test and the seemingly never ending saga of a number of Japanese citizens abducted by the North have resulted in an unprecedented amount of hostility toward the North in Japan. Similarly in a post 911 era, the American tolerance for risk and ambiguity, particularly when it comes to states in possession or pursuit of weapons of mass destruction, is markedly lower. When President Bush declared North Korea a member of an “Axis of Evil” in his January 2002 State of the Union Address, most Koreans felt that his remarks were inaccurate if not inappropriate or even offensive. Outside the foreign policy elite, however, few American’s had trouble with the President’s characterization and fewer still would disagree with North Korea’s inclusion in that ignominious group. While it may have been a self fulfilling prophecy, from an American perspective, North Korea’s actions since that speech have gone a long way towards justifying the appropriateness of North Korea’s designation.

While even South Korean military views seem to be changing in recent months with the ongoing debate about the designation of North Korea as a principal enemy, throughout the past few years there has been very little daylight between the views of the South Korean military and the U.S. military regarding the North Korean threat. The difference has been in the public articulation. When U.S. officials or U.S. military leaders voice concern about the North Korean military threat and the dangers to Seoul they are not making up anything new. However, when such views are not backed up by the South Korean government, particularly at the highest levels by the Blue House, which has been more concerned with keeping channels open with North Korea, it is easy to see how the U.S. has been cast in South Korean public perception as the aggressor. Coupled with concerns shared globally about the U.S. doctrine of preemption, President Bush's “Axis of Evil” comment, and the Iraq War, it is understandable why many South Koreans now perceive the United States, or more specifically U.S. actions, as a potential threat to South Korean security.

From this, however, has emerged the common misconception that most likely scenario for conflict on the Korean peninsula is a U.S. preemptive strike on North Korea. A senior South Korean policymaker

compared the situation on the peninsula today to a crisis in which a terrorist (North Korea) holds a young woman (Seoul) hostage and holds a gun to her head. He also holds in his hand a trigger device with which he can blow up the whole building (all of Korea). Given the risk, the policymaker asserted that rather than charge in with a S.W.A.T. team (presumably the U.S. approach) it was far preferable to use every device possible (inducements, family, friends, and relatives) to coax the terrorist down from his position. While sensible from the vantage point of Seoul which would certainly have the most to lose in the case of any conflagration on the Peninsula, the analogy is based on a disturbing underlying assumption; that the real short-term threat is posed by the maverick S.W.A.T. team (the United States.) Perhaps this might explain why when visiting Washington D.C. delegation after delegation of South Korean officials, legislators, and academics feel obliged to repeat the internally contradictory mantra that South Korea will not tolerate a nuclear North Korea, but that pressure is not an option and war is not an option. It also explains why the South Korean government feels the compunction to, in effect, act as North Korea's lawyer, explaining its actions, downplaying its indiscretions, and seeking to blunt the consequences of North Korean actions.

The tragic irony is that the harder South Korea tries to reduce the risk of a conflict by advocating on North Korea's behalf and blocking any sign of what they perceive to be potential aggression on the part of the United States, the more likely it becomes that North Korea may miscalculate. This is perhaps the most serious instance of moral hazard in inter-Korean relations today. If North Korea is convinced that South Korea truly has taken force off the table, that war is not an option in any circumstance, and that even the President of South Korea thinks that the North's pursuit of nuclear weapons is understandable, it is not illogical to assume that there is an increased risk that North Korea might actually test a nuclear weapon, fire another long range missile, take action against U.S. surveillance aircraft or any number of other potential provocative actions.

Perhaps most perplexing to U.S. observers is the way in which South Korea seems to be in denial about the severity of the current crisis surrounding North Korea's nuclear program. North Korean actions or statements regarding their nuclear ambitions are downplayed, parsed, and generally dismissed in Seoul. It is possible to be a fervent supporter of the Sunshine Policy and the process of engagement and to still understand that such a policy requires a firm security Foundation. In the context of Korea, that foundation was the 1994 Geneva Agreed Framework, a foundation that is now all but gone. As in the case of China, had Nixon not gone to Beijing and had there not been some

level of rapprochement between the U.S. and China, the later economic reforms under Deng Xiao Ping would have been impossible. The current South Korean engagement policy toward the North would not have been possible absent the relative stability created by the Geneva Agreed Framework. Yet as that agreement has unraveled and as the nuclear issue has descended to depths far worse than those faced in 1994, South Korea has apparently chosen to proceed as if there had been no change, as if the structure of its policy remained sound.

The new South Korean Ambassador to Washington was recently quoted as saying that any good horse trainer knew that lump sugar is far more effective in training a horse than the whip. While this comment was made in the context of the assumption of a North Korea commitment to de-nuclearization, it again highlighted the vastly differing perceptions of North Korea in Washington and Seoul. The Washington retort would have been simply, North Korea is not a horse. In fact, there are few in Washington, and certainly none in the Bush Administration that think that current crisis can be solved by inducements, or lump sugar, alone. Most reasonable and well intentioned proscriptions for resolving the current crisis begin with the presumption that there will have to be the some combination of pressure and inducements if North Korea is ever to be convinced to abandon its nuclear ambitions. While South Korea is likely correct in its concern that force or pressure alone would back North Korea into a corner and provoke a conflagration, it clearly diverges from the U.S. in its recommendations that force be taken off the table. In fact, not only do most specialists in the U.S. and certainly the Bush Administration, feel that taking force of the table would reduced the incentive to and the likelihood that North Korea will ever make the extraordinarily difficult decisions with which it is faced. In fact, pressure is at the very root of the current U.S. approach to the current crisis. The Six Party Talks were envisioned as a tool for applying maximum multilateral pressure on the North, whether they will succeed, however, now seems to largely depend on South Korea and of course China.

Human Rights and Humanitarian Aid: My brothers keeper

While human rights have long been a concern in both inter-Korean and U.S.-North Korean relations, it is safe to say that they have only recently become an issue. For the better part of four decades our only policy toward the North was that of deterrence. We of course assumed the worst about the situation in North Korea, but had little or no contact with or leverage over the North with which to

address our concerns. One perhaps unintended consequence of a policy of engagement has been that such issues are now very much in play. Given our ongoing and very real security concerns in dealing with North Korea, the question of how to most effectively incorporate the issue of human rights into our security and diplomatic dialogue without jeopardizing the process itself is very complicated. The South Korean government has been quite clear in its reservations about giving human rights a more prominent role, primarily out of a fear that pushing the issue would jeopardize the South Korean engagement policy and increase the risk of conflict on the Peninsula. However, despite the concerns of policy makers in Seoul, the issue of North Korean human rights now appears to have its own dynamic and is likely to be increasingly prominent in U.S. perceptions of inter-Korean relations.

As was the case with security issues, it is the dramatic change in South Korean perceptions that is likely to raise eyebrows in Washington. For the bulk of the last fifty years, the U.S. too was a recipient of South Korean propaganda about the horrors of the North Korean regime, not that we needed much convincing. It is, therefore, very puzzling to see the increasingly democratic political leadership of South Korea attempt to play down this issue. While one should not dismiss outright the South Korean argument that there are larger issues at stake and that a direct confrontation on human rights issues is not the most effective way to aid the Korean people, that is precisely that type of logic that the current leadership in South Korea decried during the years of South Korea's military dictatorships when they were anti-government democracy and human rights activists and it was the U.S. that was prevaricating.

While the Korean governments' inaction, abstention, and even opposition to pushing the issue of North Korean human rights at the United Nations garnered some attention, it was reaction of some in South Korea to the passage and signing of the North Korean Human Rights Act last fall that surprised many in Washington. The U.S. Congress passed the bill unanimously, no small feat in an election year. Yet that did not stop a group of ruling party legislators in South Korea, many of them former democracy activists, from writing a letter criticizing the act. South Koreans opponents of the act seem to give full credence to North Korean warnings that any discussion of human rights is a clear indication of hostile intent and tantamount to seeking regime change. South Korea, in its effort to avoid upsetting North Korea has at least appeared to be over eager to oblige North Korea, and has even placed itself in opposition to those seeking to facilitate defections from North Korea. The perception in Washington is that the South Korean government is being hyper-sensitive, in effect trying to be "more catholic than the pope." The challenge will be to be to de-sensitize this issue, to

deny North Korea the assertion of exceptionalism, and to apply international standards in at a minimum ensuring that human rights become a part of the inter-Korean dialogue. After all, the Europeans have been able to maintain a focus on human rights and still keep open their dialogue. Earlier this Spring U.S. Congressman Tom Lantos was welcomed to Pyongyang despite his support for the North Korea Human Rights Act. It is not then unreasonable that North Korea be expected to address the issue, both with the U.S. and with South Korea. Nor is it unreasonable to expect a country that still claims constitutional stewardship over North Korean citizens to advance this issue more vigorously.

The area of humanitarian aid is another that warrants a retroactive examination of South Korean policy in light of concerns about moral hazard. Since 1995 South Korean donations of grain, fertilizer, cattle, etc. have tended to be done on a bilateral basis. While such donations may have accomplished their immediate diplomatic or humanitarian objectives, given the scope and scale of South Korean assistance, such aid should also be assessed on its possible impact on the broader environment in which international aid organization and non-governmental organizations operate. This becomes particularly important as there is evidence of donor-fatigue, fueled in part by the difficulty in working in North Korea. While direct causal links are unlikely to be found, South Korean humanitarian assistance can reasonably be expected to have dampened North Korea's willingness to accept the intrusive standards of monitoring and transparency demanded by other national and international donors. Again, why go through all the hassles of dealing with numerous pesky NGOs, if you can get the same resources from South Korea without any strings attached. The call here is not for a cessation of aid, but rather for greater transparency, greater coordination with other donors, and greater adherence to international standards on international assistance.

Conclusion

Since this paper is written from a U.S. perspective, it likely does not give ample credit to what observers in Seoul would view as the successes of the South Korean approach. After all, not only has war on peninsula been avoided, but inter-Korean relations have also seen a summit meeting, joint Olympic appearances, an unprecedented number of people-to-people exchanges, and economic initiatives which have continued despite numerous challenges. American skepticism about the process

of inter-Korean reconciliation stems in part from an escalating crisis in areas of most immediate concern to U.S. interest. U.S. concerns are also likely driven by concerns about the implications for the alliance of inter-Korean relations.

While we may differ on some aspects of our approach to North Korea, both Seoul and Washington should recognize that the future of the U.S.-ROK alliance very much depends on the inter-Korean relationship and the U.S. role in its development, either positive or negative. If the inter-Korean relationship develops without addressing the issues of concern to the United States, such development will inevitably undermine U.S.-ROK relations. Of greater concern still is the possibility that the development of inter-Korean ties might actually impede the resolution of issues, such as the nuclear issue, of concern to the United States. Likewise, if the U.S. is perceived as being an impediment to inter-Korean reconciliation, or somehow putting the South Korean populace at risk to advance its own regional and global objectives, that also does not bode well for long-term U.S. ROK ties. While the U.S. ROK alliance was born of the Korean War, that war itself stemmed from larger regional and global trends. Both the South Korea and Washington would be wise to maintain a broader regional perspective. However the inter-Korean situation works out, Korea will remain in Northeast Asia and with the rise of what could very well be increasingly nationalistic powers in China and Japan, Korea would be well advised to take a longer-term view of its interests and relations in the region.

In the end, there are no easy answers when dealing with a regime like North Korea. Certainly, the United States has yet to stumble upon a magic solution. Some would argue that the fundamental problem is indeed neither Washington nor Seoul, but the very nature of the North Korean regime. Still even agreement in principle that However, at a minimum, South Koreans should carefully examine not just the intent and the efficacy of their policies toward North Korea, but also the possible unintended and to date ignored implications of their actions. Perhaps the most immediate change South Korea needs to make is merely one of articulation. In rightfully pushing for the U.S. to take South Korean interests into full account, South Korea should specifically couch its concerns in the context of its own national interests, not out of some need to protect North Korea's feelings or to understand North Korea, such appeals will likely fall on deaf ears.

Ultimately the solution to the large and growing divide between the U.S. and South Korea on how to deal with North Korea will not be one sided. The United States must understand that Seoul bears risk

and must more fully take into account South Korean interests and fears. That said, it is folly to think that U.S. interests in Korea deviate very far from those of South Korea. South Korea is one of the United States largest trade partners, there are thousands of Americans living in Korea, and U.S. firms have invested billions of dollars in the Korean economy, to say nothing of Korea's location in the center of one of the most economic vibrant regions in the world. To suggest that the U.S. would lightly risk a war in Korea is ludicrous. While the U.S. shares in nearly every respect South Korea's interest in maintaining the stability, safety and success of the Peninsula and the region, there is clearly growing mistrust between Seoul and Washington. This is partially explained by the dramatic turnover in South Korean leadership and the urgent need to re-establish personal ties and trust throughout all levels of the relationship.

If its policy toward North Korea is any indication, the current South Korean government seems to think that it understands both Washington and Pyongyang, but from an admittedly hubris laden Washington perspective, it may be wrong on both accounts. South Korea would be well to carefully assess U.S. interests and to re-assess North Korean intentions. Too often Koreans seem to find self-justification and perhaps overconfidence in the fact that they speak the same language and to assume that they somehow understand North Korea better than anyone else. South Korea should at least leave itself open to the possibility that North and South are, in a description once used to highlight the U.S.-British divide, "two countries divided by a common language."