POLITICAL ECONOMY OF KOREAN GOVERNMENT POLICIES ON REAL ESTATE

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I. INTRODUCTION

Economists evaluate policies using the criteria of efficiency and equity. In reality, however, policy decisions are made through a political process in which various groups seek to promote their own interests and political compromises are made on a regular basis. Of particular importance in this process is the political calculus of the government bodies that are responsible for policy and have to defend it from possible criticisms by the media and various stakeholders. In this situation, policy makers might prefer solutions that are more palatable to the constituents and the media to those recommendable on efficiency and equity ground. This paper seeks to demonstrate that such risk-averting attitude of government officials has been responsible for the piecemeal approach to real estate policy reform using a few concrete examples.

During the past three and a half decades, Korea has achieved rapid economic growth and urbanization. Per capita GNP rose from $ 69 to $10,000 between 1960 and 1995 in nominal terms, while the share of population living in urban areas with 20,000 inhabitants or more increased from 39.2 % to 85.5 %. Rapid growth of income and urban population resulted in a strong demand for urban land and housing. On the other hand, the supply of developable land and housing did not keep pace with demand due to rigid regulatory system governing land-use conversion. Naturally, prices of urban housing and land rose much faster than other prices (Kim, K 1993). But many Koreans, from government officials to the media and some scholars, believe that high and rapidly rising real estate prices are attributable to speculators. Therefore, government has committed itself to fighting speculation in the hope of making housing more affordable to the average household and business firm. Only recently, did government begin to acknowledge the various supply-side regulations as a major cause of housing and urban land shortages, and the need for relaxing some regulations to stabilize their prices.

Nevertheless, government officials are still reluctant to introduce a fundamental reform. A major reason is that they have been a captive of the unfounded claim that deregulation will invite speculation and hence lead to higher real estate prices. Whatever the reason, the lukewarm and piecemeal approach to real estate policy reform is undesirable in several ways. Obviously, it slows down the pace of reform and makes it difficult to fully realize expected social gains from reform. More importantly, a lukewarm approach may jeopardize the political support to further deregulation by giving a false impression that deregulation causes prices to increase. While massive increase in supply resulting from large-scale deregulation can bring about a noticeable decrease in land and housing prices, the most direct and discernible impact of a small-scale deregulation will be an increase in the prices of those plots that are directly affected by deregulation. On the other hand, it would be much less straightforward to understand the fact that prices of other plots rise more slowly than otherwise or even fall, and that the consequent decline in overall price of land could be significant.

In this paper, we try to explain why those real estate policies that are unjustifiable on efficiency and equity grounds have been maintained in Korea. We do this by analyzing a few examples such as the price control on new apartments, regulation on land-use conversion, green belts, and spatial deconcentration policies[1]. We first describe each case and demonstrate why it is inefficient and inequitable. We then show that status quo represents the choice by risk-averse policy-makers faced with the powerful media, a champion of the unfounded belief that overall housing and land prices will rise following deregulation. We also demonstrate that the conventional theory of interest group politics is incapable of explaining the policy inertia described in this paper.

II. Price Control and Supplementary Regulations on New Apartments

[1] Although we describe how these policies were first introduced, our major concern is with explaining how they fail to change for the better.

The Korean government has long been trying to address the housing problem by increasing the supply of new dwellings at "affordable" prices to "non-speculators". In so doing, it relied heavily on direct intervention through various regulations in housing and land markets, of which the price control on new apartments was the key ingredient. As we will elaborate later, the price control and the various regulations that accompanied it made housing supply very inelastic as well as stimulating demand[2]. The main beneficiaries of these regulations have been the middle-income class, consistent with "Director's law"[3].

The price control applies to any new dwelling supplied in twenty units or more. It was first introduced in 1977 in the form of a uniform price ceiling on new housing regardless of size, but the ceiling was differentiated according to the size of dwelling in 1985. The ceiling was made indexed to the cost of production in 1989 to stimulate housing supply. Although the price control applies to all types of housing, it affects only apartments in practice. In the case of single-family dwelling and row houses, the developer suffers only a moderate profit loss if he opts for a project comprising less than twenty units in order to avoid the price control. On the other hand, the profit of a developer of apartments declines substantially if the volume of production is reduced below twenty units. Since the vast majority of new housing supply consists of apartments, the price control has far-reaching implications[4].

Typically, a price ceiling discourages the supply of the good it is imposed upon. However, this is not the case with the price control on new apartments in Korea (Kim, K. 1997b, Kim and Kim 1999). The fundamental reason is that the supply of housing is conditioned by the availability of developable land, which in turn is controlled by government. The Ministry of Construction and Transport (MOCT) estimates the amount of land needed for residential, commercial, industrial development as well as infrastructure projects and then ensures that the 'necessary' amount of land be rezoned and developed. The Ministry also approves land use conversion, and issue permits exclusively to public sector agencies to prevent private developers from collecting a large windfall gain. Consequently, large-scale land development projects are virtually monopolized by the public sector comprising the Korea Land Corporation (KLC), the Korea National Housing Corporation (KNHC) and local governments (Hannah, Kim and Mills 1993). They purchase sizable tracts of raw land at appraisal prices, service them with infrastructures and have them rezoned as residential and commercial sites, and then sell out the developable land to homebuilders. Under this system, houses get built in response to increased demand as long as government increases the supply of developable land. In fact, the volume of housing production increased substantially since 1988 due to a five-year drive to build two million dwelling units[5]. The price of developable land is set and the construction cost is assessed so as to ensure that the

[2] This point is highlighted in Green et al (1993) and Kim (1993). Angel and Mayo (1996) also demonstrate this in an international context.

[3] Director's Law says that redistributive politics favors middle classes at the expense of both rich and poor. See Stigler (1970)

[4] Apartments accounted for 63.6 % of total new dwellings produced during the 1977-1996 period. The share of apartments was 80.2 % over the 1992-96 period.

[5] The two-million dwelling construction program , the first attempt to rely on market forces to solve the

price of new housing affordable to the target group and profitable to the developers at the same time.

The price control does have a detrimental impact on the quality of housing supplied. The revenue from a residential development project consists of proceedings of apartments and commercial premises sold through the project. The revenue from each source equals the quantity of floor space times the unit price. Since the controlled price is determined regardless of the quality of the floor space supplied, a profit-maximizing developer has an incentive to maximize the total floor space of apartments and especially commercial premises, which are auctioned off through competitive bidding. The first purchaser of a new apartment has the same incentive because the total windfall gain from purchasing an apartment at the controlled price is proportional to its size. As a result, the developer tries to fulfil only the minimum safety and other quality standards set by government such as the provision of open space. In fact, many buyers of new apartments spend large sums of money to upgrade the finishing materials and to remodel the interior after the house is completed. Also, higher quality dwellings are supplied in urban areas where the price control is not enforced.

A major efficiency consequence of the price control and its supplementary regulations is the distortion of the size distribution of new apartments supplied in favor of larger units. As was mentioned above, consumers prefer larger units as long as they are eligible to buy the units and are capable of mobilizing the funds. It is also in the developer's best interest to maximize the share of large units in a project. This is because the controlled price on the large units (exceeding 85 square meters of net floor space) is higher than that on the smaller units while the cost of production per square foot of an apartment decreases with its size. The chance of not being able to sell an apartment also declines with size. In fact, most apartments that remain unsold for a long time are small ones. Considering this, government has regulated the size distribution of apartments in order to ensure that smaller units are supplied in larger numbers so that a large segment of population can benefit from the price control. Until 1998, government mandated land development projects to allocate at least 70 % of developed residential sites to dwellings smaller than 85 square meters in net floor space, and 30 % to those smaller than 60 square meters. Also the eligibility for purchasing apartments was granted in three different size categories i.e., 85 square meters and smaller, between 85 and 102 square meters, between 102 and 135 square meters, 135 meters and above.

As a result, the supply of new housing has been concentrated in a few size groups rather than spread in a continuum. This can be seen from Figure 1 that illustrates the size distribution of new apartments supplied during the 1993-96 period. The figure shows that that 41 % were clustered between 59 and 61 square meters in net floor space, 33 % between 83 and 85 square meters, and 5 % between 133 and 135 square meters. On the other hand, two other size categories accounted for 2 % each, eight other size categories had 1 % each, while no units were found in other categories in

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problem of housing shortages and the consequent high price of housing, was made possible because existing land use regulations were overridden. Thanks to the increase in new housing supply, real housing prices dropped and the house price-to-income ratio in Seoul fell substantially from 9.2 to 5.6. However, the total floor space of housing supplied might have been larger had it not been for the price control and the accompanying regulation on the size distribution of apartments. See Kim and Kim (1999).

more than 1 % of the total supply. Most interestingly, the number of dwelling units within the range of 62 to 82 square meters or 85 to 133 square meters is negligible[6]. In short, the price control and the supplementary regulations led to a skewed and concentrated size distribution of new apartments around the maximum floor space in each size category. This certainly limits the scope of consumers' choice. In the absence of these regulations, the size distribution of new housing would more or less resemble the distribution of household income and wealth (Kim, C. 1997).

But the most important consequence of the price control lies in its equity implication. The main beneficiaries of the price control have been the middle households for several reasons. First of all, the difference between the market price and the controlled price of an apartment increases with its size. But a larger sum of money must be mobilized first to be able to reap the profit from purchasing a larger apartment later, and the amount of deposit is required to be eligible to bid for a larger unit. In the past, the rights to purchase apartments were transferable, so that some moderate-income households were able to cash in a part of the premium by selling off their privileges. However, this practice was made illegal because it was considered an act of speculation. Thus, the system ended up favoring the relatively well-to-do[7].

Finally, there is a financing constraint. One peculiar aspect of the Korean housing supply system is that all the apartments are sold well before they are completed. Homebuilders are allowed to market their supplies as early as when 10 or 20 per cent of the project is advanced. A person who has been selected to purchase such a dwelling must pay 20 per cent of the purchase price at the signing of the purchase agreement and pay 60 per cent of the proceeds in installments over the next two years or so while the apartment is built. The remaining 20 per cent is payable when the completed dwelling is occupied. But mortgage financing is highly limited and most moderate-income households have their equity tied up in the key money deposited with the landlord of the rental unit they occupy. The current 'advance sale' system generates a cash-flow problem that works at the disadvantage of low-income groups, and hence it is inequitable (Kim, K. 1993). Moreover, there is hardly any justification for distributing a windfall gain worth a few years' salary income through a random lottery process.

One may wonder how such an inefficient and inequitable system had been upheld for so long. Several explanations can be offered. First of all, the system generated its own demand because lots of people were waiting for their turn to buy an apartment at discounted prices. Therefore, discontinuing the system was considered politically dangerous. Although it can be argued that the system was inequitable because it favored the middle and high-income groups more than lower income households, the same fact provided a good excuse for maintaining the system because it helped build political constituency[8].

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[6] One may notice that the percentage shares indicated on the graph do not add up to 100. This is because the tails on both sides of the graph were cut off.

[7] The first purchaser of an apartment was required to stay for at least three years to qualify for an exemption of the capital gains tax on his primary residence. But there was no resale price control.

[8] The same logic explains why interest rate subsidies are preferred to targeted lump sum subsidies by so many governments world over (Kim, K. 1997a).

But the most important reason for the continuation of the price control has been the unfounded fear that its removal will jack up the prices of existing houses. It was argued that many households waiting in line to purchase new apartments at controlled prices will opt to purchase from the existing housing stock if the price control were lifted, increasing the demand for the existing units and hence their prices. But it is highly unlikely that a person in the queue wanting to buy a house at a subsidized price can afford to buy an existing house of the same size at the market price. Therefore, the increase in the demand for the existing dwelling units following deregulation will not be large enough to raise their prices. Housing prices may rise for a short while following deregulation only under the assumption of self-fulfilling expectations. In a separate paper (Kim and Kim 1999) we demonstrate that housing prices will rise indeed if people expect the price of housing to rise in proportion to the gap between the market price and the controlled price. However, even such price increase can last for only a short while and the overall housing price will fall in the long run if the price control and the accompanying regulation on size distribution of new apartments are removed.

Nevertheless, the popular belief that deregulation will raise overall housing price have made it difficult for government officials to initiate decontrol. About ten years ago, Minister of Construction mentioned his plan to consider lifting the price control. This remark was made when housing prices had been soaring high, and it stirred up the market and aggravated the situation. He was immediately blamed for being 'irresponsible' and 'unrealistic' by the media, and was forced to resign a few days later. Government officials became even more cautious since this incident. They would say, "There is no need to stir up the market with decontrol" when housing markets cooled down, and "It is no time to think about it because decontrol would add fuel to fire" when housing prices were on the rise. Instead, government adjusted the controlled price by an amount just sufficient to make homebuilding profitable and to ensure that housing gets built[9]. And the media criticized such moves saying that they would raise the financial burden of the would-be homebuyers, although they covered themselves by adding that appropriate margin should be provided to suppliers of housing.

Since the last administration took office in 1993, plans were announced to lift the price control when preconditions were fulfilled. The major precondition was that the shortage of housing be substantially reduced. And the price control was lifted partially in 1995 starting with large apartments supplied in the regions with substantial amount of glut on the market. The price control on single-family housing and row houses was abolished entirely in 1996. Government continued to regulate the price of small apartments (net floor space of 60 square meters or less) built with financing through the National Housing Fund, a public sector housing finance institution, and apartments built on land supplied by the public sector developers. In addition, the minimum requirement on the share of small units was removed in 1997 in two stages[10]. Finally, government lifted the price control on apartments built on land supplied by

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[9] In fact, many small homebuilders were quite satisfied with the system because it shielded them from severe competition and secured them some work.

[10] In the first stage, the requirement was removed except for Seoul and the heavily populated part of the Capital Region. In Seoul, at least 75 % of apartments built had to be of 85 square meters of net floor

public sector developers in the Capital Region in 1998 for larger units (exceeding 60 square meters of net floor space) and in 1999 for smaller units. Notice that deregulation process alone took four years and that the real deregulation took place only after the economic crisis had frozen expectations about housing price increases.

The sequence of decontrol was precisely in the order of decreasing risk to government officials. The price control was lifted first where markets were flooded with unsold new housing, and hence the price control had already become irrelevant. If the government officials had been convinced that de-control would serve the efficiency and equity objectives, they would have removed the price control in markets where the price control was binding. They might not have had the confidence in the positive outcome of deregulation, and probably that they did not want to take any chance. The benefit accruing to them when successful would have been moderate and they might not get the full credit. On the other hand, the cost of failure would have been devastating to the government officials if such a highly visible policy failed to deliver the promised result. All things considered, they probably made the best decision considering the expected political pay-off.

III. Land-use Control and Spatial Deconcentration Policies

A second example of lukewarm and peace-meal approach relates to deregulation of a set of land-use control and spatial policies. Deregulation has been the catchword in public policy of the 1990s and a wide array of deregulation measures was introduced to various sectors of the economy. In the area of land-use regulation, government recognized the need to increase the supply of developable land in order to stabilize land prices, to improve housing conditions, to meet the demand for industrial sites, and to expand and upgrade urban infrastructure. Govemment revised the National Land Use Management Act (NLMA hereafter) in 1994 so as to simplify the classification of national land use and to introduce a negative list system of land use regulation in 1994. As a result, the share of so called 'developable' land allegedly jumped from 15.6 % to 41.7 % of the nation's total land area. In practical terms, however, actual use of 'developable' land is regulated by Urban Planning Act. According to the Urban Planning Act, 14 % of the total land of the nation is designated as urban planning area (UPA hereafter), but 76 % of UPA was zoned as agricultural land or Green Belts, and hence practically not developable. Therefore, the share of land in urban use as a percentage of the nation's entire land increased from 4.3 % to only 4.8 %, and residential and commercial land area from 1.9% to 2.1% between 1989 and 1995.

Included in the category of developable land under the revised NLMA was 'semi agricultural and forest area' (SAFA hereafter). SAFA covered 27 % of the nation's land area and was located around the built-up areas outside the urban planning area. While conversion of agricultural and forest land into urban use is strictly regulated by various laws, development was allowed on land within SAFA with permission of the relevant local government except for activities causing serious environmental damages.

Initially, the maximum floor area ratio (FAR) was set at 400 %, identical to that applicable in the urban planning area and much larger than 100 % allowed elsewhere. However, a maximum was set at 30,000 square meters on the amount of SAFA land to be converted for a development project. Moreover, many of the plots in SAFA were of

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space, and 30 % must be smaller than 60 square meters. In the selected part of the Capital Region, the required ratios are 60 % and 20 %, respectively. These requirements were abolished in December 1997.

irregular topography because most of the plots comprising land that is flat and of regular shape with good access to the road network were designated as 'agriculture promotion area' and hence protected from development. These constraints rendered impossible any large-scale residential development with adequate public facilities (e.g. schools) and infrastructure (roads, water and sewerage). Consequently, only those structures for which scale is not of crucial importance were built. For example, restaurants and motels were built along the scenic drives, and isolated apartment towers were erected in the middle of paddy fields.

The media and planners pointed to such outcome as an example of failed deregulation of land use control. The Ministry of Agriculture had been unhappy with the idea of designating SAFA to begin with, and the incidence strengthened the Ministry's argument for protecting agricultural land by re-regulating the conversion that. In addition, the fact that SAFA land ownership was transferred from local residents to developers from other regions, and that the latter group took the windfall from land price increase was viewed as an undesirable act of speculation.

In response to these criticisms, the Ministry of Construction and Transport issued a guideline for development of SAFA land in June 1994, requiring local governments to prepare development plans, lowering FAR from 400 % to 150 %, and limiting building height up to 15 stories. In just one month, the guideline was revised to upgrade FAR to 200 % and to allow up to 20 stories in selected areas. Then the maximum size of land for residential development was lowered from 30,000 to 10,000 square meters. The regulation of land use conversion in SAFA was further tightened in 1996 as the maximum size of development was reduced to 2,000 square meters for factories, storage and shopping facilities, and 5,000 square meters for apartments. In order to control excessive development, a limit was introduced on the size of land for which land use conversion can be authorized by local government. The floor area ratio was also lowered to 200 % for apartments and 100 % for other buildings.

This case illustrates the consequences of an uncoordinated piece-meal approach to deregulation. One fundamental problem of SAFA was that it was designated outside the urban planning area, and hence not integrated into the urban planning system. Another cause of irregular development was the ceiling on the amount of land use conversion. The right policy would have been to introduce an integrated planning system covering both urban and non-urban areas, and to remove the ceiling on the size of development. To the contrary, government tightened the limit on the size of development. Certainly, such move was against the originally claimed objective of deregulation, i.e. to increase supply of developable land around built-up urban areas. The sequence of action taken by the government raises the fundamental question of whether they wanted to relax the strict control on the conversion of agricultural land. Most likely, the answer was no[11].

[11] Government's reluctance to deregulation concerning land use and land development can be seen from its track record. Between 1993 and 1996, 88 items of regulations were relaxed and 24 others were pending. Among the 112 items reviewed, only 41 were initiated by the Ministry of Construction and Transport and the rest were recommended by the Committee on Deregulation and the Committee on Administrative Reform, consisting of non-government members. And government accepted only 15 out of 52 requests for deregulation submitted to one of these committee meetings by the private sector.

The case also points to the vulnerability of the government against the charges that deregulation leads to speculation. The main purpose of deregulation of land use control should be facilitating the supply of developable land to absorb demand pressure with the reasonable increase in prices. If development is permitted on a particular plot of agricultural land, its price will rise inevitably. In this process, some speculators may reap capital gains, and the media and the general public do not like this. What is more important, however, is that a large-scale deregulation increases the supply of developable land and hence lowers the overall prices of land and housing. Besides, speculation is often the result of high expected price of land, not its cause. Artificial scarcity of land caused by excessive control on land use conversion leads to high land prices, and makes land a valuable item for profitable investment or speculation. Attempts to stabilize land prices by controlling speculation are only an act of "killing the messenger".

Greenbelt policy offers another interesting example. Greenbelts were designated around major Korean cities between 1971 and 1977 under the revised Urban Planning Act of 1971. The main purpose of green belt designation was to contain irregular expansion of built-up areas. It was introduced at the order of then President Park who was concerned about the rapid growth of Seoul[12] despite various measures implemented during the 1960s to control it. Green Belts were also expected to help preserve the urban environment, and more importantly, military strategic considerations were given and anti-speculation functions were assigned to greenbelts. Green belts cover 5.4 % of Korea's total land area. About 60 % of green belt land are covered with forest. Paddy fields comprise 25 %, and the remaining 15 % consist of plain land. About 740,000 persons live inside green belt areas. Development activities are strictly prohibited on greenbelt land.

Green belts have been considered untouchable because the policy was initiated at the instruction from the President. Moreover, greenbelts have enjoyed enormous support from the general public and the media most of whom do not know what green belts are like. This helped the government preserve the original green belt designation in their entirety for nearly thirty years despite the challenges by the residents living inside the belts suffering from the outright ban on development of their own private property. Whenever government relaxed some details of building regulations to alleviate the hardships suffered by owners of green belt land and residents, the media criticized the government for allowing environmental degradation and instigating speculation. In short, the media and environmental activists are carrying the banner of safeguarding green belts.

However, the popular perception that any amendment to green belt policy poses a threat to the environment is misguided. Many people believe that greenbelts serve as the source of oxygen supplies to urban residents while few people know that only 60 % of green belt land consist of wooded land worth protection for environmental preservation. Very few people mind the fact that forests are routinely destroyed and converted into residential and industrial sites as long as they are located outside green belts. Even fewer people understand that longer commuting caused by leap-frogging development beyond the greenbelts increases consumption of gasoline and hence adds to air pollution. No question is asked why the 'belt' is needed to preserve the 'green', or why greens cannot be kept in the form of parks or gardens

[12] Seoul's population increased from 2.4 million to 5.4 million between 1960 and 1970.

scattered throughout the city.

More importantly, the indirect costs of the greenbelts are rarely recognized. The costs of extending transport infrastructure to support development beyond the outer edges of greenbelts or the loss of productivity due to distortions in business locations are not obvious to the general public. Loss Virtually nobody appreciates the linkage between the scarcity of land caused by the green belts and the high prices of land and housing in Korean cities. But in fact, empirical analysis suggests that greenbelts rather than natural constraints are the major cause of urban land shortages (Son and Kim 1998). For example, greenbelt land surrounding Seoul is equivalent to 50 % of developable land in the metropolitan area. And finally, there is the fear that any release of greenbelt land will invite speculation and raise land price. Clearly, the price of land located inside the greenbelt will rise as regulations are relaxed. What people do not understand is the fact that the plot would have commanded much higher price had it not been included in the green belt, and that overall land price will fall due to the increased supply of developable land. But the fear of criticisms by the general public and the media has essentially prohibited government from even thinking about any fundamental revision of the green belt policy until 1998. At this time, efforts to reform greenbelt policy are under way but the final outcome is yet to be seen.

A third example is spatial deconcentration policy towards the Capital Region[13]. Korean government has tried to control the growth of Seoul since early 1960s and growth control was extended to cover the Province surrounding Seoul by the late 1970s. The rationale for containing the growth of the Capital Region was the belief that it had become excessively large and detrimental to balanced development of other regions. The Capital Region Control Law legislated in1982 formed the basis of the deconcentratoin policy. The Capital Region was classified into five sub-regions and each of them was subjected to different level of control. Government finally recognized that growth control on the Capital Region was too rigid and eroding competitiveness of the Korean industries by the early 1990s, and hence revised the Law in 1994. The five sub-regions were reclassified into three and economic incentives and disincentives were introduced to supplement direct regulations. But the basic approach remains intact until now, i.e. to discourage further densification of the Capital Region and to promote balanced regional development. It is within this general context that the government is trying to accommodate new industrial development and expansion of existing facilities to solicit foreign capital investment and to facilitate mergers and acquisition.

The main feature of the growth control is the dispersal of population-attracting facilities. It is often claimed that population dispersal is necessary because too large a share of population is concentrated in the Region. If this statement is interpreted as referring to the external costs to society, a logical first step would be to control the negative externalities and excessive use of resources through adequate pricing (Mills and Hamilton 1994, p.404). For example, if "over-concentration of population" in the Capital Region requires fetching water from far-away regions to support the Region, efforts must be made to curtail water consumption by raising water tariff. In fact, government officials know that water is grossly under-priced. Besides, many people buy bottled water at much higher prices. However government would rather try to contain the growth of the Capital Region instead of tackling the water problem directly, because water tariff increases will be

[13] Henderson (1988, p.15) points out that Korea has one of the most stringent deconcentration policy of the capital city. See also Choe and Song (1982).

unpopular. This may be yet another example of the risk-averting behavior of government generating inefficiency.

IV. Irrelevance of Interest Group Politics

The main thrust of this paper is that policy makers hesitate to lift price control or relax land use regulations because they fear criticisms from the general public and the media even though those regulations are harmful to the society. In short, then misguided beliefs held by the general public are the biggest barrier to improving their quality of life. Our theory might embarrass those scholars in the Stiglerian tradition (Stigler, 1971) who expect some well-organized interest groups behind the curtain lobbying against deregulation. We will show how interest group politics is irrelevant in each case we described above.

Let us consider the price control on new apartments first. Here, three major stakeholders can be identified; potential winners of the housing lottery, construction companies, and landowners. Among those three, only the construction companies that are the target of the price control are well-organized through two trade associations. We do not have any evidence that they lobby for maintaining the price control. If they do lobby at all, they must lobby for the removal of the price control since it will improve the profitability of building industry at least in the short-run. Owners of the land that is likely to be purchased by the construction companies to build apartments on have incentives to oppose the price control. But they are too heterogeneous and dispersed to form an organization, and we are not aware of any such organizations. As for the potential beneficiaries of the price control, there has been no organized effort to support the continuation of the control. Even though they will suffer from deregulation, they have no reason to spend their own resources in opposing it, since the public opinion is on their side and the legislators and the government officials represent it. All things considered, it is not reasonable to believe that the regulation is sustained by interest group politics. The only well-organized interest group in this case represents construction companies and they oppose the regulation. The fact that the price control has been sustained for so long suggests that interest group politics did not work for them.

In the case of green belt policy, the only identifiable special interest group is the Association of Green Belt Residents, a nationwide network of property owners and tenants living inside the green belts. They have fiercely protested against the regulation, but in vain. On the other hand, journalists, environmental activists and some scholars call for leaving the green belts intact. Although they have been successful so far, they may not be called a special interest group in the Stiglerian sense, because they have no direct stake. By opposing the removal of green belts they earn fame and recognition from the general public, who has every reason to remain ignorant on the issue in which it has only a very remote interest. They only represent and/or reinforce the public opinion which may be called an ideology. Policymakers weigh these two opposing forces and choose the one that yields larger political payoff. The well-organized special interest group in this case has failed to have them change the regulation so far, and this defies the theory of interest group politics[14].

[14] Kau and Rubin (1979: 384)) found that ideology is important in explaining voting by US congressmen

Politics behind containment policy of the Capital Region is not much different. Three interest groups may be identified: residents of the Seoul and Inchon Metropolitan Areas comprising the core of the Capital Region where developable land (except for the green belts) has dried up; residents of the Kyung-gi Province that encompasses the two metropolitan areas and still has plenty of developable land which are subjected to severe restriction; and residents of the other provinces and metropolitan areas outside the Capital Region. Although Seoul and Inchon metropolitan areas are the target of the regulation, they largely remain silent since the regulation is not binding because undeveloped land located inside their jurisdictions is scarce anyway. Active players in the scene are Kyung-gi Province and the other Provinces. Kyung-gi Province has been fiercely protesting against the regulation, but the central government that has the authority to lift the control has not responded favorably. The other provinces, some of which might benefit from the regulation imposed on Kyung-gi Province have contributed to maintaining the regulation with the support of the media. If the Stigler's theory were correct, Kyung-gi Province should have come out as the winner and the regulation should have been removed. It has a much more direct stake and suffers much less from the free-rider problem than the remaining provinces, which may reap only the probabilistic and partial benefit from the regulation and suffer from free riding because of its large membership. This might serve as another example showing that the theory of interest group politics may not be applicable in explaining the persistence of the inefficient regulations on the real estate market.

V. Concluding Remarks

In this paper, we tried to explain the reasons for the persistence of seemingly irrational policy decisions in real estate in Korea using a few examples. Each case analyzed demonstrates that government officials are risk-averse and very much concerned with the political ramifications of their decisions. This is especially true when they are not certain about the short-term impact of deregulation, because they are held responsible for the outcome and have to face the criticisms from the general public and the media very seriously. The piecemeal and lukewarm approach to deregulation could be understood in this context, rather than by interest group politics.

We also claimed that efficiency and equity aspects are considered only after a policy decision passes the test of a political benefit-cost calculation. The sequence of lifting the price control on new apartments is a good example. Finally, government may take advantage of criticisms against deregulation to revert to its most preferred option[15]. The series of government policy decisions on land use conversion make one wonder if

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on bills with primarily economic components.

[15] There is a sentiment against allowing market forces of demand and supply to guide resource allocation in the real estate sector in Korea. One of the referees correctly pointed out that the Korean urban sector has been run like a centrally planned economy. Moreover, real estate policy has been tainted with political slogans calling for agricultural land protection to achieve food self-sufficiency and for promoting balanced development of the regions. All of these comprise a political climate unfavorable for deregulation, and may explain for example why Korean government in the past had not allowed large scale land-use conversion for residential developments such the two million dwelling construction drive

government were interested in relaxing the regulation. If the answer were no, the criticisms against irregular development and 'speculation' following deregulation might have been a blessing that the government needed to revoke its reluctant initial decision to deregulate.

Our analysis of political dimensions of real estate policy making in Korea illustrates that the survival strategy of risk-averse government officials and the misguided public opinion may result in socially harmful decisions. It also highlights the importance of expectations about short-term dynamics and the role of the media in vindicating and propagating them. The media would take side with the majority, and this can aggravate the situation when the majority is captured by unfounded myths. Unfortunately, there appear to be no elements in Korea that are more powerful in influencing the way of thinking of the average citizen[16]. Perhaps some people may not want to have such myths broken. In this situation, it is sensible for both the media and government officials to offer what the public wants to have than trying to provide something new[17]. The alleged social ill caused by speculators is a good example. But human nature appears to be quite similar across countries[18]. Speculation tends to be more problematic in Korea because it interacts with rigid supply-side regulations.

Rectifying the current situation may not be easy. The on-going economic crisis provides an opportunity for a real estate policy reform, because the fear of speculation is much smaller and the call for deregulation is received much more favorably. However, further action will be needed to achieve a fundamental reform that 'breaks with the policy of the past' (Renaud 1993) that forced the urban population to suffer from housing shortages. Delegating the authority to issue permits for land use conversion and development to local government and establishing a system of mandatory compensation for the victims of regulations would be a positive step. Such measures will bring the political cost-benefit calculations of public servants closer to the correct social payoff, thereby enabling more rational policy decisions to be made. Experts have a lot to contribute in guiding the public debate and identify feasible options for policy reform. For example, the debate about greenbelt policy reform has bogged down to the question of whether and how to compensate the land-owners for the damages done to their property as a result of green belt designation. A better-informed decision could be made if the fact that a much larger segment of the population will benefit from rationalizing this regulation were understood.

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to alleviate the housing shortages.

[16] There is an alternative view saying that the mass media's role in the policy process is often sporadic and quite marginal (Howlett and Ramesh 1995, p.59)

[17] This point is made by Friedman and Friedman (1979, p.224) in the context of advertising. See also Tullock(1967, pp. 1-17)

[18] Case and Shiller (1988) shows that speculative motive is an important determinant in home purchase decision in some U.S. cities.

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