ANTI-SPECULATION LAWS AND THEIR IMPACT ON THE REAL ESTATE AND FINANCIAL MARKETS: THE KOREAN CASE

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I. INTRODUCTION

The Korean real estate market has represented a relatively risk-averse[1] and traditional means of wealth creation for everyday Korean domestic and non-domestic global investors. As evidence, real estate property prices in Korea have increased an average of 22.39%[2] from 1990 to 2004.

The Republic of Korea[3] has received much scrutiny from academics and practitioners since the 1997 Asian financial crisis.[4] Specifically, Korea's economic woes during the crisis were widely attributed to the country's state-dominated economic policies and crony capitalistic behavior,[5] often being referred to as "Korea, Inc." Since 1997,

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[1] Risk aversion is defined as investors who dislike risk, or alternatively, can be viewed as a function of "people's preferences on risk." Investors decide asset investment selection based on the personal preference of the riskiness of each asset's return. *See* Paul R. Krugman and Maurice Obstfeld, International Economics Theory and Policy 638 (Addison Wesley Publishing Company, Inc., 2003, 6th ed.) [hereinafter *Krugman*].

[2] According to the housing price index compiled by Kookmin Bank (a large Korean domestic bank), a sharp increase in housing prices existed since 1990. For example, the index point was 80.13 in 1990, and increased to 98.06 in 2003. This represents a 22.39% increase within a thirteen-year period. *See* Kookmin Bank website, *available at* http://est.kbstar.com/quics?page=A005332&cc=a004697:a004697.

[3] All references herein to "Korea", "Republic of Korea", "South Korea", and/or any related derivate thereof, shall be construed to mean the Republic of Korea.

[4] *See infra* note 188. *See also* Chan-Hyun Sohn, *Korea's Corporate Restructuring since the Financial Crisis* 20-21 (Korea Institute for International Economic Policy, Seoul, S. Korea, December 2002)

[5] *See* David C. Kang, Crony Capitalism: Corruption and Development in South Korea and the

however, the Korean government has taken purposeful steps towards liberalizing its economy [6] and giving greater attention to issues of transparency, restructuring of the large Korean conglomerates (known as *chaebol*[7]), and giving greater deference to free-market principles.[8]

In May 2003, however, the Korean government abruptly reversed course on its policy perspective, switching from a more laissez-faire[9] to a more hands-on market approach. Such a policy reversal relating to real estate investment markets came in the form of three legislative announcements in 2003, to be put into effect in early 2005[10] (collectively, the "Anti-Speculation Laws"). In short, the Anti-Speculation Laws' objective is to curb real estate investment speculation in the Korean real estate markets by significantly increasing tax burdens on most property owners.

Regarding the new policy approach, several threshold issues arise. First, whether the Korean government, in addition to the traditional *public* sector tasks of passing traditional legislation relating to such things as crime, education, and labor issues, should also play the market-altering role of omnipresent capital markets commentator and personal investment advisor in the *private* sector to all its citizens?[11] Second, even if the

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Phillipines 3-5 (Cambridge University Press, 1st edition, 2002). *See also generally* Chung-a Park, Chaebol Attack Anglo-Saxon Economic Model. Korea Times, October 27, 2004, *available at* http://news.naver.com/news/read.php?mode=LSD&office_id=040&article_id=0000016390&section_id=108&menu_id=108.

[6] In substance, much of the post-IMF liberalization efforts were aimed to re-instill investor confidence by increasing interest rates to increase deposits, pursue a tight monetary policy into the Korean markets, and spur domestic macroeconomic growth vis-à-vis easing of credit issuances to encourage consumer financing and therefore domestic spending.

[7] Two Chinese characters are used to describe the term chaebol. The first character translates into "wealth" or "finance", while the second character is defined as "clique". The Japanese pronunciation of these two (Chinese) characters is zaibatsu, which is used to describe giant industrial groups in pre-war Japan.

[8] "The main tool of microeconomics is the model of supply and demand. Through this model it is predicted that the market will efficiently allocate resources throughout the economy through the process of demand and supply interaction and specialization." *See* Rebecca Harding, One Semester Economics: An Introduction for Business and Managements Students 275-276 (Blackwell Publishers Ltd.) [hereinafter Harding].

[9] *See infra* note 173. Laissez-faire market price is set by supply and demand without any government intervention. Krugman at 276. Moreover, "[a] laissez-faire model of economic management develops where economic power rests in the hands of businesses and consumers through their demand and supply decisions." *Id.* at 47.

[10] The first announcement occurred on May 15, 2003. The second announcement occurred on September 1, 2003. The third and final announcement occurred on October 29, 2003. *See also infra* note 49.

[11] That is to say, when a plethora of viable and credible market commentators and information already clearly exists to the general public (who possesses the highest percentage of internet access in the world), should the government be in the business of signaling red, yellow, and green lights to every member of its population regarding when, how, and to what extent individual investment decisions should be made.

government decides that hands-on economic policies should dictate, whether the Anti-Speculation Laws are specific enough and narrowly tailored such as to impact only those short-term investors in the designated portions of the real estate markets, per the government's stated objective?

When the Anti-Speculation Laws become law,[12] a clear signal will ring throughout the Korean and global markets that a return to crony capitalism may once again re-emerge in the Korean peninsula, on a scale not seen since before the 1997 Korean financial crisis.[13]

II. PAPER METHODOLOGY

This paper provides a theoretical framework to discuss the impact of anti-speculation laws on the real estate and financial markets, with respect to the South Korean case. The methodology of this paper will consist of five parts. First, a brief background on the Korean real estate market will be given. Second, factors behind why investors may have taken such a bullish view towards Korean real estate in recent years will be provided. Third, an overview of the Proposed Laws will be given. Fourth, an analysis of the economic impact of the Anti-speculation Laws, from both a theoretical and practitioner's perspective, will be offered. Fifth, and finally, a theory-based risk assessment relating to the impact of the Anti-speculation Law, upon both the real estate and financial markets, will be discussed.

This Paper argues that the Anti-Speculation Laws will, upon implementation, have the potential of having a notable short and long-term impact on the Korean real estate and international financial markets. The specific notable ramifications of the Anti-Speculation Laws are twofold. First, tax burdens relating to most real estate investors will be significantly increased, for both short-term [14] and non-short-term investments, in both government-designated anti-speculation zones[15] and non government-designated areas. Second, the Anti-Speculation Laws have the real potential of being perceived by many investors as a

[12] The Anti-Speculation Laws are designated to pass the Korean National Assembly in early 2005.

[13] *See generally* Tomas J.T. Balino & Angel Ubide, The Korean Financial Crisis of 1997-A Strategy of Financial Sector Reform (International Monetary Fund Working Paper No. WP/99/28, 1999) (providing a comprehensive view on the origins of the crisis an dhow it affected Korea); *see generally* "What Casued the Asian Currency and Financial Crisis? Part I: A Macroeconomic Overview" by Nouriel Roubini, Giancarlo Corsetti and Paolo Pesenti, (revised version, September 1998).

[14] For purposes of this paper, short term investment is defined as a period of less than one year. *See also infra note* 71.

[15] *See id.*

worrisome return back to pre-1997 crony capitalistic economic policy-making, which could potentially disrupt the fluidity and stability of the Korean and international financial markets.

III. DRIVING FACTORS BEHIND HIGHER PROPERTY PRICES

Before we examine the Anti-Speculation Laws, this Paper will examine relevant factors that led to the Anti-Speculation Laws. What is of interest to note regarding such driving factors is that real estate investment in Korea was *not* primarily driven by financial returns on equity. Instead, the main driving factor to invest, especially in the upscale *Kangnam*[16] (southern Seoul) area--where real estate prices have increased most within Seoul and is therefore the focus of the government initiatives--was greater access to educational facilities. Furthermore, the Anti-Speculation Laws represent at least the second major effort by the Korean government since 1990 to implement strict legislative controls upon real estate investments and investors.[17]

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[16] As background, and as will be discussed further, the primary focus of the Anti-Speculation Laws is to curb real estate speculation in certain designated "Anti-Speculation Zones". The most prominent of such real estate Anti-Speculation Zones upon which the anti-speculation government policies are focused on is the *Kangnam* area, where real estate prices have increased notably relative to the *Kangbuk* (Northern Seoul) area, and has allegedly been the area upon which real estate short-term speculation is said to be most prevalent. For these reasons, the *Kangnam* area in Seoul is of considerable focus throughout this Paper.

[17] The Anti-Speculation Laws, which began in mid-2003, are the second major real estate anti-speculation proposals since 1990. The first series of anti-speculation law proposals occurred on May 8, 1990, which were intended to stymie short-term speculative investments. The intent was to "channel the proceeds into the stock market or other sound productive sectors". *See* Staff Writer, Conglomerates Will Be Barred from Buying Land for Recreational Use, *Korea Times*, May 8, 1990, at 8. The May 1990 anti-speculation laws was a direct reaction to notable increases in land prices. For example, land prices in Korea rose 28% in 1988 and 22% in 1989. *See* Chang-seok Park, Government's Fight With Business Conglomerates Expected to be Bumpy, *Korea* Times, May 9, 1990, at 8. In the late 1980s and early 1990s, real estate investments by large Korean conglomerates were purchased as a hedge against suspected rising inflationary pressures in the future. *Id.*

In general, the 1990 measures included such things as land price assessments more reflective of fair market value, a global land tax system, progress capital gains tax on land transactions, taxes on unrealized capital gains generated by land price increases, a levy on land development profits, and an upper limit on the size of dwelling sites. *See* Wontack Hong, CATCH-UP AND CRISIS IN KOREA 97, (Edward Elgar Publishing Limited, 2002) [hereinafter HONG]. What is interesting to note is that the 1990 measures were reflective of a growing trend whereby property taxes in Korea accounted for an increasingly greater property of total Korean tax revenue (both national and local). For example, in 1980, property taxes accounted for only 3.3% of total tax revenue. In 1985, the same figure rose to 4.1%. And in both 1995 and 1998, the same figure stood at 5.2%. *See Statistical Yearbook of National Tax,* National Tax Service, at 42-59 (1997). As a basis of comparison, in 1990 U.S. property taxes stood at 11.4% of total tax revenue, and 9.1% in Japan. *See* Hong at 97.

Similarities between the 2003 Anti-Speculation Laws and the 1990 Anti-Speculation laws include: (i) both the 1990 and 2003 Anti-Speculation legislation were a direct reaction to rising land prices; (ii) such rising land prices were perceived to be the primary factor behind unstable macroeconomic growth; (iii) much of the owned real estate was used as collateral in obtaining bank

Based on a poll taken in late 2003,[18] the following factors (listed in order of importance) explain why individuals chose to invest in *Kangnam* residential property in recent years: (i) education; (ii) commuting convenience; (iii) environmental issues; and (iv) wealth creation.[19] From an economic perspective, this increased demand for *Kangnam* property, in particular, coupled with little or no increase in property supply, culminated in a steady increase in property prices.

Among all factors, education is the primary reason behind the increased demand for *Kangnam* property. In total, 56% listed education as the predominant driving factor in choosing to live in the *Kangnam* area.[20] To someone not entirely familiar with Korean culture, this reason in and of itself may seem peculiar. However, within the context of traditional Korean societal norms--which still pervade in current everyday society--this factor is understandable for the reasons given below.[21]

Generally, Koreans believe that education is the key to success in life, both from a personal and professional standpoint.[22] This sense of educational importance can be traced back to Korea's early Confucian history where Korea derives many of its customs and traditions. In the Korean Chosun dynasty period (1392-1910), for example, the ruling centralized bureaucracy consisted of an educated elite, or *yangban.*[23] During this period, the traditional means by which one entered this elite class was to pass a state examination.[24] During this time, a large number

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loans; and (iv) both measures are a direct form of government intervention into the markets in an attempt to push investment flows from real estate into other investment sectors such as equity in the Korea Stock Exchange. Dissimilarities include (i) that the 1990 laws were aimed specifically towards forty-nine large Korean corporates while the 2003 Anti-Speculation Laws apply to any investor (i.e., both individual, corporate and/or institutional investors) involved in real estate transactions; and (ii) the 1990 measures merely provided for the disposal of real estate while the 2003 Anti-Speculation Laws attempt to dissuade investors from short-term real estate investment vis-a-vis broad sweeping property and capital gains tax increases.

[18] *See* Hyun-chul Bang, 강남구 교육환경 좋아산다 Education and Environment As Main Reason People Want to Live in *Kangnam*. Chosun Ilbo newspaper website, *available at* http://www.chosun.com/svc/news/.../printArticle.html?id=20020913026 [hereinafter *Bang*]. This poll by *Kangnam gu (강남구)* conducted on September, 13 2003 asked *Kangnam* residents what their primary reason was for choosing to live in the *Kangnam* area. See also In-chul Kim, 강남주민 44% 교육여건 좋아 거주 44% of Kangnam Residents Listed Education Environment As Main Reasons to Live in Kangnam, Yonhap news website, *available at* http://www3.yonhapbnews.co.kr/cgi-bin/naver/getbody?0400209120.

[19] *See id.*

[20] The same poll indicated a strong correlation between choosing education as the primary driving factor and respondents who had one or more children attending middle or high school. *Id.*

[21] *See* Sang Hyun Song, Korean Law in the Global Economy 108-109 (Bak Young Sa Publishing Co., 1996) [hereinafter *Song*].

[22] *See id.*

[23] *See* John B. Duncan, THE ORIGINS OF THE CHOSUN DYNASTY 116 (University of Washington Press, Seattle and London, 2000)

[24] *Id.*

of the Chosun founders were examination graduates.[25] Thus, at least from the *Chosun* Dynasty period, many elite and non-elite Koreans saw education as a primary means by which to pass the central examination, and either maintain or upgrade their social status, and thereby increase opportunities for themselves and their families. In this sense, the pursuit of education[26] for many in Korean society can thus be viewed as in conformity with rational behavior.

In modern Korean society today, the same perception holds true. In an industrious society where the average person seeks upward mobility, education is still seen as the primary means by which to achieve greater opportunity.[27] Students from early primary school are driven to focus on being accepted to the elite junior high and high schools,[28] and to score in the top percentile of the Korean college entrance exam,[29] in the hope of being accepted into a "top" university, which many Koreans will lead to upward social and financial mobility.[30] The university attended by

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[25] *Id.*

[26] The average Korean is said to spend 70-80% of education costs on private tutoring. *See* Ji-young Soh, Per Student Spending Reaches 3 Mil. Won, Korea Times, January 8, 2004, at 4. *See also* Staff writer, 특목고생 6 명중 1 명 ' 강남' 거주 One out of six students who entered specialized schools lives in *Kangnam* area Yunbap News website, February 15, 2004.

[27] As an example of how this perspective has incorporated itself into national public policy relating to education, South Korea spends 7.1% of its gross domestic product (GDP) on public education, the highest percentile ranking among the OECD nations. *See id.*

[28] Some of the notable junior high and high schools in the *Kangnam* area include Daechung (대청중 학교), Hyundai High School (현대고등 학교), Kyunggi Girls' High School (경기여자고등 학교). Some of the notable private educational institutes, or *hakgwons* (학원) include JungBo Hakgwon (정보 학원), Megastudy Hakgwon, and Seyun Hakgwon (세윤 학원).

[29] The Korean college entrance exam is known as the *Suhakneungrukshihum (수학능력 시험)*. In substance, this exam is the Korean equivalent to the U.S. SAT (Standardized Achievement Test) college entrance examinations, and is thus sometimes referred to as the "Korean SAT's".

Currently, the highest score on Korean SAT iKorean SAT is "400", whereby a score of approximately 390 or higher (which varies from year to year) may generally enable a student to be accepted into so-called "first-tier" Korean universities.

Regarding procedure, the Korean SAT's are typically given to students on the first Wednesday of each November, and grade results begin to be announced from early December of the same calendar year. Regarding acceptance criteria relating to the Korean SAT's, the Korean SAT score result is weighed heavily. In addition to the Korean SAT score result, some Korean universities also require and consider essay exam results (which typically average about 1,800 Korean characters in length).

Recently, some universities offer an "early admissions" acceptance track, much like in the U.S. In the Korean case, as one example, a university will de-emphasize the Korean SAT score result (and in some cases, not even require the Korean SAT score), and instead, emphasize such criteria as high school G.P.A., essays, personal interviews, TOEIC/TOEFL scores, multi-lingual capabilities, and academic honors/awards.

[30] This belief by many Koreans today in 2004 exemplifies the continuity of thought that education can lead to a better life. For example, the current thinking by many traditional Korean parents is that having their children score high on the national university entrance examination will increase the chances of being accepted into an "elite" university and therefore a better job afterwards, much in the same way as many traditional Korean parents thought towards the state examination during the Chosun Dynasty nearly 600 years earlier. *See supra note* 23.

a college student may very well determine the opportunities available to him or her on a social basis, in terms of meeting other students, or on a professional level, by forming personal connections with those other students.[31] Ultimately, this commonly seen form of Korean networking forms a strong social network that lasts and is used for an entire lifetime, both personally (i.e., meeting others with the same background or interests) and professionally (i.e., connecting to alumni for jobs or career advice).[32]

As evidence of the current extreme emphasis still placed on education as it relates to the demand for *Kangnam* residential real estate, *Kangnam* residents spent 2.6 times more[33] on tutoring[34] than the national average,[35] spending on average 621,400 Korean Won ("KRW")[36] per month.[37] Even more, the highest level of tutoring expenditures was seen among residents of four specific traditionally-affluent areas, including among them, the *Kangnam* area.[38]

The second and third factors behind the demand for *Kangnam* real estate are commuting convenience between home and work and convenience to other forms of transportation. The analysis for these factors will be merged as they are nearly indistinguishable.

Several Seoul commercial "hubs" exist which can be divided into the *Kangbuk* area (north of the Han River) and the *Kangnam* area (south

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Traditionally, the "top" Korean universities include Seoul National University, Yonsei University, Korea University, Ewha Womans University (for women's college education), and KAIST (for science and engineering).

[31] The issue of social status in Korea is, in large part, determined by one's age. The general rule is that the person with the most age seniority trumps less senior-aged persons. The Korean language even goes so far as to denote specific terms for persons who are fellow school classmates who are of the same age (*dongchang*, or *동창*), older (*sunbae*, or *선배*) or younger (*hubae*, or 후배).

[32] *See* Song at 109-113.

[33] The national average in terms of money spent on tutoring stood at 239,000 Korean Won, while the average was 342,000 Korean Won for the city of Seoul. *Id.*

[34] The use of private tutoring to supplement primary and secondary school education in Korea is widely accepted and done. Such private institutes, or *hagwon* (학원) can be seen throughout every urban area of Korea. Each institute typically concentrates on specific subjects such as English, math, science, and art. Students attend the private institutes either before or after their normal school hours. The use of such private institutes is prevalent because parents believe that receiving such additional education, albeit with the added costs, will increase the chances of having their children get accepted by a "top" university.

[35] Yong-Shik Choe, Kangnam Residents Spend 2.6 Times More on Tutoring, November 10, 2003 Korea Herald, Publication no. 15,560, at 3 [hereinafter *Choe*] The cited statistics in the article are based on findings from a recent survey by the Korea Labor Institute, which polled a sample of 5,000 households, with consisted of more than 13,000 people. *Id.*

[36] The Korean Won is the local currency for the Republic of Korea, and may also be referred to as "Won" or "KRW". For purposes of quantitative simplicity, we will assume that 1 U.S. Dollar ("USD") equals 1200 KRW.

[37] *Id.*

[38] *Id.*

of the Han River). In the *Kangbuk* area, most commercial activity exists in one of two areas: the "City Hall" (*shi-chung)* area (which has one of the most concentrated areas of private businesses and government offices, including many foreign firms[39]) and the *Yoi-do* area, which is referred to by some as the "Manhattan" of Korea.[40] However, the increasing recent trend is to have one's business locations in the *Kangnam* area, most notably in the three areas of *Yeoksam-dong, Kangnam Station,* and *Apkujung-dong.*[41]

Apart from the distance from work, the urban planning that links many people living in the *Kangnam* area could also play a factor, especially as it relates to commuting to work by car. Specifically, the urban planning structure between the *Kangbuk* and *Kangnam* areas differ in that, unlike the *Kangbuk* area, the *Kangnam* area is largely arranged in a grid-like fashion, making commuting much more efficient, tolerable, and most importantly, faster. Given that Korea has a relatively long work-week relative to other industrialized nations,[42] with many often working a six-day week,[43] any significant reduction in commuting time saved can be value-added. This can therefore play a very large factor in deciding where to invest money towards real estate property.

The fourth factor behind the recent upward trend in *Kangnam* real estate prices is the pursuit of a cleaner and healthier overall living environment relative to the *Kangbuk* area.[44] At first instance, this may seem like an unusual motivating factor. But from a Korean perspective, living or working in the *Kangnam* area is seen as having a cleaner, more

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[39] Foreign firms such as Goldman Sachs, Lehman Brothers, Morgan Stanley, and McKinsey Consulting all have their Seoul operations based in the City Hall (*shi-chung)* area.

[40] The "Manhattan" of Korea expression is derived from the fact that *Yoi-do* is a small and separate island that is built upon a grid-like urban planning structure, mostly comprised of domestic and foreign financial firms, much in the same way as the island of Manhattan.

[41] The *Yeoksam-dong* area is perhaps the newest commercial development area in the *Kangnam* area, which is where the locally famous Star Building is located, owned and named after its owner company, The LoneStar Fund (a private-equity firm based in Texas). The *Kangnam Station* and *Apku-jung* area is also viewed as highly affluent and attractive commercial and residential areas.

[42] Korea has an average workweek of over 48.3 hours per week. An average working hour per week in the manufacturing sector is 48.3 hours per week in 2001. *See* International Labor Organization: Yearbook of Labor Statistics, *available at* http://laborsta.ilo.org/cgi-bin/brokerv8.exe (select periodical data, country, type of tables, relevant first year and last year, and click on view B6 in "Your Data Selection").

[43] Recent legislative efforts, however, have been initiated to curb the predominant six-day workweek to a five-day workweek. Although this effort has met some resistance, it is nonetheless in process of finalization.

[44] *See* Se-jun Kang, 중고생 둔 학부모 56% "교육때문에 강남 산다" 56% of Parents Who Have Junior and High School Students List Education and Environment As Main Reasons For Wanting to Live in the *Kangnam* Area. Hankyoreh newspaper, December 24, 2003, at 8. The survey concluded that 56% of people who prefer to live in *Kangnam* cite to living environment and education as the primary factors for wanting to live in the *Kangnam* area. *See id.*

sanitary environment away from the older *Kangbuk* area which is the historic center of Seoul. This holds especially true when the issue of raising a family, a motivating factor for making real estate investment decisions in Korea, is considered. In short, *Kangnam* is viewed as having higher air quality, further away from the old historic center of Seoul and from the Han River (that physically separates northern from southern Seoul).

The fifth factor behind the increase in demand for *Kangnam* real estate is the apparent desire for returns on investment.[45] This is not a surprising motivating factor to purchase real estate. What is surprising, however, is that in a recent Korea Labor Institute poll, this factor—that those investors possessing the actual intent to purchase property for speculative real estate investments, which the Anti-Speculation Laws were meant to counter – accounted for a mere 2% of respondents.[46] Relating to the Anti-Speculation Laws, this means that the broad-sweeping legislation is overly-broad in that it unnecessarily impacts the vast majority of the real estate investing population. Instead, the legislation could be more exactly tailored to target the specific 2% of the relevant investing population that is investing specifically for purposes of greater returns on their investment.

IV. OVERVIEW OF THE ANTI-SPECULATION LAWS

The Anti-Speculation Laws are in effect a series of notable land, property, and capital gains tax increases aimed to curb real estate speculation in Korea. The apparent rationale behind the legislative proposals is to increase real estate investment related taxes (both direct and indirect) to such a level that it will dramatically curb many investments, specifically so-called short-term "speculative" investments.[47] The Anti-Speculation Laws represent a culmination of three previous property market stabilization packages that were announced on May 13, September 1 and October 29, 2003.[48]

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[45] The traditional definition of "investment" is "the part of output used by private firms to produce future output.." *See* Krugman at 299. However, Paul Krugman also notes that the term "investment" is also used to denote individual household purchases of stocks, bonds, or real estate (which does not show up in GDP) compared to the economic definition of "investment" (which does show up in GDP). *See id.*

[46] *See generally*, Choe,

[47] *See 부동산 종합대책 [Real Estate Comprehensive Anti-Speculation Measure]*, Ministry of Finance and Economy (MOFE), The Property Market Stabilization Package (Anti-Speculation October 29, 2003) (to be codified on or about early 2005), *available at* http://www.mofe.go.kr/data/wf2003102901.hwp [hereinafter Market Property Stabilization Package].

[48] The Korean government has announced that it will introduce the Market Property Stabilization

In relation to the Anti-Speculation Laws, this section will discuss (1) the comprehensive property tax scheme;[49] (2) capital gains tax scheme; and (3) several additional and related non property tax and non capital gains tax proposals.

A. *Anti-Speculation Property Valuation Tax System*

The new anti-speculation property valuation tax ("New Property Tax") is a yearly tax based on property fair market value ("FMV"). The New Property Tax applies to all areas[50] and applies to all types of property (i.e., residential and commercial property). Two substantive changes exist relating to the calculation of property tax owed.[51] First, the price

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Package to reform the existing property tax law. Six government branches and two local governments were involved in the Market Property Stabilization Package. *See id.*

The six government branches are the Ministry of Finance and Economy (MOFE), Ministry of Construction and Transportation (MOCT), Ministry of Government and Home Affairs (MOGAHA), Ministry of Planning and Budget, National Tax Service (NTS), and the Financial Supervisory Commission (FSC). *See* Property Market Stabilization Package. The two local branches are the Seoul Metropolitan Government and the Province of *Gyeonggi* (located in the central-west area outside the Korean capital city of Seoul). *Id.*

[49] The comprehensive property tax is scheduled to be collected from October 16 to October 31 of each year.

[50] Anti-Speculation property valuation tax [hereinafter New Property Tax] formula:
New Property Tax = statutory standard price * rate
Where:
Statutory Standard Price = basic price per m^2 * index number * deprecation rate * adjustment rate * floor space
Where:
Basic price per m^2: 170.000 KRW (year 2003), 180,000 KRW (year 2004), and 460,000 KRW (year 2005). The basic price per square meter will be increased from 170,000 KRW to 460,000 KRW in an apparent effort to better reflect FMV of property in Korea. By doing this, the net effect is relatively heavier tax burdens on high priced properties located in *Kangnam* and other government designated Anti-Speculation Zones.
Index number: government determined figure based on types of building, types of structure, and location
Depreciation rate: government determined rate at which the relevant property will decline in value over time
Adjustment rate: based on fair market value (FMV) of property and floor space (based on fourteen different levels with a rate up to 60% in 2003).
(i) Adjustment rate for residential property: 0.3%~7% with six different cumulate rates.
(ii) Adjustment rate for commercial property: 0.3% flat tax rate
Floor space: number of square meters of relevant property
See Code Civil [C. CIV.] 소득세법 [*SODEUK SEHBUB]* [Income Tax Law], Art 99, Para. 1, Item 1, National Tax Service (October 29, 2003) (to be codified on or about January 1, 2005) [hereinafter *Income Tax Law*]
According to MOGAHA's announcement of December 3, 2003, all residential properties will apply the above rules from 2004. *See id.*

The New Property Tax applies to "all areas", meaning it applies to both government designated and non-designated anti-speculation zones in Korea.

[51] *See supra Income Tax Law.*

charged per square meter for tax purposes will be increased.[52] Second, the government adjustment rate[53] will be based on the government declared value (“GDV”)[54] that can differ from property to property and from property district to property district, rather than a flat rate applied to all apartments in all areas based on the floor space of a building, which is the current method.[55]

The practical effect of the new scheme is that *Kangnam* (Southern Seoul) property holders will be forced to pay higher property value tax, due to the fact that *Kangnam* area property has a higher FMV per square meter relative to the *Kangbuk* area (Northern Seoul) property, with regard to similarly-sized property by calculating GDV closer to the fair market value (“FMV”) of property owned.[56]

B. Anti-Speculation Comprehensive Land Tax Scheme

The new comprehensive land tax scheme (“New Land Tax”) is a tax levied based on the government declared value (“GDV”) of land owned (separate from property tax paid, per 1.1 above).[57] The New Land Tax applies to all areas and applies to all types of landholders (i.e., both residential and commercial property). The most significant change is the

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[52] *Id.*

[53] The government tax standard value will be determined by the National Tax Service (“NTS”). The NTS will make its announcement January 1 of each year, beginning on January 2004. The government declared value (“GDV”) will be determined on June 1 of each year. Affected taxpayers will pay property tax between July 16 and July 31 of the same taxable year.

[54] The government declared value (“GDV”) aims to more accurately reflect the fair market value (“FMV”) of property since the government believes the current property taxation method under taxes property owners. That is, the current property valuation (upon which property taxes owed are calculated) now is perceived by the government to underestimate the FMV of property in Korea.

The National Tax Service (“NTS”) will make public announcements as to the value of property each year. *See* National Tax Service (NTS), *available at* http://www.nts.go.kr/menu/users/ntsdetail/refer_call_1_1.htm

[55] *See id.*

[56] *See id.*

[57] Comprehensive Land Tax (“New Land Tax”) formula:

New Land Tax = statutory standard price on land * tax rate

Where:

Statutory standard price on land: government declared value (“GDV”) * ratio of actualization on standard of assessment (“ASA”) * property area

GDV: government declared value of property (i.e., not based entirely on fair market value of property)

ASA: GDV/FMV

Property area: area of property measured in terms of square meters

Tax rate: ranges from 0.2%~5% (for both land and/or property)

See Code Civil [C. CIV.] [*종합 토지세*] [JONG-HAP TOHJISEH] [Comprehensive Land Tax Law], art. 194, para., 16, cl., 4, National Tax Service (September 1, 2003) (to be codified on or about December 31, 2004) [hereinafter *Local Tax Law*] imposition of much heavier landholding tax obligations, from the current range of 36.1-39.1%[58] to 50% (a total tax increase of 39% and 28%, respectively) of the government declared value ("GDV")[59] by 2006.[60] Thus, for the next two years[61] in 2004 and 2005, the government will increase the relevant landholding taxes 3% each year. Much like the New Property Tax, the New Land Tax attempts to bring GDV closer to FMV in an effort to increase tax obligations on high net worth property per the government's taxation formula, most notably in the *Kangnam* and other government designated Anti-Speculation Zone areas.

C. *Anti-Speculation Capital Gains Tax Scheme*

In general, Korean capital gains tax is a tax assessed on profits realized from the sale of a capital asset, including on property in Korea. The Anti-Speculation capital gains tax scheme ("New CGT") is a function of three variables: (1) number of property or properties owned (2) length

[58] In 2003, the national average on the ratio of actualization on the standard of assessment on property tax was 36%. The local average on the ratio of actualization on the standard of assessment on property tax was 39.1%.

Ratio of actualization on standard of assessment on property tax (2003)

	National Average	Seoul	Gyeonggi
Average	*36.1%*	*35.2.%*	*35.5%*
Minimum	30.3% (*Paju district*)	34.1% (*Mapo district*)	30.3% (*Paju district*)
Maximum	46.0% (*Uleoun district*)	36.7% (*Secheo district*)	39.0% (*Phochun district*)

See Ministry of Government and Home Affairs ("MOGAHA"), *available at* http://www.mogaha.go.kr/webapp/bbs/notice. (website temporarily under construction)

[59] The government declared value ("GDV") of property will be assessed pursuant to the following procedure. On or about January 1 of each year, the local government districts (시,군.구) will perform due diligence regarding the fair market value of property in Korea. On or about June 30, based on such due diligence, the National Tax Service ("NTS") will decide upon relevant GDV figures (for purposes of tax calculation) that will be disclosed in a subsequent public announcement. Property owners will thus be informed of the declared value on their property. Further, on or about June 25 of the same year (i.e., approximately 25 days following the NTS' GDV determination), property owners can also opt to make an inquiry with the government as to the declared value placed on their property. In the event that such an inquiry is made, the local government must respond within fifteen days thereafter to the inquiring party.
See infra Local Tax Law.

[60] *Id.*

[61] In 2003, the average ratio of actualization on the standard of assessment was 36.1%. In 2004, this figure will increase to approximately 39~42%, and to approximately 42~45% in 2005. Regarding the collection and use relating to the standard of assessment, a two-step process is followed. First, the Ministry of Government and Home Affairs ("MOGAHA") reports the assessment ratio of the standard adjustment rate to the local government authorities. Second, the local authorities will then announce on or about June 1 of each year the ratio of standard adjustment rate set by MOGAHA. *Id.*

of property ownership (which is then sub-categorized into 3 different holding periods of less than one year, greater than one year but less than two years, or two years or more); and (3) whether the property owned was registered or not.[62] The New CGT applies to all types of real estate (i.e., both residential and commercial properties) and applies to all areas (i.e., including both *Kangnam* and *Kangbuk*).[63]

Under the current system, capital gains tax rates range from 9 to 36%, depending on length of time of property ownership. Moreover, under the current system, the general rule is that such capital gains taxes are based on the government declared value ("GDV") rather than fair market value ("FMV"), which in effect lowers capital gains tax. However, under the New CGT, an exception to the general rule exists whereby capital gains taxes will be applied based on FMV rather than GDV, which in effect increases capital gains tax relating to the following: short-term[64] speculative real estate investments, transfer of unregistered property, luxury property,[65] transfer within government designated "Anti-Speculation Zones",[66] and towards multiple property holders.[67] The practical effect of the New CGT is to discourage real estate speculative investments by significantly increasing capital gains taxation burdens to

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[62] Capital Gains Tax ("Cap Gains Tax") formula:
Cap Gains Tax = (capital gains * tax rate) – deductions
Where:
<u>Reduced tax rate</u>: property owners who hold property for more than three years will qualify the taxpayer for a 0% capital gains tax rate.
<u>Deductions</u>: Certain deductions for long-term holding of property exist, which include:
- greater than three but less than five years of property holding: 10% deduction
- five years or longer and less than ten years of property holding: 15% deduction
- ten years or more of property holding: 30% deduction

*** In terms of calculating capital gains, the property-selling price is usually based on GDV, but some exceptions exist whereby the property-selling price is based on fair market value ("FMV") rather than government declared value ("GDV"). Examples of such exceptions include sales that involve short-term anti-speculation investments, transfer of non-registered property, luxury property sales, transfer of property in government designated Anti-Speculation Zones, and sales involving property holders who are multiple property holders. *Id.*

[63] *See id.*

[64] The definition of "short term" from the Korean government purview is a duration of less than one year. *See* Ministry of Foreign Affairs and Economy ("MOFE"), *available at* http://www.mofe.go.kr/egov/egov_01.php?action=view&cmd=seview&code=31527&page=1&pos=0&field=title&keyword=%C5%F5%B1%E2%C1%F6%BF%AA.

[65] "Luxury property" from the Korean government purview is defined as property that has a fair market value of more than 600 million KRW. *Id.*

[66] In relation to the Anti-Speculation Laws, the Korean government has designated twenty-two "Anti-Speculation Zones", which includes twenty-two areas in and around *Seoul*, *Gyeonggi* and south *Chungcheong* provinces. Further, fifty-eight other areas will be under close scrutiny by the Korean government for possible real estate speculative investment activity.
See Ministry of Foreign Affairs and Economy ("MOFE"), *available at* http://www.mofe.go.kr/data/tc2003101601.hwp.

[67] *See supra Income Tax Law at* art. 95, cl. 2.

all property owners, with the narrow exception of offering the unchanged rate of 9-36% capital gains taxation only to those investors who hold property for a minimum of two years or longer.[68]

As mentioned, the capital gains taxation method is a function of, among other things, length of time that property is held. The following section consequently examines the New CGT from that perspective (i.e., length of time that property is held).

V. ANTI-SPECULATION CAPITAL GAINS TAX BASED ON TIME HELD

A. Capital Gains Taxation Rate - Registered Property Holding of Less than One Year

Under the current capital gains taxation scheme, a property holder who owns registered property for less than one year is obligated to pay 36% capital gains tax.[69] Under the Anti-Speculation Law, however, the same property owner would pay 50% capital gains tax[70] based on fair market value ("FMV") of the property (i.e., a near 40% increase in capital gains taxation). The apparent government objective of the substantial tax increase is to reduce speculative short-term[71] gains. The anti-speculation scheme applies to all areas and property types (i.e., both residential and commercial property).

B. Capital Gains Taxation Rate - Registered Property Holding of One Year Or More But Less Than Two Years

Under the current system, a property holder who owns registered property for one year or more must pay a capital gains tax rate range of 9 to 36%.[72] However, pursuant to the Anti-Speculation Laws, property owners who hold property for longer than one year but less than two years

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[68] The New CGT is, in effect, a tax increase for all property holders who own property for two years or less. In other words, under the New CGT, no category of property holder receives less capital gains taxation. The most ideal scenario from a taxpayer perspective is to pay the same capital gains tax rate of 9-36% in line with the current capital gains taxation scheme.

[69] *See* Ministry of Finance and Economy (MOFE) website, *available at* www.mofe.go.kr/lib/lib_02.php?action=view&t-code=118&no=46907.
See Income Tax Law art. 104.

[70] To give a straightforward example, given the aforementioned capital gains taxation formula, if person *A* receives $1 in capital gains, then person *A* would pay 50 cents in capital gains tax.

[71] For purposes of this discussion, we assume a holding period of less than one year to constitute "short term" speculative investment activity, consistent with the Korean government definition.

[72] That is to say, no distinction is made under the current capital gains taxation scheme between holding property for greater or less than two years. *See Income Tax Law* art. 104.

will be obligated to pay a flat 40% capital gains tax[73] (instead of 9~36% capital gains tax range, based on the government declared value (GDV)). Thus, under this portion of the Anti-Speculation Laws, some property holders would be subject to a tax increase of over 444%. This scheme applies to all areas (including *Kangnam* and *Kangbuk*) and it also applies to single property owners.

C. Capital Gains Taxation Rate - Registered Property Holding of Two Years or More

Under the current system, property holders with registered property holdings of greater than or equal to two years pay a 9 to 36% capital gains tax range (based on GDV). In the anti-speculation scheme, the same property holders would generally remain paying the same 9 to 36% capital gains tax range. However, if the owner satisfies a two-part test of (1) continuously holding the property for three years or more; and (2) residing in the property for two out of the total three years, then the owner would qualify for a capital gains exemption. (see 2B-1 below). This scheme applies to all areas and also applies to single property owners.

D. Non-Registered Property Holders

Under the current taxation method, non-registered property holders are obligated to pay 60% capital gains tax. Under the Anti-Speculation Law, non-registered property holders will be obligated to pay 70% capital gains taxes (based on FMV) when selling their property. Thus, under the Anti-Speculation Law, non-registered property holders would face over a 15% tax increase. The government's objective of the anti-speculation tax increase is to curb speculative investment behavior among non-registered property owners. Without proper registration, property owners cannot exercise their right to property[74] because they would not have legal title under Korean law.[75] This scheme applies to all areas and the length of

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[73] To give a straightforward example, with the capital gains tax formula aforementioned, if person *A* receives $1 in capital gains, then person *A* would pay 40 cents in capital gains tax.

[74] As an illustrative example, assume investor *A* transferred property to investor *B*, but investor *B* did not register the said property. Thereafter, if investor *B* wants to sell the property, investor *B* does not have the legal ownership interest and/or rights to sell such property. That is, investor *B* cannot exercise his/her property right, even though investor *B* may have paid valid consideration to investor *A* for the property. In this instance, investor *A*, not *B*, still retains valid legal title to the property, assuming that investor *B* did not register the said property at the time of investor *B*'s purchase.

[75] Mr. Chun-pyo Jhong of the law firm Kim & Chang notes that "any right to or interest in immovable property must be registered with the competent court in Korea pursuant to the Immovable Property Registration Act in order for it to be valid and effective." *See Chun-Pyo*

time that property is held is irrelevant in terms of affecting capital gains tax obligations.

VI. TAXES BASED ON NUMBER OF PROPERTY OWNED

A. *Single Property Held*

Under the current tax scheme, single-home owners were exempt from capital gains tax so long as such owners owned their property for more than three years.[76] Under the new Anti-Speculation Law, to qualify for the same tax exemption of 0%, a two-part test must be fulfilled. First, the single-home property owner must hold the property for more than three years. Second, the owner must live in the relevant property for more than two years. The revised tax scheme applies only to selected cities, which include the Seoul metropolitan area (including both *Kangnam* and *Kangbuk*).[77]

B. *Two Properties Held*

Under the current system, owners holding two properties will be taxed at the rate of 9 to 36%. Under the new tax scheme, owners holding two properties will be taxed at the same rate of 9 to36%, with capital gains calculated based on the government declared value ("GDV").[78] Also under the new Anti-Speculation Law, owners of two properties in designated Anti-Speculation Zones[79] may also face an additional 15% rate, above and beyond the normal 9 to 36% capital gains rate range

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Jhong, INTERNATIONAL FINANCE IN KOREA 11 (Kluwer Law International, 2002) [hereinafter *Jhong*].

As both residential and commercial property would in most, if not all, cases be considered as "immovable" under the Korean Civil Code, then it would be highly advisable for good-faith property investors to register their property with the relevant court and/or agency.

[76] *See Income Tax Law at* art. 155.

[77] The other relevant areas in which this new proposal will affect is *Kwchun, Bundang, Ilsan, Punchun, Jungdong,* and *Sanbon*. *See id.*

[78] As the Anti-Speculation Laws are currently written, no specific definitions exist regarding exact GDV rates.. However, we assume that the National Tax Service ("NTS") would be the relevant government entity to determine the relevant value.

[79] The Korean government also selected twenty-two additional candidate areas in *Seoul, Gyeonggi* and southern *Chungcheong* provinces as "Anti-Speculation Zones". In total fifty-eight areas will be under very close government surveillance for short-term real estate speculative investments. *See* Ministry of Foreign Affairs and Economy, *available at* http://www.mofe.go.kr/egov/egov_01.php?action=view&cmd=view&code=31527&page=2&pos=18. However, the "Anti-speculation Zones" are not fixed, and thus, the government is in process of deciding to add and/or remove certain districts to the list. *See generally*, 4 Areas Named 'Speculative': Real Estate Prices Rise Fast in Seoul, Suburbs, JoongAhn Daily, April 27, 2004, at 4.

(increasing the total capital gains rate from 24% to 51%)[80] based upon the NTS' (National Tax Service) sole discretion. The revised law will be in effect from on or about January 1, 2004, and will apply to all areas.[81]

C. *Three Or More Properties*

Under the current system, owners of three or more properties must pay 9 to 36% capital gains tax.[82] Under the new tax proposal, however, such owners with three or more properties will face a 60% capital gains tax rate when selling their property (i.e., a dramatic capital gains tax percentage increase of up to 667%). The tax rate would be based on the fair market value ("FMV") of the property, rather than based on the government declared value ("GDV"), in an aggressive legislative effort to bring property valuations closer to perceived market levels.

Moreover, under the new proposal, properties that exist within government-designated "Anti-Speculation Zones" could incur a very notable 82.5% capital gains tax hike.[83] This proposal will have a one-year grace period and applies to all areas.

VII. ADDITIONAL PROPERTY TAX PROPOSALS

A. *Property Valued at 600 million Korean Won in Government Designated "Anti-Speculation Zones"*

Owners of property with a fair market value of 600 million KRW in government designated Anti-Speculation Zones must pay heavier acquisition and registration taxes under the new scheme.[84] Currently, the

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[80] *See Income Tax Law at* art. 155.

[81] *See id.*

[82] *See Income Tax Law at* art. 95 and 155.

[83] For instance, assume investor *B* gains 1 U.S. dollar from selling his or her property. According to the new property law, investor *B* must now pay 60% capital gains tax. In addition, if based on close property market surveillance by government authorities, officials detect a substantial or dramatic increase in property price, then an additional and discretionary 15% elasticity tax may be imposed. Above and beyond the 60% and possible 15% discretionary tax, investor *B* must also pay a 7.5% inhabitants' tax. Therefore, to sum up all taxes, investor *B* is now required to pay a total of 82.5 cents for every U.S. dollar of capital gains. *See Income Tax Law at* art. 95 and 104.

[84] For purposes of this section, "Anti-Speculation Zones" are Seoul (both *Kangnam* and *Kangbuk*), *Busan, Daegu, Kwngju, Ulsan, Inchen, Daejen, Gyeonggi, Chungchen, Chunan, Asan, Yangsan,* and *Changwon.* *See* Kexim Bank website, *available at* http://est.kbstar.com/quics?page=A001418&cc=a000702:a000695. As an example of real estate investments in the *Kangbuk* (northern Seoul) area, *see generally,* From Military Base to Real-Estate Wars, Int'l Herald Tribune, April 26, 2004, at 1.

For purposes of clarity, property with (1) more than 600 million KRW in non-Anti-Speculation Zones, and (2) less than 600 million KRW in Anti-Speculation Zones will not be effected by this law. *See id.*

acquisition tax rate stands at 2.2% and 3.6% for registration on reported purchase prices. Under the new proposal, the acquisition tax rate will remain at 2.2% and the registration tax rate also remains at 3.6%. However, the practical effect of the proposal is that such acquisition and registration taxes, though seemingly appearing unchanged, will be increased tax obligations. Increased taxes is the net effect because the same tax rate herein will be applied to a higher property base value since, under the proposal, property value is now determined based on fair market value ("FMV") as opposed to a government determined value ("GDV").

B. Database System Restructuring

In addition to the above mentioned anti-speculation tax reconstitutions, the government is also proposing a restructuring of the current database system used to collect information related to property investments.[85] The database restructuring began in late 2003.

Two objectives supply the rationale behind this restructuring. First, a more efficient and accurate database of property investment information is sought to better reflect fair market value ("FMV") relating to the levying of taxes on real estate transactions. Second, the new database system will aim to get a better sense of the types and investor

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According to a recent survey by Speedbank (a real estate affiliated agency located in Korea), there are more than 117,157 apartments that have a fair market value of 600 million KRW or more in the Seoul area (i.e. including both *Kangnam* and *Kangbuk*). *See generally,* Speedbank website, at www.speedbank.co.kr. 55.7 percent of *Kangnam* apartments are in that category. Nine other non-*Kangnam* areas do not have a single apartment that falls in the 600 million KRW or higher category.

[85] *See* Ministry of Finance and Economy (MOFE) website, *available at* http://www.mofe.go.kr/data/wf2003102901.hwp.

Currently the government has eight different electronic database systems: (1) the comprehensive land tax database; (2) property tax database; (3) land register and territory database; (4) residents database; (5) land transfer database; (6) housing database; (7) tax integration system; and (8) the property registration database *See* Ministry of Foreign Affairs and Economy ("MOFE") website, *available at* http://www.mofe.go.kr/egov/egov_01.php?action=view&cmd=view&code=31478&page=2&pos=17.

These systems are used in each government branch to collect data for policy formulation. However, there is no database system that will collect the property holding data for each household. The government objective in integrating the current database systems from MOGAHA (i.e., the register/ territory database and the residents database system), MOCT (land transfer database, and the housing database system), and NTS (capital gains tax database system) is to check and confirm property fair market values on a periodic basis (i.e., a periodic mark-to-market).

In general, property investors tend to undervalue their property because doing so will directly translate into less property tax owed. If the reported purchase price is lower than the government determined value ("GDV")--which is determined by the National Tax Service ("NTS")--then the government will use its toughened price standards, per this section, to calculate the relevant taxes owed, rather than the property holder's reported price to the government. *See id.*

profiles relating to real estate investments in an effort to better monitor and therefore help curb real estate speculation in Korea.

C. Anti-Speculation Property Trading Permission System

Beginning March 1 2004, all property purchased in the government designated Anti-Speculation Zones must report its trading information within fifteen days[86] of purchase date to local authorities.[87] Any violation of the new law will be subject to a maximum 11% acquisition tax rate (i.e., a 500% tax increase from the original 2.2% acquisition tax rate).

VIII. TAX EFFECT OF THE ANTI-SPECULATION LAWS

The Anti-Speculation Laws, including the New Property Tax (Section 1-1), New Land Tax (Section 1-2), and Capital Gains Tax (Section 2) are all similar in that the overall effect is to increase, at times dramatically, the tax burden on most real estate investors in many areas most of the time.

For example, sizeable tax increases are very clear for the New Land Tax (up 28-39%), new CGT for investments of less than one year (up 40%), New CGT for investments of greater than or equal to one year but less than two years (increase of up to 344%), New CGT for two years or more (unchanged), New CGT for non-registration tax penalty (additional 15% penalty tax), New CGT for one property owned (requiring an additional two-part test to qualify for tax exemption), New CGT for two properties owned (introducing a NTS discretionary additional 15% tax), and the New CGT for three or more properties owned (up 67-667%).

The clear conclusion from surveying the tax effect of the Anti-Speculation Laws is that the Korean government has sought to raise, rather than lower, taxes to force investor behavior out of designated time periods and areas relating to real estate. By doing this, the government is aggressively intervening in the real estate markets to shift the demand curve inward,[88] which in theory may bring prices down in the short-term.[89]

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[86] *See* Ministry of Finance and Economy (MOFE) website, *available at* www.mofe.go.kr/lib/lib_02.php?action=view&t-code=118&no=46907.

As the anti-speculation legislation is currently silent as to the issue of whether business or calendar days will be used, we will assume for purposes of this discussion, that the timeframe will be based on calendar rather than business days.

[87] *See infra note 129.*

[88] Chi-dong, Lee New Anti-Speculation Measures Target Multiple Home Owners *Korea Times* October 30, 2003, at 1.

However, because the Anti-Speculation Laws make little or no mention of increasing housing supply as a means to counter speculative investments, less housing will be available to an already scarce housing supply market. The net effect is that such housing scarcity may very well drive prices upward again[90] in the mid to long-term. In the meanwhile, average investors will be squeezed out of the investment choices they would want but for the Anti-Speculation Laws, resulting in net national loss and decreasing overall consumption.

Alternatively, the Korean government may want to cut nominal rates in property, land, and capital gains taxes (shifting the demand curve outward), while at the same time, suggest relevant legislation to increase housing supply (shifting the supply curve outward) to seek balanced, not biased, long-term and sustainable growth. Such a dual-pronged effort will help society by increasing property development and wealth creation.

IX. ANALYSIS OF THE ANTI-SPECULATION LAWS – BENEFITS V. COSTS

The Anti-Speculation Laws possess certain benefits and risks.[91] The real question to ascertain a legislative effort's worthiness is whether the overall benefits substantially outweigh its overall risks. If the answer is "yes", then the Anti-Speculation Laws will be an overall net positive on its society. If the answer is "no", then the Anti-Speculation Laws will be an overall net negative effect on its society. This analysis is pursued further below.

A. Benefit – Analysis and Commentary

In short, one broad benefit exists relating to the Anti-Speculation Laws: to protect investors by enacting the Anti-Speculation Laws as a means of prematurely bursting the so-called Korean real estate bubble.

The argument for this can be explained by the following parts: (i) that over the past few years, Korean real estate prices have escalated to a point beyond, or even substantially beyond, what is, or is thought to be, fair market value; (ii) that such residential real estate prices warrant enough of an overvaluation to constitute a "bubble" scenario; (iii) that, at the very least, a high likelihood exists that such a "bubble" in the Korean

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[89] Thus such lowering of short-term prices represents the effects of government intervention into the free market system. *See* Harding at 170-171.

[90] *See* Krugman at 77.

[91] *See* Harding at 166. *See also,* Paul A. Samuelson and William D. Nordhaus Economics 181-184 (McGraw-Hill Inc., 1995 5th ed. Int'l ed.) [hereinafter Samuelson].

real estate market will burst rather than enter into a "soft-landing" scenario; (iv) that because of the perceived likelihood of a "bubble burst" scenario, that the occurrence of such a "bubble" scenario in the Korean real estate markets will have a net negative effect on the domestic economy, rather than a net positive in the form of much-needed added wealth creation into society; (v) that it is the role of the government to help its people protect themselves against the "bubble burst" scenario, not by focusing on the consequences of such occurrence, but rather, by focusing on how to artificially stunt real estate price elevation vis-à-vis related legislative enactment; and (vi) that such government legislation will have the intended effect on the markets, consistent with its stated objectives.

In the following section, each part of the argument will be analyzed.

1. Over the past few years, Korean real estate prices have escalated to a point beyond, or even substantially beyond, what is, or is thought to be, fair market value.

The level of price increase in Korean real estate markets varied widely in Seoul depending on the region of Seoul in question, with little or no change in residential real estate prices in the *Kangbuk* (northern Seoul) region compared to somewhat more significant gains in the *Kangnam* (southern Seoul) region.

Overall, the prices of residential apartments in Seoul have increased 79.4% since January 2000, which averages out to approximately 19.85% returns[92] per year for the four years between 2000 and 2003.[93] From a comparative basis standpoint, residential apartment prices increased 62.02% in Seoul from 1990 to 1999.[94]

The vast preponderance of increases in overall Seoul real estate prices can be attributed to a skewed distribution of price inflation[95] in the

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[92] During the same period, 2000 to 2003, the Korea Composite Index, or KOSPI realized a -89.58% average year return on equity. See Korea Stock Exchange website, *available at* http://cs.kse.or.kr/webeng/tong/st/sp/tn_st_sp_kp2cl.jsp.

[93] Ji-eun Seo, Apartment Price Hikes Greater Than in '90s, Korea Herald, November 25, 2003, at 18 [hereinafter *Seo*]. The average price per pyeong (the traditional Korean method of measuring property sizes, whereby 1 pyeong is equivalent to 3.3 square meters) was 11.66 million Korean Won ($9,701) per pyeong from 6.5 million Korean Won in January 2000. *Id.*

[94] *Id.* In 1999, the price per pyeong in December 1999 was 6.4 million Korean Won compared to 3.95 million Korean Won in January 1990. *Id.*

[95] One definition of inflation is "Price rise in a process called 'inflation', when the quantity of money increases faster than production". *See* Michael Parkin, ECONOMICS 11 (Addison-Wesley Publishing Co., Inc., 2000).

Kangnam area. For example, the *Kangnam* area rose 118.3% in the 1990-99 period and 131.7% in the 2000-03 period.[96] However, in stark contract, the *Kangbuk* area showed minimal price elevation. As an example, the *Yongsan-gu* area, located within the *Kangbuk* area, was the most expensive area in Seoul in 1990.[97] However, the average residential housing prices in this area grew at a mere 3% from 2000 to 2003.[98]

One argument for this constant and steadfast increase in Korean real estate prices since 1990 is that such increase is due in part to the Korean government's post-1997 crisis measures to spur the nation's economy. Most notably, such measures included maintaining low interest rates to increase domestic loan issuances, spending, and investment, which in turn led to the current "unpredicted, large-scale price rise."[99] If true, then the government's policy overshot, or, put another way, was too successful in spurring post-1997 lending and investment, and culminated in a perceived need for the government to act again to counter its efforts made approximately six years earlier. Thus, if the policies created in post-1997[100] created this unforeseen problem, then the potential exists that perhaps other unforeseen problems will occur as a result of the Anti-Speculation Laws.

Another issue that arises given this is, why does the government feel compelled to act now, rather than before or later? More specifically, the apparent Korean real estate price elevation has been evident for thirteen years, since at least 1990. Since net average price levels have consistently gone up, then perhaps a strong likelihood also exists that the current prices reflect true market levels.[101] The mere fact that prices increase, even dramatically, does not always mean that prices are

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[96] *See generally*, Seo.

[97] *Id.* Housing prices in the area of *Yongsan-gu* increased 50% from 1990-99. *Id.*

[98] *Id.* During 2000-03, relevant costs were 8.6 million Korean Won per pyeong in 2000 to 13.21 million Korean Won per pyeong in 2003. *Id.*

[99] *Id.*

[100] The Korean government began its seventh five-year plan for economic and social development in 1992. This plan was primarily focused on strengthening the economy and balance of distribution. Furthermore, the government objective was to realize a gross national income (GNI) per capital of 10,000 USD, and to become a member of OECD by the end of this five-year plan (i.e., by 1997). To fulfill these development plans, the Korean government initiated banking and financial sector deregulation. By doing this, the Korean government hoped to attract foreign investors and increase market transparency. *See* Myung-Kyu Lee, 한국경제의 이해 Understanding on Korean Economy, 119-123 (Bup-mun-sa, 1997) [hereinafter Lee, M.K.].

[101] One definition of an efficient market is "a market for securities in which every security's price equals its investment value at all times, implying that a set of information is fully and immediately reflected in market prices." *See* William F. Sharpe, Gordon J. Alexander, Jeffery V. Bailey, David J. Fowler, and Dale L. Domain Investments 87 (Prentice-Hall, 2000 3rd Canadian ed.) [hereinafter Sharpe, Alexander, Bailey, and Domain]. Therefore, if efficient markets exist, then the current prices reflect true market levels. *Id.*

overvalued. New optimism could exist regarding real estate investment, or perhaps prices were simply undervalued before. And even assuming the current price levels are overvalued, and assuming that a bubble burst scenario occurs, few can be fully confident that the net negative effects will surely outweigh the net positives from the decade-long real estate bull run since the 1990s. If the variables are too complex and too unknown for quantifiable certainty, then the risks of impeding into the markets can be greater than its benefits.[102]

2. Such residential real estate prices warrant enough of an overvaluation to constitute a "bubble" scenario.

The terms "bubble" and "speculation"[103] are by definition difficult to quantify and are therefore easily subject to non-verifiable and even biased summations and/or conclusions.

For example, one definition of "bubble" is "the belief that prices occasionally rise well above their fundamental values until at some point the 'bubble' bursts and the price drops quickly."[104] But again, how does one measure the disparity, if any, between the "fundamental values" and current market values, and how does one quantify with certainty that such levels "occasionally rise well above" such "fundamental values"? For clarity, any viable answer to this question should be separate from the issue of whether the government should be involved in such activity, and even assuming that the government should be involved in such activity, what exact approach relating to the perceived bubble should be taken (i.e., artificially deflate the bubble or merely address the possible consequences in the event of a moderate to sudden decline in real estate prices).[105]

To continue the analysis, one definition of "speculation" is

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[102] Robert E. Rubin, In an Uncertain World: Tough Choices from Wall Street to Washington 80 (Random House 2003). In his book, Robert Rubin, former U.S. Treasury Secretary (1995-99) under President Bill Clinton (1992-2000) and former Co-Chairman of the investment bank of Goldman Sachs, stated, "I formed both an appreciation for and a skepticism about [mathematical financial] models that I have to this day. Financial models are useful tools. But they can also be dangerous because reality is always more complex than models." *Id.*

[103] According to the American Institute of Real Estate Appraisers (AIREA), real estate speculation is defined as "to gain profit from the investment on real estate and the return of the principal, and also to produce the capital gain from the trade" *See* LEE, R.Y.at 194

[104] *See generally,* Investorwords, *available at* http://www.investorwords.com/4643/speculation.html.

[105] On April 4th 1990, the Korean government announced the *Proposal of Revitalization on Economy.* About a month later on May 8th, the government revealed the *Anti-speculation on Real Estate.* The proposal mainly regulated the chaebol's property ownership, and the limitation on excessive property holding for banking and financial sectors. The Korean government initiated this real estate measurement predominantly to curb speculation during that time period, rather to provide balanced development on territory. See Lee, M.K. at 210-211 *See also supra* note 17.

"taking large risks, especially with respect to trying to predict the future; gambling, in the view of realizing short-term large gains."[106] But given the analysis within this Paper, a mere 2% of respondents claimed that investment returns constituted a motivating factor in deciding to purchase real estate property.[107] On the contrary, most investors in the *Kangnam* area chose education as the primary factor to invest in property. Given this, neither "gambling" nor "quick" gains seem to factor neatly into the speculation equation. In other words, the majority of investors are investing for the long-term not short-term, and not for the financial gain, but instead, for the educational benefits of relocating to a new residential area that has a reputation for relatively better educational facilities.[108]

Admittedly, price levels in Seoul, especially in the *Kangnam* area, increased in the period from 1990 to, but excluding, October 29, 2003, the date of the Anti-Speculation Laws announcement. But perhaps the increase in prices during this period is due to greater transparency in all of Korea's markets, inspiring foreign and domestic investor confidence. Since 1998, Korea has been an engine of growth for the Asia-Pacific region for many financial institutions and corporations.[109] Perhaps the series of liberalization laws enacted by the Korean government after the 1997 IMF crisis helped to increase investor participation into all the markets, including the real estate markets.[110] If this is the case, then the increase we see in the Seoul residential property prices may represent a relatively accurate fair market value. The government should thus not be concerned that prices are increasing. Rather, the relevant officials should view the price increase as a reflection of one of their earlier policy successes and should applaud themselves for having created the necessary environment – by deregulating[111] rather than regulating – to help to sustain

[106] *Id.* The future growth of assets is very unpredictable. For example, return of stock or expected return on property is very uncertain. Therefore, high-risk assets have high return, referred to as "Risk Premium." Re-young Lee, 부동산학개론 Principles of Real Estate 104-106 (Bup-moon-sa, 2000) [hereinafter Lee R.Y.].
[107] *See generally,* Choe.
[108] *See* Song at 100-102.
[109] "Korea has gradually opened sectors of the economy to foreign investors since the early 1980s. ...A significant step forward was taken under the Kim Young-Sam government in 1993 when a five-year timetable was prepared for opening most industries to foreign investment." *See* William Shepherd Edited by O. Yul Kwon, Korea's Economic Prospects From Financial Crisis to Prosperity 272-279 (Edward Elgar Publishing Limited, 2001)
[110] As a recent example, in a mere five day period between December 31, 2003 and January 4, 2004, foreign buying has been prevalent in the following industry sectors: banking (147 billion KRW), telecommunications (133 billion KRW), securities (94.3 billion KRW), chemicals (79.5 billion KRW), transport equipment (53 billion KRW), and steel (26.3 billion KRW). *See* Hyung-kwon Cho, Foreigners Active in Buying Bank Stocks, Korea Times, January 9, 2004, at 9.
[111] Harding notes some investors react to an investment environment not entire based on pure

the viability of Asia's fourth-largest economy.

3. At the very least, a high likelihood exists that such a "bubble" in the Korean real estate market will burst rather than enter into a "soft-landing" scenario.

Even assuming that the recent increase in Korean real estate prices does in fact constitute a "bubble", the issue of whether the "bubble" will revert back to equilibrium[112] by a sudden drop in price levels (a bubble "burst" scenario), or alternatively, to a slow to moderate reversion back to equilibrium prices (a "soft-landing" scenario) is relevant. The issue is relevant because the Anti-Speculation Laws are predicated on the notion of a bubble "burst" scenario.[113]

As stated earlier, the increase in Korean real estate prices have steadily and consistently increased since 1990.[114] Given that the increase in price levels were not sudden, the evidence would not therefore suggest that the decrease in price levels might similarly make a "soft" decline back to equilibrium levels.[115]

What is interesting to note, apart from the substance of the Anti-Speculation Laws, is the timing of the legislation,[116] which may have some linkage to the impetus behind the proposed acts. Assuming a "bubble" scenario, one would presume that any notable decrease in price levels would occur approximately eight years or so from the "bubble's" inception based on similar scenarios in the U.S.[117] and Japan.[118] However,

market fundamentals by noting, "Where monopoly power is great, is seen to be against the interests of consumers and is preventing a pareto-optimal solution from being reached. With this scenario the policy solution is to provide incentives to entrepreneurs to enter into otherwise barred markets. For this reason it is often called *Deregulation.*" *See* Harding at161.

[112] "At the equilibrium price demand equals to supply. There is no excess demand and supply." *See Id.*

[113] *See* Chi-dong, Lee, New Anti-Speculation Measures Target Multiple Home Owners, Korea Times, October 30, 2003, at 1

[114] Since 1990, property prices increased an average 4.37% per year. *See* Kookmin Bank website, *available at* http://est.kbstar.com/quics?page=A005328.

[115] *See* Harding at 161

[116] Since late 2002, the South Korean economy has fluctuated between flat and/or negative growth. During such periods, taxable income assumedly decreases, which then decreases government revenue. An argument can therefore be made that one motivating factor behind the real estate taxes discussed in this paper is to increase government revenue. Assuming this, and given that Korean domestic spending and confidence have still been relatively flat since late 2002, perhaps partially due to such tax increases, Korean economic growth has primarily been driven by export growth rather than domestic consumption.

[117] One relevant example can be seen in the U.S. equity markets during the 1990s. In this period, the U.S. equities markets increased approximately 514.09% in terms of NYSE reported share volume, from U.S. $39,664.50 (millions) in 1990 to 203,914.2 (millions) in 1999. *See* New York Stock

the evidence relating to the Korean real estate price levels indicates that the steady and consistent increase in property prices occurred for at least fourteen years.

The question then becomes why the government decided to implement anti-speculation laws now, rather than in the late 1990s? One reason could be that the 1997 Asian financial crisis deferred any legislative process to curb real estate speculation. Another reason could be that the Korean economy has been in a technical recession[119] since 2002. In any recession, including in the Korean case, recessions on balance lower government revenue.[120] Thus, during recessionary periods, governments must take the difficult choice of seeing their country face a current account deficit,[121] or find alternative ways to increase government revenue, such as in the form of added taxes.

Given this, and given the fact that the Anti-Speculation Laws attempt to curb real estate speculation vis-à-vis increases on various forms of land, property, and capital gains taxes, an argument can be made that the Korean government is imposing such new legislation to gain additional and much-needed tax revenue during a recessionary period.[122]

Exchange Composite Index website, *available at* http://www.nyse.com/pdfs/kaplanschoar.pdf.

[118] The relevant Japanese example is the Japanese real estate "bubble" from the early 1980s to the early 1990s. In this period, Japanese real estate price levels, including in Tokyo, and other domestic assets increased significantly due to numerous factors, including "euphoria". *See generally,* Shigenori Shiratsuka, *Asset Price Bubble in Japan in the 1980s: Lessons for Financial and Economic Stability, in* IMES DISCUSSION PAPER SERIES (Institute of Monetary and Economic Studies, Bank of Japan, Discussion Paper Series No. 2003-E-15, December 2003).

[119] The definition of "recession" used here is a decrease in GDP for two consecutive quarters or more. *See* THE COMPLETE INVESTMENT AND FINANCE DICTIONARY, HOWARD BRYAN BONHAM, ADAMS MEDIA CORPORATION, 2001, AT 541. Historically, in the U.S. case, economic contractions have lasted an average of eleven months, while economic expansions have averaged in length of 50 months. *Id.*

[120] Recessions tend to lower government revenue because in a recession, net aggregate wealth is decreased, thus average individual and corporate GDP decreases, which in turn, decreases net average individual and corporate taxable income, and therefore, diminishes government revenue.

[121] *See* Krugman at 550.

[122] *See Hong* at. 99 (noting the increase in the ratio of gross tax burden to GDP from 18 percent in 1980-89 to about 19 percent during `1991-99).

4. Because of the perceived likelihood of a "bubble burst" scenario, that the occurrence of such a "bubble" scenario in the Korean real estate markets will have a net negative effect on the domestic economy, rather than as a net positive in the form of much-needed added wealth creation into society.

The Anti-Speculation Laws assume that (i) a "bubble" scenario exists in the Korean real estate markets; and (ii) that such a "bubble" will have a net negative effect on the Korean real estate markets.[123]

In general, when faced with a "bubble" scenario, the government has several options from a policy perspective: the government can take an interventionist approach[124] by enacting legislation in an attempt to counter market forces, or alternatively, the government can simply do nothing.[125]

Real estate investments in Korea have symbolized the traditional investment means for everyday Koreans.[126] However, the Anti-Speculation Laws in effect take away the potential benefits and incentives of investing in the real estate markets that have been relied upon by investors in Korea.[127] Even further, by providing a disincentive in the real estate markets vis-à-vis higher property taxes, Korean investors will be forced to divert their money to the equity or other alternative markets,[128] or perhaps even more drastically, invest in offshore markets, which will

[123] *See* Lee, R.Y.at 1

[124] "Like Keynesians we believe that an economy can settle at a level of national income which is not at full capacity, and then we can increase aggregate demand and national income." Therefore, given this, most Keynesians would believe that government intervention can constitute an appropriate and effective means by which to stimulate economic growth. *See* Harding at 190-191

[125] "*Laissez-faire* or non-interventionist model of economic management develops where economic power rests in the hands of businesses and consumers through their demand and supply decisions." *See id.* at 47

[126] During the Chosun dynasty, many of the powerful bureaucratic elites (*yangban*) derived much of their wealth from land ownership. At times, such land was provided to the *yangban* by the Korean government. *See* Duncan at 150.

[127] *See id.*

[128] A concern also arises whether the Korean government would propose legislation which attempts to curb equity market "speculation" in the event that the Korean equity markets (i.e., KOSPI or KOSDAQ) enters into a sustained bull run scenario. Currently, many offshore investors are relatively bullish on Korean equities, based in part, that the Korean economy is primarily driven by market principles and greater regulatory reform and liberalization. However, if the government did in fact take legislative measures to curb the equity markets, offshore investors could very well switch from "greed" to "fear" mode and pull their money out of the Korean equity markets, setting off a potential panic.

If this plays out to be true in the equities markets, one must also debate whether this scenario could also occur in the real estate markets, as it relates to the Anti-Speculation Laws, either before, on, or after its implementation into law.

siphon Korean currency offshore where Korean regulators will not have jurisdiction.

Moderate or even rapid increases in value should not in and of itself be viewed as a net negative to the Korean economy. An alternative view that the Korean government could take is that (i) an increase in overall property values is a viable form of wealth creation for the country; (ii) because people's wealth is being increased, this will in turn lead to greater taxable income, which will in turn, lead to greater government revenue; and (iii) that even if the real estate markets do in fact go down, that all markets by definition fluctuate. This implies that risk exists, but that such risk inevitably exists in nearly every investment.[129]

> 5. It is the role of the government to help its people protect themselves against the "bubble burst" scenario, not by focusing on the consequences of such occurrence, but rather, by focusing on how to artificially stunt real estate price increases vis-à-vis related legislative enactment.

The above argument is more in line with the traditional Keynesian economic perspective[130] that the role of government should be active,

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[129] A good example of how risk exists in nearly every investment relates to investing in U.S. government issued securities, such as the Treasury bill ("T-bill"). The U.S. T-bill is perceived as the closest thing to a "risk-free" investment relative to other investments because the T-bill has the backing of the full faith and credit of the U.S. government. This is not to say that the U.S. government's ability to repay its debt obligations is the best on an *absolute* basis, but rather, that it is the most attractive on a *relative* basis. That is, compared to say, the Japanese or British government.

However, even with the purchase of a U.S. government security, some risk exists. For example, an inverse relationship exists between bond prices and interest rates. That is, if interest rates go up, bond prices go down. Therefore, given a 30-year U.S. debt obligation, certain changes, if any, on U.S. interest rates will affect the bond price, which is a form of risk.

Such risk can be quantified by measuring the expected portfolio return, which is done by specifying the probability associated with each of the possible future returns of a given portfolio. Each return is in effect a subjectively determined probability or likelihood of occurrence. In short, the expected return is the weighted average of possible outcomes, when the weights are the relative chances of occurrence. The formula is as follows:

$$E(R(p))= p(1)r(1)+p(2)r(2)+p(3)r(3)\ldots+p(n)r(n)$$
$$E(R(p))= \sum(I+1 \text{ to } n)piri$$

Where:
E(R(p))= expected portfolio return
Ri=possible return
Pi=associated probability
N=number of possible outcomes
See Frank J. Fabozzi and Franco Modligliani, Capital Markets: Institutions and Instruments 128 ((3rd edition, 2003) [hereinafter Fabozzi].

[130] Regarding Keynesian economic theory, "The fundamental lesson of Keynesian economics is that

whereby the government can and should play a very hands-on management role over the public to help mitigate actual, threatened, or real market failures and instill public confidence by having a watchful force to protect consumers against financial turbulence and/or crisis.

The threshold issue here to do the analysis is *what* role the government should play to help assist the general public.[131] In other words, what coverage area should an effective and highly efficient government have to help its people? Assuming that some government can provide positive value-added services[132]–most notably in the traditional governmental coverage areas, such as education, crime prevention, and welfare reduction–the government can be a highly effective means by which to reach certain objectives for the overall societal good.

One argument for a Keynesian type approach[133] as it relates to the issue at hand is that most investors in the Korean real estate market are domestic, and that such Korean domestic investors have a relatively shorter history of personal investment history.[134] Therefore the Korean government must step in to provide market signals and broadcasts as to when and where to invest money. Another conceivable argument is that the 1997 Asian financial crisis demonstrated that the markets left unattended could cause immense damage to the welfare of the people. Specifically, such was the case to the average Korean when individual purchasing power parity dropped dramatically as the KRW depreciated to unprecedented low levels against the U.S. Dollar in late 1997.[135]

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the automatic adjustment mechanism of competition cannot be relied upon to achieve such policy objectives as full employment and price stability. The main message of Keynesian economists is that the automatic adjustment process of the market is too unreliable to serve as a practical basis of full-employment policy." *See* Mark Blang, Economic Theory in Retrospect 671 (Press Syndicate of the University of Cambridge, 5th ed. 1997).

[131] This is in comparison to the separate issue of if the government should play any role at all to help assist the general public.

[132] The notable exception would be those who hold true to fundamental libertarianism beliefs that less government, or even no government, is a better government since government tends to misallocate consumer resources, thus causing more aggregate good than harm.

[133] *See* Harding at 190-91.

[134] Personal investors are also referred to as "retail investors". See Fabozzi at 263. Fabozzi notes that three distinctions exist between retail and institutional investors. First, transaction size of retail investors is much less relative to institutional investors. Second, individual investors tend to pay more in transaction commissions than institutional investors. Third, retail investors use stockbrokers, while institutional investors use institutional broker/deal desks to execute orders. *Id.* at 263-64.

[135] In late December 1997, the KRW U.S. Dollar (USD) FX rate was trading at nearly 2000 KRW / USD. Given that the current benchmark stands at about 1200KRW/USD, this means an approximate two-thirds drop in purchasing power parity within a six-month period. Regarding a general discussion on foreign exchange issues, *see generally,* Ronald W. Melicher and Edgar A. Norton Finance Introduction to Institutions, Investments, and Management 164-165 (South-Western College Publishing, 2000) [hereinafter Melicher and Norton].

On the other hand, even assuming that a short investment history exists, the underlying principle should exist that investors are free to choose what investments they should or should not pursue. If certain investors believe they need additional investment advice, they can solicit relevant advice from a countless variety of qualified sources, including licensed financial advisors, online financial information providers, and various printed financial publications.[136] On the same note, who then should be held responsible if the Anti-Speculation Laws do not have the intended effect of creating a "soft landing" for real estate prices and investors lose money when they pull out of real estate and decide to invest in say other lucrative markets such as high yield, high risk corporate debt – the investors or the financial advisor? If the answer is that the fault still lies with the investor, per the principle of *caveat emptor*,[137] then little purpose exists for the Anti-Speculation Laws in the first place because the policy would merely shift one perceived "bad" investment into yet another "bad" investment.

Regarding the second argument that the 1997 Asian financial crisis is evidence that investors need to be protected from the markets vis-à-vis government protective legislation, then perhaps useful government action could be had by focusing on the effects of a "bubble burst" rather than the perceived bubble itself. By doing this, the markets are not interfered with and will instill investor confidence. And further, less risk exists that the proposed legislation may over or undershoot its objectives, triggering a potential financial negative blip or, in a more extreme case, a potential mass sell-off in the Korean financial markets. By concentrating on the post-bubble consequences, the focus is on how to redirect monetary policy,[138] on or after the actual event of a post-bubble period to expand on economic growth, as was the case in the United States in 2000.

No doubt exists that the 1997 crisis[139] did cause instability upon the financial markets generally and to many Korean investors and non-investors specifically. But the objective should be to foster maximum wealth creation[140] within Korea. Wealth is not maximized when wealth

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[136] Such online financial information providers include Bloomberg, Thomson Financial, and Reuters, while printed publications include, but not limited to, The Wall Street Journal, Euromoney, and the International Finance Review (IFR).

[137] From Latin, meaning "let the buyer beware".

[138] Redirecting monetary policy can occur by lowering real interest rates to provide an incentive for individuals and corporates to borrow and invest to spur growth and investment. *See* Melicher and Norton at 106.

[139] The 1997 Asian Crisis was reflected the growing problem of capital flight and short-term international speculation in the currency and securities markets. *See* David K. Eiteman, Arthur I. Stonehill, and Michael H. Moffett, Multinational Business Finance 39 (Addison-Wesley Publishing Company., Inc. 2001 9th ed.) [Hereinafter Eiteman, Stonehill, and Moffett].

[140] In general "companies are said by economists to be behaving rationally when they are

creation is artificially stunted vis-à-vis relevant legislation expressly aimed to deflate prices because (i) the perceived "bubble" may not "burst" after all, and may instead level off or gradually decline; (ii) the "bubble" legislation may be too late, so that by the time it is passed into legislation, the price levels have gone in a direction different than anticipated,[141] thus having an impact on the markets different than its stated objectives; (iii) even if the perceived bubble is a reality and it does in fact burst, the time up until that time is a source of great wealth for individuals who are free to either leave their money in real estate or withdraw at any time if they perceive that the risks and/or prices do not justify the benefits;[142] and (iv) at any rate, there are always "winners" and "losers" in the markets and the government's efforts may be better directed elsewhere than to determine the investment outcome for every one of its citizens.

6. Such government legislation will have the intended effect in the markets, as was provided for in its stated objectives

Market intervention is a risky business. Apart from the risks already mentioned, such as lags, undershooting, and overshooting of stated objectives, Nobel Prize winners in Economics, from Ronald Coase[143] to the current U.S. Federal Reserve Chairman, Alan Greenspan,[144] have demonstrated strong deference to the markets, and postulated alternatives to government enforced taxation.[145]

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maximizing profits. Maximizing profits means keeping costs as low as possible and making sales revenue as high as possible. Companies will want to change a price that is high enough to cover their costs but low enough to sell everything that they produce. All their decisions about how to allocate resources will be based on the desire to maximize profit." This theory applies to the corporate level. *See* Harding at 5-6.

[141] During the period from 2000 to 2003, the Korea Composite Index, or KOSPI, experienced negative returns on equity *See appendix 1.*

[142] One explanation of cost-benefit analysis is the "weighting up both the tangible and intangible costs of a particular strategy and setting against them its possible benefits. Where the benefits outweigh the costs it will pay the company to go ahead." *See* Harding at 166. *See also,* Sharpe, Alexander, Bailey, Fowler, and Domain at 806-807.

[143] Robert Coase won the Nobel Prize in Economics in 1991 "for his discovery and clarification of the significance of transaction costs and property rights for the institutional structure and functioning of the economy". Coase served as faculty for the University of Chicago, was editor of the University of Chicago's *Journal of Law and Economics,* and received a B.Sc. (Econ) from the London School of Economics.

[144] Regarding Greenspan's view on regulation and regulators, the Fed Chairman is quoted as saying, "Super-regulators tend to over-regulate and make unbelievable mistakes. I would suspect that I would know most of the people who would be in charge of making the types of judgments that would be required for that, and I will tell you that they don't have a clue as to what to do. I would much prefer to allow very complex market forces to tell us." *See* Bob Woodward, Maestro: Greenspan's Fed and the American Boom 194 (Pocket Books, 2001).

[145] The alternative approach by Ronald Coase is known as the "property rights" approach, which is

Irrespective of these risks, the actual market effects of the Anti-Speculation Laws, which culminated into the October 29, 2003 government announcement of the Anti-Speculation Laws, seem to have had a nominal effect at best on the Korean real estate markets.

In the weeks following the government's October 29, 2003 announcement, little impact has been made on the Korean real estate markets. For example, in the one-month period from October 29, 2003 to November 28, 2003, Seoul apartment prices fell a mere 0.85%.[146] Separately, the Korea Housing Institute (KHI) predicted that Seoul housing prices would decrease a total of a mere 1.8%.[147] Averaging the two figures, one can reasonably presume that Seoul housing prices could fall on average around 0.94%, barely reaching 1%. Thus, if putting notable downward pressure was the objective of the Anti-Speculation Laws, then the actual market affect falls short of expectations.

Above and beyond the evidence that housing prices have reacted nominally to the Anti-Speculation Laws, is the fact that the Anti-Speculation Laws ironically may have triggered a larger "bubble" in the Korean real estate markets.[148]

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an alternative approach to the more standard "tax or subsidy" approach posited by British economist, A.C. Pigou. The "property rights" approach suggests that creating new private sector institutions is better than using taxes or subsidies. *See* Thomas A. Pugel, International Economics 189 (McGraw-Hill, International Edition, 12th edition) [hereinafter *Pugel*].

More recently during a speech in Berlin, Greenspan also was quoted as saying, "we should be very careful in trying to alter the markets driving towards balance because with very major changes—not all of which we fully understand—there are risks that unexpected events can occur." *See* 'Unexpected Events' Risk Market, Greenspan Says, Korea Times, January 15, 2004, at 7. *See also generally,* Greenspan Defends Fed's 1990s Bubble Management, Korea Times, January 5, 2004, at 16.

[146] *See* Ji-eun Seo, Apartment Prices Dragged Lower, Korea Herald, November 28, 2003, at 17.

[147] *See* Keun-min Bae, Seoul Housing Prices to Fall 1.8%, Korea Times, January 8, 2004, at 10.

[148] Three pieces of evidence offer support for this. First, in a direct reaction to the Anti-Speculation Laws, construction companies in Korea have lowered sales targets for fiscal year 2004. *See* Keun-min Bae, Seoul Housing Prices to Fall 1.8%, Korea Times, January 8, 2003, at 10. This will in turn lower construction efforts, which will lower housing supply, and therefore, increase housing prices (counter to the Anti-Speculation Laws' stated objectives of lowering property prices). This methodology is based on the economic principle that scarcity drives prices higher. See Pugel at 700-702. Second, because the housing markets reacted nominally to the Anti-Speculation Laws, rumors have circulated throughout Seoul residents that housing prices have essentially "bottomed out" in the *Kangnam* area, and that prices will soon be on the rise again. See *supra note* 194. This type of market sentiment spurs (rather than curbs) housing investment, which in turn, will again fuel upward pressure on prices. Third, and finally, housing prices in some areas (including *Kangnam),* rose rather than fell, less than two weeks after the government's October 29, 2003 announcement. *See* Keun-min Bae, Seoul Apartment Prices, Korea Times, November 17, 2003, at 10. The article here provides evidence that the *Kangbuk* area saw prices rise 0.01 to 0.3% in mid-November, 2003 (i.e., approximately two weeks following the government's October 29, 2003 announcement). As further evidence of how the government's anti-speculation proposals have had little, or even an opposite effect, as the government intended, following the government's first real estate anti-speculation announcement on May 25, 2003, as Seoul saw a 0.9% *rise* in apartment prices and

B. Risks – Analysis and Commentary

In short, several broad risks exist with implementing the Anti-Speculation Laws, in addition to several tangentory sub-risks.

The first broad risk is that the government could possibly be incorrect in its view that current Korean residential real estate market prices far exceed its market values[149] (hereinafter, "calculation risk").[150]

The irony of trying to suppress such a profitability premium[151] is that a rise in market value after the purchase of property is a very necessary and appropriate means of increasing revenue for the government and its taxpaying constituents. In short, less profitability premium means less government revenue. Thus by artificially suppressing the domestic housing market, the government could be doing itself more harm than good in terms of government revenue, separate from the other risks discussed herein.[152]

Moreover, if the government wrongly labels the P1 to P0 differential, for example that a normal and beneficial profit premium was wrongly mislabeled as a housing "bubble" scenario, then two (2) specific inherent problems would arise, assuming legislative action in the form of the Anti-Speculation Laws were passed. The first problem is that wealth would unnecessarily be taken away from everyday investors. Rational

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Gyeonggi Province saw a 1.43% rise in the following month (i.e. June 2003). *See supra note* 194.

[149] If we assume that free market entry and market competition in the real estate markets are given, then the fair market price can be set according to market supply and demand. When buyer and seller both agree on a price set by free market competition, such a price is referred to as the "market price". *See* LEE R.Y. at 104

[150] Specifically, this calculation risk has three (3) subset risks. The first sub-set risk is that the government may inaccurately gauge, or alternatively, cherry-pick certain data of the large pool of data available relating to the housing market, to ascertain the current market price levels (P1). The second sub-set risk is that the government must also play market commentator by gauging a designated level as the appropriate market level (P0). The third sub-set risk is that, first, the government must correctly ascertain that the difference, if any, between P1 and P0 exists, and second, such difference is enough to constitute a so called "bubble" scenario rather than a perfectly acceptable profitability premium that exists in many residential housing of the world. A counter-argument exists, reflective of the government's argument, which states that, "Bubble theory of speculative markets is, asset prices sometimes move wildly above their true values. Eventually prices fall back to their original level, causing great losses for investors." *See* Stephen A. Ross, Randolph W. Westerfield, Jeffery F. Jaffe, and Gordon S. Roberts Corporate Finance 372 (McGraw-Hill Ryerson Ltd., Canadian 2nd ed., 1999)

[151] *See* Aswath Damodaran Investment Valuation 342 (John Wiley & Sons, Inc. 1996).

[152] Even assuming that the government has enough evidence to conclude that a difference between P1 and P0 exists, then the government must be forced to follow a very difficult, risky, and potentially subjective two-pronged decision matrix. The first prong is that the P1 to P0 differential constitutes a so-called "bubble" scenario rather than a profitability premium. The second prong is that, even assuming that a "bubble" scenario does exist in the Korean housing market, that such "bubble" is substantial enough to warrant extreme legislative action

investors[153] in the markets play by the same rule of buy low, sell high. That is, the vast preponderance of investors do not invest their resources into a select piece of property with the expectation to lose invested principal.[154] In fact, the opposite should hold true in that one very positive role of a well-functioning government should be to create a lucrative investment environment for both domestic and foreign players within a designated sector.

The Korean government did just this very effectively immediately after the 1997 IMF crisis. Specific efforts were taken to eliminate and/or liberalize many constraints to domestic investment. Examples of such efforts included measures to stop directed lending,[155] the elimination of foreign investment limits in certain industries, urging of domestic banks to increase lending to domestic consumers to help spur domestic spending, and other structural reforms in an effort to increase governmental transparency. The bottom line effect of all these efforts was a clear signal to the markets that Korea had rapidly transformed itself into a more investor friendly and transparent investment environment. In direct reaction to such positive governmental efforts, domestic and foreign investors began re-investing in the Korean markets, including the Korean residential real estate market.[156]

Here, however, the Anti-Speculation Laws would have the opposite effect than was intended. Instead of sending a clear and positive message to the markets that Korea is a strategic investment environment, the Anti-Speculation Laws would send a clear but unsettling message that Korea is no longer a strategic investment environment, and is rapidly racing back to its old habits of pre-1997 crony capitalism.[157] The net

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[153] *See id.* Sharpe, Alexander, Bailey, Fowler, and Domain at 138-140

[154] With the notable exception to the general rule being those investors who invest to lose money for purposes of reducing their taxable income. In this instance, it benefits the investor more to invest to lose than invest to gain.

[155] The term "directed lending" refers to practice of government-led financing to select industries and/or corporations. The most common form of such "directed lending" was below market interest rate loans to designated large Korean conglomerates, or *chaebol*.

[156] One of the most publicized examples of re-investment back into the Korean real estate market was the purchase by the Star Building, located in the *Kangnam* area of *Yeoksamdong*, by the Texas-based private equity firm of The LoneStar Fund in January 9, 2002. Such a large-scale investment of Korean real estate was a clear indication that investor confidence had been restored regarding Korean real estate investment in the post-1997 period.

[157] The term "crony capitalism" refers to a variant of capitalism in which the opportunity to open or succeed in business is heavily dependent on one's connections. This results in business decisions being powerfully influenced by business friendships and family ties rather than by impersonal market forces. The term is typically used to explain why a superficially market-based system (i.e., a market not fully driven by market forces) fails to generate economic growth. The term has been used to describe the economic systems of Korea, Japan, and Indonesia.

Crony capitalism also often describes a close relationship between government and business, but to a much lesser extent. Instead of the government directly controlling businesses, the government effect of even the mere perception of such a return back to crony capitalism, even if untrue, will be an immediate and potentially drastic net outflow offshore. In this event, capital would flow out of the Korean real estate markets to other domestic onshore markets. But perhaps much more of a risk from the Korean government's perspective would be capital outflow to non-domestic offshore markets.

The second broad risk is that the Anti-Speculation Laws would send a dangerous signal to the markets that the Korean government was in the business of acting as a constant market surveyor ready to strike at any given moment when it perceives that designated price levels have somehow crossed the fine line from equity appreciation to "bubble" levels warranting instant market price deflation.[158] Investors enter into every transaction on the basis of *caveat emptor.* But if the government sends out signals that it is in the business of acting as market commentator—holding up red, yellow, and green lights as signals as to if, when, and how its populace should invest—then the country's public policy is to create a nation dependent on the government, rather than the relevant individuals themselves or other qualified investment advisors trained to give investment advice, to make individual investment decisions on an independent basis. Related risks exist as well, which include inaccuracies of information, lags in receiving information, and lack of needed information.[159] In short, the public policy message that the Anti-Speculation Laws gives is that individual investors need not evaluate relevant investment risks because the government will do the analysis for them.

The United States government, with rare exception,[160] purposely

gives legislative favors to certain businesses - ease of permits, government grants, and specially created tax benefits. *See* David. C. Kang, Crony Capitalism Corruption and Development in South Korean and The Philippines, 51-53 (Cambridge University Press, 2002) *See also* Myung-hun Kang. 재벌과 한국경제 The Korean Business Conglomerate: Chaebol Then and Now, 172-176 (Nanam, 1996) *See* Eiteman, Stonehill, and Moffett at 43.

[158] The main problem in this scenario is that such instant price deflation towards a certain designated level would be chosen not by the markets, as in most developed nations, but by government officials.

[159] One of the well-known examples on incomplete information is "the parable of separate islands." This concept was first introduced by Edmund S. Phelps in, The Microeconomic Foundations of employment and Inflation (New York: W.W. Norton, 1970). Robert Lucas used this parable to explain the concept of incomplete information. In his explanation Lucas made up the economy with one single business unit based in a separate island, such as no one knows what happens on other separate islands. With this lack of information, the investor based in the separate island can make incorrect investment decisions. Therefore, incomplete information may increase the risk much more than expected. *See* Martin Neil Baily and Philip Friedman Macroeconomics, Financial Markets, and the International Sector 468 (Richard D. Irwin, Inc.,2nd ed., 1995)

[160] One example of such a rare exception occurred in the late 1980s with the savings and loan (S&L) crisis. Here, the U.S. government created the Resolution Trust Corporation (RTC) as a mechanism

chooses not to send out such clear market signals that would have the net effect of explicit guidance relating to personal investment decisions. For example, Alan Greenspan, current head of the U.S. Federal Reserve Board, elected not to implement monetary policy (i.e., to raise real interest rates) in an effort to burst the apparent equities bubble of the late 1990s. Instead, Greenspan opted to focus Fed policy towards the bubble's "consequences" rather than the bubble itself.[161] This type of non-interventionist policy relating to bubble bursting helped to fuel the largest post-war economic expansion in U.S. history and created unprecedented wealth creation for millions of Americans.[162] And from a broad policy standpoint, the Fed's policy instilled confidence that the markets, not the U.S. government, would dictate prices in the short and long run.

The Japanese government however does maintain such a practice from time to time. However, one clear outcome of this practice is a decade-long recession that put a sudden and grinding halt to the world's second largest economy.[163] Even more, in this scenario, even those investors left who are willing to take the risks of investing in the Korean real estate market, despite the Anti-Speculation Laws, will reap notably less financial rewards.[164]

The third broad risk is that, even assuming a "bubble scenario," what test should the government apply to intervene in the real estate markets? Ideally such a test should be uniform, clear, and transparent to instill investor confidence. But as it stands now, no statement has been given to the general public regarding the exact methodology as to when, how, and to what extent the government will apply any further related legislation. Such inaction does not reflect uniformity, clarity, or

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to assist the many troubled banking institutions involved. *See generally,* Mark Cassell, How Governments Privatize the Politics of Divestment in the United Stats and Germany, 3 (Georgetown University Press Washington, D.C., 2002)

161 *See* Associated Press, Greenspan Defends Fed's 1990s Bubble Management, Korea Times, January 5, 2004, at. 16.

162 Alan Greenspan's policy of not attempting to burst the late 1990s' equities bubble is sometimes colloquially referred to as "bubble management".

163 Japan currently ranks as the second largest economy in the world. *See* Gross Domestic Product (GDP) for OECD countries (February 6, 2004), *available at* http://www.iht.com/cgi-bin/adv_search.cgi?key=James+Brooke&from_year=2004&from_mon=2&to_year=2004&to_mon=2.

The United States ranks as the world's largest economy with 9463.9 US$ billion. Japan ranks second with 5867.2 US$ billion. According to one report, "The Japanese economy grew at a robust 7 percent annual rate in the fourth quarter of 2003, the Cabinet Office reported Wednesday, bringing the 2003 growth rate for the world's second-largest economy to 2.7 percent." *See* James Brooke, *Int'l Herald Tribune,* February 19 2004, at 1 & 8.

164 This effect follows yet another finance mantra of "no risk, no reward". But under the proposed legislative initiative, the risks remain the same while the returns are substantially diminished. Thus net investment flows will flow out of the real estate market, as was intended, but may flow to a much more severe degree and for a much longer time period than was ever projected or intended.

transparency, which will thus signal to the markets that the socio-political, economic, and legal landscape in Korea has indeed changed drastically from a once transparent investment environment based on open and free market principles back to the pre-1997 type crony capitalistic days of old where government and state were indistinguishable, where the government heavily influenced macroeconomic growth, and where the government, not the markets dictated investment behavior.

The fourth broad risk is that, even assuming that the Anti-Speculation Laws were completely valid at the time of conception, no assurance exists that the basic assumptions of the Anti-Speculation Laws will continue to hold true until they begin to take effect vis-à-vis formal approval by the Korean National Assembly.[165]

Alternatively, what if P1 fluctuates between P0 and P1, as markets historically have done, such that no material period of "bubble" sustainability exists but that the P1 to P0 premium constitutes a "bubble" from the government's perspective for several short-term periods, rather than one long sustained one. In this case, the government is again put in the awkward position of having to decide whether such conditions would warrant legislative action or not while the markets await nervously.[166]

The fifth broad risk is that the Anti-Speculation Laws may prove too successful. That is, the Anti-Speculation Laws can run the distinct risk of overreaching its stated objectives. This notion may at first blush seem counter-intuitive. But if one looks at recent Korean economic history, then a clear reminder of this very possible outcome arises. For example, closely following the post-1997 so called IMF crisis in Korea,[167] the government initiated several useful measures aimed at liberalizing regulations stifling free market competition and encouraging consumer lending to spur domestic economic spending and therefore macroeconomic growth.

Currently, however, a mere six years from the 1997 Asian financial crisis, we see the Korean economy in trouble again. This time no run on the official Korean Won exists. Instead, we see a population

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[165] The most obvious example is if the perceived current market price levels (P1) decline such that the "bubble" can be reconstituted as a mere profit premium either in the short or long term or both. In this case, the government is put in the awkward position of having to decide whether to move forward with the proposed legislation, or postpone such until the "bubble" reaches a designated and agreed upon period of sustainability. Then the question arises as to what such a period of "bubble" sustainability should be to warrant legislative action.

[166] Such investor anxiety runs the additional risk that emotions on Wall Street can turn from "greed" to "fear" with little or no notice, based on reality, or even the mere perception of reality, albeit accurate or not. The bottom line here is that truth and clarity matters to investors for the benefit of the Korean and global capital markets.

[167] *See* Krugman at 687-692.

heavily debt-ridden [168] because the government's post-1997 national economic plan to increase consumer lending worked too effectively. Korean consumers, many for the first time, had instant access to a large pool of funds in the form of credit availability. Consumers with little experience and apparently little fiscal discipline began to spend money that they could not repay in the short or perceivable long term.[169]

On the creditor side, Korean banks--per the government's post-1997 government initiatives--began to offer long lines of credit in the forms of vanilla loans and/or credit cards to undeserving consumers.[170]

Similarly, the Anti-Speculation Laws could easily overshoot its stated objectives causing a greater than expected deflation[171] of prices in the Korean real estate markets. Once investors see prices begin to drop steadily as a result of the formal passing of the Anti-Speculation Laws by the National Assembly, panic can quickly ensue. At first wealthy and well-informed investors[172] would pull out of real estate, quickly followed by less wealthy everyday investors. The possible cumulative net effect would be a rapid downward spiral in the Korean real estate market. Such herd-like behavior[173] may at first blush appear "irrational", but upon closer examination, such behavior may well indeed be "rational" since investors

[168] This in turn led to the current day worrisome high levels of personal indebtedness and bankruptcies. This reality ran counter to the policy assumption that the Confucian ideals of honor and discipline that many believe often epitomize Korean society would prevent payment defaults. As it turned out, this assumption was simply wrong.

[169] In a 2003 survey by the Bank of Korea ("BOK") of nearly 780 bank customers, credit card payments were the most popular form of payment method. Further, BOK economist Ji-ho Lee noted that South Koreans avoided using cash advance services in an effort to "control spending". *See* Jae-kyoung Kim, Koreans Have 3.9 Credit Cards on Average, Korea Times, January 6, 2004, at 11.

[170] One reason for this is that current Korean law does not readily allow creditors to gain access to individual credit history, and further, no truly comprehensive and centralized credit-reporting agency currently exists in Korea similar to such agencies like TRW in the U.S.. A very well publicized example of such problems on the creditor side can be seen with LG Card, a division of the LG Group conglomerate, which is in process of seeking reorganization and/or bankruptcy. To quote a source, "LG Card which has more than a million customers, is teetering on the brink of a liquidity crisis, and it is expected to suffer a shortage of about 400 billion won today in cash alone. Government officials are fretting over the worst-case scenario, under which the collapse of LG Card would have a domino effect on the entire financial market." Chi-dong, Lee, Banks to Decide Fate of LG Card Today, Korea Times, January 5, 2004, at 15.

[171] *See id.* at 378

[172] The 1998 Russian crisis is a classic example of high-end investor flight. During events leading up to the Russian crisis, the ruble exchange rate came under "severe pressure as capital flight by wealthy Russians led to large sales of rubles for foreign currencies." *See* Pugel at 530-531. During the last half of 1998, investor confidence dropped with downward selling pressure on both the Russian equities and debt markets. *Id.*

[173] "Electronic Herd" was discussed in Thomas L. Friedman's The Lexus and the Olive tree, as it related to global investors. In his text, Friedman explained that "the global market has become an electronic herd of anonymous traders and investors connected by screens and networks." These electronic herds invested globally to seek short-term gain. *See* Thomas L. Friedman The Lexus and the Olive tree, 13 (First Anchor Books, 2000)

are pulling out of their investments in an effort to mitigate potential losses. On a more macro and global scale, such a downward spiral in the real estate market could also conceivably trigger a possible slowdown in the Korean economy and/or reverse any economic recovery hoped for in fiscal year 2004.[174]

Global investors monitoring these events offshore may then decide to pull out of Korea altogether because of the perceived uncertain investment environment. Investors, both domestic and foreign, would then exchange KRW for U.S. Dollars, putting massive downward pressure on Korea's domestic currency.[175] The Bank of Korea would be forced to defend its currency by buying Korean Won and selling foreign currency, thus depleting its badly needed foreign currency reserves.[176] As investors witness these events in Korea, they may then become fearful of all their investments in Asia, such as in mainland China, Indonesia, and Thailand, as well as in seemingly unrelated emerging markets, such as in South America and Eastern Europe. The possible net effect here would be worldwide global contagion highly analogous to the 1997 Asian financial crisis.

The seventh broad risk is that the sudden government intervention into the real estate markets could un-nerve investors as it relates to investments in either related or even seemingly unrelated domestic financial markets. Such domestic markets may include, but not be limited to, the equities markets (i.e., KOSPI / KOSDAQ), bond markets (most notably high-profile corporate debt), and the foreign exchange (FX) markets.[177] As an example of how the Korean markets could be unsettled by foreign investor sentiment alone, foreign investors made up 5.24% of the total stock trading value in the Korean equity markets in 1999,[178] with

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[174] The reason for this is that investors pulling out of real estate would be fearful of reinvesting into the equity or bond markets because neither market would appear attractive, and would instead hold their money in the form of savings deposits or similar risk-averse instruments.

[175] *See* J. Orlin Grabbe International Financial Markets 436-441 (Prentice Hall International, Inc., 3rd.ed., 1996)

[176] This is one of the defensive actions, which can be initiated by the central bank. *See* Chou Son, Jung Wun Chan, and Jeun Sung In, 경제학원론 Principles of Economics, 664-671 (Yulgokbooks, 7th ed., 2003).

[177] In terms of investors being driven from real estate property markets to other areas, one notable trend following the recent October 29, 2003 anti-speculation proposals is the shift of money into the *land* market (as opposed to the real estate property markets). Korean investors are investing in land in areas surrounding metropolitan areas and speculation zones, where large developments plans are thought to begin. Such land is at times traded at auctions, where bidding prices soar up to twice that of face value. Thus, in this sense, even assuming the Anti-Speculation Laws did counter the real estate *property* "bubble", its legislation has subsequently and directly created the beginning of a new real estate *land* "bubble". *See* *Byung-joon Koh*, Housing Prices Seen Dropping 3-5% Korea Herald, January 28, 2004, at 18.

[178] *See* Korea Stock Exchange, Stock Trading Value by Investor Group, *available at*

the figure increasing to 16.73 percent in 2003.[179]

The eighth broad risk is that increasing the tax burden on individuals during a time of recession or recession-like conditions as in the case of Korea, can greatly exacerbate efforts to spur domestic consumption because individuals will have relatively less disposable income[180] to spend on domestic goods and services, which may very well act to protract not spur macroeconomic growth. For example, the Anti-Speculation Law acts to curb real estate investment by dramatically increasing the transfer income tax rate by 60% for individuals owning more than three homes, with a maximum transfer income tax rate on multiple homeowners of 82.5%.[181]

Even assuming that the government should play the role of market commentator, one way that the government can send out market signals[182] is to cut taxes in certain residential zones, rather than increasing taxes in others. And as an alternative to the alternative, do both. That is, cut taxes in certain regions of Seoul while at the same time—if absolutely necessary and assuming no other viable options exist—also increase taxes in certain target regions of Seoul. In this scenario, tax burdens can perceivably net out at zero, thus achieving the government's objective of signaling exactly where investors should invest their money without imposing any additional tax burden on its residents.

One additional consideration in the analysis is that the broad risks outlined above should not be assumed to be mutually exclusive.[183] One or more of the broad risks outlined may occur simultaneously or near-simultaneously. When investor confidence weakens, a panic mentality can quickly engulf the markets as a whole, and may seemingly override

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http://www.kse.or.kr/webkor/tong/tong_index.jsp.

[179] *See* id. The figure is based on stock trading value by investor group.

[180] Regarding disposable income, "Domestic disposable income is influencing the current account. Since a rise in domestic disposable income causes domestic consumers to increase their spending on all goods, an increase in disposable income worsens the current account, other things being equal." *See* Krugman at 437.

[181] *See* Staff Writer, Real Estate Speculation, *Korea Times*, January 1, 2004, at 5.

[182] Political scientists Rawls and Nozick present us with two different principles about the role of government. Rawls focuses on "appropriate regulation" to ensure that the outcomes of a market economy are "just". *See* Edward E Zajac, Political Economy of Fairness, 141-142 (MIT Press, 1995). However, Nozick believes "abhorrent any government interference beyond that necessary to protect individuals from harms inflicted by others." *Id.* With these two views of government role, we can start to look the goal of government. The most important goal of government has been to "stabilize the economy" with fiscal and monetary policy to control inflation and to stimulate the economy. *Id.* The second important goal of government has been to redistribute income to achieve a social purpose. To achieve these goals, the government has two main instruments—taxes and direct control of actions. *Id.*

[183] *See* Ross, Westerfield, Jaffe, and Roberts at 162.

"rational" behavioral tendencies in the short run.[184]

X. CONCLUSION

The Anti-Speculation Laws may seemingly represent a good faith effort on behalf of the Korean government to curb real estate investment speculation. However, notable risks and increased tax burdens exist (such tax burdens applying to nearly every type of investor, not only to short-term property investors, but also to long-term property investors as well) which could outweigh the benefits of the Anti-Speculation Laws' objective of curbing perceived short-term property investment speculation.

As an alternative, the government may be better served to provide more specific legislation (i.e., which increases property and capital gains taxes only for "short-term" property investments) and in all other cases, reduce (not increase), property and capital gains tax obligations to serve as an investor incentive. By doing this, tax burdens are minimized and property investment incentives are reallocated per the government's objectives.

In conclusion, the combination of the risks noted herein and the increased tax burden not only sends a worrisome policy message that (i) the government and not market forces play the dominant role in setting real estate prices; (ii) the broad measures that apply to most property owners may be overly broad, as it applies not just to short-term investors involved in possible speculative investment activity, but to the majority of

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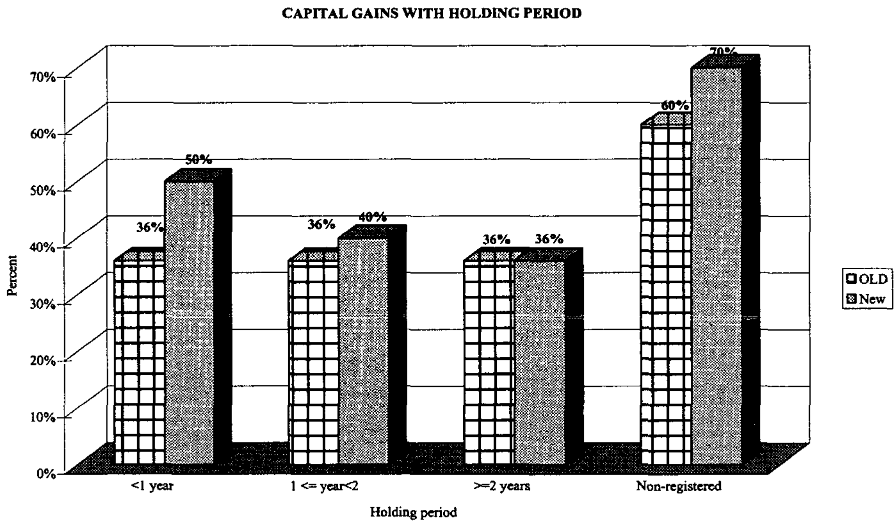
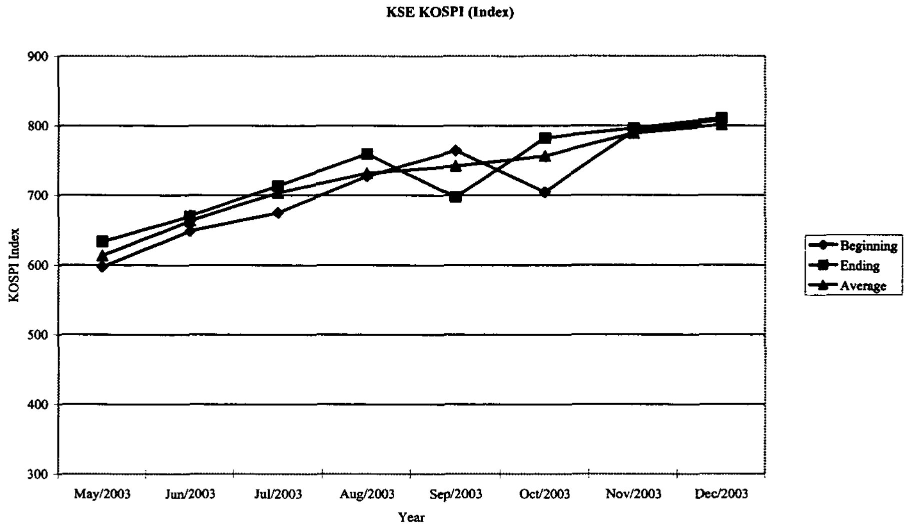
[184] As the mantra in the financial markets and Wall Street goes, only two emotions exist in the markets, "greed" and "fear". In this respect, history has clearly demonstrated that it does not take much, in substance or form, to go from one extreme to the other. History has also shown that government action that goes against the grain of the markets tends to fail more than succeed. For example, this year alone, the Bank of Japan (BOJ) has spent nearly 100 billion U.S. Dollar to keep its domestic currency, the Japanese Yen, from depreciating further against the U.S. Dollar. *See* Ronald I. McKinno and kenichi Ohno, Dollar and Yen the Resolving Economic Conflict between United States and Japan, 228 (MIT, 1997). The monetary policy of undervaluing one's domestic currency represents a deliberate and overt method by the Japanese government to help its domestic producers boost exports by making its products appear less expensive relative to the importing country's domestic goods.

This type of monetary policy may seem fine at first instance, but upon closer examination, it is the Japanese consumer not producer that pays for the trillions of Japanese Yen to fund Japan's monetary policy. Taking this analysis one step further, one can surmise that Japan's overall wealth is not maximized by allocating precious monetary resources from its consumers--who themselves would and should be in the position to make investment decisions--to its large producers. One clear instance of such aggregate national wealth loss is that Japanese consumers have relatively less earnings to spend domestically on goods and services. Such loss in domestic consumer spending could very well offset any gains in producer exports. And even more, this runs counter to the Japanese government's apparent policy of export-led growth in an effort to end its decade-long economic malaise.

property investors, both in the short and long term; and (iii) such legislation could scare investors out of the Korean markets, which could jeopardize Korea's economic sustainability as well as the stability of the international financial markets.

XI. APPENDIX




KSE KOSPI (Index)
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KOSPI Index
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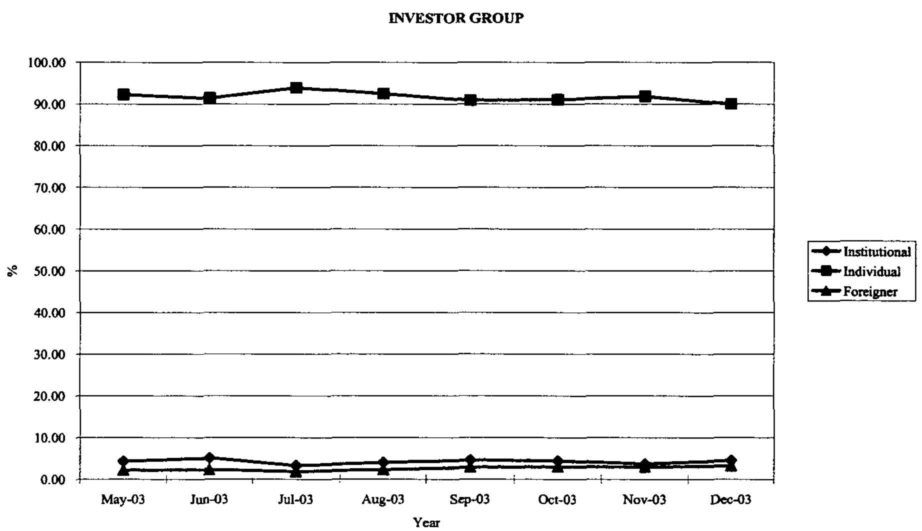
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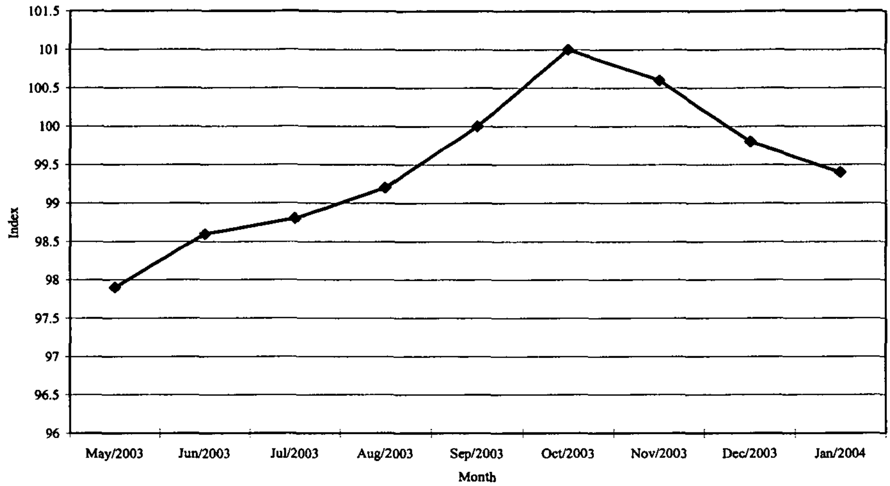
MONTHLY PRICE INDEX



YEARLY HOUSING PRICE (1990~2003)