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Government housing policies and housing market instability in Korea

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A B S T R A C T

This study examines the impact of housing policies and macroeconomic variables on housing price instability during the Roh, Mu Hyun Administration (2003–2008) in Korea. Although researchers have documented the role of macroeconomic variables on changes in housing prices, few have addressed the relationship between governmental housing stabilization policies and housing price fluctuations. Using a statistical method, this research focuses on whether policy initiatives taken by the Roh Administration to stabilize housing prices resulted in the expected outcome of a stabilized housing market. Controlling for macroeconomic variables, our empirical analysis reveals that the housing price stability policies of the Roh Administration had no observable impact on the stabilization of the Korean housing market. Conventional macroeconomic variables—the money supply, corporate bond returns, and the number of permits for building construction and actual orders for building construction—have a statistically significant association with housing price instability in Korea. This research discusses policy implications resulting from the ineffectiveness of housing stability initiatives in the Roh Administration.

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Introduction

Since the housing market is an imperfect, competitive market, governments have always justified intervention in the housing market. In particular, governmental intervention that aims to stabilize prices in the housing market has been a popular approach taken by Korean governments over the past several decades. Rather than depending on the housing market that may correct itself, the Korean government, in an effort to control for speculative demands, has been actively engaged in the stabilization of the housing market. During the national financial crisis of 1998, the government of Kim, Dae Jung took dramatic measures to stabilize the real estate market, but the deregulation policies of his administration led to a decrease in the housing supply and an increase in housing prices (Hong, Kim, & Lee, 2007).

In 2003, Koreans elected a new president, Roh, Mu Hyun, who established a new administration called the "Participatory Government." During his administration between 2003 and 2008, the participatory government announced numerous real estate and housing policies to facilitate housing price stabilization. However, Ahn (2007) has asserted that the real estate and housing policies of the Roh Administration lacked consistency and attempted to limit the control of speculative demand. Aside from this study, few researchers have evaluated the impact of the housing policies of the administration on housing price fluctuation.

Many studies have attempted to identify the relationship between governmental housing stabilization policies and housing price fluctuation (Hong et al., 2007; Kim, 2005; Kim, 2007; Kim & Jung, 2001; Jung, 2007). Kim (2007) identified the relationship between housing policies and housing costs after the foreign currency crisis in 1998. He claimed that real estate policies were unable to accomplish the expected goals. Similarly, Kim (2005) argued that real estate policies failed to stabilize the market by decreasing housing prices as intended. Clearly, the timely implementation of the policy did not achieve the expected results, and government regulations aimed at lowering housing prices were ineffective. Among the few other studies, Hong et al. (2007), calculating the duration of the impulse response through their impulse response functional analysis, showed that real estate policies influence housing prices.

Previous studies focused on only the relationship between housing policies and housing prices over a long period of time, but they have not addressed the dynamic relationship between housing policies and housing prices. Many earlier studies simply examined housing price fluctuation with housing policies in each administration without applying any meaningful statistical methods. To remedy these shortcomings, this study departs from previous studies by using the following methodological approach. First, this study defines and measures instability in the housing

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market and examines whether the housing price stability initiatives of the Roh Administration have resulted in the expected outcome of a stabilized housing market. Second, it will estimate housing price instability that was defined as unexpected change during the period of the Roh Administration using an autoregressive model. Such a model is very useful for measuring housing price instability. Finally, the study examines the impact of official announcements of governmental housing policies on housing price fluctuations, controlling for macroeconomic variables that may affect housing price instability.

This study contributes to the body of literature that examines the impact of governmental housing policies on housing price fluctuations by taking into account macrovariables and other explanatory variables. The findings in this study provide policy implications to stabilize the housing market in Korea.

Real estate and housing policies in Korea

Since Korea has experienced significant fluctuation in housing prices over the past several decades, the government has intervened to stabilize them and reduce the magnitude of fluctuations in the national economy. The stabilization of the housing market has been a major focus of Korean public policy.

Fig. 1 illustrates historical trends in housing prices for the nation, the capital city of Seoul, and the Gangnam area (located in the southern part of Seoul) from 1986 to 2008. Housing prices peaked in the late 1980s, followed by a continuous decline in the 1990s after the Korean government initiated the construction of two million housing units between 1989 and 1992 in order to relieve a housing shortage. This massive buildup in the supply of housing contributed to stabilizing housing prices with a continuous decrease in housing prices until 1997. During the Kim, Dae Jung Administration, however, housing prices rose almost 40% from 1998 to 2003. The priority of the new administration of Roh, Mu Hyun in 2003 was to stabilize the housing market and deter speculative demand.

Housing prices experienced significant fluctuation during two periods between 2001 and 2006. After housing prices plummeted during the Asian financial crisis in 1998 and bounced back in 1999, they soared in 2002 and again in 2006 (Jones & McDaniel, 2007; Jones & Yokoyama, 2008). Housing prices rose 23.9% over the next 5 years until the end of 2007, showing a 64.6% increase over the previous ten years. In addition, a real estate bubble rose in the geographically limited area of Gangnam and in some suburban cities (Jones & Yokoyama, 2008).

The Korean government has traditionally relied on a package of regulation, taxation, and finance to stabilize the housing market. Between 2003 and 2007, the Roh, Mu Hyun Administration announced diverse real estate and housing polices for housing market stabilization. These policies were aimed at removing the instability surrounding the real estate market as quickly as possible and intended to shape real estate regulations for a stabilized and advanced real estate market in the long-term. The campaign was convincing and the policies were geared toward achieving the goals of stabilizing housing for ordinary people and restraining speculative demand. While firmly pushing ahead with the core policies, the government intended to minimize the inconvenience and burden placed on ordinary people from. Practicable and tangible supply policies along with strong anti-speculative actions were formulated to ensure maximum utilization of readily usable land for housing. In addition, an institutional mechanism, that laid a solid foundation for stabilizing real estate prices, was put into place (Ministry of Strategy and Finance in Korea, 2005a).

Real estate and housing policies in the Roh Administration were comprised of three parts: an increase in the housing supply, a decrease in housing demand, and a decrease in housing prices. To increase housing supply, the Roh Administration expanded monetary support for public and rental housing projects. The government also provided incentives in terms of regulation and taxes to encourage the private sector to purchase the supply of rental housing units. In addition, the Roh Administration intended to regulate speculative housing demand. For example, it limited mortgage loans to only one per person in the designated speculation zones. The administration simplified the complicated patchwork of regulations that were improved by the Land Use Regulation Rationalization Act. Finally, the administration tried to depress inflated housing prices by implementing a new housing stabilization policy referred to as the 8.31 Measure (August 31, 2005). The primary goal of the measure was to stabilize the housing market, controlling for speculative demand in real estate submarkets such as the Gangnam area (the southern part of Seoul). This measure imposed stiff penalties on the violation of permits and development charges for new construction. The regulations also restricted the height at which an elevator becomes compulsory. To increase the supply of affordable housing units, the regulation legalized small previously illegal structures or expansions upon the submission of written acknowledgment. Despite these measures, housing prices soared in the Gangnam area in early 2006 and then spread into the Gangbuk area (located in the northern part of Seoul).

Housing market instability and its determinant factors

Instability is defined as frequent and unexpected changes in fiscal, monetary, and trade policies (Ali & Isse, 2004). According to Chowdhry and Nanda (1998), the source of price instability is the

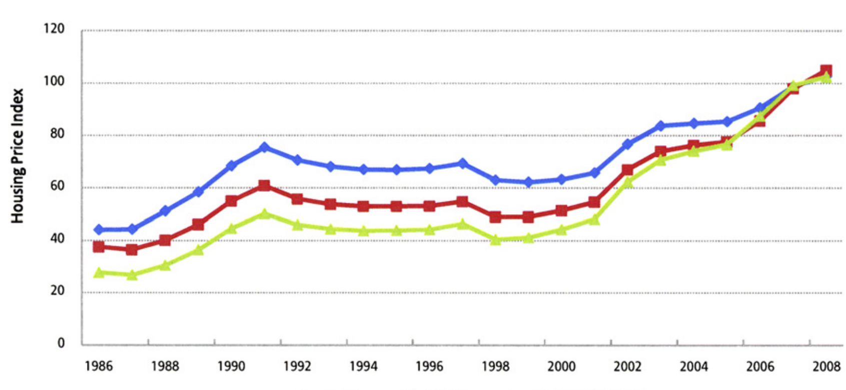

Fig. 1. Trends in the Housing Price Index, 1986–2008, South Korea. Source: Kookmin Bank, National Housing Price Survey.