

Lee, Hojun

Research Report

Regulatory Takings and Evasion of Compensation Requirement through Overlapping Regulations

KDI Focus, No. 70

Provided in Cooperation with:

Korea Development Institute (KDI), Sejong

Suggested Citation: Lee, Hojun (2016) : Regulatory Takings and Evasion of Compensation Requirement through Overlapping Regulations, KDI Focus, No. 70, Korea Development Institute (KDI), Sejong,
<https://doi.org/10.22740/kdi.focus.e.2016.70>

This Version is available at:

<https://hdl.handle.net/10419/200870>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.



KDI FOCUS

August 29, 2016 (No. 70, eng.)

For Inquiry: KDI Communications Unit

Address: 263, Namsejong-ro, Sejong-si 30149, Korea

Tel: 82-44-550-4030 **Fax:** 82-44-550-0652

Writer | Hojun Lee, Fellow at KDI (82-44-550-4752)

KDI FOCUS | Analysis on critical pending issues of the Korean economy to enhance public understanding of the economy and provide useful policy alternatives

Korea's Leading Think Tank

www.kdi.re.kr

Regulatory Takings and Evasion of Compensation Requirement through Overlapping Regulations*

Hojun Lee, Fellow at KDI

“The public’s awareness of property rights has improved significantly, and judicial authorities, including the Constitutional Court, more frequently rule in favor of property rights protection than ever before. Accordingly, it has become vital that a shift be made with regards to conventional perceptions of property rights protection and compensation, and existing systems are reformed in the process of adopting or upgrading regulations.”

I. Introduction

Despite the high premium placed on the protection of property rights in the market economy, the government can also lawfully curtail these rights in line with public needs. Indeed, the constitution of the Republic of Korea stipulates that private property can be partially expropriated, utilized or restricted for public necessity, with the provision of compensation.¹⁾ In other words, even a market economy that is in full compliance with the principles of property rights protection can sanction the infringement of rights for the

* This paper is written based on Lee, Hojun, “A Study on Regulatory Takings and Property Rights: Focusing on Development Restriction Zones,” Policy Study 2015-09, Korea Development Institute, 2015 (*in Korean*).

1) Articles 23.3 and 37.2 of the Constitution of Republic of Korea.

purposes of rectifying certain systematic side effects such as market failure.

Nonetheless, to efficiently manage a market economy, explicit criteria—founded on fair, institutional and historical principles—on the conditions for state limitations and compensation provisions are essential. When the challenges presented by the government's intervention become harder to anticipate and uncertainties over the guaranteed compensation run deep, the cost shouldered by society inevitably mounts. The social cost here refers to the conflict and unethical practices such as illegal lobbying that can arise when the matter of reimbursement relies solely on the discretion of the individual in charge. Consequently, growing uncertainties will distort investment decisions of market participants and hike up insurance expenses to cover the related risks.

Korea has of yet to establish such criteria and instead, simply relies on the discretionary decision of those who hold administrative authority. As such, this paper intends to discuss the legitimacy of restrictions and standards for compensation, particularly focusing on relevant regulations. Then, the evasive practices of both central and local governments in dealing with the provision of compensation are identified and suggestions to improve the existing system are presented.

Korea lacks definitive criteria that define justifiable state limitations on property rights and compensation and instead, relies on the discretion of those who hold administrative authority.

II . Regulatory Infringement on Property Rights and Criteria for Compensation

Governmental regulations affect the economic activities of individual agents, exerting direct and indirect influence over their property rights in the process. For some, the impact may be significant and as such, the consequences of intervention and reimbursement must be carefully considered before making important decisions.

Accordingly, the issue of establishing set standards for compensation is critical as they determine whether and how much compensation is required in certain cases of regulatory infringement, especially for property loss. Moreover, the standards must be applied in a consistent manner to enhance the accuracy of expectations for regulations as this has great significance to economic efficiency. In this context, this section presents two criterions and illustrates how they can work in hypothetical cases.

The decision on compensation requires consideration of both the nature of the regulation and the amount of loss. Thus, the two representative criterions²⁾ are as follows and summarized in <Table 1>:

The two representative criterions to determine whether to compensate for loss are (1) well-recognized right before infringement and (2) disproportionality.

- (1) Is the right thoroughly recognized to be worthy of protection before the infringement?
- (2) How large is the disproportionality between the loss and benefit for a specific party due to the concerned regulations?

2) Refer to Lee (2016) and Kim and Lee (2016) for further details.

<Table 1> Standard for Compensation

	Well-recognized right before infringement	Disproportionality	Compensation
A) Product designated as hazardous	x	0	x
(b) Property designated as historic architecture	0	0	0
(c) New traffic light	x	x	x
(d) Ban on factory construction in a residential zone	0	x	x

And here are four hypothetical cases that apply:

- (A) Producer who is no longer able to manufacture a certain product as the product has been deemed “hazardous.”
- (B) Building owner subject to restrictions as his/her building has been deemed to be historical architecture.
- (C) Driver who has to spend more time and fuel on commuting because of a new traffic light.
- (D) Land owner who is denied permission to build a factory on his/her own land because the land is located in a residential zone.

In case (A), the producer will suffer from asset losses due to government regulations. Manufacturers’ participation and protection in the market are guaranteed only under the premise that the product is not hazardous. Therefore, despite the huge disproportionality between the loss and benefit on the producer’s side, i.e. the incurred loss is much larger than the earned benefit, compensation is deemed unnecessary.

Despite the fact the free use of one’s own property, within reason, is a just and fully recognized right, the building owner in case (B) will incur loss as the use of his/her own property, including additions, renovation and reconstruction, has been restricted by the government’s designation of the property as historical architecture. However, as the designation entails a much larger disproportionality than case (A), compensation is necessary.

The driver in case (C) will experience loss in the form of increased commuting time and fuel costs due to the installment of a new traffic light on the way to work. However, it is difficult to say that the loss is an established right to be protected. In fact, the benefits may outweigh the loss as the traffic light may improve traffic flow. As such, compensation is unnecessary.

Government regulations have forbidden the land owner in case (D) to build a factory on his/her own land as it is located in a residential zone. Although it is a recognized right to use one’s land, within reason, for production activities, the question of whether there is disproportionality or not is dubious. In principle, all land is subject to certain regulations, hence land owners are obliged to use the land in compliance with the law. And, unlike case (B), the regulations do not create excessive burdens that are carried by the owner alone.

That is, the regulation in this case creates both social benefits and burdens that are shared by the public, hence there is no large disproportionality and no need for compensation.

III . Actual Cases Demanding Compensation for Regulatory Takings

Representative regulatory takings that call for proper compensation include regulations on development restriction zones and development activity in areas designated for urban planning facilities.

Based on the above criteria, this section looks into two actual cases of regulatory takings that call for proper compensation. First is the case of development restriction zones (green belt regulations), a major regulation that affects private property rights. Since the 1970s, the government has restricted development in the city's neighboring regions by designating them as 'development restriction zones,' which account for 5.4% of the entire land. The regulations aim to prevent urban sprawl and ensure a healthy living environment for citizens through the conservation of nature. Designated zones are subject to regulations that prohibit "constructing buildings and changing their use, installing structures, changing the form and quality of land, felling trees, dividing land, or stockpiling articles." Given that the regulation is severely restrictive compared to other regulations on general land, the recognized rights of land owners in development restriction zones are infringed upon.

The property loss generated by the regulations is confirmed through specific data on land prices. Lee (2015) closely examines the regulatory impact on land prices, focusing on restriction-lifted areas in the early 2000s. The lifting of restrictions often comes with large-scale development projects, therefore it is difficult to differentiate between which consequences were caused by the revocation and which by the project. Accordingly, Lee (2015) and this study analyzed the impact of the designation and revocation on land prices, particularly in Jongno-gu and Seocho-gu in Seoul, and Siheung-si and Hanam-si in Gyeonggi province, all of which were unrelated to any development project.³⁾

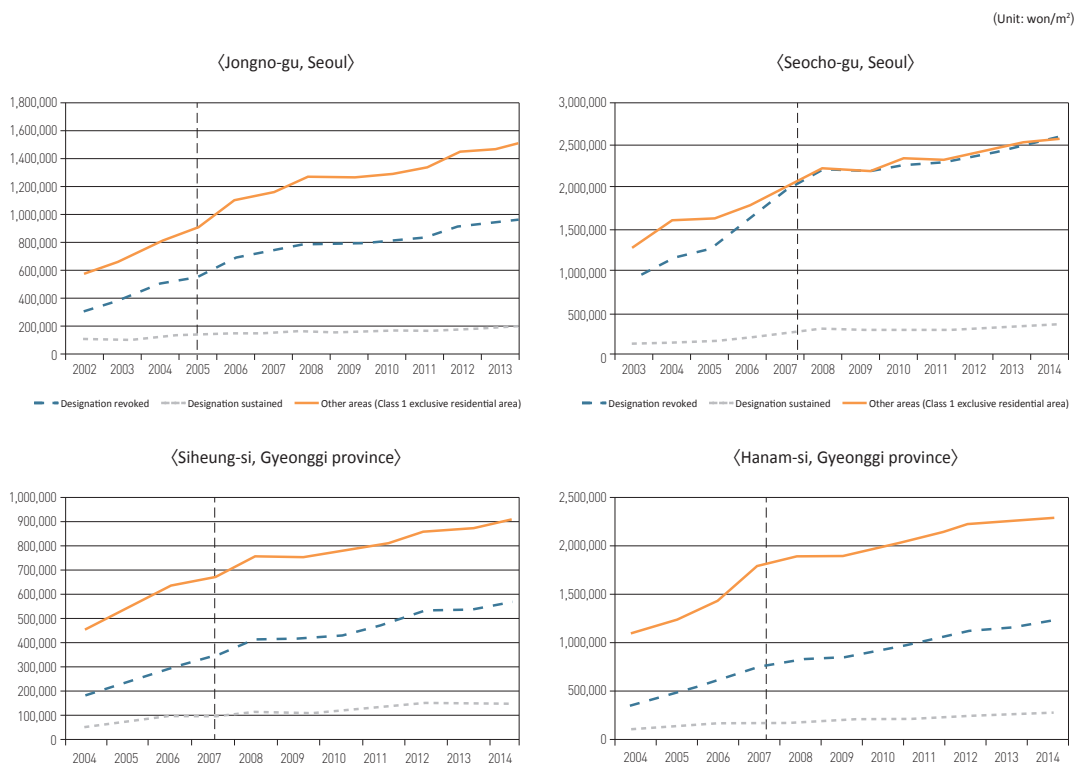
As anticipated, the analysis results showed that land prices were significantly affected by both designation and revocation. The average price of restriction-lifted land increased by 360%-660% higher than that of neighboring development restriction zones (in the same land category), but merely by 46%-94% than that of neighboring land that have never been designated. The price variation in the former is due to the possibility for future development while that in the latter is the accumulated result of limited development investment over the past three decades.

As shown in [Figure 1], the price of restriction-lifted regions rose much higher after revocation than that of nearby designated zones, but lower than that of nearby land that have never been designated.⁴⁾ This implies that designation considerably influences the rights of property owners in designated zones.

3) Refer to Lee (2015) for intensive empirical analysis based on land price data.

4) As shown in [Figure 1], land prices of development restriction zones have been affected by the revocation of designation prior to the announcement of the final decision, because revocation procedures take several years, which is enough time for land prices to reflect the relevant information.

[Figure 1] Comparison of Land Prices Pre- and Post-revocation



Source: Lee (2015).

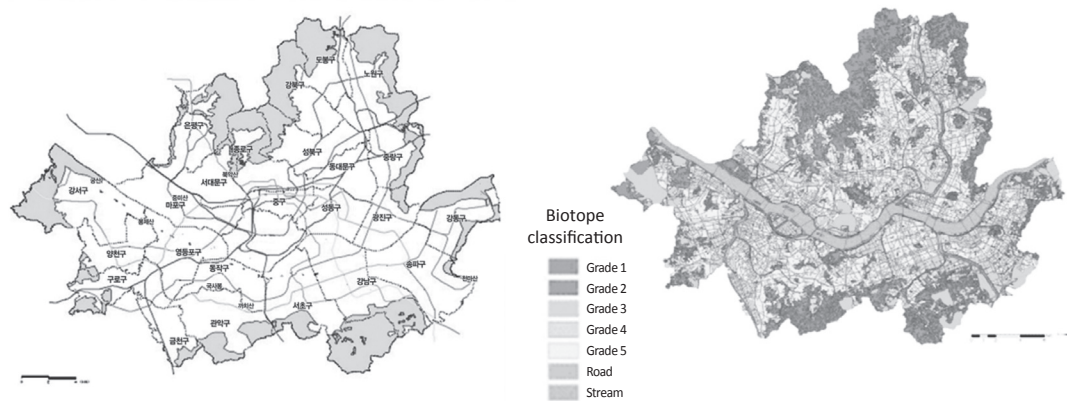
Since the aim of designation is to “ensure a healthy living environment for citizens,” the benefits are shared by the public, not a specific group. Nevertheless, the burden arising from the designation is solely shouldered by property owners, pointing to a relatively huge disproportionality. Thus, according to the criteria above, the property owners in this case deserve compensation. Using a similar rationale, the Constitutional Court of Korea decided in 1998 that the existing regulation lacked compensation rules.⁵⁾ And although the government later established measures for compensation in the form of ‘Application for Land Purchase,’ there still lacks a direct form of compensation provision.⁶⁾

Take for example, land that has been designated for ‘urban planning facilities’ by the Urban Planning Act. Once designated, any and all development activities are prohibited

5) According to the decision by the Constitutional Court (90 Heon-Ma 16), the system for development restriction zones under the National Land Planning and Utilization Act is itself constitutional in principle, but can be deemed unconstitutional only in exceptional cases in which just compensations are not provided to the owner of the land to whom the designation has imposed severe burden beyond social constraints. To put it another way, when the land owner is prohibited from using the land for its original purpose or there are no other legal ways to use the land, and the owner is left no option with regards to the use of land or profit, this case is considered to be subject to the category of burden beyond social constraints, as the land owner has nothing more than the ownership of the land; he is deemed to have nothing substantial.

6) Refer to the decision by the Constitutional Court (99 Heon-Ba 110, 2000 Hen-Ba 46, consolidated). There was a discussion as to whether to compensate the owner of the land designated as ‘national parks’ by National Parks Act for the loss from the land use limitation. At the Constitutional Court, five out of nine judges delivered their opinion that the Act newly added the provision for ‘Application for Land Purchase’ but still lacks compensation methods, and hence the regulation is ‘Unconformable to Constitution’ or ‘Unconstitutional.’ The Act is ruled constitutional due to the insufficient required quorum, but still the decision has great implications.

[Figure 2] Comparison between Development Restriction Zones and Biotopes in Seoul



Source: Seoul Metropolitan Government.

under the assumption that there will be a future need to build public facilities. However, even when a project is underway, it may take several decades due to delays and difficulties including a lack of funds. As such, land owners incur huge losses as they are unable to use their land for the duration of this period. As in the aforementioned case of development restriction zones, the property rights of the owners are not unlike that of general property owners and as such, there exists significant disproportionality and the appropriate compensation should be provided.

For this reason, the Constitutional Court decided in 1999 that the future designation of urban planning facilities shall have proper guidelines for the provision of compensation for property rights infringement and that preceding cases of infringement shall also be compensated. Accordingly, relevant laws were revised to revoke projects for ‘urban planning facilities’ that have been stalled for several decades after 2020 and also to remove similar future projects that do not commence within 20 years of designation.⁷⁾

IV . Evasion of Compensation Requirement through Overlapping Regulations

The above implies that compensation is necessary to a certain degree for the loss incurred by development restrictions. In reality, however, some local authorities have implemented additional regulations with the intention of avoiding the Constitutional Court’s decision on the provision of compensation. See [Figure 2].

The map on the left illustrates Seoul’s development restriction zones as of 2010, while the right shows biotopes (urban ecological status)—for which mapping started in June 2010. The darkest areas on the edge indicate Grade 1 biotopes.⁸⁾ The comparison shows the

7) Refer to Article 48 of National Land Planning and Utilization Act. The provision was newly added to the amendment of the Act in July, 2000, and with 1st July 2000 as a starting point of reckoning, several unstarted facility projects that were determined or announced before then will be revoked on the following date of 1st July 2020.

8) Biotope is a term coined from the Greek words ‘Bios’ meaning life and ‘Topos’ meaning place, and describes an area with specific uniform environmental conditions providing habitat for a specific biocenosis. Biotope evaluations conducted by

dark areas of the two maps overlap almost completely. According to the Seoul Metropolitan Government Ordinance on Urban Planning, all development activities are prohibited from Grade 1 biotopes, leaving no room for development permits. In this context, biotope regulations and development restriction zone regulations are very much alike.

In the wake of the Constitutional Court's decision, there have been a rapid outpour of complaints from owners of restricted land. However, instead of implementing regulatory reform to provide better protection of property rights, local governments have avoided compensation responsibilities by newly adopting similar but outwardly different regulations.⁹⁾ In other words, after being ordered to pay out compensation by the Constitutional Court, local authorities evaded the obligation by adopting overlapping regulations that have not been ruled upon.¹⁰⁾

Similar cases can be found for urban planning facility projects that have not commenced for long periods. In accordance with the Constitutional Court's decision, heads of local governments in charge of granting approval for such projects, must decide by 2020 on whether delayed projects should continue. [Figure 3] shows yearly data on the number of delayed projects by ten or more years for urban planning facilities. The number of unstarted projects has receded slightly since the court ruling, but the designated land is still 1.5 times larger than Seoul in size. This is because local governments have been lax in revocation while hesitating to commence projects due to budget constraints.

Meanwhile, as shown in [Figure 3], parks account for the largest proportion of urban planning facility projects that have been stalled for long periods. Among the type of park, 'urban natural parks'—definition from the Act on Urban Parks, Greenbelts, etc.—is the largest and most common type, with the most problems regarding property rights infringement caused by long-term delays.¹¹⁾

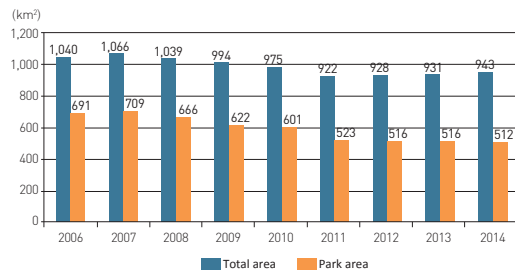
A closer look reveals the following. According to [Figure 4], the area for urban natural parks has rapidly decreased since 2008, possibly implying that the degree of infringement

Despite the Constitutional Court's decision in favor of compensation for the loss incurred via the regulations on development restriction zones and long-protracted projects for urban planning facilities, local authorities have sought to adopt additional regulations in order to evade paying compensation.

the Seoul Metropolitan Government consists of its type and individual assessments: Depending on the results, areas are classified into five grades (1-5) in type assessment and three grades (1-3) in individual assessments. According to Article 24 and its attached <Table 1> of the Seoul Metropolitan Government Ordinance on Urban Planning, areas that are assessed to be Grade 1 in both type and individual assessment in the investigation into current status of urban ecology requires absolute conservation, meaning no development activities are allowed with no room for permission.

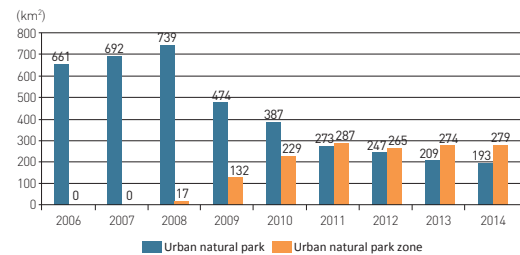
- 9) The Green Area Planning Division of the Ministry of Land, Infrastructure and Transport, handling policies on development restriction zones, commented that areas subject to development restriction and biotope regulations are somewhat overlapping, but each seek different goals with little room for suspicion with regards to intentions of evading compensation payment. Also, it stressed that it has consistently expanded budgets to provide residents in the development restriction zones with more convenience facilities so as to make them feel more comfortable.
- 10) It is the central government that introduced the system for development restriction zones, but local governments as well have to shoulder the burden of claims regarding compensation and revocation. It seems that they have tried to lighten the burden by adopting new regulations. Also, the Constitutional Court's decision has made them reach this recognition that development restriction zones are no longer enough to meet the demand for regulations such as environmental protection.
- 11) Before the amendment in 2005, the Act on Urban Parks, Greenbelts, etc. listed five subdivisions of urban parks; children's parks, neighborhood parks, urban natural parks, cemetery parks and sports parks. After the amendment, these divisions were further divided into sub-categories, removing urban natural parks from the list. However, its Enforcement Rule allows that areas designated urban natural parks before the amendment shall be left subject to previous regulations: the term 'urban natural park' is still in use.

[Figure 3] Unstarted Projects for Urban Planning Facilities (delayed by ten or more years)



Source: Ministry of Land, "Infrastructure and Transport, Urban Planning Status," each year.

[Figure 4] Changes in Areas for 'Urban Natural Parks' and 'Urban Natural Park Zones'



Source: Ministry of Land, "Infrastructure and Transport, Urban Planning Status," each year.

has been alleviated. However, the reduction comes with a gradual increase in a new park type, the 'urban natural park zone.'

To understand this situation requires a clear distinction between 'urban natural park' and 'urban natural park zone.' The former is a type of urban planning facility, as earlier mentioned, while the latter is a 'special-purpose zone' defined by the National Land Planning and Utilization Act; difference in legal personality. As shown in the comparison summary in <Table 2>, areas designated as 'urban natural park zones' are subject to de facto regulatory limitations, as was the case for development restriction zones. Besides, the Constitutional Court's decision in 1999, including the 20-year time limit, is only applicable to urban planning facilities, meaning that urban natural park zones a.k.a special-purpose zones, will not experience backlash even if the projects remain unstarted for several decades.

Recognizing that 'urban natural park zones' severely infringe upon property rights in a similar way to development restriction zones, the Act on Urban Parks, Greenbelts, etc. provides detailed criteria and guidelines on area designation. However, its Enforcement Decree—Article 2 (Special cases concerning existing urban natural parks) of the Addenda—stipulates that areas which were designated as urban natural parks but have not been completed can be reserved as a 'urban natural park zone,' notwithstanding the designation criteria and guidelines. In other words, the central government chose to offer an easy bypass that allows a transition of term instead of overseeing local governments' expedient evasion of the Constitutional Court's decision and National Land Planning and Utilization Act.¹²⁾

Indeed, such transitions can be observed in many local areas. Consequently, the bypass has been used by local governments as a stronger regulatory means to suppress or shun the problem, instead of a solution to property right infringement through project commencement or designation revocation. In this context, the scaling-down of urban natural parks in [Figure 4] cannot be seen as a problem solved but rather, an exacerbation of overlapping regulations.

12) The Green Area Planning Division of Ministry of Land, Infrastructure and Transport, explained that in the wake of the Constitutional Court's decision, it has distinguished lands into two types; urban development planning facilities and reservation. And, only the lands recognized to be worthy of reservation are designated as 'urban natural park zone.'

<Table 3> Urban Natural Park vs. Urban Natural Park Zone

	Urban natural park	Urban natural park zone
Basis	National Land Planning and Utilization Act, Act on Urban Parks, Greenbelts, etc.	National Land Planning and Utilization Act, Act on Urban Parks, Greenbelts, etc.
Type	Urban planning facility	Special-purpose zone
Authority	Head of local government	Head of local government
Restriction on activities	Purposes other than a 'park' according to the urban management plan are prohibited. ※ Prohibition shall be lifted after a 20 year lapse from designation.	"The construction of any building, change of use of any building, installation of structures, change in the form and quality of land, collection of soil and stone, division of land, clearing trees, piling up of goods and the implementation of any urban planning project provided for in subparagraph 11 of Article 2 of the National Land Planning and Utilization Act (hereinafter referred to as "urban planning project") shall be prohibited." ※ Non-expiry

V . Policy Suggestions

The above presents the case for regulatory infringement on property rights and compensation criteria and shows how wrongfully they have been applied in reality. The two regulations for development restriction and urban natural park zones are typical examples where regulations adopted without thorough consideration of compensation have created problems, and attempts to solve them have only exacerbated the situation. In light of this, there is a strong necessity to reconsider regulations that are in serious violation of property rights and then to formulate basic alternatives. This study suggests the following policies.

First, overlapping regulations that allow a bypass to avoid property rights infringement claims must be placed under full inspection. In particular, in line with the government's policy direction to reduce overlapping regulations on land use, corresponding efforts must be made to overhaul such regulations. In this context, it would be appropriate to terminate the biotope regulations—which provide no compensations—and the Article 2 Addenda to the Enforcement Decree of Act on Urban Parks, Greenbelts, etc.—which simply enable a transition in terms or wordage, i.e. from 'urban natural parks' to 'urban natural park zones.'

Second, institutional improvements are crucial to bring regulations that considerably infringe on property rights back within the scope of law and not local ordinances. Even for development restriction zones that were designated based on the law, in light of the Constitutional Court's 1998 decision, it would be unreasonable to adopt noncompensatory regulations simply based on urban plans and ordinances, as in the biotope case. Such attempts should be prevented by amending the provisions of the National Land Planning and Utilization Act, which will in turn satisfy Article 23.3 of the Constitution of the Republic Korea; "Expropriation, use or restriction of private property for public necessity, and compensation therefore shall be governed by the Act."

Potentially overlapping regulations need to be overhauled, and regulations that may inflict severe damage to property rights must be based on the law, not on local ordinance. Also, sincere consideration should be given to adopting rules to provide just compensation for the loss incurred.

Third, mid- to long-term considerations must be taken into account with in-depth reviews of whether to formulate substantial compensation rules or to alleviate or terminate the use restrictive regulations that significantly violate property rights. Although realistic barriers, such as budgetary constraints, need to be considered, they do not serve as valid reasons for several decades of sacrifice, which will eventually undermine the sustainable growth of the national economy. In particular, in order to resolve problems involving long-term protracted projects for land designated to urban planning facilities, local governments must draw up mid- to long-term budgetary plans while hastening the procedure to revoke the projects their budget cannot afford.

Such practices limiting the right to use one's own property for decades without explicit commitment or capacity, and imposing stricter regulations in an attempt to shun the pending problems arising from legal claims cannot be sustained given the public's growing awareness of their property rights. Other practices such as early designation for unidentified purposes at some unforeseeable future are also undesirable. Cases of severe property rights infringement can be observed not only in development restriction zones, but also in other local regulations for environment and urban plans.

When adopting regulations such as those for biotopes and urban natural park zones which severely infringe upon property rights, all decisions must be based on the law, even if it is a local regulation, and at the same time, they should be thoroughly and carefully reviewed and verified by the central government. Institutional reform and improvement must also include a process for compensation decisions. Considering that the public has grown more aware of their property rights and that judicial institutions, such as the Constitutional Court and Supreme Court, regard the protection of property rights more highly than in the past, it is of great necessity to change the basis, and to improve existing perspectives on and the system for property rights protection and compensation. ■

References

- Kim, Iljoong, and Hojun Lee, "A Workable Formula for Regulatory Takings: A Synthesis of Michelman and Epstein," Working Paper, 2016.
- Lee, Hojun, "A Study on Regulatory Takings and Property Rights: Focusing on Development Restriction Zones," Policy Study 2015-09, Korea Development Institute, 2015 (*in Korean*).
- Lee, Hojun, "Public Interest Criteria and Korea's Scrutiny System," in Iljoong Kim, Hojun Lee, and Ilya Somin (eds.), *Eminent Domain: A Comparative Perspective*, Cambridge University Press, 2016 (forthcoming).
- Ministry of Land, "Infrastructure and Transport, Urban Planning Status," each year (*in Korean*).