

The Land "Bubble": A Comparison between Tokyo and Paris

Natacha Aveline*

Abstract

During the second half of the 1980's, both Paris and Tokyo have experienced a huge increase of the urban land prices (the so-called "land bubble"). This phenomenon showed similar features in both capital cities : it was generated by the deregulation process of the financial markets and the development of the service sector. In addition, the deregulation of planning and construction rules, the tax incentives to buy and keep real-estate assets, and the myth of land scarcity have helped the land prices to rise in both countries.

Despite the emergency countermeasures adopted by the Japanese and French governments two years after the land boom started, the speculation process lasted until the end of the 1980's. The public authorities had than to react more efficiently : in 1990 and 1991, more drastic reforms concerning the tax system and the planning rules were adopted. But this measures intervened while the real-estate markets were registering a severe slow-down in Paris and Tokyo. The present market's slump and the strong pressure of the real-estate and construction companies to deregulate the land tax system and the planning rules are entraving the efficiency of a long term policy to regulate the land and property markets.

Introduction

During the second half of the 1980's, several metropolis in European, American and Asian countries have experienced a huge increase of urban land prices. This phenomenon has ended 4 or 5 years later with a drop of prices, causing a general economic slow down in some countries. Such was the case of France and Japan, where the land markets can be paralleled. We will thus try, in this paper, to compare both cases of Paris and Tokyo. Such a comparison has to be done carefully, because of the scale's difference between France and Japan (in economy, population...), and also because each country has its specific economic framework and agents. Nevertheless it is interesting to analyse the comparative trends on the land markets and the governmental strategy of both countries towards the so-called "land bubble"¹.

From 1985 to 1989, the average price of commercial land (used for office space) increased

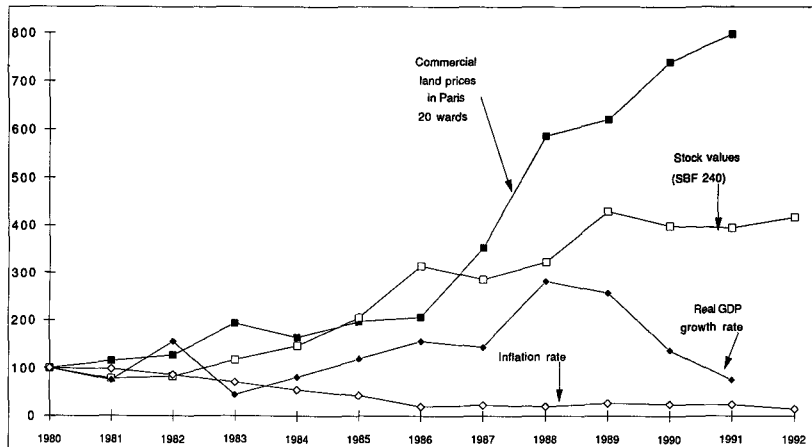
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threefold in the 20 wards of Paris (from 6 900 FF/sqm to 22 600 F/sqm, that is 126 400 yens/sqm to 414 000 yens/sqm), and went up 2.7 times in Tokyo's 23 wards (from 3.3 to 8.9 million yens/sqm). In the most attractive areas, the increase was far more important : 15 times in the west of Paris (up to 106 000 FF/sqm, 1.9 million yens/sqm) and about ten times in the five central wards of Tokyo within ten years (up to 19.26 million yens in 1991 in Chuo ward). Yet the Japanese land prices remained on average 14 times higher than those observed in France.

Despite this huge difference, this phenomenon has had some similar features in both cities:

-It first concentrated in a narrow area (the 3 central wards in Tokyo, downtown and west of Paris), then spread to the contiguous business zones, and finally reached the residential land markets in the suburbs of the two capital cities.

-a gap has progressively appeared between land and stock prices on one side, and the economic "fundamentals" on the other side. As for Tokyo, the nominal GDP, the consumer price and the wage index increased respectively and 1.2, 1.04 and 1.1 times from 1986 to 1989 (fig.2). While in Paris, during the same period, the GDP increased 1.2 times and the inflation rate even decreased (see fig.1).



Data : land prices : ADEF (prices in 1992),

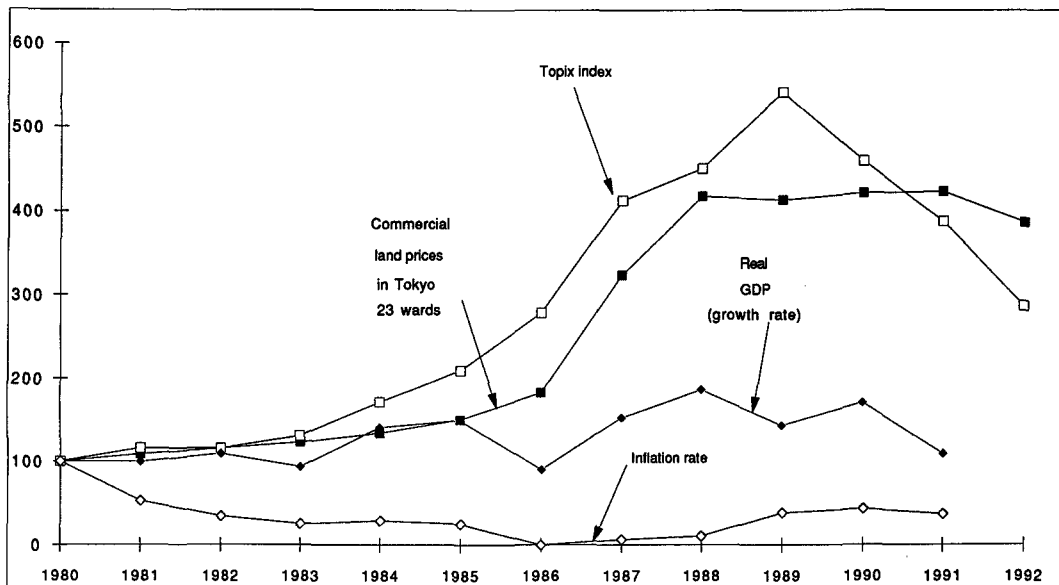
Inflation rate : Le particulier de l'Immobilier

The Stock index is the SBF 240 (yearly average of January and June datas -end of period-).

GDP real growth rate : Keizai Koho Center

Fig.1. The French Bubble(1980=100)

¹ The economic theory gives no unique definition of a "bubble". Some economists do not even agree with the existence of such a phenomenon. We propose to take the definition given by the Japanese Research Committee of Fiscal and Monetary Policy, in its official report issued in April 1993, "The Mechanism and Economic Effects of Asset Price Fluctuations", (Japanese Ministry of Finance, see footnote 22): "bubble(is) referring to a deviation between actual and theoretical asset prices, ...of such magnitude that it has an impact on the livelihoods of many people and interferes with a nation's normal economic management".



Data : Tokyo Stock Exchange, yearly average of the Topix index (TSE first section price index) calculated with the quarterly datas of end of period.

Land prices, GNP and inflation rate : Mitsui Fudosan Kanrenshu, September 1992.

GNP real growth rate : Keizai Koho Center.

Fig.2. The Japanese bubble (1980=100)

The rental office market followed a similar path. The office rents did not increase as much as the land prices. This was particularly true in Tokyo, where the average office rent in the business areas was 20 724 yens/sqm/month, whereas the figure for Paris was 7 293 yens/sqm/month, with land prices 14 times lower² (it must be noted that the building height in Paris is higher than in Tokyo : 5.5 stories against 2.4³). As a result, the profitability of the office investment has dropped in both cases : a yield of 4% only in the prime locations of Paris⁴, and a yield frequently below 1% in Tokyo.

Along this framework, one question needs to be answered for both cities : how could such an anomalous phenomenon happen? To give an answer, we must reconsider the events of the 1980's.

The rise of land and stock prices

In the early 1980's, after recovering the oil shocks of the 1970's, the economy has been affected by deep adjustments in the major developed countries. This new tendency was characterised by the development of the service sector and the globalisation of the financial markets.

² NOGUCHI Y., IGARASHI T., 1990, *Nippon tochi jihô* 90, Local Authorities Research Center, Tokyo, p.97.

³ OTANI Sachio, 1989, *Toshi ni totte wa tochi wa nani ka*, Tokyo : Chikuma Shobo, p.78.

⁴ Auguste THOUARD, 1990, *Le marché de l'immobilier d'entreprise*, tome I, p. 26.

This tendency led to a progressive deregulation of the financial markets in both countries. It started in Japan in 1980 (new act on currency and foreign business, followed in 1984 by the Baker-Takeshita agreement) and it took its biggest step in 1985 with the "Plaza agreement" (which led to the "strong yen" period). This process was followed by a rapid growth of the Tokyo's stock market ; in five years, the secondrange Tokyo stock-exchange office became one of the first in the world financial markets. As for France, credit controls were removed in 1987, but the development of the financial markets took place at a slower pace.

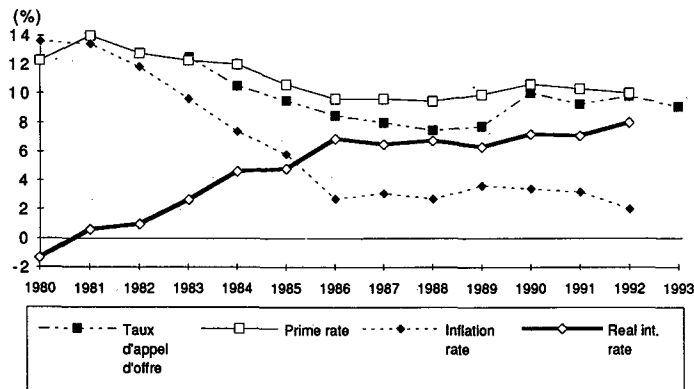
The stock-market boom and the development of the service sector attracted an increasing number of tertiary companies to both Paris and Tokyo. Thus, the demand for office space grew stronger, firstly in prime locations (companies willing to establish their headquarters in the vicinity of the business zones), then to the adjacent areas. The strong centralisation of both countries explains why this boom in the demand was first limited to Paris and Tokyo regions.

Meanwhile, the central government started to lower the interest rates in Japan (cf. fig.4). The main target was to avoid the negative effects of the strong currency (*endaka*) by increasing the Japanese investments abroad and providing the manufacturing sector with a flexible monetary policy. Within 17 months (December 1985-May 1987), the official discount rate was lowered from 5% to 2.5%, and the prime rate decreased accordingly from 7.2% to 4.9%. This monetary policy helped the companies to develop firm's investments -and to cope with *endaka* as early as 1987-. However, this credit was rapidly channelled into real-estate markets (investment or speculation). Driven by a strong competition due to the deregulation framework, banks aggressively entered the mortgage markets. Nevertheless banks were new to this product (since industrial loans were their major concern), so they were not so aware of the credit worthiness of their clients. According to the experts, they used to grant loans up to 120% of the land value.

In France, the central Bank did also decrease its interest rate ("taux des appels d'offre"), from 12.5% in January 1983 to 7% in June 1987. The prime rate decreased accordingly, from 14% in 1981 to 9.45% in 1988 (on average), but the real interest rates jumped from 0.6 to 6.75% during the same period (see fig.3). That is to say that in the case of France, the real-estate boom occurred despite the increasing cost of the credit. The French banks were as eager as their Japanese counterparts to enlarge their market's shares on the mortgage markets, because of the growing competition due to the deregulation process.

The financial deregulation played the role of "catalyst" of the speculation process, but other factors helped the land prices to rise:

-the strong tax incentives to buy and keep, particularly in Japan : tax incentives for companies to balance their accounts by buying land and building office space (tax allowance, until 1990), incentives for owners to avoid the capital gain tax by acquiring real-estate in the suburbs (*kaikae tokurei*, until 1985⁵). Moreover, the land property taxation is not burdensome in both countries, espe-



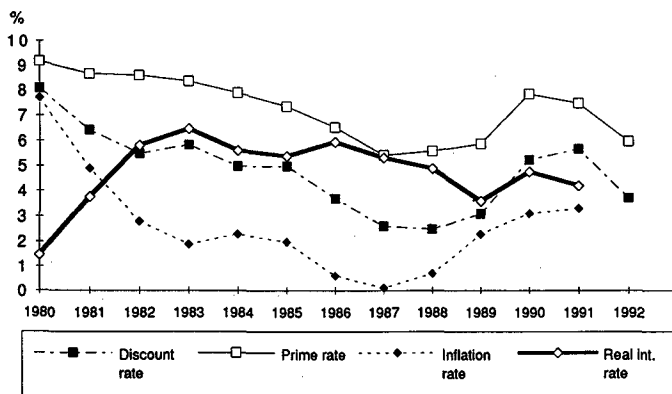
Datas :

Prime rate : Banque de France yearly average values

The "taux d'appel d'offres" is the monetary tool of banque de France (short term interest rate). It is more relevant for a comparison with the Japanese discount rate. Only the value on the first January is considered here.

Inflation rate : yearly average value of consumer price index (Le Particulier de l'Immobilier)

Fig.3. Interest rates in France from 1980 to 1993



Datas : Mitsui Fudōsan Kanrenshu 1993 (yearly average values)

Fig.4. Interest rates in Japan from 1980 to 1992

cially for the farm land within Tokyo area up to 1992. This factor incites to keep land without using it.

-the deregulation of planning and construction rules : in Japan, the Prime minister Nakasone started in 1983 a new policy called "Minkatsu", which aimed at developing private investment in the construction sector. Minkatsu policy was characterised by an important deregulation of the urban planning rules and the sale of public land at a high price. The main purpose of deregulation

⁵ The *kaikae tokurei* system is a "special tax treatment for residential property replacement". According to this taxation, the households who own a property in the centre of a large town and want to move in the suburbs can avoid the huge capital gain tax if they buy a new property at the same value (at least) as their former one.

was to increase the Floor Area Ratio (FAR, *Yōseki ritsu*), extremely low for a city such as Tokyo (the effective FAR was 102% in 1989⁶, that is about one third below the Paris FAR). In France, the 1985-1986 set of measures⁷ aimed similarly at helping the construction sector by deregulating the urban planning rules. In 1985, the procedure which prevented the developers to build more than 2000 m² of office space without a permission (“procédure d’agrément⁸”) was abolished, as well as the “legal density ceiling” (Plafond legal de densité, PLD) inside Paris in 1987⁹.

This deregulation policy played a major role in the rise of land prices in both capital cities. Sachio OTANI has observed that every 100% increase in density was correlated with an increase of 2/2.5 million yens/sqm¹⁰ in Chiyoda ward. Similarly, the growing flexibility of urban planning tools (land-use plan, PLD...) provoked a rise of the land prices in Paris¹¹.

-the “myth effect” : in Japan, the “land myth” which states that land prices can only go up, is said to be partly responsible for the abruptness of the “land boom” ; the central government supported this erroneous belief during the first period of the bubble, by over evaluating greatly the demand of office space in Tokyo¹². The extreme scarcity of land in the capital region was another mistake. According to a recent study, there are about 400 millions m² of land (farm land or idle land) available for urban use in the capital region (Tokyo Prefecture and the three adjacent prefectures) by the year 2000, where 2.6 to 3.7 million housing units could be built¹³. In Paris, the myth of land scarcity also played a role, as well as the wrong belief that the Parisian land prices were under-evaluated when compared to other European capital cities.

It must be noticed that despite the severe increase of both commercial and residential land, the land and real-estate markets have been particularly active : the increase of land transactions in Paris 20 wards¹⁴ is correlated to the increase of prices (from 70 in 1986 to 236 in 1989, that is 3

⁶ NOGUCHI Yukio, 1992, “*Nihon toshi ni okeru tochi riyō to shakuchi. shakka hō*” chapter 6 *Saiteki toshi o kangaeru*, Tokyo Daigaku Press, edited by UZAWA Hirofumi and HORIUCHI Kozo, p.134.

⁷ Mehaignerie is the name of the French construction minister of that period.

⁸ This procedure was introduced in 24 cities of the western part of Ile de France (Département des Hauts de Seine) to equilibrate the unbalance between, on one side, the West and the East of Paris, and on the other side, Paris and the countryside.

⁹ The PLD was introduced in 1975 to discourage high-density schemes by fiscal means that also brought extra resources to the local council's set limits to landowner's development rights. Initially, the PLD was 1 square meter of floor area per square meter of land area and its rate applied to the whole of France, except Paris where it was 1.5. To build above this ratio, the owners have to pay a tax.

¹⁰ It means that the price of a plot of land with 1000% FAR is about 2/2.5 million/sqm higher than a plot of land with 900% FAR. See OTANI Sachio, 1989, *Toshi ni totte wa tochi wa nani ka*, Chikuma library, p.154.

¹¹ Joseph COMBY, December 1988, *Etudes Foncières* n° 41.

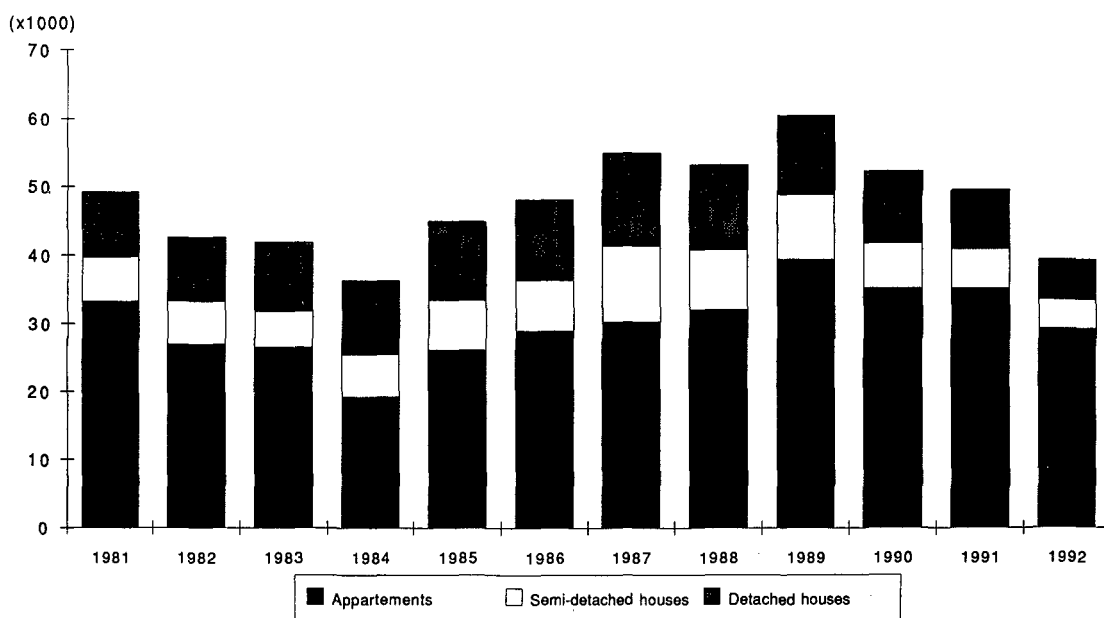
¹² In May 1985, the *Kokudochō* (National Land Agency) issued its official forecast for office space demand in Tokyo, from year 1985 to year 2000. The forecasted surface, 5 140 hectares, was over evaluated, and the Kokudochō had to lower its estimation down 1600/1900 hectares in 1987 (OTANI S., op.cit. p.21).

¹³ NOGUCHI Y., IGARASHI T. op.cit. p.101.

times). As for Tokyo capital region, the number of transactions went up from 440 000 in 1985 to 520 000 in 1987 ; nevertheless, they dropped to 400 000 in 1988 and remained at the same level during the two following years. The construction sector displayed good results in both cities : 13 millions sqm of office space were built from 1985 to 1991 in Ile-de-France region (that is 45% the amount of the previous office stock in 1985 : 29 millions sqm¹⁵), and 40.7 millions sqm in Tokyo Region (40% of the office stock in 1985 : 101,118 millions sqm); the housing sector followed a similar trend : 25.7% increase of housing starts in Ile de France from 1986 to 1989 (from 48 265 to 60 686 units) and 49% increase in Tokyo capital region from 1985 to 1987 (from 414 000 to 617 000 units, see fig. 5 and 6).

The turning point

After respectively four years and two years of skyrocketing in Tokyo and in Paris, the land prices finally dropped in both cities by the beginning of the 1990's. The last official datas in Japan (*kijunjika* values of July the first 1993, published in September) show a decrease of the land prices down to their previous level of 1986-1987 in Tokyo, Osaka and Nagoya regions¹⁶. This means that



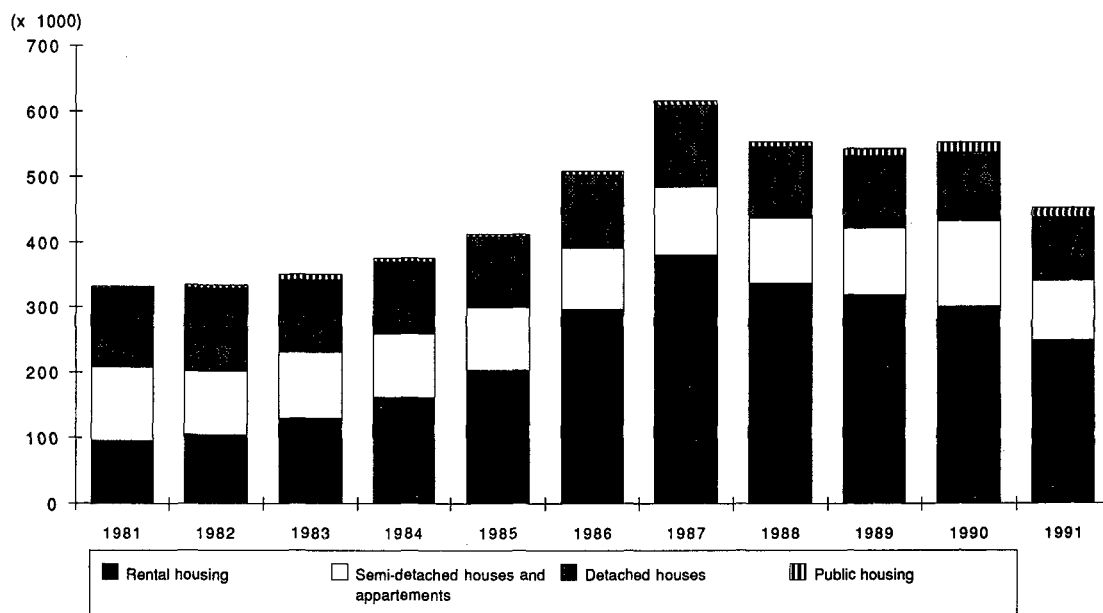
Datas : SIROCO/SICLONE.

Fig.5. Housing construction in Ile de France region from 1981 to 1992

¹⁴There are no datas on land transactions for Ile-de-France region.

¹⁵Bertrand DE FEYDEAU, "L'investissement immobilier a-t-il encore un avenir?", *L'observateur de l'immobilier* n° 23-24, May 1993,p.16.

¹⁶Nihon Keizai Shinbun, the 21th of September 1993. According to this data, the residential land prices dropped respectively 30% and 50% in Tokyo and Osaka prefecture, and the commercial land prices (used for office space) decreased more severely than last year (-20.5% on average, up to-30% in Shinjuku and Minato wards).



Datas : Mitsui Fudosan Kanrenshu 1993.

Fig.6. Housing construction in Tokyo capital region from 1981 to 1991

the bubble has partly burst. As for France, the data on land prices are not recent, and still reveal a stand still position ; but the rental level of office space has decreased by 25 to 30% on average (from 6500 F/sqm/year to 4000/F sqm/year in the prime locations) and the housing prices are said to be 30% down from their previous level.

We can assume that the drastic increase of the interest rates in July 1989 (bank rate rose from 2.5 to 5% within less than one year) was the main factor for breaking the speculation movement in Japan, but it is likely that the land markets were already weakened by the over heated prices. In France, the government did not adopt a monetary policy to stop the speculation process. Nevertheless, the real-estate markets finally registered a slump.

The real-estate sector is undergoing a severe crisis in both countries. The debt of Japanese real-estate companies having gone bankruptcy goes from 500 billion yens a year on average during the 1980's to 2 900 billion yens in 1991. Not only companies having lately joined the real estate industry went bankruptcy (Aoyama Building Development for example) , but also well-known real-estate companies, such as Maruko, pioneer of the "one room manshon" (one-room apartment) . The banking sector was consequently affected : in October 1993, the Bank of Japan estimated to 14000 billion yens the amount of bad debts of the 21 *city banks*. According to the experts this figure was largely under-evaluated, the actual value could be closer to 40000 billion yens¹⁷. In France, bad debts were evaluated to 50 billion francs in May 1993 (915 billion yens) , that accounts for one

¹⁷According to figures given by Philippe PONS, *Le Monde*, 3rd of November 1993.

year trading results of the whole banking sector¹⁸. As in Japan, the middle range and foreign banks are mostly concerned. But top banks are also affected : the Credit Lyonnais Bank has committed 20 billion francs in real-estate loans (366 billion yens), Indosuez Bank had to sell a part of its prestigious building (NMPP) recently acquired in Paris, by depreciating it by 20% of its value¹⁹.

One of the most important feature of the "bubble" was the office space oversupply (which mainly resulted from the bad effects of the tax system in Japan). Many redevelopment projects had to be abandoned in both cities. In Paris, the postponement of many ZAC schemes²⁰ is equally prejudicial for the future social housing supply.

The governmental policy

How did the central government react toward the "bubble" phenomenon in the two countries?

In Japan, the government issued an "Outline of Emergency Land Policies" in October 1987. On the basis of this document, several measures were taken : special governmental hearing on real-estate loans provided by the financial institutions (October 1987), stopping the sale of the public land to private developpers (in particular, the land owned by the Japanese National Railway), institution of a "short term capital gain" tax for plots resold within 2 years by companies (October 1987), enlargement of the surveillance district system (land transactions involving plots above 100 or 300 sqm in certain designed areas must be checked by the local authorities) in November 1987, limitation of the *kaikae tokurei* system to special cases in March 1988.

Nevertheless, except the reinforcement of the control of land transactions, those measures were confined to limit the excessive effects of speculation. The land skyrocketing did therefore follow its trend. It is only in 1989, four years after the land boom started, that significant countermeasures were taken : rise of the official discount rate (revised four times from Mai 1989, up to 5.25%), and "window-guidance" to the banks, exhorting them to limit their mortgage lending (April 1990).

Yet the interest rates could have been risen two years before, since the economy had recovered from *endaka* as early as November 1986. So why did not the authorities react efficiently?

According to an official report issued by the Finance ministry²¹, *there is a time lag between the recognition of economic conditions and the effect of policies aimed at dealing with them*. This vague response is not sufficient to explain the governmental "apathy" despite the strong criticism against speculation and

¹⁸Pierre DURIF, *L'observateur de l'immobilier* n° 23-24, May 1993,p.2.

¹⁹Francois RENARD, *Le Monde*, 23 th of April 1992

²⁰Zone d'Aménagement Concerté, developing zones where a system of cross-subsidisation is implemented by the local authority to support the cost of public infrastructure and social housing.

²¹Japanese Ministry of Finance, The institute of Fiscal and Monetary Policy, *The Mechanism and Economic Effects of Asset Price fluctuations-A report of the Research Committee*, April 1993,p.12.

its social consequences. Other reasons can be put forward : the high level of land prices provided a higher tax income for the State (it was particularly the case of the inheritance tax and the capital gain tax), which increased by 53% from 1984 to 1989²². It also allowed the State to balance the accounts by selling public land. On the other side, the rise of the land prices stimulated the real-estate and the banking sectors where the profits were decreasing in the beginning of the 1980's. The private developers took greatly advantage of low interest rates and credit facilities, coupled with the *minkatsu* policy incentives (sale of huge plots of public land and deregulation of FAR). This process contributed to develop the domestic demand, as expected by the Maekawa report in 1986 to balance the loss generated by the strong yen on the exportation markets²³.

By the end of 1989, seven months after the first rise in the interest rates, a new statute was adopted by the Japanese Diet : the "Basic Land Act". Although it did not stipulate concrete measures to cope with the land boom, this act led to rather drastic reforms concerning land and real-estate : the Land Tax Reform in December 1990, the Land and Building Lease Reform in September 1991, and the Urban Planning Reform in June 1992. The general philosophy, behind this set of status, was to promote urban land supply and to fight against land holding by land owners through tax incentives, especially targeted towards so-called "farm land" within urban areas. However, those decisions occurred too late : such a tightening policy is now likely to worsen the market's slump. Consequently, even the *kaikae tokurei*, which had been criticised for having propagated the price boom in the suburbs, was reintroduced in April 1993 to help the real-estate construction recover.

The French government did also take emergency countermeasures two years after the land boom started. In October 1989, an "Emergency Action Plan" was adopted in Ile-de-France Region. Its content was the re-introduction of the agreement procedure of office space and the institution of a new tax annual tax on office space in Paris²⁴. In November 1989, the regulation restricting the transformation of housing into office space was tightened. Finally, a new act on city planning, called LOV (Loi d'Orientation de la Ville) was enacted in July 1991. It aimed at four main targets : to re-establish the social balance within the urban zones, to encourage the input of the population in the planning procedure, to take into consideration the housing problem in the local plans, and to facilitate intervention of local authorities on land markets by creating public land agencies. A new tax on future development projects, called PDH (Participation à la Diversité de l'Habitat) was also introduced to promote the diversification within those markets : for every new private development program, the local authorities were allowed to levy up to 15% of the land cost (or a plot of land for the same amount) to the benefit of social housing. Needless to say, private developers did not agree with this measure. However, the present market's slump reduces the efficiency of its implementa-

²²Natacha AVELINE-DUBACH, *Bulle foncière, équilibres macro-économiques et gestion urbaine au Japon*, thèse de Doctorat NR, EHESS, 29 th of April 1993, 292p.

²³The Maekawa report, issued in 1986, proposed a succession of measures to adjust the Japanese economy to the new international environment. Although it was not official, it had a great impact on the governmental policy.

²⁴The tax amount is from 15 to 50F/sqm (from 274 to 915 yens/sqm), depending on the localisation.

tion.

This comparison between the French and Japanese cases shows that neither in France nor in Japan was the governmental policy efficient to stop the speculation process. Moreover, the measures adopted in both countries have proved to be short-viewed, and not to fit with the present real-estate crisis. Some of them are thus likely to be progressively abandoned for the sake of the economy at large. In order to go beyond such myopic guidelines, it is urgent to work at a long term system regulating the land and property markets.

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