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## Chapter Two

### Property Markets in Tokyo and the Management of the Last Boom-Bust Cycle (1985-2002)

Natacha AVELINE

#### Introduction

In the late 1980s, the small Japanese archipelago challenged the economic supremacy of the United States. Skyrocketing land prices became the absolute benchmark from which to measure the growing wealth and financial power of Japan. According to the Japanese Economic Planning Agency estimates, the land of the capital city of Japan was valued as much as the whole of the United States in 1991<sup>1</sup>. It was said that the Emperor could even have bought the entire territory of California with the proceeds from the sale of the Imperial Palace grounds! Booming land and stock values allowed Japanese companies to buy such icons of American capitalism as the Rockefeller Center and Columbia Pictures. After 1990, however, Japanese land markets changed - from boom to bust. The 1990s witnessed a loss in land asset value estimated at ¥800 trillion (\$6.04 trillion) nationwide, or the equivalent of 1.6 times gross domestic product<sup>2</sup>. Comparisons with the United States no longer favour Japan, and American commentators are now in turn comparing the current situation in Japan to that of the Great Depression in the U.S.

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<sup>1</sup> According to these estimations, an 80 percent mortgage on all Tokyo estate in 1988 (\$US7.7 trillion) could, in theory, have allowed Japanese investors to acquire all the land in the United States (\$US3.7 trillion) and all public companies (\$US 2.6 trillion).

<sup>2</sup> *Yomiuri Shimbun*, September 12, 2001. Estimations vary between ¥800 trillion to ¥1000 trillion.

(Dattel, 1999).

The magnitude of this land market cycle should not obscure the fact that land values were already considered excessive in Japan even before 1985; hence despite the continuous decline over the past decade land values have only just been realigned to their 'pre-bubble' levels. Such values are far higher than those recorded in other large cities in Europe or in the United States. For example, the average land price in Tokyo's ward area is around 7 times that of Paris's 20 wards, despite a GNP/capita and a population density of similar scale<sup>3</sup>.

It is generally acknowledged that expensive land prices in Tokyo cannot be explained by the scarcity of urban land<sup>4</sup>, or by economic fundamentals. Yet explanations of this striking feature are divergent. Scientists dealing with Japanese land issues can be roughly divided up into two groups. The first group comprises American and Japanese economists using neo-classical approaches (Hatta, Miyao, Ide, Mera, and Elderstein among others). They argue that the current tax system and urban planning rules strongly hamper urban development and therefore sustain inflated land values. Consequently, they advocate addressing the 'land problem' with a massive liberalization of town planning and tax regulations. The second group is composed of a few economists (Noguchi, Hasegawa, and Hanayama among others) and most Japanese planners. Contrary to the first group, they consider that expensive land prices are due to loose planning regulations and more generally to an excessively weak involvement of public authorities in urban development. The second group advocates the strengthening of public control over land

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<sup>3</sup> The population density in Tokyo 23 wards and Paris 20 wards+3 surroundings prefectures was respectively 12,848 and 8,079 inhabitants/km<sup>2</sup> in 2001.

<sup>4</sup> Several authors have discussed the 'land scarcity myth' in Japan. See, among others, Calder (1986) and Noguchi (1992).

markets. Both groups, nevertheless, recognize the misallocation of land resources generated by the tax system during the ‘bubble period’, in particular the misallocation due to the excessive protection of farmers until the tax reform of 1991.

The purpose of this chapter is to examine closely the various constraints over the land markets in Tokyo and to observe how they interacted during the last boom-bust cycle period. The chapter is divided into five subsequent sections. In the first section, the major features of land ownership structure and regulations are briefly outlined. The second section discusses the striking prominence of land over buildings in Japan and its effect in terms of land policy and information. In the third section, the author reviews the changes in commercial and residential land prices in Tokyo over the past two decades, focusing on the roles played by tax and urban-planning regulations in each real estate sub-sector. The fourth section examines the relationship between the land market cycle and the economy in general. Finally, the author reviews public policies addressing land problems over the past two decades.

## **1. Major features of Japanese land structure and regulations**

### ***Fragmented land ownership***

Undoubtedly, land markets in Tokyo are hampered by numerous constraints. For historical reasons, land structure is highly fragmented. In 2002, residential parcels owned by individuals were on average 211 sq.meters in Tokyo’s 23 wards. Almost half of them (46%) were smaller than 100 sq.meters. The proportion was even higher in the two central wards of Chuo and Chiyoda, where it reached 75% and 61%, respectively<sup>5</sup>. In addition, property rights are intricate, especially in the central wards, as one parcel

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<sup>5</sup> Tokyo Municipal Government, *Tôkyô no tochi 2002*, p.56-57.

frequently holds three different types of rights: the right on the landed property (*sokochiken*), the land-lease right (*shakuchiken*) and the building tenant right<sup>6</sup> (*shakkaken*). Plot fragmentation and multiple ownership rights mean that redevelopment requires the time-consuming and expensive intervention of specialized operators to purchase the various property rights on the tiny plots to create sizable parcels.

### ***Taxation on land***

The heavy inheritance tax burden also plays a role in the splintered pattern of land structure. The marginal rate of bequest tax rises rapidly to 70%, and there is no simple way to create a tax-exempt trust for one's heirs. As a result, inherited landed property has often to be divided up and partly sold to pay the bequest tax. However, the other taxes are not particularly heavy by international standards. The effective rate of the property tax stands well below 1% of the land market value, a level commonly observed in Europe and in the United States. It was even officially acknowledged, in 1992, that the effective tax rate was 0.05% of the land market value in Tokyo. Additional taxes on land ownership have been introduced to curb speculation, namely the 'special tax on land holding' (*tokubetsu tochi hoyūzei* in 1973) and the 'land price tax' (*chikazei* in 1992), but the wide range of exemptions have significantly reduced their scope. Similarly, taxes on property transfers (tax on real estate purchase, special tax on land holding for the local authorities,

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<sup>6</sup> The *shakuchiken* cannot be compared to the English leasehold right. The *shakuchiken* cannot be sold on the market without the agreement of the holder of the *sokochiken*, despite the fact that the value of the former is generally far higher than that of the latter (typically 80% and 20% of the land market value, respectively). The high share of the *shakuchiken* right is due to the fact that lump-sum fees paid by the lessees, when the land-lease contract was established, occupied a high share of the land value at the time.

registration and stamp taxes<sup>7</sup>) do not weigh heavier on taxpayers than in other countries. Short-term capital gains are, nevertheless an exception, because the resale of land within a period of five years is severely taxed.

### ***Urban planning and construction rules***

Town planning and construction rules form a comprehensive framework devised to control urban growth in the metropolitan areas. Land-use plans are divided into two major zones: UPAs (Urbanization Promotion Areas), where development is allowed; and UCAs (Urbanization Control Areas) devoted to future development. However, looking at Tokyo's urban form, town planning and construction rules do not seem to have channelled or even controlled urban growth. UPAs are much larger than the actual urbanized zones. UCAs are dotted with numerous "mini-developments" or construction clusters. Land prices between UPAs and UCAs consequently do not differ as much as, for example, they would in European countries<sup>8</sup>. In the UPAs, idle land can be seen everywhere even in the sought-after areas of the center, often taking the form of temporary parking lots. Middle-rise or high-rise buildings are mixed up with clusters of detached houses, as if the 'invisible hand' was that of each landowner. Why is Tokyo's urban profile so chaotic? The answer is to be found in the supremacy of land over real estate, which has been acknowledged and even supported by public authorities over the last century.

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<sup>7</sup> In Japanese, respectively, *fudōsan shotokuzei*, *tokubetsu tochi hoyūzei* (the part of the tax specifically levied on transactions), *tōroku menkyōzei* and *inshizei*.

<sup>8</sup> For example, in the vicinity of Aodaiba station, in Yokohama, prices in UCAs are only 20 to 30% lower than in UPAs. In Paris, the difference would be about one to ten.

## 2. The supremacy of land

Looking at surveys and research papers on Tokyo's property markets, the central feature is the infrequent reference to the term 'real estate' (*fudôsan*) when referring to the property market. Instead, 'land markets' (*tochi shijô*), 'land bubble' (*tochi baburu*), 'land boom' (*tochi bûmu*), or expressions of the like referring to land, are used to describe the change in property markets at large. The term *fudôsan*, literally meaning 'immobile asset', was introduced in Japan in the early Meiji period, via the package of laws imported from Europe. In fact, this concept did not match the Japanese notion of property, as a strong distinction between *land* and *building* was already the norm (Inamoto 1989, 2000). The use of the term *fudôsan* has consequently been extremely limited over time, in spite of the growth of real estate markets after the Second World War. Nowadays, it is still restricted to specialized uses, in relation with its primary legal meaning (real estate property, real estate inheritance, real estate seizure, real estate transaction, real estate registration<sup>9</sup>) or in reference to the real estate industry (real estate industry, real estate company, real estate appraiser, real estate management, real estate accounting<sup>10</sup>). Yet the recent use of the terms 'real estate securitization' (*fudôsan shôkenka*) and 'real estate cycle' (*fudôsan saikuru*) reflects the growing influence of the Anglo-saxon approaches and methods in the Japanese real estate sector.

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<sup>9</sup> Respectively *fudôsan shoyû*, *fudôsan sôzoku*, *fudôsan*, *fudôsan torishiki*, *fudôdan tôroku*.

<sup>10</sup> Respectively *fudôsangyô*, *fudôsan gaisha*, *fudôsan kanteishi*, *fudôsan kanri*, *fudôsan keiei*

### ***The prominence of land over construction***

The prominence of land over real estate in Japan should not be surprising, given the scant interest in constructions erected on land. Whatever their appearance or their historical background, buildings have been considered to have little neither cultural nor even economic value. The destruction of the major historical civil patrimony of Tokyo provides a strong evidence of the lack of consideration for buildings<sup>11</sup>. Another evidence of the poor economic value of buildings is given by the method used by certified real estate appraisers (*fudôsan kanteishi*), which tend to under-use the discounted cash flow method (based on the expected rate of return of the real estate property) in favour of market comparison of land values, estimated by comparisons with official land values and land transaction prices in the same or a similar area<sup>12</sup>. More generally, real estate professionals do not use the wide range of tools and methods that are well developed by Anglo-American liberal analysts to survey property markets, as Japanese have sought the benefits generated by land (taking the form of profit from the sale of land parcels as well as ‘hidden assets’ on the balance sheets) rather than the profitability of real estate investment. The focus is on land, even in the academic field, as proven by the trouble taken to use property markets data in hedonic price formulas (Hidano & Yamamura in the subsequent chapter, Suzaki & Ôta, 1994).

The prominent role of land is also evident in the change in land rights over the past five decades. Strong protection for tenants was introduced during the Second World War to prevent landlords from evicting families while the head of the family was fighting on

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<sup>11</sup> Although a townscape preservation policy has been introduced in Japan in the late 1960s, the Tokyo region lags far behind other areas, such as Kyoto and Nara. In 1993, the 23 Tokyo wards had only 11 districts of historic township, mostly located in Bunkyo-ku (Hohn, 1997).

<sup>12</sup> For further details on appraisal methods, see Aveline, N. (1995).



the front. However, there is a sharp difference between tenants of housing units (*shakkakensha*) and land-lessees (*shakuchikensha*). Both enjoy strong protection of their contracts –provided the building is not rebuilt, but the latter dramatically benefit from the sale of their tenant’s right while the former do not. In Tokyo, land-lease rights can be sold up to 90% of the market value of the land, leaving a very small portion to the owner of the landed property (the *sokochikensha*). Land lessees can thus be to a certain extent classed as landowners, and it is probably safe to say that they have benefited from the supremacy of land over construction.

What are the roots of this absolute prominence of land? Several factors can be put forward to explain this striking feature.

The first one that comes to mind is the pattern of natural disasters regularly occurring throughout the Japanese archipelago. Typhoons, earthquakes, volcanic eruptions and tsunami have regularly damaged constructions and even destroyed sizable areas in Tokyo –not to mention the Second World War– that resulted in the destruction of most of the urbanized areas in the capital city. In such a highly vulnerable context, land was the only physical asset that could not be seen as being ephemeral.

A second factor is the physical features of the constructions. Prior to 1980, decaying wooden-framed housing units and ‘pencil buildings’ covered a large part of Tokyo. Although many of these sites have been redeveloped over the two past decades, a significant portion of the land in the capital city is still occupied by old wooden houses and narrowly-built apartment buildings. This fact partly results from the Land and Building Lease Act, which prevent land-lessees from rebuilding their construction (if they do, a new contract based on the current value of land must be negotiated). But the

major cause of the poor quality of construction in Tokyo may be the lack of public housing policies to supply public housing units and provide funds to property owners.

The low building density is partly the result of the poor state of construction. By the end of the 1980s, the average height of constructions in Tokyo's 23 wards did not exceed 3.4 stories (including ground floor), whereas it reached 6.5 stories in Paris (Noguchi, 1991). Building density in Tokyo is far lower than in other large Asian cities, such as Seoul, Shanghai, Singapore and Hong Kong. This low building density, combined with the poor quality of the buildings, has facilitated the distinction between land and constructions, thereby enhancing the status of land.

Another factor increasing the mobility of construction is more fundamentally based on the Japanese conception of historical patrimony. As Berque puts it, “ *the Japanese tradition [...] has put the stress on codifying temporal forms (rituals) rather than spatial forms (urban morphology) [...] the most noticeable feature of Japanese cities is their relative lack of monuments; it seems here that monumentality [...] stands less in the buildings than in the perpetuation of gestures. What recalls to individuals their common belonging to a society is the pregnancy of the group on their current behaviour rather than its involvement in the material form of the city*”<sup>13</sup>. A strong evidence of this argument is provided by the implementation of the recent policy imposing protection on several ‘historical buildings’ in Tokyo. For example, the Mitsubishi group has rebuilt in Marunouchi some of its old office buildings targeted as historical patrimony, integrating

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<sup>13</sup> Berque, A. (1993) : “La tradition japonaise...a placé plus de poids sur la codification des formes temporelles (les rituels) et moins sur celui des formes spatiales (la morphologie des villes)... ; la caractéristique remarquable des villes japonaises est l’absence relative de monuments ; il apparaît qu’ici la monumentalité ...réside moins dans les édifices que dans la perpétuation des gestes. Ce qui remémore aux

them into high-rise buildings. The fact that these ‘old buildings’ are made out new construction materials does not matter, provided that the ‘gesture’ of rebuilding them is properly implemented.

An additional cause of the high status of land is the priority given to private land ownership (whether landed property right or land-lease right) over public welfare. As previously mentioned, UPAs are large enough to house construction, even on remote parcels, and public authorities are highly reluctant to use compulsory purchase for the sake of public purposes. In addition, there is no strong policy to protect old buildings comparable to those of Europe, nor any policy encouraging specific forms of land use. Landowners do have to respect the land-use regulations set by the land use plan and apply for development permits, but they can escape many constraints and enjoy higher FARs in the numerous ‘district zones’ introduced after 1980.

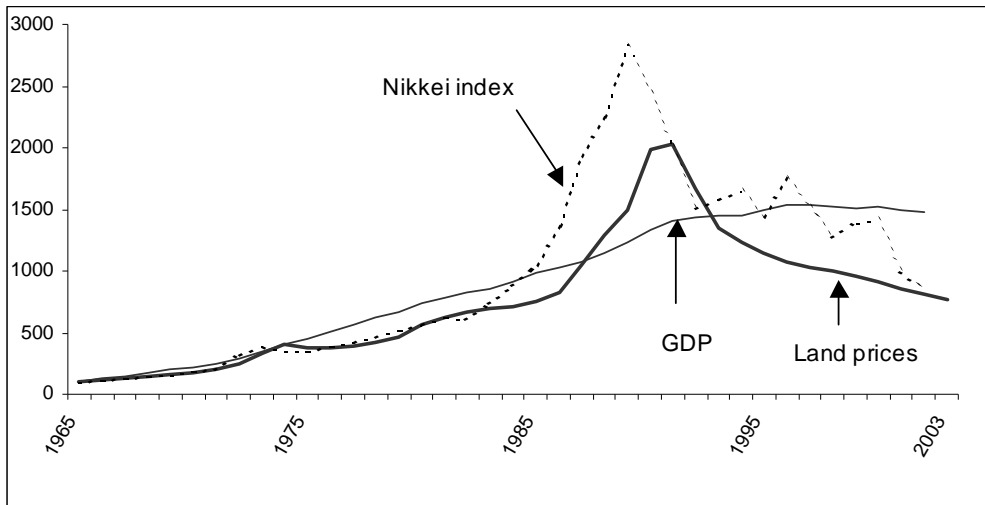
Tax policies have also accelerated the rate of land price increases and discouraged investment in housing stock. In particular, preferential taxation of agricultural land in urban areas has encouraged both land hoarding and inefficient low-density land use.

Last but not least, land would not have been so highly regarded if land values had not dramatically increased during the post-war period. From 1955 to 1991, residential land prices increased by more than 200 times in the six major metropolitan areas, whereas GDP and consumer price respectively grew by 56 and 6 times, respectively, over the same period. Despite the sharp decline of land values in the last decade, the price of residential land is still around 100 times that of 1955.

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individus leur appartenance commune à une société, c’est la prégnance du collectif dans leurs conduites présentes, plutôt que son investissement dans les formes matérielles de la ville »

**Chart 1. Change in residential land prices in the six major Japanese metropolitan areas from 1965 to 2003 (1965 = 100)**



Source: composed by the author with data from *Mitsui Fudōsan Kanren Tōkeishū* 2002.

The six major metropolitan areas are Tokyo, Osaka, Nagoya, Yokohama, Kyoto and Kobe regions.

Low taxation on land ownership and easy release of parcels from their constructions<sup>14</sup>, together with continuously rising land values (except in 1974 and after 1991), have led landowners to become reluctant to sell their properties. Consequently, urban planning tools avoiding the definitive transfer of land, such as land readjustment and urban renewal procedures (respectively *tochi kukaku seiri* and *toshi saikaihatsu*) have been used more and more by both private and public developers. In parallel, real estate companies and institutional investors have developed new kinds of contracts allowing construction on someone else's parcel. This trend is named *sofutuka* (from the English word 'soft' and the Japanese 'ka' for transformation) whereby the development process is softened by avoiding land transfer. Under the progress of 'soft' development formulas,

land has tended to be less and less mobile in terms of property transfer, whereas construction has kept its amazingly high turnover pace, thereby reinforcing the sharp contrast between land and buildings. Given the growing potential of land use through perpetual building renewal, it is no surprise that land has been considered by far the most valuable asset and has thus been widely used as collateral for loans.

### ***The basics of land policies***

It would be difficult to definitely say whether public policies are the result of this supremacy of land, or whether they generated this supremacy (particularly due to the lack of housing policies), but the unquestionable fact is that public policies regarding urban planning and real estate issues have traditionally put the stress on land issues.

Institutional arrangements for the control of land use in Japan go back to the pre-war period, but the current regulatory framework has been constituted in response to the three post-war land booms: the City Planning Act introducing UPAs and UCAs, enacted in 1968 to prevent further sprawl after the land boom from 1961 to 1962; the National Land use Act in 1974, providing state legislation for comprehensive planning, after the nationwide speculative period culminating in the period from 1971 to 1973; the Basic Land Act in 1989, followed by various reforms implemented 1990 to 1991, after the dramatic surge in land prices from 1985 to 1991 in the largest metropolitan areas. A public institution, the National Land Agency (*Kokudochô*), currently supervised by the ministry of Land, Infrastructure and Transport, was founded in 1974 to monitor land markets nationwide.

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<sup>14</sup> We consider here that found owners and land-leasers have a similar kind of ownership on land. As for building tenants, many have moved from their previous places since 1941. They hold new kinds of contracts, similar to rental contracts in other countries.

Despite the filling out of a comprehensive regulatory framework, the general philosophy of land policy has not significantly changed over time. It has never lost faith in the mechanism of the free market and the notion that a land policy giving preference to public welfare over private rights would inevitably harm the effective utilization of land (Hanayama, 1986). Land policy has not, therefore, tried to impose social intervention on the private ownership of land. Rather, its major concern has been to seek adjustment of land markets through indirect means. Two main routes have been followed, simultaneously or alternatively, depending on the property market's conditions: securing the stability of land values, and promoting a greater supply of land in urban areas.

Efforts to stabilize land values have taken two main forms: 1) introduction of new tools to curb speculation, such as taxes on underdeveloped land and short-term transactions or Price Control areas where local authorities have the right to reduce the value of land transactions; and 2) compilation of official land prices that depart from the market values and are used as benchmarks for various uses (tax bases, certified land appraisal).

The promotion of a greater supply of land has sought to provide affordable housing in the largest metropolitan areas and has mostly taken the form of deregulation of urban-planning and construction rules. The strong belief that the best utilization of land occurs under free market mechanisms has led public authorities to allow a dramatic rise in FARs in the center of cities (to provide affordable apartment units in medium or high-rise buildings) and to grant massive development permits in the remote suburbs (to provide affordable detached houses).

Contrary to the cases in other cities in Asia such as Seoul or Hong Kong, there has been no attempt in Japan to determine quantitative objectives for housing construction in

the capital city. Rather, an official definition has been given to designate an ‘affordable’ housing price (set at 5 years’ total income of white-collar worker) and land supply policy accordingly, no matter how far from the city center. In fact, the distance of affordable housing units from Tokyo’s CBD dramatically changed during the last land cycle. Taking the official ratio of 5 years’ salary for a typical housing unit of 75 sq.meters, the supply was located 30 to 40 kilometres from the center in 1985, than extended out 50 to 60 kilometres from 1990 to 1991, before re-contracting to 30 to 40 km during the last decade<sup>15</sup>.

### ***Strategic information on land***

Given the highly strategic role of land in Japan, both as a valuable asset and as an expensive resource for industrial and human settlement, information on land has become a major pillar of public intervention. Far from being limited to a simple instrument for monitoring land markets, it is aimed at no less than market regulation. Official land values therefore do not display *actual* land prices (i.e. real values of land transactions) but ‘prices under normal conditions’ (*seijô kakaku*), or in other words, non-speculative prices. How is it possible to compile such values? It is useful to take a closer look at the general setting of official land prices.

Contrasting with the great diversity of data on housing and office markets, information on land markets is provided by only a few institutions and shows a remarkable convergence. In the two major metropolitan areas of Tokyo and Osaka, official or quasi-official land prices are issued each year: the *kôji chika* (‘Official Prices’)

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<sup>15</sup> Noguchi, 1992, p.99, for the period up to 1991 ; Tokyo Metropolitan Government, *Tôkyô no tochi 2002* (p.16) for the period 1991-2002. In 2002, the average price of a condominium was ¥46.7 million in Tokyo 23 wards or 6,1 the

issued nationwide every March by the National Land Agency; the slightly less official *kijun chika* ('Reference Prices') issued nationwide six months later in the 47 prefectures; and additional data on land prices issued twice a year, in summer and in winter, by Tokyo and Osaka prefectures. Whatever the nature of these different statistics, they are all based on the appraisal of a sample of parcels (respectively 17,000 parcels nationwide for the *kôji chika* and 26,000 for the *kijun chika*,) using a similar appraisal method. Two official appraisers, who take into consideration both discounted values of rentals and actual transaction prices at similar locations, evaluate the price of each point<sup>16</sup>. Official evaluation committees then review the reports by the appraisers and make final judgments to capture the 'normal prices' by lowering or upgrading official land values. Official prices therefore tend to underestimate land values when markets are booming and to overestimate them when markets are sluggish.

Operators involved in property markets are perfectly aware of this fact, since they have a rather accurate knowledge of the actual trends on land markets. However, no private institution would attempt to challenge these official data. For example, the Japanese Real Estate Research Center (*Nihon Fudôsan Kenkyûjo*), founded by the Daiichi Kangyo Bank, also issues statistics on land values on a regular basis. More than 500 certified experts are sent twice a year (in March and September) to 140 cities, to appraise the value of residential, commercial and industrial parcels. But despite the high cost and painstaking work involved by this compilation, no information is displayed on land values. The results take the unique form of indices, which in addition seem to move

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yearly wage of a 'white collar' worker (*sarari-man*).

<sup>16</sup> The three appraisal formula are the following : 1) take as reference the transaction value of similar parcels in the vicinity ; 2) take into consideration the cost of developing the plot ; 3) cash-flow method. For further details on land appropatif methods, see Jinno (1990) and Aveline(1995 ).



in accordance with official statistics. In fact, the National Land Agency has a very strong involvement in the JRERC, not only to complete its own information but also to make sure that the secret on actual changes in land markets will be kept.

Japan is probably the only industrialized country where the information system on land values has been introduced primarily to regulate the markets (though South Korea and Taiwan have modelled their systems on the Japanese one). As official values are used as a benchmark for public and private land transactions and for government assessment of inheritance and property taxes, they might play a stabilizing role, particularly with regard to the value of the loan collateral (Kerr, 2002). However, the last cycle has proved the poor ability of such device to prevent dramatic changes on property markets. In addition, the lack of reliable information might also have a destabilizing effect on land markets-aggravating their volatility rather than reducing it.

### **3. The changes in commercial and residential land prices in Tokyo during the so-called ‘bubble period’**

One result of the dominance of official land price data is that observation of changes in the land markets must rely on official data. One must be therefore be aware that the following description tends to underestimate the actual magnitude of the land cycle.

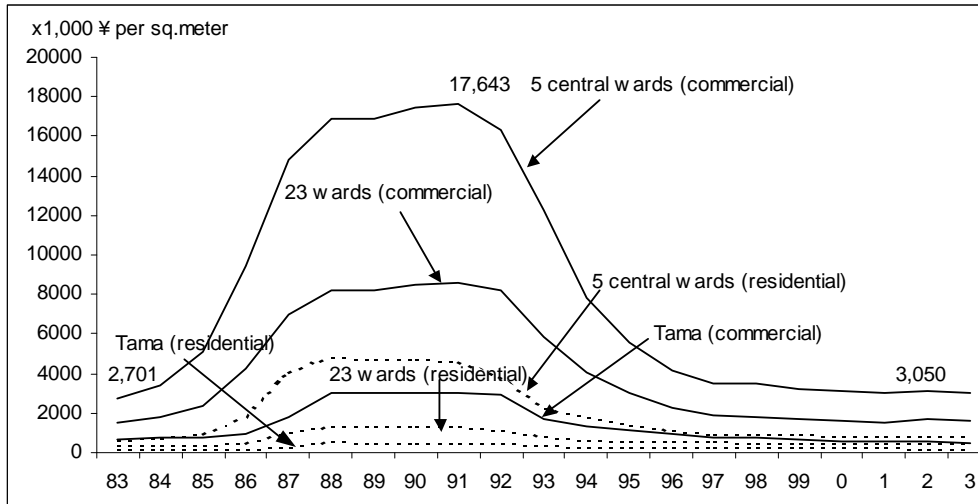
#### ***General description***

The rise in land prices began in the three central wards of Tokyo. Commercial land (land devoted to office or retail industries) started rising in Chiyoda, Chuo and Minato

wards in 1983. This trend was followed, in 1985, by a rise of land values in other business and commercial areas in the 23 wards. From 1986 to 1987, the inflation spread to the residential areas of Tokyo, then to the neighbouring prefectures of Kanagawa, Saitama and Chiba in that order, following a clockwise motion from the high-income to the lower-income residential areas (Mera, 2000). It is worth mentioning, however, that the five central wards (Chiyoda, Chuo, Minato, Shinjuku and Shibuya) experienced by far the sharpest increase in land values. From 1983 to 1991, commercial prices rose by 6.5 times, reaching an average value of ¥17.6 million per sq. meter. The National Land Agency's appraisals peaked at ¥38 million per sq. meter in West Shinjuku and Ginza in 1991. The boom in residential areas was of similar magnitude in the five central wards, since prices rose sevenfold (from ¥669,000 to ¥4,678,000 per sq. meter) during the period from 1983 to 1989. In the other parts of the metropolitan area, commercial and residential land increased respectively by 3-4 and 2-3 times, commercial land keeping the top position. Even remote suburban areas experienced significant increases in land prices. For example, in West Tama, an area some 40 to 50 kilometres west of the center of Tokyo, commercial and residential land values went up by 4 and 2 times (from ¥680,000 to ¥3 million per sq. meter, and from ¥200,000 to ¥500,000 per sq. meter) respectively.

The tide turned in the land markets in 1991, taking two distinct patterns. First, residential land values decreased less sharply than commercial land values: respectively by 53% and 73% in the 23 wards from 1991 to 1998. Secondly, the gradient of decrease was much more acute in the center than the periphery. Consequently, commercial land is currently under its previous 'pre-bubble' level in the central wards of Tokyo, whereas residential land in the suburbs is still above its 1983 values.

**Chart 2. Change in commercial and residential land prices in Tokyo Prefecture from 1983 to 2003**



source: composed by the author with data from official land prices (*kôji chika*), Tokyo Municipal Government, *Tôkyô no tochi 2000* for the period 1983-1985, and *Tôkyô no tochi 2002* for the period 1985-2003.

How did the Japanese land market cycle reach such a magnitude, in particular within the five central wards? There has been much discussion about the generative factors of the 'land bubble'. New trends such as the internationalization of financial activities and structural changes in the Japanese economy did undoubtedly increase the demand for office space during the 1980s, which worsened the shortage of land in the central districts of Tokyo. However, as stressed by Noguchi, the rate of land price increase was greater than that of office rents (Noguchi, 1990). Hence the stratospheric levels reached by land prices in the center of Tokyo during the late 1980 cannot be explained only by the concentration of economic activities. It is thus necessary to examine more accurately the role played by the land structure and its related regulatory framework in the process of urban development.

### *The practice of jiage in the center of Tokyo*

Before the early 1980s, Tokyo was mostly covered by narrow buildings of small or medium size, shaped in accordance with the extreme fragmentation of the land structure. To meet the new demand of prime office space for larger buildings, it was necessary to assemble several parcels, thus implying the purchase or transfer of a sizable number land ownership rights. Specialized agents called *jiage-ya*<sup>17</sup> undertook this painstaking work. Given the low height of constructions in Tokyo, there was a huge gap between the fairly high, legally permitted, volumetric ratios set in the land-use plans (FAR, Floor Area Ratio, ratio of the floor space to the site area, *shitei yōsekiritsu*) and the effective building density (*gaisan yōsekiritsu*). In Tokyo's 23 wards, legally allowed FAR was set on average at 242% in 1984 (meaning that a 242 sq. meter floor area could be built on a 100 sq.meters parcel), whereas the actual density was as low as 90%. Even in the central wards, where legally allowed ratios reached up to 1,000% in several business zones, actual density did not exceed 400% on average (410.6 % for Chiyoda, 347.4% for Chuo and 192.7% for Minato<sup>18</sup>). There was a great potential of building densification from which *jiage-ya* could benefit.

The low building density in Tokyo was not only the result of the fragmented land structure; it was also produced by the peculiar methods used to calculate the effective allowable FAR for each parcel. In fact, volumetric ratios effectively allowed have to be checked parcel-by-parcel, according to the width of the adjacent road. Below a 12-meter

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<sup>17</sup> The word *jiage-ya* comes from the action of *jiage* (literally 'to raise land') which originally consisted in making up reclaimed land. *Jiage* is now ordinarily used to designate the action of gathering small plots to make up a large parcel. This action is undertaken by operators called *jiage-jin* or *jiage-ya*, but the latter term has become pejorative, as its meaning changed into 'land price raiser' during the period of the 'bubble'

<sup>18</sup> Tokyo Metropolitan Government, *Tochi no tochi 2000*, p.68.

road width, effective volumetric ratios fall under the level of the legally allowed ratio on the land-use plan. For example, a parcel located next to a 4-meter-wide road will be granted no more than 240% volumetric ratio, even if the legally allowed ratio is set at 800%. As the road network is very narrow inside residential blocks in the center of Tokyo, only low-rise buildings may be built there. However, if a parcel adjacent to a small road is contiguous to a parcel adjacent to a road wider than 12 meters, and if both parcels are developed together as one construction site, then the higher legally allowed volumetric ratio set in the land-use plan applies. In the previous example, the allowed building density of the parcel adjacent to a 4-meter street jumps from 240% to 800%.

*Jiage-ya* followed a similar strategy to purchase land: at first, to buy small contiguous plots occupied by individual houses at low prices, in accordance with the low effective building density allowed; then, purchase as soon as possible the ‘masterpiece’ of the puzzle, i.e. the parcel adjacent to a wide street –providing the whole perimeter with the maximum allowed volumetric ratio. After combining the plots, the resulting parcel was sold to a developer at a high price, in accordance with the high effective density. Given the rarity of large parcels in the early 1980s in Tokyo, one can easily figure out the tremendous profits generated by this *jiage* process.

**Table 1. Designated and actual FARs in Tokyo’s 23 wards**

	1984	1986	1988	1990	1992	1994	1996	1998	2000	2002
Designated FAR ( <i>shitei yōsekiritsu</i> ) A	242,0	242,0	243,0	252,0	252,3	253,0	253,5	253,7	254,0	254,4
Actual building density ( <i>gaisan yōsekiritsu</i> ) B	92,0	94,6	99,3	104,6	110,8	116,7	122,8	129,1	132,5	136,1
Gap of density (1-B/A)x100	62%	61%	59%	59%	56%	54%	52%	49%	48%	46%

Source: Tokyo Municipal Government, *Tokyo no tochi 2000* for 1984, and *Tokyo no tochi 2002*, for 1986-2000.

At first, *jiage-ya* gained most of their profits from this grouping process –since owners of individual houses in the cores of residential blocks did not realize how much their parcels were worth as pieces in the larger ‘puzzle’. In many cases, land was leased to tenants, so the purchase of land rights by the *jiage-ya* was seen as a good opportunity by land-owners to get rid of the land-lease contract and to get back their share of the land value<sup>19</sup> (usually 20%). However, landowners soon became aware of the high potential of their properties and tried to sell at the highest possible price. The land spiral thus spread into the core of residential zones distant from arterial roads, which were previously protected from speculative transactions. *Jiage-ya* agreed to pay excessive prices for these tiny plots because they were seeking sizable profits from the assembly of parcels. But when the real estate bubble burst, along with the sharp increase in interest rates, many *jiage-ya* were stuck with scattered land holdings purchased at excessive prices, which were totally unmarketable.

As a result of the *jiage* process, the discrepancy between legally allowed and effective building volumetric ratios was progressively reduced during the 1980s and 1990s. In 1983, the ‘gap of density’ amounted for 62% of the legally allowed density, whereas it fell to 46% in 2002 (Table 1). Yet the gap would have been filled quicker if legally allowed ratios had not been increased meanwhile (from 242 to 254.4%). As mentioned previously, public authorities have based part of their land policies on the ‘massive supply of land’ by increasing FARs. The rise of designated legally allowed ratios was undertaken through the revision of land-use plans: changing the designations of zones and increasing the building ratios inside the zones. Yet the most effective way to

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<sup>19</sup> When the owner of a landed property wants to sell his parcel, he must convince the land-lessee to leave and provide him compensation (typically 80% of the market value).

increase FARs was to designate new types of zones where the established rules would not apply.

This policy started in 1981 with the introduction of a ‘district system’ (*chiku keikaku*), modelled from the German B-plan. At first, this system only allowed stricter FAR, building coverage and other regulations, in areas considered worthy of protection. But in 1987, the ‘Special District Plan for Redevelopment’ was introduced, which allowed bonuses to FAR and deregulation. The latter purpose soon exceeded by far the former, and the designation of districts mostly sought deregulation of land-use and construction rules (Ishida, 1994). Such policies were far from being limited to Japan. In other industrialized countries, development zones of similar kind were introduced or increased in number during the 1980s. However, the district system paved the way for further fragmentation of planning control in Japan, because it fitted well with the traditionally sketchy planning process in this country<sup>20</sup>. Increasing fragmentation of the urban planning process during the 1980s undoubtedly allowed more flexibility to meet rapidly the demand of commercial and office space. But it caused severe damage on a broader scale. High-rise buildings were erected without taking into consideration their impact outside the development zone. This not only worsened the overall traffic

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<sup>20</sup> Overall pictures of global scale such as master plans, land use plans or road plans, certainly do exist, but concrete projects are not implemented in accordance with global objectives. For example, roads and even railroads are developed piece by piece, taking opportunities of land readjustment or urban renewal projects to expand. This fragmentary conception of urban planning results to some extent from the extreme spreading out of existing urban zones which hampers the effective control over the whole territory. It also results from the reluctance of landowners to sell their property, the reluctance of public authorities to use compulsory purchase, and, more fundamentally, the need to gain a broad consensus for each project, thus requiring a rather small-scale of implementation.

congestion but also aggravated environmental problems in the city (pollution, lack of sunlight, among others).

### ***Impact of the increase of volumetric ratio density in land prices***

Yet the major ill effect of the increase in building density was to drive up land prices, contrary to the official expectations of land policies. How could that all happen? We have already mentioned the filling up of the FAR gap by *jiage-ya* and the spreading of the price inflation it caused within the quiet low-rise residential areas. We must now examine more closely the causal link between building density and land prices. According to the official theory, such a link does not exist. Official expectations are based on the unrealistic assumption that land values are totally inelastic to building density: increasing the FAR does not upgrade land values but increases the aggregate floor surface and leads to a lower price per housing or office unit. In fact, however, land values are elastic to building density. When purchasing land, developers first estimate the aggregate revenue that can be generated from the sale of the total floor area, taking the current market prices as a basis; then they deduct the various expenses (including the profit expected from the project) to infer the maximum amount they can pay for the parcel<sup>21</sup>. If the FAR is increased, aggregate revenues rise proportionally to the increase in the floor area, but costs do not move accordingly. Some expenses are inversely proportional to the increase in FAR, but others are not, because there are economies of scale in the construction process. As a result, revenues grow higher than costs, thus significantly increasing the residual amount available for land purchase.

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<sup>21</sup> According to the « backward count theory » expressed by Topalov (1974), adapted to the French planning context of the 1980s by Vilmin (1991) and discussed in J-J., Granelle & Vilmin, T. (1993) .



In the case of Tokyo, the rise in land prices caused by the increase in FARs was even more pronounced than in other cities, for two main reasons: 1) in most of the high-rise areas, office and commercial space was built rather than housing units, increasing the aggregate revenues, and accordingly, the residual amount devoted to land. 2) The rise in FARs was widely announced as a key issue of the public land policy. Purchasers of land could thus expect further deregulation when land values became too excessive to secure profitable development projects. The loud talk of deregulation (including FAR increases) also made landowners more reluctant to sell land, and thus drove up prices, as they could reasonably expect that their parcels would gain value from later deregulations.

On the other hand, companies were also encouraged to purchase land by the strong incentives of the tax and accounting rules. They could deduct 100% of their land investments from their taxable revenues and use their land portfolio as collateral for further investments, without having to pay a tax on the ‘unrealized profits’ (*fukumi eki*) generated by the increase in land values. Given the favourable prospects for further rises in land prices and deregulation of urban-planning rules, along with the light taxation on land ownership, there was no need to bring forward developing land, and many companies just kept their parcels vacant (Hasegawa, 1990).

Construction nevertheless progressed at a rapid pace in Tokyo, particularly in the office sector. From 1983 to 1992, a total of 3,633 hectares of office floor area was built in the 23 wards, 56% of which was concentrated in the 5 central wards. Not surprisingly, it was in these wards (except in Shinjuku) that the sharpest increase of residential land values occurred, under the *jiage* process. But the spread of land inflation in the residential sector affected the peripheral wards differently. In the outer ring of the ward area, there

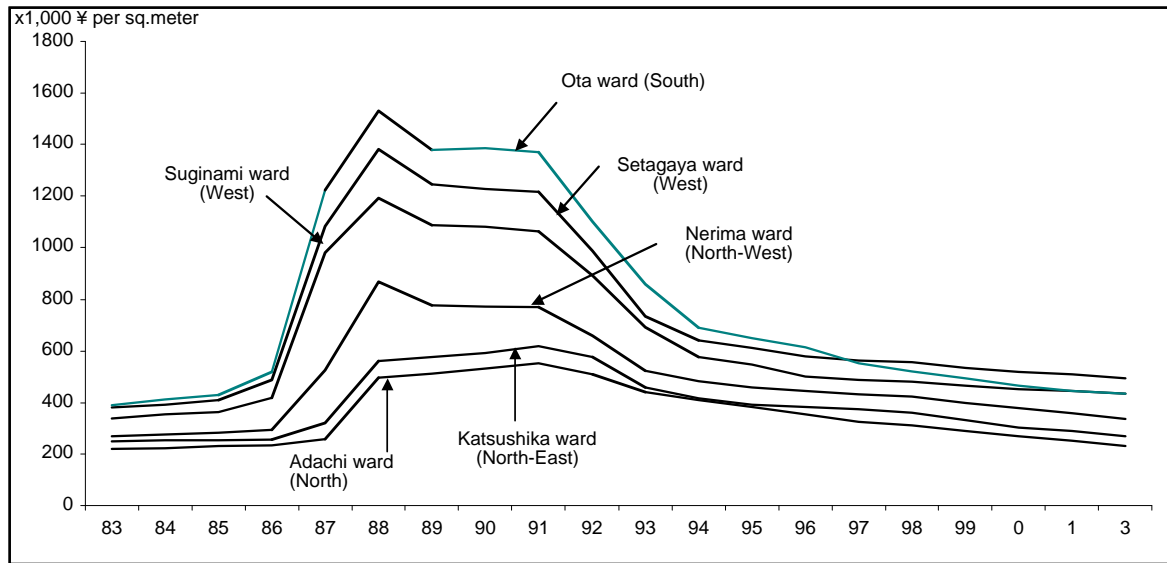
was no great difference in residential land prices between the wards prior to 1983. Residential land values ranged from ¥250,000 to ¥390,000 per sq. meter. Nevertheless, after 1986, prices rose more sharply in the western and southern wards than in their eastern and northern counterparts. In the most sought-after residential wards of Ohta, Setagaya and Sugiyama, land values increased 3.5 times on average, whereas they rose only by 2.5 times in most of the eastern and northern industrial wards. There is something striking in this pattern. One might expect the land rise to have been more acute in the cheaper wards, especially after 1987, when affordable residential land prices went beyond the reach of well-off households in the most expensive wards, as it happened for example in Paris.

The tax system played a major role in this pattern. Capital gains on both residential and commercial land are taxed when the owner sells his parcel. Yet if land has been held for a period of more than ten years, individuals can avoid taxation of the capital gain if they reinvest the same amount into a new property within a period of one year. This specific tax device, called *kaikae tokurei*, enforced until 1987 and reintroduced after 1993, was aimed at encouraging residential land owners leaving or running a small business in the center to release their parcels for office construction. Selling a parcel in the center provided sizable capital gains that the owner had to reinvest as soon as possible. He or she could thus afford to buy very expensive housing units in the most desirable residential areas of western Tokyo. This explains why the spiral spread towards the most western sought-after residential zones, regardless of the excessive values, which jumped over ¥9 million per sq. meter in the most expensive sites<sup>22</sup>.

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<sup>22</sup> Tokyo Metropolitan Government, *Tôkyô no tochi 2000*, p. 18.

**Chart 3. Change in Residential Land Prices in 6 Wards of Tokyo (1983-2003)**



Source: composed by the author with data from official land prices (*kôji chika*), Tokyo Metropolitan Government,,  
*Tokyo no tochi 2002* for the period 1983-1985.

#### 4. Land inflation and the general economy

The land boom in Japan was very closely linked to the general economy. It is generally acknowledged that the ‘bubble’ was triggered in part by the low interest policy followed by the Bank of Japan (BoJ) right after the Plaza Agreement of 1985. According to this Agreement, the Japanese currency had to be increased to reduce the huge American trade balance deficit towards Japan. The BoJ intervened on the monetary markets to raise the level of the yen in response to international pressure. However, the BoJ began, at the same time, to lower the official discount rate, to balance the expected slide in Japanese exports by expanding domestic demand. From January 1986 to April 1987, the official discount rate fell from 5% to 2.5%, thus fuelling the property sector

with cheap loans. While the loans outstanding for the manufacturing sector increased by 75% from 1984 to 1989, those to the real estate sector expanded by 195% during the same period. Major landowners, especially large corporations, enjoyed further credit opportunities through the use of land collateral to secure loans, as the value of their land portfolios boomed. They could, in addition, levy funds directly on the newly deregulated monetary and financial markets. This new supply of funds was partly reinvested into speculative purchase of land and shares, but it was also broadly used for domestic and foreign direct investments, allowing industrial groups to expand over the world.

### ***Cause and consequence of the high GDP growth***

With the increase in demand for office space in Tokyo, both from domestic and international firms, the shift from an export-based economy to an increasingly domestic-based economy was smoothly achieved by the expansion of the property markets, in accordance with the recommendation of the official Maekawa Report, published in 1986. In addition, domestic consumption at large was supported by the ‘wealth effect’ generated from the rise in value of individual properties. The Japanese economy thus enjoyed a boom from 1986 to 1990, with annual GDP growth exceeding 4%. Undoubtedly, the ‘land bubble’ occurred with the best possible timing and helped the Japanese economy to cope with the rise in the value of the yen (*endaka*).

Although one cannot deny that the low-interest-rate policy of the Bank of Japan was a major factor behind the dramatic magnitude of the ‘land bubble’, it is possible that the land boom would have occurred even if interest rates had been higher. Land values had already started to increase in the central business districts of Tokyo as early as 1983, supported by a steady demand of office space. Land booms occurred in many other

industrialized countries during the same period, even in Paris –despite an increase of real interest rates in France after 1986. Therefore, one must not only consider the interest rate policy, but rather the overall context of deregulation –not only towards financial and monetary markets, but also towards property markets– to comprehend the land surge in Tokyo.

### ***Equity stock prices and land prices***

A striking feature of the Tokyo's land bubble was its similar trend to that of the stock markets. From 1983 to 1985, the Nikkei index increased around five times. This strong surge of corporate shares occurred slightly ahead of the rise in the official land prices (by about 6 months) in the major metropolitan areas. Many commentators have therefore argued that the two cycles were closely linked. Stone and Ziemba (1993) found that changes in the stock markets influenced changes in the real estate markets, and not the other way around. However, the poor reliability and the time lag of the official data used for this causality test do not allow definite conclusions to be drawn<sup>5</sup>. According to another theory, the increase in share values was, at least partly, caused by the booming value of corporate land portfolios. This is not, however, consistent with the change in share values in the various industries during the bubble period. Companies holding the largest land portfolios (paper, railway industries) and those owning the most valuable land assets (real estate industry) generally recorded a fourfold increase in their share values. Conversely, companies involved in the financial, IT, and insurance industries, which land assets were far less significant than the previous group, enjoyed dramatic rise

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<sup>5</sup> Compilation of official data takes three months, whereas shares prices are immediately available.

in their share values, up to more than 10 times in some cases (Aveline, 1995<sup>23</sup>). Land and stock markets have thus been exposed to common factors, namely low interest-rates and optimistic prospects of emerging service and financial industries in a new deregulated environment. It is difficult to ascertain which of the two markets went ahead, but it is clear that both markets were closely interwoven. Undoubtedly, profits generated on the stock markets were reinvested on land markets, and *vice versa*, during the period 1985-1989.

## **5. Public policies towards the ‘land bubble’**

The reaction of public authorities towards the land cycle can be divided up into three major periods: a period of *laissez-faire* from 1985 to 1989; a period of strong opposition towards speculation (1989 to 1993) and a period of ‘post bubble’ policies.

### ***The laissez-faire period***

From 1986 to 1989, the government did not really take any drastic measures to curb land price inflation in spite of the growing misallocation of land resources. The reasons are threefold:

- 1) Increasing land prices offered good prospects to the construction industry despite the decrease in yields. This trend was in accordance with the shift of the Japanese economy towards domestic markets, as recommended by the Maekawa Report.
- 2) A major part of the population enjoyed a rise in their property assets. Similarly, corporate landowners benefited from the leverage effect of land inflation and from profits

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<sup>23</sup> According to the Annual Corporation reports of 1,700 companies.

on land sales.

- 3) The Japanese government took great advantage of the surge in land prices. It enjoyed rising tax revenues as well as huge profits from the sale of public land until 1987.

Several measures were nevertheless taken to curb the most excessive effects of speculation. In 1987, the sale of public land was abandoned. In the same year, the *kaikae tokurei* special tax device was removed and a new tax on short-term resale of land (two years) was introduced. However, probably the most effective measure to rein in excessive speculation was the strengthening of public control over land transactions between 1987 and 1990. It might seem paradoxical that such a severe constraint upon private land ownership could have been introduced in a country where ownership rights are so strongly protected. In fact, the control of land transactions was a legacy of the previous land boom of 1971-1973. To prevent further inflation of land prices, local authorities were allowed to designate new 'control zones' (*kanshi kuiki*) in areas where speculation could arise. Under to this system, transactions of parcels larger than 2,000 sq.meters had to be reported to the local authority, which had to make sure that the reported transaction values would not greatly exceed the 'normal values' based on official prices. If a reported value were considered excessive, a lower price would be recommended to the seller; and if he or she did not behave accordingly, the case would be reported in the media (newspapers, television). Such a threat was normally strong enough to persuade sellers to follow the directive of the local control committees. However, the scope of the control was not significant until the mid-1980s, as most of transactions concerned parcels of less than 2,000 m<sup>2</sup>. After 1985, the size of the targeted parcels was progressively reduced, down to 100 m<sup>2</sup> in Tokyo's 23 wards in November 1987. The control was thus fully implemented only during the two last peaking years of the land cycle (1988-1990). It was

then progressively relaxed after the crash of the land markets, to avoid hampering the already sluggish property markets. During the short period of time it was fully implemented, the control over transactions turned out to be rather effective. According to a survey made by the author on a sample of 131 transactions in the Tokyo Prefecture over the period 1987-1989, land prices were reduced by 20% to 40% in most cases by the Prefecture committee. The control was especially efficient in the remote western suburbs. For example, near Hachioji (40 minutes by train from the center), reported prices were reduced by as much as 60 to 70% (Aveline, 1995).

### ***Fighting against speculation***

After four years of land euphoria, things became more worrying. Skyrocketing land prices started to seriously threaten the investment capacity of companies and the savings of households. Worst of all, the inflating money supply threatened to cause a general rise in consumer prices. The Bank of Japan thus decided to increase the official discount rate: within 15 months (from May 1989 to July 1990), it rose from 2.5% to 6%. Meanwhile, banks were ordered to limit further real estate loans to the same rate as the growth in their overall general lending. These measures were soon followed by the crash of the second-hand condominium and office markets. Land prices also started to decrease in Tokyo, but the National Land Agency did not acknowledge the reverse trend in land markets before 1992, to avoid a panic on the land markets. Official data even displayed a continuous rise in land values in 1991 in the Tokyo Metropolitan Area, while the crash in land markets was already obvious. After 1992, The National Land Agency pursued its 'soft landing policy' by overestimating the level of official land prices.

It is generally assumed that the credit tightening policy of the BoJ was the primary



cause of the real estate crisis. Yet endogenous factors were already leading property markets over the precipice. Yields on rents had fallen below 1% and many new office buildings were empty. What also undoubtedly hastened the crash in the property sector was the reverse attitude adopted by the public authorities to address land issues, beyond the monetary measures previously mentioned. The Basic Land Law advocating a wide range of reforms was adopted in December 1989. Although this act did not specify any concrete measures, it was a strong signal of the change in public policies. Several months later, the Economic Planning Agency and the BoJ published reports displaying the enormous discrepancy between actual land values and theoretical land values calculated by the discounted cash flow method (Bank of Japan, 1990). The discrepancy was called a 'bubble' (referring to the well-known theory of speculative bubbles) and the cause of this anomaly was speculation. Using the bubble theory allowed the public authorities to undertake reforms in a more simplistic and understandable way, by putting the blame on speculators (Aveline, 1997).

The core of the Basic Land Law was the tax reform, adopted in 1990 and enforced in 1991. It was aimed at discouraging further speculative land purchases and to bringing underdeveloped parcels onto the market. The concept behind this reform was again the belief in the market mechanism, with the expectation that a dramatic increase in land supply would automatically provoke a significant decrease of land values. Besides, it allowed punishment to be dealt out to the 'speculators' (i.e. the landowners of unused parcels), accused of having generated the bubble.

The new regime put consequently a heavier taxation on land transactions and land ownership. The long-term capital gain tax (for resale of land over a 5-year period) was raised for individuals and corporations. The corporate capital gains tax became a totally

separate tax from the general corporation income tax, thus preventing corporations from offsetting capital gains with losses elsewhere. Two main measures were taken to strengthen land ownership: the introduction of a new property tax (*chikazei*), which symbolized the best government intention to break the ‘land myth’ and the removal of the tax privileges of agricultural land (agricultural land within UPA had to be taxed at the same rate as urbanized land). None of the two measures, however, actually caused a drastic increase of land supply. The scope of the new property tax was reduced under the pressure of the corporate lobbies. Initially projected to be 1% of the market value of land, the tax rate was actually fixed at 0.3% in 1992. Further exemptions were introduced, and the tax revenues dropped from ¥605,3 billion in 1993 to ¥1 billion in 2001<sup>24</sup>. The new taxation system on farmland did not provoke a massive supply of land, but it did encourage farmers to build housing for rent on their parcels.

Following the tax reform, two other major revisions were implemented in the early 1990s in accordance with the objectives of the Basic Land Law. In September 1991, the revision of the Land and Building Lease Act was adopted (enforced in 1992). The new regime did not reform the existing land lease contracts, but introduced new types of short-lease contracts strongly protecting land ownership, to promote the use of underused parcels. The maximum leasing period was set to 50 years for residential use and from 10 to 20 years for business use (family restaurants, gasoline stations, etc). In 1992, the reform of the town planning and construction rules completed the set of measures addressing land issues. This revision was aimed at rationalizing and strengthening the public control over FARs. It also allowed construction in the UPAs with, in counterpart, a stronger control of development projects. Finally, it increased the number of urban

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<sup>24</sup> Ministry of Finance, *An Outline of Japanese Taxes*, 2002, p.370.

planning zones in the UPAs, from 8 to 12.

### ***Post bubble policies***

The three main revisions based on the Basic Land Act were devised to depress skyrocketing land prices, but they were enforced too late. In 1992, official land prices in Tokyo Prefecture had already decreased by 10.3% on average in the 23 wards and by 8% in the business zones. With the drop in land values, the crash of the stock markets and the rise in interest rates, the Japanese economy had entered a recession. In 1992, GDP growth fell from 2.9% to 0.4% and the financial system began to face a growing mountain of bad debts. The BoJ quickly lowered the official discount rate, from 6% to 1.5%, within two years, from 1991 to 1993.

Under the new circumstances, the land-related reforms were considered irrelevant. The tax system was accused of impeding the recovery of the property markets. Hence the new property tax, which had symbolized the anti-speculative attitude of the central government, was further lessened. Taxation on short-term capital gains was similarly lowered, and the *kaikae tokurei* device was fully reintroduced in 1993.

Early forecasts predicted that the recession would not last very long. Banks did thus not publish complete information about their bad debts –in the hope that stock and land markets would soon recover. However, after a few years, several financial institutions went bankrupt with debts far exceeding their capital, threatening the stability of the entire Japanese financial system and the credibility of Japanese banks abroad. After 1997, the Japanese government ordered banks to disclose more accurate information on their financial statements.

In the late 1990s, the government shifted from an ‘anti-speculative’ policy to a policy promoting ‘efficient land use’ (*yûkô riyô*). The primary purpose was to dispose of bad debts by boosting land values (or at least limiting their fall) through an increase in building density. This new policy also legitimised the removal of previous reforms. In 1998, the new property tax was removed. The other taxes were maintained, but many measures were introduced to lessen the tax burden of both individuals and corporations. Tax incentives were also introduced to promote housing investment: a two-year program of tax exemptions on loans from 1998 to 2000, followed by a new system of tax reductions running until 2003. In September 2001, the listing of Real Estate Investment Trusts (REITs) on the Tokyo market Exchange was begun. REITs are companies that manage portfolios of real estate, including office buildings and commercial facilities, to earn profits from shareholders. Real estate companies are now eagerly establishing REITs, but they are lobbying for a drastic revision of inheritance and gift tax, to make these products more competitive with other financial products. Generally, despite the lightening of the tax framework, the tax burden is still considered too heavy by corporations. They ask for a further deregulation of the ‘dinosaur’ regulations.

Pressure was also applied to deregulate existing land-lease contracts, since surveys have shown that land-lessees were on average wealthier than their landlords in Tokyo (Noguchi, 1992). However, there is a strong consensus to maintain the current rules, as most of the land-lessees are elderly people who cannot be easily moved from their local community. The new land-lease contracts introduced in 1992 have gained some success, through to a limited extent. In 2002, 15,480 housing units (including 4,125 condominium

units) had been supplied in the Tokyo Capital Region through this system<sup>25</sup>. A new kind of short-term building tenant contract (*teiki shakka*) was also introduced in 2000 to increase the flexibility of the housing rental market. Alike the land-lease contracts, the new rental contracts cannot be renewed after the term of the rental period. Tenants and landlords can decide freely upon the rental period, thus allowing temporary use of buildings.

Town planning regulations were also revised through the new framework. The new set of measures seeks two main objectives: 1) promote the best economic use of land by increasing the building density; 2) achieve the best social use of land by providing a better urban environment, through the development of open space, the construction of public facilities and the participation of citizens in the town planning process.

Promoting the economic use of land involves bringing back idle parcels to the markets – either unmarketable plots purchased by *jiage-ya* during the bubble period, or former industrial sites (especially on the waterfront). The effective use of these parcels should be secured through two major means: 1) Establishment of a ‘bank of underused land’ nationwide, using Internet resources, where underused parcels can be registered (by public corporations, NPO, professionals and individuals) and advice can be found. 2) Cooperation between private landowners of scattered parcels or former industrial land, to allow the redevelopment of large sites. This task will be undertaken by specialized institutions, such as the public corporation Urban Development Corporation (UDC, *Toshi kiban seibi kôdan*) and the incorporated foundation Organization for Promoting Urban Development (OPUD, *Minkan toshi kikô*). Both institutions will purchase land, with

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<sup>25</sup> Mitsubishi Fudôsan, *Fudôsan kanren tôkeishû*, n°26, 2003, p.123. The Tokyo Capital Region encompasses the Tokyo Prefecture (23 wards and the Tama area) and the four adjacent prefectures (Saitama,

government guarantees and non-or low-interest loans, redesign the land structure and provide basic infrastructure, then sell it to private or public developers.

The new framework gives more autonomy at the local level to ‘achieve the best social use of land’. Local governments can choose whether they will keep the distinction between UPAs and UCAs in the master plans or not. They can also decide, through municipal ordinance, that district plans should be designated with citizens’ acceptance. Since May 2001, local authorities are allowed to set up ‘semi-urban zones’ (*jun toshi keikaku kuiki*) in areas outside urban planning zones, where district areas or land-use zones can be designated to allow better control of development.

### ***Urban renewal as a means to encourage deregulation***

The overall relaxation of previous anti-speculation measures did not rein in the bad debts, which officially reached ¥37 trillion in September 2001 (perhaps closer to ¥50-60 trillion, according to unofficial sources). Of that amount, about ¥15 trillion was secured by land – meaning that even a slight drop in land prices is likely to rock the financial sector. The Koizumi government, urged to solve the problems of non-performing loans and revitalize the economy, listed an urban renewal policy as one of its seven high-priority policy issues, and founded an urban revitalization headquarters in September 2001. The primary purpose of this new urban renewal policy, referred to as ‘town regeneration’ (*toshi saisei*), was to boost land values –and consequently collateral values, as well as to stimulate domestic consumption (Aveline, 2003a). Little public funding was to be directly involved in the renewal projects, as the government’s intervention primarily consists, as usual, in creating new types of districts where normal

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Chiba, Ibaraki and Kanagawa).

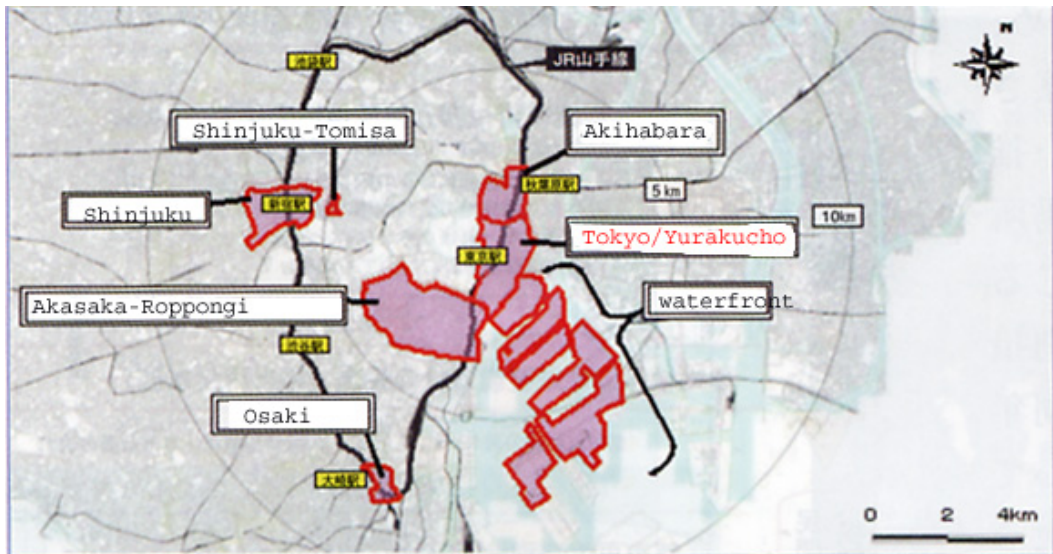
rules (in particular FAR regulations) are relaxed. One of the first steps of the *toshi saisei* policy was to approve, in April 2002, a bill designed to end the government monopoly on development planning. The new regulations allow private companies to submit development plans to the ministry of Land and Transports, provided they receive the approval of two-third of the landowners in the targeted area. The approval procedure for the development takes only 6 months, and private contractors are granted interest-free loans to cover the cost of the roads, parks and other facilities that are traditionally developed by the public sector.

Seven districts covering 2,370 ha, mostly concentrated along the bay area, have been accordingly designated in Tokyo 23 wards as ‘priority urban renewal areas’ (*toshi saisei kinkyû seibi chiiki*, map 1). This new step up in deregulation has resuscitated an old project of Mitsubishi Estate, seeking to transform the Marunouchi area into a Manhattan zone. Mitsui Estate’s plan proposes that the current FAR, already at the highest in Japan (1,000%) could be boosted to 2,000%, and the maximum height of buildings rose to 200 meters, without substantially affecting transportation or sewers in the area. This project has been so far repeatedly rejected by the Construction ministry and the Tokyo Metropolitan Government, but the designation of a priority urban renewal district in the vicinity of the Tokyo and Yurakucho stations can be seen as an encouraging move.

Needless to say, the designation of these districts has provoked strong opposition among planners and ‘anti-deregulation’ economists. As Hasegawa puts it, the

government is trying “to treat the wounds of the bubble by the bubble”<sup>26</sup>. But can a new land bubble possibly occur in the near future?

**Map 1. The priority urban renewal districts in Tokyo (2003)**



At a first glance, large-scale development proved to have pushed up land values. In 2003, land prices in central Ginza –the most expensive for the 18 straight year– rose for the third year in a row, by 6% to ¥12.72 million per sq. meter. Land values soared likewise in Shinagawa and Marunouchi districts, owing to renovated office buildings, prime accessibility (new Shinkansen bullet train station in Shinagawa), and increased attractiveness of urban living by the opening of new luxury stores. This trend, however, is limited to a small group of ‘favoured few’ downtown locations. Elsewhere, land prices are continuing to decrease, with record decline rates in Yokohama and Chiba where large-scale development projects, unable to compete with Tokyo’s downtown

<sup>26</sup> Hasegawa Tokunosuke (2002), « Tsukurareta bîmu no uragawa wo misugosuna » (Let us not overlook the dark side of the boom that we generated), *Economista*, February 26, 2002, 46-47.



redevelopment districts, are facing a severe office glut (with vacancy rates ranging from 10 to 20%<sup>27</sup>).

Therefore, the notion that massive redevelopment will serve as an engine for reinvigorating the Japanese economy is fairly questionable. Over 2,2 million sq. meters new office space hit the market in the 23 wards of Tokyo in 2003, a record one-year supply exceeding by far the 1994's at the peak of the bubble (Chart 4). The ratio of empty space in Tokyo's five central wards is expected to surpass in 2004 the record 8.08 % set in 1994<sup>28</sup>. In the intensifying competition to attract tenants, the new extra-large buildings next to the JR Yamanote-line will capture most of the demand, as only 5%<sup>29</sup> of the total stock of office buildings meet the standards of prime office space (i.e. a surface over 30,000 sq. meters) in the three central wards. Most of the companies currently involved in large projects are major developers, such as Mitsubishi Jisho, Mitsui Fudôsan or Mori Building. They expect large adjustments on the office markets, with a massive migration of tenants from the post-war generation of office buildings, owned by medium-size companies and individuals, to their new prime office buildings<sup>30</sup>. They are confident that they will largely be unaffected during the 2-to-3 years of forecasted high vacancy rates (from 2003 to 2005).

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<sup>27</sup> Non official estimation quoted in the Nikkei Weekly, February 24, 2003.

<sup>28</sup> According to Miji Shoji Co estimates quoted in the Nikkei Weekly, September 15, 2003, the average office vacancy rate in the central five wards of Tokyo (Chiyoda, Chuo, Minato, Shinjuku and Shibuya) reached 8,57% at the end of August 2003, 2,51 percentage points higher than the same period in the previous year.

<sup>29</sup> Only 640 buildings among 12 377 buildings in the 3 central wards can be considered prime office buildings.

<sup>30</sup> Statistics on Tokyo's office market show that the large-scale buildings (more than 330 sq. meter per floor) from the late 1990s record the lowest vacancy rates in comparison with small and medium-sized office buildings.

Undoubtedly, the frenzy of large-scale project development is far from being primarily demand-driven. Depressed business conditions, marked by large corporate restructurings, do not encourage expanding business space. In addition, Tokyo's role as the business center of East Asia is diminishing rapidly amid China's ascendancy, while the population aging is expected to contract the number of workers after 2010.

In fact, the construction of urban complexes is mainly driven by unprecedented opportunities to construct large projects in Tokyo. In addition to the dramatic decrease in land values, the following three key factors are strongly encouraging large-scale construction in the center of Tokyo.

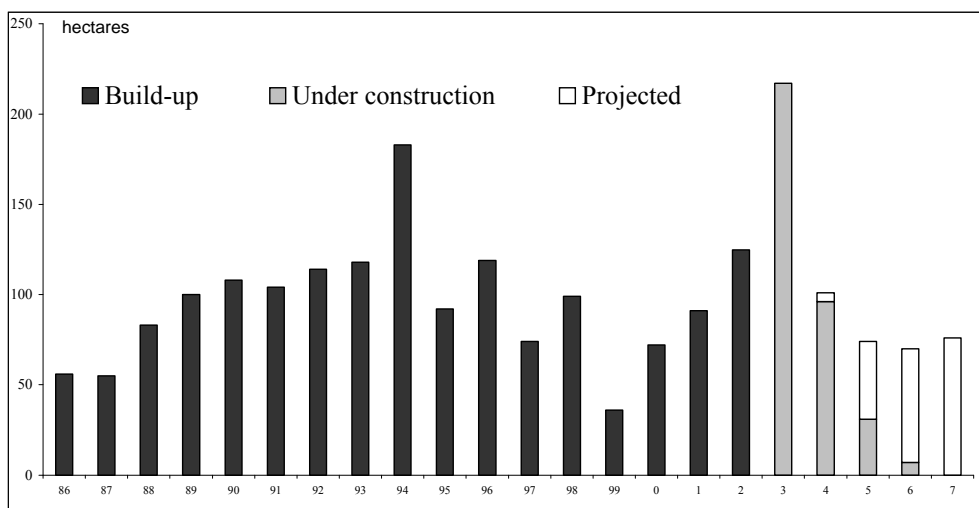
- 1) Large tracts of land are now available after a long process of purchasing and assembling small parcels, which started in the period of bubble euphoria. A typical example is the Mori Building's Roppongi Hills complex (office, retail and residential), opened in April 2003<sup>31</sup>. It occupies a massive 759,700 sq. meters on the edge of the city's popular nightlife district. The purchase of land started 16 years ago, when the center of Tokyo had very few large land tracts.
- 2) The release of large development sites through the sale of land previously owned by the Japan National Railways following its privatization in 1987. Most of the current large-scale projects are going ahead on JR company land. These sites are particularly well located, along the Yamanote loop railway, and adjacent to major railway central stations. Typical examples are Shiodome (31 ha of land), Shinagawa (17 ha) and Yaesu (6.5 ha).
- 3) Deregulation of floor-area-ratios in central locations, allowing the rebuilding of low or middle-rise office buildings into high-rise constructions.

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<sup>31</sup> This redevelopment project, referred to as 'the ultimate in urban life', costed almost \$ 4.2 billion. The complex includes 209 stores, 800 condominium units, a high-grade hotel and entrainment facilities.

While the 1994 record vacancy returned to a normal level in about three years, supported by a boom in information technology and an steady demand of foreign firms in the financial sector, it seems unlikely that the coming oversupply will be easily absorbed, given the poor prospects of the business environment. This does not, however, discourage the central State and the Tokyo Metropolitan Government to keep promoting redevelopment through the deregulated frameworks, in the hope that it will regenerate the economic conditions by rising Tokyo's attractiveness as a world city. Large real estate companies may take advantage of this policy, at least in the short run, but small and medium-scale landowners, as well as municipalities and citizens of the remote suburban areas will be the loser of the construction boom in central Tokyo.

**Chart 4. Construction of large offices in Tokyo's 23 wards**



Source: composed by the author with data from Mori Building, 2002.

Large office space refers to buildings over 10,000 sq.meters in floor area.

Only floor area for office use has been taken into consideration.

**Table 2. Major Redevelopment Projects in Central Tokyo**

	Area in hectares	Cost in billions yens	Key tenants, facilities	Number of residences
Roppongi district	11	500 (all projects combined)	-Goldman Sachs (Japan) Ltd. -Cinema complex -Hotel	793
Marunouchi district	111	63 (Marunouchi building only)	Mitsubishi Tokyo Financial Group -Mizuho Financial Group	-
Shiodome district	31	140 (land for Shiodome City Center only)	-Dentsu Inc ; -Fujitsu Ltd. -Theater	1,800
East side of Shinagawa station	5	184 (land only)	-Mitsubishi Heavy Industries Ltd. -Mitsubishi Motors Corp	852
Former Defense Agency site	10	400 (all projects combined)	-Hotel -Convention center	700-800

Source : Nikkei Weekly, April 28, 2003.

## Conclusion

The last land boom-bust cycle, triggered by the Plaza agreement in 1985, provided favourable conditions to help the Japanese economy shift from being export oriented to more domestic consumption oriented. Low interest rates, together with booming land and stock markets, offered strong support for private investments in office and residential construction in Tokyo, as well as in other large cities. This was facilitated by the relaxation of urban planning rules and the strong incentives of tax regulations to invest in the real estate sector. Such rapid changes in the structure of the economy were achieved thanks to the supremacy of land over construction, allowing a more flexible use of parcels, and conferring to land the highest status of any collateral.

In the early stage of the land boom, the central government took great advantage of the rising land values. It even fuelled the bubble with low interest rates, loose construction rules and various signals encouraging private investment in land

development. But, after a few years of this regime, the skyrocketing levels of prices started to threaten the macroeconomic equilibrium (through pressure on consumer prices) and to challenge the mythic ‘one-class-society’ structure. The central government consequently reversed its attitude towards land markets, increased interest rates and introduced ‘anti-speculative’ measures targeted at investments in property. It was impossible to avoid the subsequent crash of share values, given the high sensitivity of the stock markets to the change in interest rates. But the government managed to limit the panic on land markets by publishing overestimated official land prices and counselling the real situation of bad debts until the late 1990s. Failure to deal quickly with the crisis inflicted –and still continues to inflict– enormous damage to the Japanese economy.

These macro-economic and monetary policies have left significant marks on the urban pattern of large metropolitan areas. In the capital region, the urban fringe expanded outwards, up to 50-60 kilometres from the center, forcing part of the population to endure more than three hours of commuting a day. Those who acquired 25-year mortgage to buy their first house in the remote suburbs will have to sell at a greatly reduced price (provided they can even find a buyer) if they want to move to a better location closer to their working place and to key facilities. In the central zones, large urban projects offer the best living and working conditions to the wealthier households. Not far from these prestigious urban redevelopment areas, in the zones where the *jiage-ya* operated before being blown away by the bursting of the bubble, lies the legacy of the *jiage-ya*’s handiwork in the decaying wooden houses and empty lots.

Public authorities have a responsibility to improve the urban environment. This would be supposedly the goal of an urban renewal policy. But the government’s concern has once again opportunistically turned about-face, shifting from an anti-speculative to a

pro-speculative policy. Neither of the two policies is likely to improve the living environment. The former is short-termed and tailored to the ascending phase of a cycle –and is therefore usually implemented too late, while the latter does not allow an adequate allocation of land resources since it encourages the more profitable uses; moreover, it raises speculative expectations of further deregulation and keeps land values at high levels.

This latest experience of a land boom-bust cycle clearly shows that land policies are not sustainable in Japan. Policies are alternatively addressed to cope with excessive land values when property values are inflating, and are subsequently designated to boost the economy in deflationary periods. These ups and downs result from the fact that land policies are not really designed to adequately address town and housing issues. Rather, they are primarily designed to manage land as a financial asset class, and they depart from this view only when excessive land prices challenge the myth of ‘one-class society’ or threaten to push up consumer prices.

The Japanese urban planning and construction rules are thus far from rigid by international standards, contrary to what is often stated by neo-liberal Anglo-Saxon analysts. Constraints to urban development do exist, and even play a major role, but they result more from the emphasis given to land ownership rather than from public control on land-use and construction. The framework of regulations related to town and housing issues focuses on securing the equality of landowner’s rights (both corporate and individuals, including land-lessees, who can be assimilated to the landowner group) instead of seeking the most adequate land use. This is where the problem lies. In giving the priority to land ownership while relying on the market mechanisms, urban policies cannot prevent major distortions in the allocation of land resources. Japanese public

authorities should therefore not only keep full control over city development; they should also consider limiting the scope of land ownership to achieve better regulation of land uses.

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