

RABBIT HUTCHES

Did Land Use Politics Shortchange Japanese Consumers?

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Abstract

Political scientists have argued that Japan's political system has failed to give its citizens a reasonable quality of housing and domestic comfort, despite rapid economic growth. In particular, they highlighted interest group politics (the political power of landowners) and developmentalism (the prioritization of industrial growth over domestic comfort) as factors that contributed to high housing prices and poor urban infrastructure. This paper examines three aspects of policy – housing finance, land use regulation, and measures to combat high housing prices in the Bubble era – to reassess the view that Japan's deficient housing is due to these political factors. Clientelism and developmentalism clearly played some role, but on the whole the case is less clear than critics have made it out to be.

1 Introduction

One of the enduring puzzles of Japan's postwar economic growth is the relatively low quality of housing and the urban environment in Japanese cities. For many observers, particularly those whose attention turned to Japan in the heady 1980's, the "Rich Japan, Poor Japanese" dichotomy was epitomized by the fact that many employees of Japan's world-beating corporations returned home to small, cramped, and far-flung quarters in neighborhoods blessed with neither sewer systems nor sidewalks. And they paid more for these humble abodes, too: in 1988, the average Japanese worker paid almost a third more for housing than the average American, and two-thirds more than the average English worker (Woodall, 1992, p. 118).

The deficient domiciles of typical Japanese came to be known (inside Japan and abroad) as "rabbit hutches," an epithet whose history provides some insight into both the domestic and international significance of housing in Japan. The originator of the phrase is reportedly Sir Roy Denman, who, as director-general for external relations of the EC Commission in 1979, referred to the Japanese in a confidential internal memo as "workaholics living in rabbit hutches." The context of the memo was increasing trade friction between the EC and Japan, particularly over automobiles. A view was becoming widespread in both Europe and the US that Japan was engaging in "social dumping": unfairly neglecting the material comforts of its people in order to produce low-cost exports. Denman's comment was leaked to the press and seized upon by the Japanese media (Lehmann, 1992, p. 41). Japanese who sought to improve the condition of housing and urban infrastructure interpreted Denman's critique as echoing their own frustrations, and used the phrase "rabbit hutches" to

refer to what they saw as Japan's embarrassing housing problem.

The "social dumping" critique current in trade debates of the time had its analog among social scientists studying Japan's political economy. Analysts emphasized that Japanese industrial policy generally prioritized producers ahead of consumers, as demonstrated by the fact that consumer prices were much higher in Japan than in other industrial countries (Samuels, 1989). These higher prices were a result of import restrictions and other government policies that effectively transferred wealth from domestic consumers to domestic producers. A number of explanations have been provided for the general "producer bias" evident in Japanese economic policy, including the political weakness of unorganized consumer groups, economic nationalism (Samuels, 1989) (McCraw, 1986), the electoral system (Rosenbluth, 1996), and political bargains and economic relationships between consumers and producers (Vogel, 1999a).

A small number of analyses in this vein written in the late 1980's and early 1990's focused attention directly on the "rabbit hutch" problem. Kent Calder's *Crisis and Compensation* (1988) provided the most broad-ranging treatment of the political economy of land use in Japan. At a time when international attention was focused on the apparent effectiveness of Japan's industrial policy in helping Japanese manufacturers conquer global markets, Calder's book focused instead on policymaking in non-traded sectors like agriculture and small business. In contrast to industrial and trade policy, where politically-insulated bureaucrats pursued a technocratic, efficiency oriented course, Calder argued that in domestic sectors redistributive and particularistic politics played a dominant role. The "materialist" orientation of domestic

policy was particularly pronounced in periods of political crisis (more common than widely perceived, given the LDP's nearly-unbroken hold on power), when politicians and bureaucrats used policy to buy political support and assure self-preservation.

Land use was one area of policymaking that provided evidence of the “crisis and compensation” dynamic Calder stressed. Land use policy, in his view, left Japanese consumers with the worst of both the bureaucratic establishment (the “developmental state,” in Chalmers Johnson’s term) and the clientelistic LDP party machine. Developmentalist policy generally put economic growth ahead of citizens’ housing needs; when political crisis forced conservative policymakers to address problems in housing and urban infrastructure, they made only superficial gestures at planning, constrained from making significant reforms by the interests of major client groups in real estate, construction, and agriculture. The result was what he called “land use policy minus urban planning”: a set of rules catering to special interests, with neither the bold vision that might produce green, efficient, and modern cities nor a consistent concern for more mundane infrastructure like sewers and residential streets. Japan’s “rabbit hutches” thus stood as a symbol for the ways in which policymaking in the domestic arena had failed its citizens, in contrast to the apparently dramatic successes of industrial policy.

A number of political scientists, economists, and legal scholars followed up Calder’s critique with papers on Japan’s land problems presented at a University of Washington conference in 1991, near the peak of Japan’s real estate bubble. Their papers were later released in a book entitled *Land Issues in Japan: A Policy Failure?* The answer to the title’s question was a resounding “Yes.” Anchordoguy (1992) emphasized

how interest group politics stymied reform of tax laws encouraging the unproductive use of land; Haley (1992) analyzed the recent tentative reform of a counterproductive landlord-tenant law; Woodall (1992) argued that structural corruption in public works prevented needed reforms; and Yamamura (1992) asserted that the benefits of high land prices to LDP constituent groups had prevented policymakers from enacting countermeasures that would provide relief to strapped consumers.

Since the early 1990s, very little has been written about the political economy of land use in Japan.¹ I venture three explanations for this gap. First, land use policy – zoning, development standards, housing finance, public projects – is an underdeveloped field generally in social science, despite the clear distributional and economic consequences involved. Second, as the world has become less impressed with Japanese industrial policy, analysts have also become less interested in explaining persistent deficiencies in the Japanese standard of living; in other words, absent the “Japan as Number One” paradigm, Japan’s rabbit hutches seem less puzzling and more consistent with failures elsewhere in the Japanese system. Third, the situation in the market for housing has changed so radically since the early 1990’s – with the price of land plunging to 1980 levels and urban planners concerned about an *oversupply* of housing as Japan’s population shrinks – that it is hard for anyone to say what policies would have made sense in the bubble period and before, when prices were astronomical and there was a widely perceived shortage.

In this paper, I consider some of the arguments that critics in political science and urban planning have made on this issue. I do not update the debate to the

¹Brian Woodall’s *Japan Under Construction* 1996 is one important exception, but it deals more squarely with structural corruption in public works than it does with land use and housing.

present day (although this would be a valuable contribution), but instead focus on the period from the 1950s to the end of the bubble era. My analysis is divided into three sections. The first two address policy areas in which critics have alleged that the Japanese political system shortchanged consumers – land use planning and public financial support for housing. The third section reconsiders arguments made during the “bubble era” about the LDP’s failure to make reforms that would control the price of housing. In general, I find the argument that consumers were shortchanged by either national economic policy or partisan politics to be less convincing than critics have made it out to be.

I conclude that clientelism and developmentalism had their place in Japanese land use policy, but that for the most part the policies we observe are not too far out of line with what consumers might have wanted. Some of the ways critics emphasized in which housing and the urban environment in Japan differed from that in the West were unrelated to land use policy, and had more to do with either deep-rooted differences between Japanese cities and Western ones or policies in other domains, such as finance. Some policies, such as federal support for housing finance and public housing, that appeared to be very different in Japan were actually fairly similar. Future studies of land use that hope to pin down a role for politics will have to take more careful account of the non-political reasons for the distinctiveness of Japan’s urban environment.

2 Financing housing and infrastructure

Even in countries where the cost is below Japan's (during the bubble or otherwise), buying housing is a major investment – often the largest single category of expenditures consumers make. Consumers rely on the financial system (typically in the form of mortgage loans) to amplify the purchasing power of their savings. In his survey of the history of urban planning in Japan, *The Making of Urban Japan* (2002), Andre Sorensen holds weaknesses in Japan's mortgage financing partly accountable for constraining consumers' choices in Japan's housing market. In a criticism echoing other analyses of ways in which Japan's financial system channelled capital to industry, Sorensen alleges (p. 182) that financial regulators blocked the use of bank deposits for home mortgages in order to direct as much investment as possible to industry. Before 1965, he asserts, only public sources could provide mortgage finance, and continuing regulation retarded the emergence of commercial home lenders. In housing finance, did the conservatives' emphasis on industrial growth restrict the purchasing power of housing consumers?²

Seko (1994) (who is the source of Sorensen (2002)'s claims) points out a number of ways in which Japanese homebuyers were constrained by conditions in the market for home mortgages. In the early postwar period, almost all housing loans came from public sources, since, before 1965, “private financial institutions had to allocate their

²It might occur to some economics-minded readers that expanding the financial resources consumers can leverage in the housing market would contribute further to the high cost of housing, and thus that there is a tradeoff between the cost of housing and access to housing finance. Expanding mortgage borrowing would lead to increases in the nominal price of housing, but it would simultaneously increase the incentives of real estate companies to offer more housing, including units that were larger and of higher quality. Most importantly, easier finance would mean that a given salary could be used to purchase a more valuable house.

funds to the huge demand for business investment (for industrial capital formation)” (p. 52). Even after the rapid rise of private mortgage lending in the second half of the 1960’s, a secondary market for mortgages³ did not exist, a fact that Seko attributes to below-market government lending rates, the absence of specialized private-sector mortgage institutions, and ambiguities in real estate law. Most troubling of all, Japanese homebuyers regularly contributed down payments averaging up to 40% of the value of the home, a level that Seko notes is “unheard of in other industrialized nations,” where commercial housing loans are more widely available.

In some ways, these glimpses of the financial arena provide the most convincing evidence of an anti-consumer bias in postwar Japanese housing policy. In particular, the restrictions on private mortgage lending prior to 1965 (which, based on the rapid rise of private lending starting in 1965, appears to have been actively holding back resources from the housing market) seem to clearly document the state’s prioritization of large-scale industry over domestic comfort.

In other ways, though, the picture is not so clear. Some aspects of state policy seem to suggest that regulation was designed to channel resources *into* housing, similar to the way in which the state funnelled resources into prioritized industries like steel and chemicals. The linchpin of Japanese housing finance prior to 1965 was the Japan Housing Loan Corporation (JHLC), established in 1950 as a special public corporation with the mission of providing long-term capital at below-market interest rates for the construction and purchase of housing.⁴ JHLC was funded

³A secondary mortgage market is a market in which lenders package and sell a mortgage as a security. A functioning secondary market reduces risk for the mortgage issuer and thus improves the terms of mortgages for borrowers.

⁴Note that, if we replaced the end of this sentence with “heavy industry,” it could describe the

by the Fiscal Investment and Loans Program (FILP), a massive government fund drawn from postal savings and government bonds and disbursed as loans to a variety of development projects including roads, education, regional development, and trade promotion.⁵ JHLC loans (which constituted over 10% of the FILP budget already in 1955) carried a rate of interest well below the FILP standard, and the difference was made up by a special subsidy. Indeed, Seko (1994) notes that the criticism has been levelled at JHLC that it constituted a transfer from taxpayers to homebuyers, exactly the opposite dynamic from the one espoused in the standard criticism of Japan's housing policy. The housing portion of FILP expenditures (of which JHLC accounted for the lion's share) continued to rise throughout the postwar period, to the point where, in 1985, housing expenditures amounted to 25% of the FILP total and 10% of the general account. In the late 1980s, roughly 40% of the financing of an average detached house came from public sources, mostly the JHLC (Seko, 1994, p. 57).

Not only did public funds provide below-market home financing, but JHLC and other public agencies (most notably the Housing and Urban Development Corporation and its antecedents) aggressively built public housing, such that by 1988 there were almost 3 million units of public rental housing in Japan, constituting over a fifth of all rental units nationwide (Ito, 1994, p. 223). By contrast, in 1980, the peak of public housing in the US, only in Atlanta and Baltimore were more than 10% of rental units built with public money (14.6% and 10.3%, respectively), and most major cities (including New York, Chicago, Washington, DC, and Detroit) had

Long-Term Credit Bank of Japan (LTCB) or another of the classic Japan Inc. financial organs.

⁵Calder (1988, p. 164) traces the evolution of the FILP budget from 1955 to 1985.

figures between 5% and 6% (Poterba, 1994, p. 252). The comparable nation-wide figure was undoubtedly much lower.

Of course, the fact that the public sector was actively involved in financing mortgages and building housing does not invalidate the argument that policy restricted home financing for Japanese consumers. It could be the case that regulation of the interest rates on deposits, subsidies creating below-market mortgage rates, and public efforts to build housing crowded out private efforts that would have better served consumers. If so, the situation would not be much different from housing markets in other countries, such as the United States prior to deregulation in the 1970s. (See, for example, Poterba (1994).) While I cannot conclusively reject the assertion that policy (and thus politics) deprived the Japanese people of resources for housing in the postwar period, the active role of public funds in financing and building housing suggests otherwise.

3 Land use regulations: a bias toward supply

Above all, Calder (1988) criticizes Japan's conservative policymakers for a failure to *plan* – a failure to organize development in a way that would produce a livable environment. As one example of better planning he provides postwar West Germany, where both federal and local governments took an active role in planning land use, including the “systematic creation of greenfield suburbs around major cities” (p. 392). Calder's other model, somewhat curiously, is Japanese planning in Manchuria, where (as Calder himself notes) the fact that local citizens lacked political rights freed the

hands of Japanese officials to carry out bold designs.⁶ In contrast to these cases, where land use rules channelled development in socially beneficial ways (creating green space, encouraging productive land use, producing enough housing to meet demand), Japanese policymakers repeatedly chose to treat land and land use regulation as political pork, trading policy for electoral support. The result was sprawling development on urban fringes, chronic housing shortages, and the irreversible underprovision of public space and greenery: “land policy minus effective urban planning,” in his words.

It is clear that the Japanese government could have done more to acquire land for public use; it could also have devoted publicly-owned land to public purposes like parks rather than selling it for private development. (It should also be clear that turning public land into parks would have further restricted land for development, worsening shortages of housing and commercial space.) In this section I consider another aspect of planning – policy affecting how private parties use their property.

Before examining the history of Japanese land use controls, much of which confirms Calder’s critique, it may be useful to distinguish between two types of regulations: zoning and development standards. Land use zoning dictates what land can be used for what purposes. Development standards establish minimum levels of quality for buildings and associated amenities, such as sewer connections, sidewalks, and even roads. On both counts, Japanese land use regulation has given developers

⁶Sorensen (2002, pp.142–144) notes that Japanese planners referred to China as a “blank page” or “white paper,” and that their successes in occupied Manchuria confirm that “one of the primary obstacles to comprehensive planning in the home islands was not any lack of technical ability, but rather the political weakness of the planning movement” (142). He might also have added the political strength of Japanese citizens.

and landowners a relatively free hand. From the first system of statutory land use designations, passed in 1919, through revisions and intensifications in the late-1960s and 1970s and deregulation in the 1980s, and to the present day, land use zoning and development standards in Japan have been relatively permissive on paper and even more so in practice.

Japan's first system of land use zoning, passed in 1919, imposed very minimal restrictions on the types of allowable uses. It defined three types of zones: industrial zones, in which all uses were permitted; commercial zones, in which large factories or noxious uses like crematoria and garbage incinerators were forbidden; and residential zones, in which medium-sized factories, noxious uses, theaters, "places of assignation," and parking garages were outlawed. It also imposed similarly-permissive height limits: anything under 7 stories was allowed in a residential zone, and under 10 stories was acceptable anywhere else. As Sorensen (2002) notes, the system "was never intended to promote the rigid separation of land uses that is commonly associated with zoning today." (115) The function was mainly to separate housing from heavy industrial uses; even this goal was not really met, since companies commonly (and legally) built employee housing in industrial zones close to their own factories. The law delegated the job of drawing up zoning plans to local governments, but fewer than a third had a zoning plan ten years later, and many had no zoning as late as the 1960's (Sorensen, 2002, p. 118). While the 1919 law was a relatively early attempt at land use zoning (Germany and England each had established zoning systems but zoning was only affirmed in US courts in the 1920's), its permissive provisions endured until the late 1960's and set the tone for successive zoning regulation.

Turning to development standards, the 1919 system did regulate building safety and established standards for building materials and basic safety features. It also required landowners and developers to ensure that any buildings they constructed would be served by at least a rudimentary road. This measure was based on a German model, but set a lower standard for building construction, allowing essentially any farm lane to be considered a road (Sorensen, 2002, p. 119-121). Crucially, the 1919 system also left little leeway to local governments to refuse building permission. In effect, if a proposed development met zoning and building requirements, local governments were powerless to prevent it from going forward (Sorensen, 2002, p. 217).

The 1919 system of zoning and development standards persisted all the way until 1968, when an update was passed. The changes came at a time of rising dissatisfaction with pollution, urban sprawl, and invasive public projects, and the LDP proposed the measure just before 1968 Upper House elections in a bid for electoral support (Calder, 1988, p. 405). The new zoning regulations were somewhat more restrictive. The three zoning designations advanced in the 1919 law grew to eight, but effectively only two of these (the most exclusive residential category, applied to 20.5% of zoned land, and the exclusively industrial category, applied to 7.5%) meaningfully limited development. In fact, according to Sorensen (2002, at 221), “it is virtually impossible to distinguish between the zones on the ground.”

A further degree of zoning regulation was created in the 1968 planning law by the demarcation of Urbanization Promotion Areas (UPA), in which development would be encouraged, and Urbanization Control Areas (UCA), in which it would be discouraged. The stated goal of this policy was to combat the sprawling, haphazard

development of suburban areas poorly served by roads and sewer systems. One of the means by which development would be encouraged was that agricultural land in the UPA areas would be taxed at the same rate as residential land. This aspect of the plan was fought by farm lobby groups and their supporters in the Ministry of Agriculture, Forestry, and Fisheries. The full taxation of agricultural land was delayed throughout the 1970s and, in 1981, was essentially torpedoed by a loophole supported by the LDP exempting farms larger than 990 square meters in size that were intended to be farmed for at least 10 years (Yamamura, 1992, pp. 45–47). With their land safe from taxation, farmers pushed along with other landowners for UPA designation, which allowed more leeway for development and ensured a higher land price. Sorensen (2002) argues that the UPA designation was conferred so widely that the anti-sprawl intent of the measure was largely thwarted.

The 1968 law marked an important strengthening of development standards by providing local governments with the right to permit or reject proposed projects. In many cases, local governments used this opening to improve the condition of urban amenities in and around new developments. Prefectural planning offices developed detailed “development manuals” articulating to what extent a developer should contribute resources to roads, parks, or school facilities; although these manuals did not carry statutory power, satisfying the guidelines was effectively a prerequisite for obtaining development permission (Upham, 1987, p. 174). In this respect, Japanese local governments gained a degree of power similar to subdivision control in the US. In practice, though, the restrictions were undercut by loopholes, the most important

of which exempted developments smaller than 1000 square meters (.25 acres)⁷ from the need to obtain development permission (Sorensen, 2002, p. 218).

Japan's already-weak system of land use regulation was further weakened in the 1980s, when, the Nakasone government encouraged relaxing land use rules as part of a combined program of deregulation and economic stimulus. Soon after taking power in late 1982, the Nakasone government ordered the Ministry of Construction to review zoning in central Tokyo in order to promote the construction of high-rise buildings. The MoC had already begun a move toward deregulation several months before, instructing the prefectures to review their UPA/UCA designations with an eye toward increasing the land available for urban development. Under the Nakasone cabinet's direction, the MoC issued a series of new deregulatory reforms, including measures encouraging local governments to ask for less social investment from developers and encouraging more residential building in commercial zones. Deregulation culminated in the Comprehensive Economic Measures bill passed in May of 1986, in which redevelopment of downtown areas by deregulation took center stage as a means of economic stimulation (Otake, 1993).

It should be clear that Japan's land use regulations through the 1980s were relatively lax compared to corresponding policies in other rich democracies. Land use zoning and development requirements were permissive at the proposal stage and subsequently undermined by lobbying for loopholes, lukewarm implementation and, in the 1980s, deregulation. The question for political scientists to answer is why this was the case. I suggest that the evidence I have presented is consistent with at least

⁷One thousand square meters is about a quarter of a football or soccer field, or slightly larger than two basketball courts.

three explanations.

First, Japan's record of lax land use regulation is consistent with a story in which interest group pressure shaped the rules of development. The LDP's close ties with real estate, construction, and agriculture are well known. The pattern of policymaking we have considered here (particularly the role of developers and landowners in hobbling the 1968 City Planning Law, and the contribution of developers to 1980s deregulation) suggests that lobbying by these groups continually undermined efforts to impose meaningful restrictions on development.

Note that the evidence on land use regulation is *not* consistent with a slightly different interest group explanation. The economic theory of regulation (Stigler, 1971) stresses that regulation often serves to benefit the regulated industry by erecting barriers to entry or otherwise creating scarcity. An interpretation of land use regulation in this vein would be that, by establishing zoning rules and building standards that curtail new development, the state can raise the value of existing and future development, which works to the benefit of the real estate developers, landowners, and construction companies⁸ who are ostensibly the victims of the regulation. (Yamamura (1992) comes closest to articulating this view of Japanese land use policy; see Rosenbluth (1989) for an explicit application of the economic theory of regulation to finance in Japan.) In accounts of Japanese land use policy, though, these actors seem to have consistently undermined regulation by fighting against new restrictions and progressively undermining existing ones. Perhaps this is an indication that one of the assumptions behind Stigler's theory – that the interest groups have solved

⁸Construction companies indirectly benefit because there is more developer profit to bargain for in writing construction contracts.

collective action problems and lobby for collective benefit – does not apply in this case. A particular real estate developer’s first choice is for strict zoning rules on all land except the parcels he owns and plans to develop. A second best scenario might be if zoning rules restrict development everywhere (including his land), cutting into the extent of land he can develop but increasing the total value of his remaining projects. A slightly worse outcome would be no zoning anywhere, which would give him free rein to develop his lands but would not create scarcity. If landowners and real estate developers and construction companies could somehow coordinate their lobbying, they might be able to attain the second best option (uniformly high regulation, creating scarcity and rents). If, however, coordination is impossible, the outcome might be something like what we see in Japan: low regulation, with uncoordinated lobby groups fighting new restraints and individual landowners grasping for local exceptions.

Second, a “developmental state” interpretation would hold that Japan’s leaders settled on weak land use regulation because they chose to pursue economic growth at the expense of citizen comfort. A different policy was possible, in which tighter regulations produced higher quality housing that was better integrated into social infrastructure. In order to pay the extra cost of higher-quality development, the state would need to divert resources from industrial development toward subsidies for housing finance. But, according to the “developmental state” interpretation, this was possible and indeed might have been implemented if not for the control of technocrats over policy, to the exclusion of consumer interests.

Finally, we could also conclude that the Japanese political system produced per-

missive land use policy because that was what voters (including consumers of housing) wanted. Immediately after World War II, there were about 4 million more families in Japan than there were homes for them to occupy. By 1968, the total number of houses in Japan was above the number of families; by 1973 the same benchmark had been reached for every prefecture.⁹ At a time when people needed homes, it is not surprising that regulations made it easy to build them. A policy of permissive zoning and low development standards, in this view, is not puzzling at all. We therefore have no need for a political conspiracy theory explaining how either growth-minded bureaucrats or election-minded politicians contravened the interests of Japanese consumers.

Which of these three explanations – the clientelistic state, the developmental state, or the responsive political system – best explains the low level of regulation in Japanese land use? Unfortunately, I don't believe I have produced evidence that allows us to distinguish between them in this case. As noted, we can exclude the possibility that coordinated interest groups have captured land use regulation (à la Stigler), but otherwise there is little we can conclude. The land use policy produced by a developmental state might look very similar to what would result from uncoordinated lobbying by landowning interest groups. (Anchordoguy (1992) makes a similar point about land tax reform.) Distinguishing between these two interpretations and the “responsive state” interpretation (which was that the state was responding to citizen demands) requires taking a stand on what Japanese consumers and voters

⁹Figures are from a lecture by Dr. Hiroto Izumi, Deputy Director for the Housing Bureau, MLIT, “Conversion to a new housing policy: applying market mechanism to Japan,” September, 2005.

wanted from land use regulation. Often, critics have assumed that they know the answer to this question (e.g., Japanese people must have wanted mandatory sewer connections, more parkland, less intermingling of factories and housing). I return to this issue in my conclusion, but for now it may be sufficient to say that I have not seen evidence that allows me to judge whether or not consumers in general preferred stricter land use regulation.

4 Containing prices: bubble policy and bubble politics

From the perspective of the late-1980's and early 1990's, the most persuasive indictment of Japan's land use policy was the mind-boggling price of land in Japanese cities. A widely circulated figure held that the square kilometer of land beneath the Imperial Palace and its grounds was worth more than the entire state of California. High land prices directly limited the options of potential homebuyers and indirectly drove up the price of rental housing as well.

Meanwhile, land was used in puzzling ways. Even as real estate in Tokyo skyrocketed, small urban farms persisted on increasingly high-priced land. Citing a study in *The Economist*, Calder (1988, p. 409) noted that converting the remaining farmland in Tokyo to residential space could provide housing for a million people. Other critics noted that buildings in Japanese cities were shorter than seemed logical given the high price of land. According to a Tokyo Metropolitan Government report, the average building in the 23 wards of Tokyo was just 2.7 stories tall, far less than

building codes allowed. The National Land Agency estimated that remedying these inefficiencies together would create enough room in Tokyo for not just the current eight million people but an additional five million as well (Noguchi, 1992, p. 17).

A central assertion in Calder (1988)'s critique, extended and refined by scholars writing in his wake, was that poor policy explained this inefficient use of land. Japanese tax law was (and still is) set up such that landowners pay much lower property taxes for farmland than they do for housing or commercial land. The difference could be quite large: converting a rice paddy to a condominium could multiply one's tax bill almost ten times (Yamamura, 1992, p. 45). The favorable tax treatment given to farmers helped explain a 1980 study that had reported that nearly half of Tokyo's farmers had zero agricultural sales (Calder, 1988, p. 409): many owners of farmland were not farmers at all, their gestures toward agriculture merely a ploy to protect an investment from taxes. Even taxes on non-agricultural land were too low, encouraging savers to invest in land rather than other assets (Noguchi, 1992, p. 22-23). Both of these tax distortions were widely recognized, and unsuccessful efforts to pass corrective legislation were made as early as the 1960's.¹⁰ Japanese landlord-tenant law was biased in a way that further encouraged the unproductive use of land. Because landlords had little legal power to terminate leases (a remnant of World War II-era concessions to struggling tenants), many landlords preferred to leave their land vacant, use it as a parking lot, or maintain a farm (read: tax shelter)

¹⁰The Land Price Countermeasures Council suggested an increase in the land tax in 1965, and removing the preferential treatment of agricultural land within Urbanization Promotion Areas was planned with the 1968 City Planning Law, and implemented (ultimately unsuccessfully) in the Local Taxes Law of 1971 (Calder, 1988, pp. 405-407).

rather than lease it to tenants.¹¹

4.1 Bubble politics: ideological and political constraints on the LDP response

As Calder (1988), Woodall (1992), Anchordoguy (1992), and others pointed out, the policy response to rising prices in the 1980s was slow and tentative. The best indication of this is that, while study committees were formed and cosmetic emergency measures taken as early as 1986, the first meaningful step occurred only in 1988; many reforms widely recognized as important were either never implemented or enacted in emasculated form after the bubble had started to deflate. I focus on two reasons for these policy lapses. First, LDP leadership, particularly at the time of the bubble's onset, was ideologically committed to not interfering in markets, and opposed corrective measures on principle. Second, as others have pointed out, many measures widely seen as important promised to hurt valued LDP constituents and were thus scuttled by political pressure. Others were not particularly damaging to LDP constituents but still promised a political cost too great to overcome. Ironically, the ideological and political constraints on the LDP's response were more severe for the tax and legal reforms called for by Calder (1988) and other critics than they were for financial measures that ultimately were more effective in remedying the problem.

One drag on reform was the political commitment of the LDP, and particularly Nakasone's cabinet (which came into power in November of 1982), to unfettered free enterprise. Nakasone's governing philosophy closely matched that of Reagan and

¹¹Haley (1992) discusses the origins and effects of landlord-tenant law at more length.

Thatcher, emphasizing small government, deregulation, and privatization. In land use policy, this meant dismantling constraints on development, selling government-held land to real estate developers, and energetically promoting the infusion of private money into public projects. When land prices began to jump in 1985, Nakasone's cabinet and like-minded reformers in related ministries were reluctant to raise land taxes or impose constraints on real estate purchases. (Otake (1993) provides an extended discussion of ideological battles over land use during Nakasone's administration.) Instead, they emphasized the need for further deregulation and land sales to further boost the supply of housing and office space.¹²

With land prices rising and the opposition gaining political strength,¹³ Nakasone's cabinet reluctantly formulated a policy response to mounting real estate prices. In August of 1987, Nakasone established the Ad Hoc Commission on Land Problems. The Commission's interim report, issued two months later, consisted of largely symbolic measures, the most important of which was a surveillance system for real estate transactions in certain high-priced areas. In essence, buyers and sellers in land transactions of a certain magnitude were required to notify officials and, if the agreed-upon

¹²Ironically, because Nakasone had been promoting the sale of large public land holdings (such as the JNR freightyards at Tokyo's Shinagawa station) since the time he took office, an impression developed that bringing public land onto the market had somehow stimulated speculation and contributed to the inflation of land prices (Otake, 1993, p. 262). Thus one of the three suggestions in the interim report of the Ad Hoc Commission on Land Problems (Tochi Rincho), released in October of 1987, was to halt the sale of nationally owned public land (Noguchi, 1994, p. 302). I assume the causal relationship observers drew between Nakasone's land sales and subsequent land price rises was spurious, and that the sale of additional public land could only have reduced prices. By creating resistance to supply-increasing policies, then, Nakasone's pre-bubble administrative reform agenda may have precluded the introduction of a market-based policy response.

¹³Otake (1993, p. 253) refers to a "partial comeback" and a "resurgence" of the Socialists in 1986-1987 due to rising land prices. Given the JSP's poor electoral showing in 1986 (down to 85 seats from 112), I assume he means a resurgence since the election, but I am not sure.

price seemed too high, listen to recommendations about “price corrections.” A nationwide surveillance system was enacted in the 1987 National Land Use Planning Act.¹⁴

The adoption of only cosmetic measures up through 1987 could be attributed entirely to the Nakasone cabinet’s reluctance to intervene in markets, as well as uncertainty about whether there was a problem at all. But the mix and timing of reforms that followed in the next several years suggests a more political story. Despite ideological differences over the extent to which government should interfere in markets, there appears to have been broad agreement that a number of reforms to Japanese tax law would end distortions that encouraged an inefficient use of land. Of these, the one that most directly targeted real estate speculation (a high tax on capital gains realized from the sale of land held less than two years) was passed in 1988 (Yamamura, 1992, p. 69), and thus constituted the first meaningful policy response. The other measures, including ending the tax exemption of agricultural land in urban areas, raising the fixed asset tax and property tax, and boosting the inheritance tax on land, would exact a price from all landowners, and particularly from the LDP’s electorally significant farm constituency. Each of these reforms was passed after the bubble had already begun deflating, and each was weakened by concessions to interest groups, particularly the farm lobby. A measure enforcing the taxation of urban farmland, passed in 1991, left much farmland exempted and raised the tax burden on the remainder by a very small amount (Anchordoguy, 1992). A new land

¹⁴A surveillance system had been introduced in December of 1974, when Japanese land prices had undergone a previous surge. Tokyo was the first to reintroduce surveillance, enacting an ordinance in December of 1986, and a number of other prefectures and cities soon followed leading up to the national measure (Noguchi, 1994, p. 301-302).

value tax was passed in April of 1992, but it was so watered down by exemptions that it provided little new incentive to use land more effectively. A reform to the inheritance tax, also passed in 1992, raised the burden by only a very slight amount and created a new exemption for small holdings (Noguchi, 1994, pp. 307–310).

Another area Calder (1988) and influential Japanese analysts identified as requiring reform was leasing law. Critics pointed out that Japanese law was (and still is) sharply biased against landlords in a way that limits the supply of both land and buildings for lease. Because of concessions granted to tenants during the domestic social strain caused by World War II, leases in Japan effectively cannot be terminated, which means that landlords have no bargaining power with which to negotiate rent increases. The result is a kind of rent control, in which long-term tenants pay antiquated, bargain-basement rents and the dysfunctional market discourages landowners from renting out properties they own (Haley, 1992). According to Noguchi (1992), the rigidities thus created by tenant protections are the major reason why high-priced urban areas in Japan are flecked by parking lots and otherwise-underused parcels of land: it simply doesn't pay to make those lands productive.¹⁵

¹⁵In effect, the fact that landlords could not terminate leases created what economists call an “incomplete contracts” problem. Regardless of what they told landlords, tenants could not commit to leaving a property at the end of a lease, because their right to stay was effectively supported by law. Landlords thus had to assume that leases would continue indefinitely. Given this expectation, a landlord would not benefit from renting a property unless he could receive a high rent for it – higher than what he would accept for a short-term and terminable lease. Compared to a situation with enforceable termination, therefore, fewer properties would be leased: some potential housing sites would remain parking lots, vacant lots, or pseudo-farms; some potential lessors would choose to live with their parents or purchase a property far from the city. This situation, predicted by economic theory, is apparently exactly what happened in Japanese cities. A 1990 study by the National Land Agency reported that many landowners in the center of Tokyo were reluctant to rent their properties for fear they would be locked into an unprofitable bargain. Meanwhile, rental payments were significantly higher for more recent leases than old ones, while the average ground rents even in the center of Tokyo were far below a reasonable market rate (Haley, 1992).

As the housing bubble soared to scary heights, some analysts proposed reforming Japan's lease law as a way of controlling housing prices. The Kaifu Government in March of 1991 proposed a modest reform bill that gave landlords only a modicum of extra leverage over tenants, and applied only to future leases (Haley, 1992). After initially being repulsed by the opposition parties (Noguchi, 1992, p. 29), the measure passed in late 1991, by which time the bubble had started deflating. To the extent that legal reform in this area was tentative and tardy, the episode could be included with the political failure of land tax reforms discussed above, but clearly the political dynamics here were different. The direct losers from this reform would be urban tenants, not a group conventionally thought of as an LDP constituency (although small businesses were among the lessors affected by these reforms). In this area, at least, it appears that the LDP was held back by broad electoral considerations rather than particularistic politics.

While in reforming land use policy the LDP policy machine was slow and ineffective, the record is somewhat better when it comes to financial reforms that indirectly curbed real estate speculation. First, the Bank of Japan began raising interest rates in May of 1989, from 2.5 percent to 6 percent by August 1990. While economists have since questioned both the causal link between monetary policy and asset bubbles and the wisdom of using monetary policy to "prick bubbles,"¹⁶ as early as 1990 the BOJ publicly attributed the rise in real estate values to monetary laxity and made clear

¹⁶Posen (2004) provides a discussion and references on this debate. The essential argument is that while loose monetary policy can cause a general overheating of the economy (and the resulting inflation), it cannot be held responsible for asset bubbles, which are defined as increases in asset prices without a corresponding increase in the general price level. Monetary policy can be relied on to cause a downturn in the economy, but this is seen as a needlessly blunt way of constraining asset prices.

that it intended to reduce land prices by tightening monetary policy (Noguchi, 1994, p. 303). Perhaps more importantly, given later assessments of the cause of the bubble, in 1990 a cap (known as the “total quantity restriction”) was set on the total amount of bank lending that could be directed toward real estate (Noguchi, 1994, pp.303–304). This measure effectively raised the interest rate on real estate loans, providing a targeted brake on land speculation.

Why did these measures get enacted earlier and with fewer concessions than the tax and legal reforms? One possible explanation is that the financial measures exacted a less onerous political cost. Monetary policy was a maximally blunt instrument with which to address the real estate bubble, creating no focused group of losers who could mobilize and avert rate hikes. Real estate companies, who have consistently been a top source of LDP electoral campaign funds (Woodall, 1992, p. 137), were singled out to some extent by both the 1988 capital gains measure and the 1990 “total quantity restriction” on bank lending for real estate. Perhaps, as Yamamura (1992) argued, the LDP passed these measures relatively speedily despite the political cost as the result of a calculation: they sacrificed some support from real estate, a major but narrow (in an electoral sense) constituent group, in order to gain broad support for having targeted the most damaging speculation. The tax reform measures that were delayed and hobbled by political maneuvering promised to transfer money from key LDP constituents (including not just farmers but also large companies, who held lots of land) to government coffers. Reform to lease law would make victims out of a wide group of urban interests who could threaten LDP dominance. The degree to which policymakers were able to introduce changes in

various policy domains seems consistent with what might be expected based on the economic interests at stake and their ability to obtain political advantage.

A simpler explanation is that the financial measures circumvented the legislative process as a matter of administrative procedure, while tax and legal reforms were by necessity run through the political gauntlet, where change was delayed and diluted by interest groups. The political failures of bubble policymaking thus reaffirm one of the universal commandments of economic policymaking: do not manage macroeconomic policy in the legislature.

4.2 Could tax and legal reform have lowered the price of housing?

In the years since Calder, Anchordoguy, and Yamamura were writing on land use policy, it has become the consensus view that the high land prices they observed were largely a speculative bubble. But no one suggests today that failures in land policy that they criticized – tax distortions and deficiencies in landlords’ legal rights – were the root of the problem. In fact, current interpretations of Japan’s real estate bubble almost completely disregard the role of the supply of land for development and focus instead on mistakes in financial regulation to explain speculative demand.

As laid out in Posen (2004), the standard interpretation of Japan’s real estate bubble, developed through examination of both Japan’s experience and other real estate bubbles in the US and East Asia, goes as follows. Financial liberalization deprived many banks of their best clients – firms large enough to seek financing in newly deregulated equity markets – while simultaneously permitting them new

leeway to diversify their client pool. Many banks took advantage of that leeway to increase their exposure to real estate. Meanwhile, banks remained confident that the “convoy” system would rescue them in the event of crisis. The result of the aggressive expansion of lending for real estate investment – with annual increases in bank lending to the real estate sector exceeding 5% throughout the early 1980’s (Ito and Iwaisako, 1995, Table 5.2) – was an initial run-up in land prices. What followed was a cycle which, depending on the year and one’s financial position in Japanese real estate, could be called either virtuous or vicious. Since Japanese companies hold large amounts of land, higher real estate prices directly increased stock values. Higher stock values and inflated land prices increased both the franchise value of banks and the collateral of land-holding borrowers, which provoked further lending and yet more real estate purchasing, much of which was speculation based on the observed upward trend in prices. What began as a runup in prices of commercial real estate in downtown Tokyo soon spread to neighboring residential areas and then throughout Japan (Ito and Iwaisako, 1995, p. 11). The cycle continued until sufficient numbers of investors were persuaded that it could not continue (partly due to the imposition of lending restrictions and tighter monetary policy), at which point bubbles in both the stock market and real estate market began to deflate.

Does this story leave any role for the tax and legal measures that, as Calder (1988) and others assert, were torpedoed by political pressures? It could be argued that, even if speculation dominated the real estate market by 1987 or so (as Ito and Iwaisako (1995) claim), the initial run-up in prices could have been prevented if there was a greater supply of land for development (particularly commercial property in

central Tokyo, according to Woodall (1992)) or if tax policy had been less favorable to land as an investment. Since the mechanism outlined above depends on an initial jump in prices to start the speculative spiral, policies that could have prevented this jump might have averted the bubble. But given the magnitude of the increase in bank lending to real estate, it is hard to imagine that any plausible increase in supply could have absorbed it. And the size of the profits in real estate that occurred at the beginning of the run-up suggests that the tax on land would have had to be very large indeed to discourage investment in the real estate sector.

In sum, critics of land use policy in the bubble era may have been right that the high price of land was a policy failure, but it appears that they criticized the wrong area of policy. Missteps in financial policy – incomplete liberalization that encouraged reckless speculation – rather than land use policy explain the high real estate prices these critics observed. In retrospect, blaming the run-up in Japanese land prices in the late 1980's on failures in land taxes and leasing law is a little like blaming the well-known “Tulipomania” bubble in 17th-century Amsterdam on the lack of a subsidy for tulip growers: in both cases what seemed like scarcity turned out to be the product of speculation and collective irrationality.

5 Conclusion: How to spot a political failure

In this essay, I sought to assess claims that political factors created a policy bias against consumers of housing. In finance I argued that public mortgage lending and subsidies for public housing were more generous than critics have recognized; in land

use regulation I found the permissive nature of zoning and development standards to be consistent with a number of interpretations. Criticisms that pinned the high cost of Japanese housing in the bubble era on failures to reform tax and legal statutes were largely correct in interpreting the political causes of delay but missed the fact that these reforms would do little to lower prices.

My attempts to uncover political roots for a policy bias highlight some of the pitfalls of doing research in political economy. Research in this vein typically looks for ways in which policies (and outcomes) are affected by institutional features of a political system, including electoral rules, policymaking practice, and interest group characteristics. One approach is to show how deviations in policy from what might be considered “efficient” or “just” are related to the political setting; another is to show how policy variations across countries are related to variations in the political setting. Researchers often don’t make explicit which methodology they are using, but generally it boils down to some combination of these two.

Vogel (1999b) pointed out one way in which the political economy model of inquiry can go wrong: sometimes political actors do not have or express the interests we assume they do. In the issues he was considering (the politics of liberalization in Japan), consumers did not push for lower trade barriers and less financial regulation, as we would expect, because they were locked in political alliances with regulated producer groups. My assessment of the fairly limited literature on the political economy of land use regulation in Japan suggests another reason why actors may not have the preferences we expect: we may not have a good picture of the choices they face. In the analysis above, this was most clear in the case of land use regulation.

Critics sometimes assume that Japanese consumers wanted tighter regulation of zoning and higher development standards. Given the acute housing shortage, they may have instead preferred low regulation in order to keep prices down. I do not claim to have demonstrated that this was the case, but I do want to stress that attributing Japan's lax regulation to interest group politics or developmentalism requires making an assertion about consumer preferences that I do not think has been proven.

I conclude with another example demonstrating the danger of claiming that we know what land use policy Japanese consumers wanted. It is very commonly pointed out that a much lower proportion of households in Japan are connected to sewer systems than is the case in Western countries. In 1984, only 34% of Japanese households were connected to sewage systems; this compared unfavorably with figures for the US (72%), UK (97%), and West Germany (91%) (Calder, 1988, p. 384). (Today, about half of Japanese people have sewer connections, which is on par with Iraq.¹⁷) When we look deeper into the history of sewage, though, we discover a number of reasons to believe that the low degree of sewer usage was more a result of historical circumstances that led Japanese consumers to have different preferences than it was an effect of political factors. Sorensen (2002, p. 72) notes that, by the time Japanese cities turned their attention to public health issues in 1900, it was known that water, not "miasma," or bad air, was the more important vector of disease. (By that time, 30% of Americans were already connected to sewers (Haines, 2001, p. 13).) Another reason why Japanese people did not push for sewer systems is that, until the end of the Meiji period, an active market for "night soil" existed in Japan, with collectors

¹⁷UNEP, "International Source Book On Environmentally Sound Technologies for Wastewater and Stormwater Management," 2000, <http://www.unep.or.jp/>

purchasing human waste from urban residents, transporting it to surrounding farms, and selling at a profit to farmers who used it as fertilizer (Tajima, 2005). Proposals to install sewers in Tokyo in the Taishō era were turned down in part because city council members thought of night soil as a valuable commodity.¹⁸ Finally, houses not connected to sewer systems generally employ septic systems that can function perfectly well. Once enough people have invested in private septic systems, it is hard to justify public investment in a sewer system.¹⁹

The bottom line is not that we can never make claims about the role of political institutions in explaining differences in housing and urban infrastructure across nations. In order to single out these political factors with any confidence, though, we need to be very attentive to the historical and economic factors that make urban environments different.

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¹⁸Personal communication, Kayo Tajima, January 23, 2006.

¹⁹As a further indication that people who don't have sewer connections can have acceptable living environments, a 2004 survey by the Pioneer Institute indicated that sewer usage varied greatly among wealthy Boston suburbs: 90% of homes in Lexington were on a sewer system, while just 30% in neighboring Concord were; neither Lincoln nor Sudbury had a sewer system. www.pioneerinstitute.org/municipalregs

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