The 1980s property boom

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Abstract. In this paper the causes and consequences of the property boom of the late 1980s are considered that in one way or another affected most developed economies and several industrialising ones. It is suggested that technical change in key service industries caused an upsurge in building demand from the mid-1970s onwards. Shifts in employment patterns then generated repercussions in housing markets. The classic conditions were created for a 'Kuznets style' building cycle. The detailed effects of these changes in specific countries depended on the responses by agents involved in the process of building provision, which in turn were affected by the changing economic and institutional contexts that they faced. Property development, financial liberation, housing markets, property taxation, and land-use planning are all considered in this context, with examples drawn from several countries.

Introduction
During the second half of the 1980s, booms spread like wildfire through housing, land, and commercial property markets in many countries. The greatest of them were in the English-speaking nations of the USA, United Kingdom, and Australia, in Scandinavia, and in the new economic giant, Japan.

The characteristics of these booms were broadly similar—the world's major economies were in the longest, albeit the slowest, upturn of the post-1945 era following the severe recession of the early 1980s; all were experiencing substantial growth in their service sectors; financial systems were being liberalised so that credit was easy to come by; consumer spending was rising fast; and there was widespread optimism that governments had finally cracked the mystery of sustained growth by allowing free rein to markets.

The painful outcomes when the booms collapsed are also well-known—tumbling prices for property; huge debts held by households and firms secured on properties whose values are wasting; large-scale defaults; widespread failures of financial institutions, forcing unparalleled intervention by governments and regulatory institutions; and, finally, debt-depressed national economies.

It is very easy with hindsight to classify this particular and very spectacular property cycle as market madness watched over by misguided governments. The greed and ridiculous optimism of developers and financiers imposed pain on us all—may it never happen again. Yet, although there is no denying the importance to world history of the heady brew of fantasy, greed, and politics, its significance in explaining the 1980s property boom is probably exaggerated. Systematic forces linking property markets to broader economic development can more convincingly explain what happened.

Core issues
The two outstanding characteristics of the 1980s property boom were its scale and international spread (BIS, 1992; IMF, 1992). This suggests that there were common processes at work across the world's advanced economies. Some of those processes
were undoubtedly short-term in nature, such as the coordinated relaxation of monetary policy after the crash in the world’s stock markets in late 1987, but many common changes have been more basic and persistent in their effects. There is a need to identify those longer term trends which have affected all the world’s economies to varying degrees and to integrate them with the short-term features that turned the last phases of the boom into a speculative frenzy.

Longer term features of interest here are those associated with the consequences of technical change and shifting patterns of demand. Buildings are the spaces within which much of all economic activity takes place, so alterations in those basic economic characteristics fundamentally influence the demand for buildings. The desired stock of built structures wanted in any economy will alter. To accommodate the shift the existing stock of structures will be altered and new additions made. The adjustment process will tend to be long-drawn-out(1) because of the sheer resource costs involved, and it may include periods of boom in one or more construction markets. Supply factors are important as well as demand factors because technical change affects built structures as products and determines the methods by which they are made. There are associated long-term shifts in the relative price of construction inputs which also affect levels of demand and supply.

The most obvious long-term characteristics of relevance to the 1980s boom are the effect of information technology on the production of goods and services, the consequences of rising real incomes (which over the past two decades have frequently been associated with greater inequality in the distribution of income), and the growing importance of service industries, especially financial and other business and professional services.

These types of longer term change and their impact on the built environment have been considered primarily within the literature on building cycles (for example, Barras, 1987; Van Duijn, 1983). The 15–20-year building cycle was first suggested by Kuznets (1930) for US 19th-century data. Controversy has surrounded its applicability to the 20th century, partially because of the statistical methods used to identify these cycles (Klotz and Neal, 1973). The Kuznets cycle has been rather unfashionable since the mid-1970s but the issues raised in the debate over its existence and role are still pertinent. Concern with technological shocks has been part of the emphasis of the recent school of macroeconomists associated with real business-cycle theory. They argue that macroeconomic fluctuations occur because of real shocks to the economy (Plosser, 1989). If real technological shocks have affected the world’s property markets, real business-cycle theory might be a useful way to approach the issue, but the emphasis in the theory placed on continuously equilibrating markets seems particularly unrealistic for property markets.

The idea of technical change as a series of shocks, however, is useful in understanding the property markets of the 1980s, because developers, particularly in commercial sectors, were then facing output and input markets whose technological parameters were changing rapidly but in unknown ways. More generally, technologically driven alterations in property supply and demand need to be understood in the context of the risk that pervades property development. With all investment goods, decisions about future trends have to be made in situations of considerable uncertainty. Building investment has a particularly long gestation period, stretching over years—land has to be purchased, plans drawn up and approved, and building work undertaken. The costs of cancelling projects become progressively higher.

(1) Think of the time it took to complete railway networks in the 19th century, or road systems in the 20th.
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during each of those successive phases, so property development is an exceptionally risky industry. If for no other reason, this means that periods of overbuilding, producing the wrong types of structure, or building at the wrong locations are part of the nature of property development. Usually, buildings that turn out to be investment mistakes eventually get completed and used for something, but not in the way, nor at the price, envisaged by the original investors. What is interesting is whether such mistaken investments are bunched at particular times. It is being suggested here that the 1980s was such a time—an argument that will be expanded upon later.

The final longer term theme is the importance of integrated property development. Property markets are obviously multifaceted. Every built structure is unique if for no other reason than its spatial location. Yet buildings exhibit strong interconnections—they only have use when linked to other structures through transportation systems or proximity. The 1980s boom was predominantly associated with three types of structure—offices, shopping complexes, and private housing. Expansion in these sectors is interlinked—an increase in financial sector employment induces demand for more offices and homes, for instance, as people need somewhere to live as well as work. However, unlike previous postwar property booms, the 1980s one was purely a private affair. Nonmilitary public sector construction investment languished. In housing, particularly in Europe, this may have stimulated private sector investment, but overall the lack of public investment made the boom lopsided and private sector investment more uncertain, as inadequate public goods, such as corroding transportation systems, lowered the external benefits and raised the external costs of locations where most of the private sector money was pouring in. Such interlinkages between different types of built structure will be a theme of what follows in this paper.

Major causes of the building boom

Technical change and the service sector revolution

Over the past 30 years the world's major economies have experienced substantial shifts in their economic structures, with a growth of services and a relative decline of manufacturing. The employment composition of service activities has also changed away from transportation and distribution towards personal and financial services. These changes were initially employment enhancing in aggregate but, during the 1990s, they have overall been labour shedding.

Some data illustrate the scale of the change. Between 1960 and 1991 in the USA, service jobs rose from 62% to 78% of nonagricultural employment. Between 1969 and 1990 UK service sector workers grew from 48% to 56% of the total workforce; and the real net output of Japan's service sectors rose more than sixfold over the same 21-year period. Large increases in service employment were recorded in most other advanced countries, giving rise to notions of 'deindustrialisation' and the 'postindustrial society'.

Each of the millions of new service sector jobs required an adequate place of work, with floor space and building quality demands frequently far higher than in manufacturing. The locational and infrastructure demands of these new jobs, moreover, differed from the earlier manufacturing-oriented pattern. Furthermore, advances in information technology helped to encourage a transformation of the buildings required; and the same technical changes made buildings previously used in these service activities redundant, so there was substantial replacement demand.

Service sector activity is highly varied. Of particular significance for the 1980s property boom was the growth of financial and professional services and distribution. These rapidly expanding and changing sectors had exceptional requirements for dedicated, high-quality buildings. Offices have had to be built to a far higher
standard than in the past in order to accommodate new technology, to create the better working conditions expected by employees, and to reflect the increased importance of location and architectural design to the prestige of firms. Similarly, retailers became aware of the importance of interior design and shop quality to entice shoppers into their stores; even the ubiquitous McDonalds needs substantial building work to fit out its standardised outlets.

The shift in building requirements stimulated by these changes in any specific country, region, or city depends on the relative importance of those activities and the extent to which their importance is growing. Cities such as New York, London, and Tokyo experienced particularly large office-building programmes because of the location of many of the world's international financial service activities and corporate headquarters within them. The property markets of the most 'deindustrialised' countries, including the United Kingdom and USA, will similarly be most affected because of the relatively greater importance of service sector activities in those economies. Greater volatility of property markets in those countries in contrast to a country such as Germany—with a smaller financial services sector and a higher share for manufacturing in overall economic activity—may consequently be as much a result of those structural characteristics as of policy differences or any claimed short-termism on the part of those countries' financial institutions.

Take the case of the United Kingdom. Between 1979 and 1989 it recorded one of the fastest growing financial service sectors of any country. The net share of GDP from financial services rose from 6% to 13% over that decade. As the growth of services outpaced the supply of buildings in which those activities could take place, rents began to rise. Wholesale financial activities put particular pressure on premium office space in London; and the multiplication of outlets for retail financial services encouraged rents to rise in the high streets of many towns and cities.

In financial services much of the rationale for the expansion of retail financial outlets was based on hoped for—but rarely realised—economies of scale and scope in selling consumers financial packages, the core of which was a mortgage (Ball, 1990). Britain's experience was typical. Banks, insurance companies, and building societies thought they had found a bonanza. To implement it they purchased at inflated prices high-street estate agents and also expanded their own retail outlets. As a result, the average traditional high street saw a noticeable shift in composition towards financial and housing market services—all of which required substantial expenditure on new buildings and refurbishments. In the United Kingdom, and sometimes in the USA, this expansion of demand in central urban localities more than offset the downward pressure on town-centre rents that was caused by the growth of superstores and out-of-town shopping.

In retailing there has been a major shift in shopping patterns over the past 20 years. Superstores and shopping malls have been built within cities and at new out-of-town locations to reap genuine economies of scope and scale. The large investments necessary, particularly in buildings, were encouraged by contemporary buoyant demand from consumers. Upstream from the point of sale, distribution systems were simultaneously adjusted to the new shopping patterns. Computer technology, food preparation, goods handling, and refrigeration systems made warehouses and the factories linked into them much more sophisticated places than their predecessors, all of which required new, complex, expensive buildings.

The location of retailing and wholesaling activities is a function of transportation systems and the pattern of residential location. Populations have been decentralising from urban cores for decades encouraging the suburbanisation of retail outlets.
Government planning restrictions and transportation investments affect the growth and location of out-of-town shopping centres, and in Europe at least they have probably slowed down the change. Nonetheless, by the early 1990s many of the changes arising from the new retailing technologies have worked their way through the retailing chain. The big profit opportunities from the technical change have been identified and implemented, so future growth in the sector is likely to be far more muted—at least until the next major set of retailing innovations occur.

The impact of information technology on office-based activities has similarly been enormous and its effect on the organisation of production has undergone a number of stages which at first greatly increased the demand for central office space and now in the 1990s is reducing it.

Overall, therefore, it is clear that the late-1980s property boom was part of a much longer upturn in commercial building engendered by structural and technical change. In this sense, the decade could be said to represent part of the upswing in a Kuznets-style building cycle—with information technology and productivity improvements, in manufacturing as well as in services, spearheading the growth of private sector commercial development.

Data from the USA and Britain illustrate the above points. To start with the USA, in figure 1 indices of output growth for housing, commercial building, and national income from 1970 to 1990 are compared. Over that 20 year period there were two general recessions, in 1974–75 and 1980–82, and the economy was again sliding into temporary decline at the end of the period. How did property markets fare in relation to this general pattern of economic change? The story is very different for commercial and housing development.

![Figure 1](image-url)  
**Figure 1.** US construction of housing and commercial buildings and real GDP, 1970–90.

Commercial building tracked the general economic cycle in the early 1970s, conforming to the predictions of standard models of investment behaviour over the economic cycle (Dornbusch and Fischer, 1990). Yet, from 1976, for almost a decade, strong upward growth made the sector virtually immune to the early 1980s recession. Then, after 1986, a decline set in, several years before the economy as a whole entered its next downturn in the early 1990s.
Unlike US commercial building, housing output fluctuated throughout the period in line with the general economic cycle. The difference with commercial building arises because of the importance of changes in disposable income, which is closely correlated with the general business cycle, for housing demand and the sharp rises in real interest rates associated with recent recessions. But what was so noticeable about the 1980s US housing cycle was, first, the muted response of housing output to the general upswing when compared with previous housebuilding cycles and, second, that its downturn proceeded that of the economy as a whole by several years, whereas in previous cycles it had been more or less coincident (see figure 1). Unlike major office developments, which can take years to complete, the time lag in housebuilding is short—builders start houses according to the current state of demand and complete them within a few months. So the output data closely reflect the contemporary state of new housing demand—meaning that either price or credit constraints (or both) choked off demand earlier than in previous cycles. Supply factors may also have contributed as the increase in housing output was competing for construction resources with the booming commercial sectors. This would have raised input prices and possibly made inputs less easy to acquire, both of which would have dampened housing output.

An even longer-term perspective, 1955–91, for the United Kingdom highlights important similarities to the US situation (figure 2). The 1980s boom was again unlike earlier cyclical behaviour, and housing and commercial output reacted distinctly. Commercial building reached a trough in 1976 and, after a faltering start, accelerated rapidly to peak in 1990 at three times that trough level in real terms. Even building for production industries (which were declining as a proportion of national output) rose rapidly during the 1983–90 period.

Figure 2. UK construction of buildings for the private sector, 1955–90.

Housing output—as in the USA—followed the broad pattern of economic activity, but it declined earlier than the rest of the economy at the end of the 1980s. The overall response of housebuilders to the 1980s rise in real house prices was again much weaker than in the earlier booms, even though real house prices rose to their highest ever levels.
An obvious conclusion from the US and UK experience, which could be repeated for much of the rest of Western Europe and for Japan, is that commercial building from the mid-1970s took on a leading role in property markets in terms of the rate of building activity. There was much talk of restructuring the world's cities on the lines of developments in New York and London (Sassen, 1991), although in practice the causes of changes were often more prosaically linked to national economic developments.

What type of commercial building?
Even though strong demand for new 'high-technology' commercial structures existed during the 1980s, development was still a risky business, both in terms of the assumed parameters of the investment calculation and in terms of deciding the type of product that should be built.

When working out the viability of specific projects, developers faced considerable uncertainty. All of the key price and cost factors affecting their calculations were subject to wide variations throughout the decade, including the real selling prices of commercial buildings, construction and land costs, and interest rates. Property prices and rents exhibited marked variations over the decade, especially in real terms, as table 1 illustrates. A growing commercial output was actually

| Property type | Average annual percentage change |
|---------------|----------------------------------|
|               | 1980-85 | 1985-90 |
| **Commercial:** |         |         |
| Northeast USA | 8       | 1       | 5       | 4       | 5       | 2       | 0       | -7      | -18     |
| Tokyo         | 7       | 22      | 13      | 48      | 61      | 3       | 5       | 4       | -7      |
| United Kingdom | 2       | 5       | -1      | 6       | 16      | 35      | 1       | -24     | -20     |
| Canada        | na      | 5       | 3       | 4       | 6       | 8       | 9       | -3      | -6      |
| Sydney        | 18      | 11      | 11      | 17      | 40      | 30      | 6       | -24     | -21     |
| Denmark       | 10      | 3       | 21      | 17      | 0       | 3       | 1       | -7      | -2      |
| Sweden        | 6       | 21      | 12      | 27      | -8      | 49      | -2      | 51      | -1      |
| Stockholm     |         | 25      | 0       | -35     |         |         |         |         |         |
| **Residential:** |         |         |         |         |         |         |         |         |         |
| New York      | 16†     | 5       | 27      | 20      | 14      | 0       | 0       | -5      | -2‡     |
| Los Angeles   | 4       | 11      | 3       | 8       | 8       | 22      | 5       | 14      | 0‡      |
| Tokyo         | 4       | 19      | 3       | 22      | 69      | 0       | 7       | 7       | -9      |
| London        | 14‡     | 13      | 16      | 23      | 24      | 24      | 2       | -7      | -5      |
| Paris         | 10      | 18      | 10      | 10      | 19      | 20      | 24      | 18      | 6       |
| Frankfurt     | 4       | 5       | -6      | -11     | 5       | 14      | 0       | 20      | 20      |
| Milan         | na      | 13      | na      | 3       | 9       | 13      | 33      | 10      | na      |
| Toronto       | 7‡      | 14      | 16      | 38      | 25      | 26      | 3       | -15     | -4      |
| Brussels      | -2      | 15      | 2       | 7       | 6       | 11      | 2        | 22      | 0       |
| Copenhagen    | -1      | -2      | na      | 13      | -10     | -1      | -1       | -8      | -2      |
| Madrid        | 5       | 28      | 10      | 13      | 43      | 40      | 27      | 20      | 9       |
| Stockholm     | 2       | 17      | 6       | 10      | 21      | 28      | 19      | 11      | 3‡      |
| Sydney        | 5       | 11      | 11      | 14      | 25      | 53      | -13     | -10     | 8       |

na not available. * Fourth quarter to fourth quarter. † Twelve months to January of the following year. ‡ Twelve months to March of the following year. § Twelve months to December. 

Small-sample estimates. ‡ 1981-85. * First three quarters. h 1983-85. i Twelve months to June. j First quarter to first quarter. k 1982-85. l 1980-84; break in 1985. m Twelve months to December.
associated with years of falling real office rents as well as rapidly increasing ones, for example, presumably because developers build in anticipation of demand.

Some of the greatest risks were associated with the type of built structure that should be erected, especially in office development as the implications of new technologies in retailing were more clear-cut. These risks can be highlighted by looking at the nature of innovation processes.

At this point it is worthwhile to speculate on the ways in which computer technology has been introduced into office work. Computer technology in both the way in which it has evolved and the way in which it has been adopted has built upon previously existing technologies to replace specific dedicated pieces of equipment—the best example being the replacement of typewriters by word processors—and increasingly powerful personal computers (PCs). This has enabled the gradual introduction of computer-based systems into office life.

In the first phase of this innovation cycle, service sector productivity was increased and profitability with it. The scale of the gains probably induced firms to expand before the full implications of the innovations had worked themselves through. In terms of the typewriter–PC example, a secretary and her or his manager a decade or more ago would each have been given a relatively bulky machine as a stand alone or part of a network. Both would probably have chronically underused this equipment, which would then have been gradually upgraded with technological advance.

The technology in this scenario has increased productivity, but so far there is little change in work organisation; once the new technology is refined and integrated, the two functions of secretary and manager may both be redundant. The technology, in other words, when properly used is highly labour substituting, but the learning and coercive pressures to achieve it have long time lags. The incentives to overcome that internal inertia grow as new entrants enter the sector or as competitors adopt the improvements. Recessions, when demand is slack and profitability is squeezed, may encourage the technological adoption process to be speeded up.

In this stylised example, technical change has not simply been labour substituting but has also altered building space needs. The adoption of computers would first have led to greater floor space per office worker as the machinery had to be accommodated with little substitution of other activities. Over time, however, space needs would fall well below the original precomputerisation level. The process being suggested here is a classic example of learning-by-doing, which is now argued to be one of the key factors in general economic development (Lucas, 1993).

In practice, some of the actual space savings achieved through technical innovation have been spectacular. Many new technologies, furthermore, are only just coming onstream so the effect of office design and space needs is still working its way through. Document image processing, for example, is only beginning to find wide market acceptance. It replaces traditional paper-based transactions, filing, and storage systems. According to a survey by consultants Nolan Norton (reported in the Financial Times 8 December 1992), this new technology reduces staff time by 30%–40% and lowers floor space requirements by 50%–80%. The continuing impact of such changes on the traditional office building will consequently be substantial in the medium term.

The innovation diffusion process being suggested here is a model with movement along one diffusion curve and then progressive shifts to others as better technologies and understandings of their use in office work come along. The consequence for the demand for office buildings is one of continuous shifts in the quantity and type of office accommodation required.
With hindsight it is clear that the progress of these changes was badly misforecast in the 1980s. Far too many large-scale office developments were brought onstream at central city locations. They were designed to enable firms to locate at prestigious locations and to gain economies of scale from bringing all their work forces together to share in the high fixed costs of 'new' technology, whereas codeterministically that technology was changing so that less staff were needed, and they no longer had to be consuming together the previously relatively bulky and expensive new equipment. Developers simply got it wrong. But they were not the only ones. IBM for one made a similar and expensive misforecast when it clung to mainframe technologies as the central thrust of its business at a time when smaller computers were about to take over many tasks previously undertaken only on mainframes.\(^{(2)}\)

Strong growth in the demand for offices for the previous decade, I would suggest, gave property developers and their financiers a false sense of the risks associated with technological change by the mid-1980s. They were unaware of the costs to them of creating obsolete built forms because they had overoptimistic projections based on the experience of previous diffusion curves.

This argument would suggest that the 1980s was the false dawn of a golden age for office developers. New technology was changing the ways in which services operated and the feasible range of activities an individual enterprise could undertake. The technology also forced firms to invest in new office space. Older buildings frequently could not cope with the complex wiring and temperature-control systems demanded by the computerised office. Most of the expansion for a firm, moreover, would be at one location, often a prime city-centre site; whereas information technology made increasingly feasible the locational separation of data handling and higher-level executive tasks and, paradoxically, reduced the significance of having buildings dedicated to the new technology. PCs, as their manufacturers are at pains to tell us, can go virtually anywhere.

One other factor to be taken into account when trying to explain why developers so badly misforecast the nature of the buildings firms would require in the 1990s was financial liberalisation. As will be argued later, this initially greatly increased central city office demand only to be cut back later as firms retrenched in the face of overinvestment in their sectors.

On this hypothesis about the form that the service sector revolution has taken, the 1990s is a period of service sector shakeout as the organisation of office work and competition between firms catches up with the potential of the existing technology. The earlier high demand for building space is reduced in amount and content as a result because firms rationalise their use of space as well as labour, and search out lower-rent locations for all or part of their activities. Even when demand again rises for these types of service activity, any future growth in office work will probably be associated with a proportionately smaller demand for office space, particularly in high-rent locations and large office complexes.\(^{(3)}\)

\(^{(2)}\) In Japan, because of the relatively high price of PCs which has been encouraged by the market structure of the computer industry, Japan still uses mainframes where other countries use PCs. So the Japanese property industry may well be in for another shock when office requirements change as the computer market opens up. Analysis of the linkages between Japan's property markets and changing economic structure during the 1980s are given in Machimura (1992) and Oizumi (1994).

\(^{(3)}\) Some would argue that technology has entirely removed the traditional benefits of central locations (Pascal, 1987), though this view tends to downplay important urban externalities.
Improvements in construction performance

In the late 1970s and during the 1980s greater offsite prefabrication of building components and progress in site-management techniques and construction times—by using methods such as fast-tracking—greatly improved construction productivity and noticeably shortened building times. Part of the reason for the extensive office building of that period might well have been improvements in construction technologies. Buildings could be built for less cost, much faster, and with far more sophisticated features, including those beloved of contemporary postmodern architects.(4) Many of these construction innovations originated in the USA and were transferred to the indigenous construction industries of Europe and Asia.

In some of the 'catch-up' countries the effects were dramatic. In the United Kingdom, for instance, between 1981 and 1985 labour productivity for the construction industry as a whole rose by 23%, and the increase was probably far greater for the commercial sector alone where many of the innovations were being introduced. Much of this change in the United Kingdom was made possible by a major restructuring of the social organisation of the industry, with new contractual relations between firms and clients, a shift from direct employment to subcontracting, and new roles for building professionals (Ball, 1988).

The effect on developers' calculations of these improvements in construction was to bring forward development. Lower costs, especially when generated through better site control and shorter construction times, reduced risk. The fall in completion times also led to improved prospects of catching upturns in demand, so more developers were tempted to 'beat the bust'. Faster building times as a result may have intensified the amplitude of the property cycle. Technical innovations have also shifted the balance between the cost of a commercial building's foundations and shell and its interior and exterior final fittings. This has led to far higher finished quality and unit costs. This enhanced quality makes a modern office or shopping complex a particularly lumpy investment that is difficult to abandon once the initial commitment is made.

Changes in the commercial development industry

A considerable amount of academic interest has emerged over the institutional structure of the property development process. This is a welcome breath of reality after more than a decade of much radical literature trying to subsume property development under dubious theories of rent and capital switching.(5)

The problem faced by investigations of (property) institutions, of course, is the general one of being able to specify causal connections and avoid the problems of inductivism (Pheby, 1988). Agents involved in property development are highly unlikely to be able to provide an adequate explanation for building cycles, nor, by implication, even know their own roles and importance within them. Instead, the

(4) 'Plastic' Corinthian and other capitals, for example, became very cheap to make and fix and were more realistic (though often still Hollywoodesque).

(5) Hoffman et al (1991) made one of the most extensive up-to-date literature surveys of different countries' housing markets (also, see Ball et al, 1990; Harsman and Quigley, 1991). The Bartlett School, University College London, is about to produce a series of books arising from Europeanwide cooperative research on development processes and land markets. I have argued the importance of structures of building provision and against a predominance of rent theory (Ball, 1985; 1986). Harvey (1982) expounds capital switching as a means of explaining building cycles. This hypothesis still seems to excite interest despite poor theoretical foundations and no adequate empirical evidence found to support it.
understanding of such causal processes is a specialised activity that has to produce theories and hypotheses able to encompass known institutional structures and behavioural objectives.

The fact, for example, that financial institutions such as pension funds are said to have managements with a desire to hold financial assets with repayment profiles that broadly match their financial liabilities says nothing about the consequences for financial and property markets of that discovered behaviour. In sophisticated financial markets, institutional preferences such as those, can be met by many different types of portfolio, so that the discovered preference of individual institutions may have little overall market impact, even when those institutions are large players. Furthermore, to state a preference is not to say how an institution's overall objectives, of which that preference may only be a part, are maximised subject to the constraints the institution faces. One of the oddest claims frequently made in the literature is that pension funds invest in property because it has a long-term profile of returns similar to that of the pension plans which these funds are in business to offer, without mentioning the relative risk-weighted returns of investment in property in contrast to other financial assets. In a reasonably competitive market over the medium term the risk-weighted returns to all financial assets, whatever their repayment profiles, should be the same—unless some regulatory barrier exists—as investors look for arbitrage possibilities. Pension funds are likely to switch in and out of property as much as any other type of institution in light of relative changes in its perceived risk and short-term returns. If they did not they would be doing their clients a disservice by providing them with very poor returns on their investments.

In terms of specific institutional behaviour, what the 1980s boom perhaps showed most clearly is the ease of entry into the property development process and its financing, whereas the subsequent slump illustrated the ease of exit. For some the costs of exit were not particularly high as they had financed their activities with someone else's money. A developer may go bankrupt, for example, but will have enjoyed several years of much higher earnings than he or she would otherwise have enjoyed, which for many is ample reward. One problem is that so many aspects of the property development processes contain risk, and two parties to a transaction have unequal knowledge of the ability and competence of the other, so that efficient outcomes are severely threatened.

One standard solution is to rely on agents with a good reputation. Lending to the property development firm that does not take excessive risk or using the reliable traditional local estate agent in negotiating a property purchase or sale would seem to be an appropriate strategy, but it can easily fail because of the character of property transactions. Estate agents, for example, are used too infrequently by individuals to make many such firms bother about building up a good reputation at the expense of short-term profitability. Reputation, moreover, is gained by firms' past performances, which may be poor guides to their current behaviours. During booms, it may well pay a firm to milk its previous reputation rather than sustain it. Property developers themselves are likely to be risk lovers, partially because the activity itself is risky but also because more risk-averse developers will be consistently outbid for sites or projects by risk lovers. Financiers may be more cautious

(6) Massey and Catalano (1978) provided an early, and still influential, exposition of the different objectives of property investors, yet they failed to demonstrate why it was important to distinguish those objectives for our understanding of overall property market dynamics.

(7) Kay (1993) contains an interesting discussion of the benefits to firms of milking a reputation they have acquired in a market.
but they will have problems in separating good-quality developers from the merely reckless. Again, past experience is generally used as a guideline but this is fraught with problems. In a risky industry, even cautious developers may make substantial losses. So recent past performance may indicate good luck as much as good skill plus the ever present threat of developers milking their reputations by taking on far greater than previous risks without telling their financiers. The rewards are greatest during property booms so it is likely that the adverse consequences of agents taking advantage of asymmetrical information in property development and sales is highest then.

Property booms are always associated with relative newcomers to the development world. Generally, these entrants start with little own capital and borrow to undertake large-scale developments. Even during upturns many entrants will not be particularly successful; but some will. Media curiosity with their business and personal lives then creates the impression that these individuals have discovered some new formulae for business success. Some of the innovation is true because their buildings, by virtue of being new, will reflect contemporary best-practice design, scale, and technology. They will also sometimes utilise previously untried financial packages when funding their schemes. But, in practice, little innovation has occurred because the apparent institutional changes are disguising greater investor risk. Ease of entry and exit, in other words, encourages newcomers whose existence is a reflection of the greater risks investors are prepared to take in property lending at specific stages of the property cycle as much as any genuine developer-led innovation.

Monitoring of behaviour in property markets is sometimes made difficult by firms taking advantage of contemporary accounting standards. Some accounting rules encourage risk taking by hiding the extent of the risk. During the 1980s boom, for example, nonrecourse loans became commonplace in the United Kingdom as developers and banks adopted an earlier US financial innovation. Nonrecourse loans are specifically tied to a particular project and in theory have no call on the parent property company, so they do not appear on their balance sheets. Lenders consequently do not know the full extent of a developer's loan exposure—a risk brought out most forcibly in the collapse of Olympia and York in 1992 when it was the world's biggest and most indebted developer.

Other accounting practices add to the risk. Interest charges in UK property companies accounts, for example, can be capitalised rather than regarded as a current cost. In this way interest payments on a development are treated as an asset rather than an expense. This makes a development company look far more secure than it actually is, especially when associated with off-balance-sheet finance.

The most widespread accounting convention disguising lenders' and borrowers' true financial positions is the fact that book values do not have to reflect accurately the current market value of property assets and loans. Write-downs can be spread over years and lost in company accounts rather than sudden financial pain being imposed when property values collapse and the repayment of loans is in doubt. Some would justify this practice as helping to preserve the stability of the financial system, but the long-term effect is probably the opposite.

In the USA, the Bush administration's banking reforms of 1990 were an attempt to impose market-value accounting criteria on US financial services, but the package failed to pass through Congress.
Housing markets
Housing output fluctuates broadly in line with general economic activity, albeit with a much greater amplitude. These wider fluctuations in housing output are typical for consumer durable and investment goods because stock adjustments lead to far greater variations in market flows than is typical for shorter-life goods and services.

Demography, financial liberalisation, and housing wealth boosted housing markets in the 1980s. Household formation was exceptionally high. The baby boom of the 1960s had worked its way through so there were many young households with expectations of rising income looking for their first owner-occupied dwelling. The age structure of the population also shifted, increasing dwelling requirements for older households. Demographic patterns consequently generated a good contemporary mix of movers who were trading up and trading down—a situation that was reversed by the early 1990s.

The service boom itself encouraged household formation through its income effects and the high-spending young professionals it spured. The spatial concentration of these activities put pressures on specific regional housing markets—for example, the New York and Boston metropolitan areas, Tokyo, and London and the South East of England. The wealth and relative price effects frequently spilt over into contiguous regional housing markets, creating a ripple-like pattern of housing market change.

Income data for this time period show marked shifts of income and wealth shares away from lower-income groups, particularly in the United Kingdom and USA (OECD, 1993). These distributional changes greatly benefited owner-occupied housing markets, especially the medium and upper market sectors. In the United Kingdom, for example, average real household incomes grew rapidly—rising during the 1980s by 30%—and most of the increase went to middle-income and upper-income groups and households (HMSO, 1993). Many of the gainers lived in the southern half of the country where the house price boom was greatest.

Housing debt and wealth situations in the mid-1980s also encouraged existing homeowners to contemplate moving or remortgaging to tap into their housing wealth. Australia, the USA, and the United Kingdom all had mature housing markets, with many homeowners by then having accumulated considerable housing-related wealth. Previous bouts of inflation had by the mid-1980s reduced the real value of outstanding mortgage debt considerably. [This is a well-known consequence of the ‘front-loading’ characteristic of nominally denominated debt during inflationary periods (see Hills, 1991).] Meanwhile, house prices over the medium term had more than matched inflation. For many existing homeowners, by the mid-1980s their mortgage-debt-to-income ratios were lower than many desired, but housing wealth was higher than previously. Borrowing more and moving, when feasible, were attractive options.

Given these debt and wealth effects it was probable that by the mid-1980s many existing homeowners were in suboptimal housing situations. Why had they not readjusted their financial and housing situations before? Two reasons stand out. First, the severe recession and high interest rates of the early 1980s created log jams in many housing markets, frustrating many potential moves. Second, credit

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(8) Smith et al (1988) provide a useful survey of housing market models; Poterba (1991) considers the US situation in the 1980s; Muellbauer (1992) contrasts the experience of Britain and Germany in the same decade; Tomann (1990) also considers Germany; and Koskela et al (1992) examine the Finnish boom.

(9) Case (1992) has well documented these interlinkages for the greater Boston area during the 1980s.
constraints were frequently binding under contemporary mortgage finance systems so that many homeowners were forced to accept lower than desired mortgage-to-house-price ratios and, by implication, higher than desired net housing wealth.

These employment, demographic, wealth, and mortgage-debt characteristics added to the general behavioural patterns of the housing market cycle to induce great surges of existing homeowner demand during the mid-1980s as nominal interest rates fell, incomes rose, and housing market transactions freed up. The effects were most noticeable in regions benefiting most from the dynamic service sectors—which tended at the time to be some of the world's major cities (many of which had beforehand been in relative decline, as they are again). Table 1 (see page 677) shows estimated residential prices in a number of major world cities for the period, each of which shows a period of sharply rising prices. In some cases, such as in Britain, ripple-out effects led to national house price booms.\(^{(10)}\)

Housing models generally assume continuous market clearing, though in practice such market clearing may be achieved only through creating severe disequilibrium in housing stock demands and supplies. (Apparent flow equilibria, in other words, rest on hidden stock disequilibria caused by discontinuities and other constraints.) Particular categories of households find moving easiest at specific stages of the market cycle and may well delay a desired (stock) change in their housing circumstances until market conditions permit. Existing owners, for example, often prefer to move during housing market upturns because then their transactions costs are lower because buyers are more quickly found and rising house prices increase their wealth. First-time buyers conversely find housing less affordable during periods of price rise. The period of market recovery after a slump is ideal for first-time buyers, whereas existing homeowners may find the transactions costs of selling too high. So the proportions of households active in specific market segments varies systematically over the housing market cycle.

Country-specific housing market factors spurred on house price booms. In the USA, the 1986 tax reforms removed tax relief from all personal loans except those relating to housing, encouraging households to switch into housing-related borrowing. In the United Kingdom, the bulge of new households had a particularly marked impact on owner-occupation because the supply of rental housing was severely curtailed below general postwar levels by the programme to promote the sale of council housing and the sharp curtailment of the production of new public housing. The most spectacular price effect came when the Chancellor announced at the height of the boom that six months later tax relief would be limited to one person per household. The announcement had the unfortunate effect of bringing purchases forward, so for the next six months, unsurprisingly, prices escalated more, only to begin to fall when the tax measure finally came into effect.

\(^{(10)}\) The housing market econometric literature generally ignores the impact of changes in regional labour markets on house prices, because they are nationally calibrated models. Perceived positive employment shocks to regional labour markets would, however, help to explain why some households were prepared to take on much higher mortgage-to-debt ratios in the mid-1980s in order to stay in those buoyant labour markets. Extended commuting would then alter the balance of supply and demand in contiguous regions, starting off the house price ripple effect. On this hypothesis, owner-occupiers as well as commercial property developers misforecast the impact of the service sector revolution on employment in large cities.
One other housing market tax change rarely commented upon is property tax.\(^{(1)}\) Like mortgage interest tax relief, some of the impact of property taxes is capitalised into house prices, but the impact is more diverse. Areas with well-regarded schools, good parks, low crime rates, etc, find those characteristics reflected in house prices, whereas the property tax lowers the effective price. However, the level of the property tax is uncertain and it changes from year to year because of the state of local government finances and so only the expected part of them should be capitalised.

The variation in the incidence of property taxes moreover tends to have cyclical characteristics in line with general economic activity. Recessions weaken local authority tax bases while some costly services face higher demands, especially in countries such as the USA where many welfare programmes are state responsibilities. This means that recessions generally raise the property tax burden (and may lead to reductions in the quantity or quality of local public services) whereas economic upturns lower it. During an upturn, consumers may find that their property taxes are less than expected. House purchasers may adapt by lowering their forecasts of property taxes and thereby raising their house price bids. In recessions, reverse mechanisms occur, depressing the housing market. Unless households accurately forecast these cyclical patterns, house price volatility will probably be heightened over the market cycle.

During the 1980s, the procyclical effect of property taxes on house prices was exacerbated in the United Kingdom by the short-lived replacement of the property tax—known as rates—by a per capita tax, officially called the community charge but commonly called the poll tax. The introduction of the poll tax, announced several years in advance, removed a substantial property tax burden. Many people expected the tax to stay, so the measure was probably capitalised into house prices even before its actual introduction. The tax created such controversy it was unexpectedly withdrawn and replaced with a hybrid of per capita and property tax—the council tax. This again probably was partly capitalised into house prices—this time by lowering them. The house price effects of the British poll tax saga consequently may well have been substantial, as the removal of rates coincided with the 1980s upturn and the reintroduction of a property tax took place during the 1990s downturn. Forecasts at the time suggested that the removal of rates would increase house prices by 15%–30%. The council tax has a lower property element than the old rates but the downward effect on prices could still be substantial, especially in the short run.

Whatever the merits or deficiencies of the decade of reforms to local government finance in the United Kingdom, the government unintentionally, if perversely, through these taxation policies further stimulated house price rises when they were already rising, and then managed to accelerate the subsequent price falls. It produced a similar effect on the London office market through new planning strategies, as will be argued later.

Financial liberalisation

The 1980s was the decade of financial liberalisation. Most countries' financial structures had previously evolved under strict regulation, especially after the experiences of the 1930s. The controls were primarily associated with a separation of financial functions (housing mortgages, for example, were predominantly provided

\(^{(1)}\) The literature on property taxation is enormous, particularly with reference to the Tiebout hypothesis (see the survey in Krelove, 1993; Mieszkowski and Zodrow, 1989). However, it mainly centres on the local public expenditures and has had little impact on housing market models.
by specialist institutions); limits existed on international financial transactions, especially via strict exchange controls in Europe and elsewhere; and in retail financial markets there was official encouragement of a cartelised determination of interest rates and financial charges—in the case of the USA, the federal-government-imposed deposit interest-rate ceilings (under Regulation Q).

Technological changes, shifts in the structure of financial services demand towards the personal sector away from business, the inadequacies of previous regulatory regimes, and prevailing political ideologies all pushed for change. It came to many countries in just a few 'short' years after the late 1970s. In the United Kingdom, for example, exchange controls were abandoned in 1979, regulation and dealing in the City were revised under the 'Big Bang' of 1985, the building societies cartel was dismantled in 1983, and the banks were encouraged to be more competitive.

Depositors in the United Kingdom and elsewhere in Europe could shop around for the highest deposit interest rates without concern about institutional risk, because their deposits were always believed to be safe through a mixture of the generally accepted hypothesis that it is too politically embarrassing for a major financial institution to fail and of (limited) depositor insurance. Only the collapse of the Bank of Credit and Commerce International has subsequently tarnished this image in the United Kingdom—and even that was an exceptional concern.

In the USA, deposit interest-rate controls were abolished by 1986. Savings and Loans institutions were permitted to hold far more nonhousing assets than previously, and competition for retail deposits intensified—federally guaranteed deposit insurance remained, however. Japan also introduced innovations to its financial system.

Housing in many countries was still given the unique privilege of being eligible for the tax deduction of interest payments—sometimes capped as in the United Kingdom to a maximum mortgage value and a midrange marginal tax rate. In the USA, housing achieved this privileged tax benefit with the mid-1980s tax reforms which abolished all prior interest-payment tax relief for households, with the exception of housing-related loans.

Financial changes of this sort induce several interrelated effects on the demand and supply of financial services. First, in the case of demand, whereas households were previously constrained in their consumption of financial assets they could now alter their debt-to-income and debt-to-wealth ratios up towards their desired levels. Second, they were able to shift their portfolios of financial assets and liabilities from the previously constrained ones. In the general consumption-function literature, liquidity constraints have been argued to be important determinants of the consumption patterns through which consumers translate expected long-term income into contemporary consumption levels (Dornbusch and Fischer, 1990), and this argument has been widely echoed in the housing market literature, especially in Britain (Miles, 1992). So theory would suggest that financial liberalisation would lead to greater mortgage demand. Mortgage-to-income ratios rose dramatically in many countries during the 1980s. As households shifted towards partially tax-exempt mortgage borrowing, greater activity in the housing market was induced, putting upward pressure on house prices.

In commercial property markets, similar responses to the weakening of financial constraints occurred. In the 1980s, property developers had a much wider range of financial institutions to choose from than previously, especially as international constraints had been lowered. They could all consequently expect better competitive terms, including the passing on of more of the project risk onto the lender.
On the supply side the picture of the response to deregulation is more complex. Once controls come down, before competition has fully adjusted the margins, the apparent profitability of entering new areas of business is high. Firms move into new markets and new enterprises set up, many of them subsequently to be squeezed out once the extra competition starts to bite. As mentioned earlier, in financial services extra entry was induced by the apparent attractiveness of economies of scope and scale which were widely believed to exist in the 1980s.

Such competitive drives greatly expanded capacity. To take the UK case again, as it looked as though capacity in UK retail financial services was set to double as commercial banks, building societies, and others raced to become the dominant financial supermarket of the future (Ball, 1990). This overcapacity was office-space demanding, sending out more wrong signals to property markets.

The supply-side changes in financial services suggested so far relate simply to new entry in the face of changed regulatory and technical conditions. Most concern, however, has been with the behaviour of institutions and individuals in the new regulatory environments. Their behaviour seemed to raise the riskiness of the new investments which financial institutions undertook well above rational levels. The argument is that deregulation substantially increased moral hazard because financial institutions, their customers, and managers did not always bear the full costs of their actions. This led to reckless lending in the hope that the high risks incurred would turn good and with the knowledge that if they did not, which had a higher probability, then someone else would pay the cost.

The argument is most commonly associated with the US practice of federally guaranteed deposit insurance with limited constraints on the riskiness of the loans made with those deposits. In this situation, depositors need not fear losses no matter how reckless the lending activities of the deposit-taking institution, because the deposit insurance scheme will repay them if the business fails. The moral hazard here is that, as the insurance covers any risk, depositors are encouraged to search out the highest deposit interest rates even though these rates are offered by the riskiest deposit-takers. Deposit-taking institutions and their managers and owners themselves are subject to moral hazard as they are encouraged to take excessive risks because their investments are funded by the deposits they take. This means that they are heavily geared, with little or no own capital at stake, and so stand to profit handsomely if the low-probability high-return outcome turns out to be the actual outcome. Deposit competition encourages more institutions to become risk-loving. As the rates paid to depositors rise, institutions are forced to take on even more risky investments. The costs of the inevitable failure of many of these institutions is then borne by the federal government. Such a situation occurred in the late 1980s and early 1990s when large numbers of thrifts and regional banks failed. The moral hazard can only be avoided by equalising the risk profiles faced by all parties—a conclusion that has so far proved impossible to implement, even though the crisis of the deposit insurance schemes has heightened the federal budget deficit and raised real interest rates for over a decade (Mishkin, 1992; Shoven et al, 1992).

The moral hazard debate has not featured so much in European discussion despite de facto 100% deposit insurance in most countries—especially through the too-big-to-fail stances of governments and central banks. This is probably because of the much greater concentration of firms in retail financial service markets in Europe than in the USA, which affects both the way in which deposit interest rates are set and the prospect of institutional collapse.

Persistent moral hazard effects only make sense when linked to specific theories of competition. In a competitive market the threat of moral hazard should be reflected
in price charged or the nonexistence of markets in the activity. Insurance premiums, for example, should rise to compensate for the higher insurance risk and some types of risk should be uninsurable as a result. What made moral hazard so pervasive in the 1980s and 1990s with respect to property markets was the response of many financial institutions to the impact of deregulation, because they lowered rather than raised preexisting risk-taking safeguards.

The central competitive problem here, I would suggest, is the structural problems of money-centred financial institutions—such as banks, savings institutions, and building societies. New technologies and competition have opened up a wide variety of means through which individuals and firms can borrow and deposit money for long-term or short-term investment, and the opportunities may well still increase. Without unique economies of scale or scope, money-centred institutions have only two potential competitive advantages. They may claim to lower depositor risk—a position that has been severely tarnished in many countries. Alternatively, they can gain a marketing edge through their market presence, which is usually a function of market share. The limited empirical work on retail bank profits indicates that they are only positively correlated with one variable market share (Rhoades, 1986).

The evidence of financial institution behaviour in the 1980s would suggest that many took the market-share maximum as the overriding objective (Ball, 1990). In temporarily relaxing lending criteria, retail financial institutions may have been aiming to protect their market position (and their longer-term profitability) in the face of greatly expanded financial services capacity and technical change. But they did so at the expense of higher risk (and by implication lower actual short-term profits). As many financial institutions adopted this same strategy simultaneously, the risks it involved were considerably enhanced, as all found out to their cost.

Were the effects of financial liberalisation one-off or could similar effects occur again? Some of the moral hazard may be removed by a tightening up of regulatory rules, although the changes needed are extremely difficult to accept politically. Every time a financial institution fails, governments are implored to bail out depositors with no general understanding of the spillover effects of doing so. US deposit-insurance reform has foundered in the political process. Overall, moral hazard remains a major fear for the stability and efficiency of the world’s financial systems.

As soon as money-centred institutions raise their deposit rates relative to general interest rates, exercise greater risk evaluation through rationing or pricing criteria, or try to increase the margin they achieve between lending and borrowing rates, they increase the attractiveness of internationally traded capital market alternatives which then cause catastrophic falls in their own business.

The general point is that if one part of the financial system tightens its rules, opportunities are opened up for new entrants. So, if the money-centred institutions and their regulators remember the lessons of the property market collapse, the next property market upturn may simply see a switch in borrowing to capital market instruments rather than a more constrained flow of credit.

It may, in fact, be the case that financial liberalisation affected more the form in which that credit was made available—by encouraging direct loans from money-centred institutions to property investors—rather than its volume, which was probably influenced more by the global macroeconomic environment. One of the outstanding features of the 1980s property boom was the central role played by banks and mortgage institutions using short-term financial assets as a means to fund their long-term mortgage and other property-related loans rather than there being an emphasis on institutions using capital market instruments as their sources of funds. This switch
was predicted in the early 1980s but capital markets then followed rather than led property finance, with the possible exception of the specialist US secondary mortgage market.

Table 2 shows the extent to which bank property lending increased as a share of all bank lending—much of it on housing. Apart from Germany and France, which experienced minimal financial deregulation during the decade, virtually all countries saw their banking systems greatly increase their involvement in property lending. (The data for Japan are too poor to assess bank lending.) Property loans subsequently turned out to be a much higher proportion of defaulting loans than all loans for most banks in the subsequent downturn. French banks were badly hit by the collapse of the Paris office market, and even German banks had severe problems with their property loans. The scale of the temporary shift by much of the world’s banking system into property must have meant that screening criteria for loan approvals were weakened—these lenders are unlikely to have had sufficient expertise to evaluate adequately the property markets into which they were lending.

Table 2. Bank real estate lending in selected countries (sources: BIS, 1992; IMF, 1992).

| Country        | 1985  | 1987  | 1991  |
|----------------|-------|-------|-------|
| United States: |       |       |       |
| total          | 29    | 34    | 42    |
| commercial     | 13    | 17    | 17    |
| United Kingdom:|       |       |       |
| total          | 19    | 23    | 31    |
| nonhousing     | 7     | 8     | 12    |
| Japan          | 13    | 15    | 17    |

| Country      | 1985 | 1987 | 1991 |
|--------------|------|------|------|
| Canada       | 33   | 39   | 49   |
| France       | 29   | 29   | 31   |
| Germany      | 46   | 45   | 40   |
| Norway       | 48   | 41   | 52   |
| Portugal     | 28   | 33   | 32   |
| Spain        | 19   | 20   | 29   |
| Switzerland  | 28   | 29   | 34   |

* Break in series resulting from the inclusion of a building society that was converted into a bank.
* Construction and property companies.
* Construction and real estate management firms.
* 1990.

Governments will have considerable problems in the future if they want to implement policies that specifically limit the movement of credit into property because they have no effective means of doing so. In the absence of exchange controls, which most governments have now abandoned, there could well be serious conflicts with the aims of macroeconomic policy if governments try to curtail the flow of credit into property by raising interest rates. If governments want exchange rate stability, moreover, they will not even be able to have much effect on property markets via interest-rate policy.

In sum, it is unlikely that another future property boom will be held back by a lack of credit; not simply because lender’s forget the lessons of the past but because the then present may make those lessons irrelevant.
Why were the booms coincident?
The peak of the property price boom occurred in 1987 or 1988 for most countries both in their housing markets and in their commercial property markets (see BIS, 1992, page 142). A classic asset-price bubble had arisen, with property prices increasing for several years well above their longer-term trend values, to be followed by several years of sharply falling prices which went well below the trend until slowly readjusting back to levels determined by 'fundamentals'. Stock markets in some countries, most notably Japan and Scandinavia, followed a similar path; and all the world's major stock markets fell in the closing months of 1987 (IMF, 1992).

An important feature of property markets is shown in the ups and downs of property price change—prices are flexible and respond rapidly to the prevailing balance between demand and supply. Rental markets are the exception as they generally exhibit downward stickiness in nominal rents as landlords are reluctant to lower rents at times of excess supply, and tenants have limited bargaining power because of the high transactions costs of imposing the only effective threat—moving—especially when there are binding clauses in long-lease contracts.

The price sensitivity of property markets makes any shock affect those markets rapidly. What is remarkable about the 1980s and 1990s is how closely correlated are the booms and slumps in each country. The pattern in countries with booming housing markets was fairly similar, with real prices peaking in the last years of the decade, followed by major falls; those declines, however, still generally kept real prices above their early 1980s levels. Commercial property exhibited somewhat wider price variation between countries—with Japanese price rises well in the lead—and far greater subsequent falls than for housing. In the USA and the United Kingdom, for instance, real prices in the commercial sector fell to well below their preboom levels (BIS, 1992).

Some international transmission mechanism would seem to have been at work. Several explanations could account for it. It could be that the technological changes elaborated earlier were affecting all countries simultaneously. Yet the structures of economies are too dissimilar and the time period of the technological shift too long to be a sufficient justification for this argument. Alternatively, the whole advanced world may have experienced a shift in expectations—with market-oriented governments creating the prospect of much higher future incomes. Yet collective wishful thinking on such a scale seems unlikely. Financial liberalisation could have done it. But again there are problems. The financial regimes of countries have substantial differences, and liberalisation encompassed distinct events in each country. Why, therefore, should they all lead to the same boom? Moreover, the timing of reforms was insufficiently close to justify the last few years of the 1980s as the date when they would all simultaneously have an impact on property markets. One set of financial constraints, nevertheless, did have a common impact on all the world's major banks towards the end of the 1980s, which might help to explain the ending of the boom. Then, banks were beginning to feel the constraints on lending being imposed by adjustment towards the requirements of the international Basle accord on minimum capital adequacy ratios. But that should not have led to a sudden curtailing of property lending as long as the contemporary value of property assets was sustainable, which, of course, they turned out not to be, but that does not explain how they came to be so inflated in the first place. Another possible explanation is the impact of the structural imbalances in the world's trade system of the 1980s which turned the United Kingdom and the USA into large net importers of capital from the trade-surplus countries, Germany and Japan, with part of that
imported capital being diverted into property speculation. Again, this phenomenon might have some bearing, yet the scale of the boom dwarfed even those sums.

One final candidate seems most likely to have acted as the catalyst that stoked the price spirals, and then enabled the other factors to come together to create the property boom. This is the combined effect of financial innovation and monetary policies in the 1980s, which made credit much more easily available and less easy for governments to recognise or control (IMF, 1992). In the period after the 1987 stock market crash, most governments considerably relaxed monetary constraints for fear of creating an interwar-style financial crisis when financial institution after financial institution folded for want of a lender of last resort (Friedman and Schwartz, 1982; Kindleberger, 1987; OECD, 1989). The world's stock markets responded well to the 1980s treatment, but perhaps excess liquidity spilt over into property markets as investors temporally redirected their interests there. This has been a common feature of previous financial crashes. Kindleberger (1991, page 46) has suggested:

"At the time the stock market collapses, real-estate speculators congratulate themselves. They own real assets instead of pieces of paper ... But demand for real estate falls sharply ... if there has been a boom ... the shakeout ... may go on for four, five or even eight years, with strong negative effects on the industry and on the banks lending to it".

The role of property booms and slumps as a precursor of general economic downturns also has precedents, as Van Duijn (1983, pages 17–18) has noted:

"Historically, major downturns in aggregate economic activity have always been preceded by downturns of the Kuznets cycle: 1871–73, 1927–29, and, in our time, 1972–73."[And in our time 1987–89.]

The speed of the subsequent downturn in the property market also has monetary and financial aspects. Governments belatedly reacted to the macroeconomic imbalances created by 1980s boom conditions by reimposing stricter monetary policy, especially via higher interest rates, which particularly hit debt-laden property markets. This sharp tightening of credit conditions was exacerbated by the problems arising from financial liberalisation, especially those associated with the US banking crisis, which led to a simultaneous reinforcement of regulatory controls in some countries. A credit crunch quickly ensued when the speculative bubble burst, because banks and other financial institutions were, as Bernanke and Lown (1991) have argued, forced to cut back lending sharply as defaults on property and other loans threatened their capital bases. So governments' monetary and financial policies must bear part of the blame for the bubble.

The weakening of land-use planning

The 1980s were not good years for land-use planning. As a public policy it was the antithesis of the free-market ideologies so fashionable amongst governments, central and local, because land-use planning encapsulates a series of features at variance with free marketeers' views of how a market should work. Evaluation and control of land-use change is primarily done on quantitative rather than profitability criteria. The objectives to be achieved are set by public officials and the political process rather than in a marketplace. Within the political process, the rhetoric of community politics often finds greater purchase than the arguments of development lobbies. And, perhaps worst of all, the process involves implicit distributional questions, and the liberal training of the planning profession may encourage concern for redistribution towards the poor. Later in the decade, planning did become viewed more positively as a protector of the environment, but, even then, this role became powerfully confused with the NIMBY (not-in-my-backyard) phenomenon.
This ideological crisis for planning was associated with a decline in many countries of urban infrastructure expenditure—a reduction which had started earlier in the 1970s. The provision of new public works not surprisingly channels the pattern of development activity, as it opens up new profitable opportunities for private sector developers. So the rundown of infrastructural expenditure weakened a major source of public sector leverage over private development. Paradoxically, the cutback in infrastructure expenditure probably heightened the NIMBY effect because governments were less able to help transform non-NIMBY localities into more attractive residential locations.

The overall outcome was to weaken the influence of planning (and governments) on the land-use development aspects of the long-term economic shift towards service sector activities; and the success of the NIMBY effect enhanced the consumption possibilities of those living in privileged, environmentally attractive areas.

In response to prevailing fashions and government directives, planning did acquire a new market-related edge. Much publicity has been given to new-style public-private urban renewal initiatives—most notably London's Docklands. These projects, however, are small in comparison with overall land-use development, and they do not herald a transformed planning system, as so many of these experiments have proved unsuccessful. Their apparent lack of success is unsurprising, because planners and development corporations do not have uniquely privileged knowledge about property markets and so at best are just as fallible as their private sector counterparts. In some cases, public subsidies may tip the balance in favour of profitability, but this raises questions of fairness and equity—why should those investment projects be subsidised? Frequently it has been painfully discovered that the public infrastructure subsidies cannot revive dodos—again London's Docklands demonstrates this.

The greatest reorientation of land-use planning systems in the 1980s came in the English-speaking world, where New Right market ideologies gained most political success. Continental Europe saw less change.

There are two consequences of this to which I should like to draw attention as they help to explain some aspects of the boom and its aftermath. First, the change in planning regimes altered the context in which private sector developers operate. One key feature was enhanced uncertainty. Under rigorous planning control, developers know clearly at which localities particular types of development are feasible. Regional and national coordination of land-use plans gives additional information on feasible overall building supply and its location. The restrictions on development at nondesignated locations by restricting competing building supply confers a greater probability of financial success on permitted development. A weakening of these interlinking constraints therefore heightens the risk of failure for private investors.

Office development control in London throughout the 1980s illustrates the point. The series of shifts in planning rules, which no one could have foreseen, considerably increased the riskiness of office development throughout London. When the Docklands Development Corporation was set up in 1979, large-scale office development in the area was not envisaged; instead, the Docks were to be used primarily for housing, industry, and warehousing. Meanwhile, the Corporation of London during the late 1970s and early 1980s had adopted an increasingly conservationist planning policy which limited the prospects of new office supply in the core of the City. Given the City's planning policy, office development in nearby Docklands locations became extremely attractive, especially after the success of several small-scale pioneer schemes. The perceived role of Docklands consequently shifted to the
more ambitious one of being an outpost of the world's largest international financial centre. Office projects gained momentum, culminating in the massive Canary Wharf scheme. Infrastructure expenditure in Docklands had to be upgraded accordingly from an already high level.

Competition between local planning authorities ensued. In the absence of a London-wide planning control system, after the abolition of the Greater London Council in the middle of the decade, the Corporation of London took notice of its own perceived interests in sustaining the importance of the Square Mile against the threat of the Docklands or banks moving overseas and altered its planning rules accordingly. Far more office development was permitted in the City. For all developers knew, the easing of planning constraint might well have been only temporary, so it is not surprising that many schemes were then rapidly started in the financial core. The subsequent oversupply at all locations doomed the London office building boom, and Docklands developments suffered particularly badly because of their worse location. Not surprisingly, the functional role of the Docklands area is again in doubt.

The other important feature of planning that I wish to stress is that it restricts development. One of the beneficial effects of this is the unintended effect of smoothing the property cycle. During booms, new building supply is restricted and the price of development land rises. This does not initially affect the final price of buildings which is primarily determined by stock demand and supply relationships because of the long gestation period for most building projects. The constraints on new supply then lead to less overbuilding when the boom breaks. Planning control thus acts as an imperfect regulator of property markets. It is interesting to note, for example, that German and French office markets suffered far less than those in the USA and United Kingdom, in part because fewer projects had managed to get through the planning process during their respective booms. Similarly, because UK housing developers were particularly subject to considerable NIMBY-style planning constraints, they survived the crash in the housing market in much better shape than their office building counterparts.

Conclusions

The arguments made here suggest that neither credit explosions nor 'mad' animal spirits are adequate explanations of the recent boom and slump cycles in the world's major property markets. Instead, a variety of different factors came together during the 1980s to encourage development but also to increase considerably its riskiness.

In part, developers and their backers consciously reacted to changing patterns of risk by taking on more risk. This may have been for moral hazard reasons—in such cases they were not contemplating taking the downside of the risk. But others were more savoury—construction times were shortening, credit constraints were falling, and planning regimes were shifting. It has to be remembered also that the boom took place over a number of years and that once a commitment is made a major project is costly to abandon. Many of the factors described above unfolded over a space of years, so many investors would have found themselves committed and then have had to cross their fingers as the riskiness of their investment rose.

With hindsight it is easy to see that the service sector revolution would not always demand more and more high-quality central city office space and suburban shopping centres. But it was less clear a decade ago when many of today's empty offices were being planned.

There was undoubtedly a speculative bubble towards the end of the boom, much of it an unfortunate side effect of government monetary and financial liberalisation
policies, and there were many excesses before that. But some of the wilder predictions of the bubble phase were still extrapolations from more solid foundations—although as the boom proceeded the recent past became a progressively poorer predictor of the immediate future.

What will happen now? For property markets the medium-term future is bleak. Developers and households are saddled with debt that will take years to pay off, and financial institutions are wary of further commitment. As one of the major providers of fixed capital, the property world got its forecasts of future economic and social needs horribly wrong. It now has an uncertain role in the economic restructuring still being induced by the continued service sector revolution and the growth of more countries towards advanced economic status.

The outcome for the world's cities is ambivalent. Lower rents and property prices may encourage more activity back into central areas. Conversely, the lopsided nature of the boom has left many urban areas with chronic imbalances in land use and major problems with transportation. These imbalances and the poor urban environment created may encourage yet more people to leave the urban cores in search of a higher quality of life. Unfortunately, dispersed neighbourhoods are extremely expensive to service, are environmentally damaging, and generate long travel times. Those costs are in many ways borne by all. Cumulatively, the environmental quality that the movers went in search of is lost and even greater dispersion is necessary. In contrast, more densely spaced urban life can generate substantial economies of scale and lower environmental costs for a given national standard of living. Like all fine relationships, however, good city life does not just happen. The problem is that neither the public sector nor the private sector seem yet to have got it right.

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