

## LAND PROBLEM IN JAPAN

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### *Abstract*

Land problem in Japan has a long history. The sharp rise in land price in recent years has spotlighted the aberrance of the problem. It is widely accepted that land problem is one of the most serious social and economic problems that Japan faces.

In this paper, I discuss four points relating to the land problem in Japan. First, I review the movement of land price using government statistics. Second, I analyze the nature of land price, in particular the large difference between land price and the rental cost. Third, I will examine the causes underlying the land problem. In this connection I would like to point out that the cause of the land problem we face today is not the absolute shortage of land but the fact that land is treated marketable asset. Finally, I will discuss the government's land policies and various measures it has taken, with a particular emphasis on land taxes, the Land and Building Lease Laws, and the securitization of land.

Land problem in Japan has a long history. The sharp rise in land price in recent years has spotlighted the aberrance of the problem. It is widely accepted that land problem is one of the most serious social and economic problems that Japan faces.

In this paper, I discuss three points relating to the land problem in Japan. First, I will discuss the movement of land price and focus on the large difference between land price and the rental cost. Second, I will examine the causes underlying the land problem. In this connection, I would like to point out that the cause of the land problem we face today is not the absolute shortage of land but the way people treat land as a piece of marketable asset. Third, I will discuss the government's land policies and various measures it has taken, with a particular emphasis on land taxes, the Land and Building Lease Laws, and the securitization of land.

### I. *Land Price in Japan*

#### (1) Recent Trends of Land Prices

Table 1 shows the trend of land prices in the three major urban areas in Japan for the second half of the 1980. In Tokyo, land price almost tripped during the two years 1987 and 1988. The recent survey shows that while rises in land price in the Tokyo district have subsided, the upward pressure on land price has spilled into the Osaka district, boosting the

TABLE 1. RESIDENTIAL LAND PRICE INDEX  
(1963=100)

	1984	1985	1986	1987	1988	1989	1990
Greater Tokyo	102.2	103.9	107.0	130.1	219.3	220.2	234.7
Tokyo	102.9	105.9	112.7	169.6	283.2	265.3	264.5
23 wards	103.2	107.2	117.9	208.5	300.5	284.9	286.0
Kanagawa	102.0	103.6	106.0	118.8	220.7	203.9	205.3
Saitama	101.5	102.0	102.3	104.7	167.3	181.5	202.0
Chiba	101.8	102.6	103.4	109.8	179.3	210.3	261.6
Greater Osaka	103.6	106.7	109.5	113.2	134.3	178.2	278.1
Osaka	103.5	106.9	110.4	115.2	138.9	188.2	298.5
Kyoto	103.9	107.1	110.5	114.3	124.5	164.1	274.2
Hyogo	103.6	106.0	107.1	109.7	140.1	182.6	269.3
Nara	103.2	105.8	107.7	109.5	112.7	143.0	214.8
Greater Nagoya	102.4	104.0	105.5	107.2	115.0	139.9	160.9
Aichi	102.2	103.7	105.1	106.7	115.1	136.5	163.9
Mie	103.7	106.0	108.1	109.9	112.2	118.0	136.0

Source: National Land Agency.

TABLE 2. RATIO OF AVERAGE HOUSE PRICE TO ANNUAL INCOME

	1894	1985	1986	1987	1988	1989
Greater Tokyo	5.64	5.62	5.36	6.48	8.14	8.62
0-10 km area	6.93	6.95	7.10	10.89	15.62	15.31
10-20 km area	6.15	5.78	5.93	7.93	10.43	10.68
20-30 km area	5.20	5.12	4.94	5.86	7.25	8.18
Greater Osaka	4.44	4.36	4.13	4.34	4.94	6.27
Greater Nagoya	3.53	3.54	3.45	3.51	3.89	4.27

Source: Toshi Kaihatsu Kyokai

prices of both residential and commercial-district land, and that it has spread to Nagoya and other regional cities.

As a result of this, even ordinary houses have become too expensive for workers to purchase. It is generally pointed out that the maximum value of houses that can be purchased out of labor income is about five times the annual income. Figures in Table 2 shows that housing price in Tokyo district have exceeded this limit.

## (2) Comparison of Land Price and Rental Cost

As is often pointed out, land price in Japan is extremely high. This can be corroborated by statistics. Table 3 shows the price level of residential land in Great Britain. (I use the land price in Great Britain, because the geographical conditions of that country are similar to those of Japan, thus lending themselves to meaningful comparison with those of this country). Residential sites which command the highest price in Great Britain are located in the inner city of London, and one square meter of land at such locations fetches ¥100,000 at the current rate of exchange. According to Table 4 which shows bench mark prices of residential sites reported by the government in 1987, one square meter of land at locations in metropolitan Tokyo comparable to the samples of London costs ¥4 million

TABLE 3. PRICES OF HOUSING LAND IN GREAT BRITAIN  
(As of Oct. 1, 1986; in £1,000 per 1 ha.)

	A	B	C
Inner city of London	£3,113	£2,956	£4,036
Outside fringes of London	1,181	1,333	1,642
Northern district	196	180	193
Northwestern district	216	163	215
Yorkshire	222	156	226
Wales	164	127	211
West Midland	277	225	238
East Midland	282	203	300
East Anglia	513	467	805
Southwest district	403	347	497
Southeast district	774	746	988

Notes: 1. A represents small sites, B bulk land, and C sites for flats or maisonettes.

2. £4 million per one hectare is roughly equal to ¥100,000 per one square meter.

Source: Valuation Office, Property Market Report, No. 46, Autumn 1986.

TABLE 4. MARKET AND THEORETICAL VALUE OF HOUSING LAND

Location	Market value (¥10,000/m <sup>2</sup> )	Rent (¥10,000/m <sup>2</sup> /year)	Theoretical value (¥10,000/m <sup>2</sup> )	Volumetric ratio required (%)
(Areas bordering on the Chuo Line)				
Yotsuya	¥445	¥7.9	¥153	300%
Nakano	110	4.2	71	170
Ogikubo	105	3.3	51	230
Kichijoji	93	3.1	46	160
Musashi-Koganei	48	2.6	36	160
(Areas bordering on Toyoko Line)				
Shoto	545	6.9	131	440
Nakameguro	150	3.9	64	260
Jiyugaoka	170	4.3	73	250
Hiyoshi	54	3.2	49	130

Notes: 1. "Market value" represents bench mark prices reported by the government in 1987 (housing land within the radius of 1 km from the nearby railway stations.)

2. Rents for apartments are estimates made on the basis of advertisements carried by Shukan Jutaku Joho (Weekly Housing News), Sept. 1987; those located within a distance 15 minutes walk from the nearby stations.

3. "Theoretical value" is based on an assumed 100% volumetric ratio (yielding a return of 4.11 %).

4. "Volumetric ratio required" means the minimum volumetric ratio required to justify the current market price.

or forty times that of London. The same is true of commercial property, and land prices in Japan are at least ten to thirty times as high as in London.

This is not particularly surprising. One should, however, compare it with the cost of land utilization such as rent of office space. Table 5 shows office rent (including guarantee deposits) in major cities. The cost of renting one square meter of office space at Marunouchi, a business district of Tokyo, ranges from ¥100,000 to ¥200,000 per year. Table 6

TABLE 5. OFFICE RENT IN MAJOR CITIES OF JAPAN

	Rent (A)	Guarantee Deposits, etc. (B)	Guarantee Deposits (C)	Rent (D)
(Tokyo)				
Marunouchi-Ohtemachi	45-50	800-1,500	3.3-6.3	177-204
Kasumigaseki-Uchisaiwaicho	30-50	800-1,400	3.3-5.8	121-202
Ginza	22-35	500-1,000	2.1-4.2	87-142
Shimbashi-Toranomon	22-43	500- 900	2.1-3.8	87-170
Akasaka-Aoyama	20-30	500- 800	2.1-3.3	80-121
Shibuya-Harajuku	17-25	400- 800	1.7-3.3	68-102
Shinjuku-nishiguchi	23-35	500- 900	2.1-3.8	91-141
Ueno	14-23	350- 500	1.5-2.1	56- 91
Kawasaki-Higashiguchi	9-11	120- 170	0.5-0.7	34- 42
Yokohama-nishiguchi	9-12	250- 300	1.0-1.3	36- 48
Nagoya-ekimae	9-11	200- 250	0.8-1.0	35- 43
(Osaka)				
Midosuji	12-19	250- 600	1.0-2.5	47- 78
Umeda	15-18	300- 450	1.3-1.9	59- 72
Shin-Osaka	8-11	200- 300	0.8-1.3	32- 44
Kobe-Sannomiya	7-12	84- 300	0.4-1.3	26- 48
Fukuoka	6- 9	70- 150	0.3-0.7	22- 35
Sapporo	7-11	100- 200	0.4-0.8	26- 42

Note: Rent (A): in ¥1,000 per 3.3 m<sup>2</sup> per month, Guarantee deposits, etc. (B): guarantee deposits and caution money in ¥1,000 per 3.3 m<sup>2</sup>, Guarantee deposits. (C): Interest accruing monthly in ¥1,999 on guarantee deposits and caution money. Rent (D): a total of (A) and (C) in ¥1,000 per 1 m<sup>2</sup> per year.

Source: Figures under (A) and (B) are based on the Feb. 23, 1987 issue of the Nihon Keizai Shinbun.

TABLE 6. OFFICE RENT AND RATE CHARGES IN MAJOR CITIES OF GREAT BRITAIN  
(in ¥10,000 per Year per 1 m<sup>2</sup> as of October 1, 1986)

Location	Rent Office for Space	Rate Charges
(London)		
Tower Hamlets	4.70-5.38	4.20
Holborn	3.78-4.12	3.33
Islington	8.0	3.58
Waterloo	2.50-2.75	2.25
Lewisham	1.63	1.18
London Bridge	4.75-5.25	4.13
Kensington	5.00-5.88	1.48
Mayfair	7.25-8.13	2.70
Marylebone	5.18	2.38
City	6.25-10.75	—
Cambridge	2.40-2.50	1.15
Manchester	2.10	1.25
Liverpool	1.30-1.50	0.89
Oxford	2.10	0.65
Reading	4.00	0.95

Note: 1. Downtown locations.

2. £1=¥250.

Source: Valuation Office, Property Market Report, No. 46, Autumn 1986.

shows that in London, it costs ¥100,000 a year to rent one square meter of office space at locations comparable to Marunouchi, Tokyo—meaning that office rent at Marunouchi is twice as high as in London. A similar situation exists on Manhattan, New York.

As measured in terms of office rent, the land utilization cost in Japan, surprisingly, is not as high as the land price would lead us to believe. This is important because land price should be the discounted present value of future rents. If this theory holds true, the land price in Japan, other conditions being equal, should be only twice as high as those in Great Britain. But those in Japan are actually more than ten to twenty times as high as in these countries. What accounts for this large difference? The answer to this questions holds the key to understanding the land problem we face today.

To shed light on this question, I compute land prices as discounted present value of future rents. Naturally, the result depends on the rate of returns and the estimation of future rents. Land prices computed on the basis of certain plausible assumptions are shown in the column "Theoretical Land Value" of Table 7. According to this calculation, the current market price of land at Ohtemachi, Tokyo falls in line with its theoretical value, while the former at other locations is twice as high as the latter, and the difference between the two is larger in regional cities. From these findings, we can conclude that land in Japan

TABLE 7. CURRENT MARKET PRICES OF OFFICE SITES AND THEIR THEORETICAL VALUE

	Current Market Price (¥10,000/m <sup>2</sup> )	Rent (¥10,000/m <sup>2</sup> per year)	Theoretical Price (¥10,000/m <sup>2</sup> )	Volumetric Ratio Required (%)
Ohtemachi, Chiyoda-ku	¥2,500 (1,650)	¥19.1	¥2,149	970%
Ginza, Chuo-ku	2,300 (1,600)	11.5	1,203	1,660
Shimbashi, Minato-ku	2,850 (2,050)	12.9	1,377	1,780
Akasaka, Minato-ku	2,080 (1,300)	10.0	1,016	1,810
Nishi-Shinjuku, Shinjuku-ku	2,860 (1,600)	11.6	1,216	2,040
Yokohama City	1,140 ( 635)	4.2	295	4,600
Umeda, Osaka	1,820 (1,210)	6.6	593	2,930
Fukuoka City	820 ( 600)	2.9	133	18,090
Nagoya City	940 ( 630)	4.2	295	3,800
Sapporo City	653 ( 430)	3.4	195	5,300

- Notes: 1. Current market prices are based on the bench mark prices reported by the government in 1987. Those given in parentheses are for 1986.  
 2. Rents are based on a survey reported in the Feb. 23, 1987 issue of the Nihon Keizai Shinbun.  
 3. Theoretical prices are based on the case of 8-story buildings (with a rate of return of 4.11%).  
 4. Volumetric ratio required means one which justifies the current market price.

is valued considerably above its theoretical value—suggesting that a commercial building built on a piece of land purchased at market price is a money-losing proposition.

The most important factor for this is the expectations for capital gains. Thus the difference between theoretical and market prices may be called “speculative bubble.” Speculative bubble can—and indeed, does—occur in stocks and other forms of investments, but that of land investment is far more durable than that of other investments. If the market functioned more efficiently, land investment bubble could not survive for long. However, the property market is least efficient and only a tiny fraction of land is bought and sold. Unlike the stock market on which a large number of shares change hands daily, investment bubbles on the property market are structurally durable.

A study of relationships between land price and rent in Japan shows that while rent rose in step with the growth in the economy, land prices increased only in spurts. In other words, land prices rose erratically, not along a trend line as the rent does. The divergence between the two that had occurred in the second half of the 1980s was a radical one. The bubble is bound to disappear eventually, but given the imperfection of the land market, the difference between the two is not likely to disappear for some time to come.

## II. *Causes Underlying the Land Problem*

### (1) Easy Money Policy

Factors pushing up land price may be divided into short-term ones and long-term, structural ones.

Short-term factors were responsible for the sharp rise in land price occurred in the second half of the 1980s. More specifically, one should not overlook the fact that the dramatic loosening of credit reins was behind it. In an effort to curb the sharp appreciation of the yen following the Plaza Accord of September 1985, the Bank of Japan lowered its discount rate to a historic low, triggering a surfeit of money, which led to land speculation. There is no denying that this easy money policy was the primary cause of the sharp increase in land price occurred in the second half of the 1980s. The fact that the rise in land price has spread to regional cities as noted earlier suggests that the surfeit of money which had fueled the increase in land price in recent years still remains unchanged.

Although the discount rate has since been raised, land price does not show remarkable declines. This means that there are structural reasons of high land price, which are discussed below.

### (2) Underutilization of Land

Next, I would like to examine structural factors for high land prices in Japan. It is often said that the scarcity of land is the cause of land problem in Japan. The size of land available in Japan however, has nothing to do the kind of land problem we face today, because the area of land occupied by cities is only a fraction of national land of Japan—2% to 3% depending on the definition of urbanized area. It is true that the area of land of

this country is small compared with other countries and that a large portion of it is covered by mountains. But if we compare the area of land devoted to urban uses, we are not worse off than other countries. As discussed before, the land utilization cost in Japan is not much different from that of Great Britain. In the sense that rent is the cost of utilizing land and space, the supply of space for urban use is not particularly worse than in other countries.

The same is true of urbanized land. As far as the area of land is concerned, even the Tokyo metropolitan area still has plenty of idled land. According to the data by the Ministry of Construction, there still are 65,000 hectares (approximately 160,000 acres) of land within the Greater Tokyo Area that can be developed into housing tracts. This is equal to the area of the 23 wards of Tokyo. It consists of 36,000 hectares (89,000 acres) of farmland, 23,000 hectares (56,800 acres) of under-utilized land (vacant lots and parking lots), and 6,000 hectares (14,800 acres) of vacated factory sites, publicly-held land and idling land belonging to the now defunct Japan National Railways.

Moreover, most of the housing land is under-utilized. To casual observers, urban land in this country may appear highly densely utilized. In fact, the opposite is true. The volumetric ratio authorized by the building code stands, on average, at 242% of the land area, but only 40% of the authorized ratio is actually utilized.

To summarize, Japan, contrary to the widespread belief, still has a surplus of land in the following three senses: First, the urbanized areas account for only a tiny fraction of the inhabitable land of Japan. Second, plenty of land is still under-utilized or left idling. Third, even the existing urbanized land is utilized at a low density. This suggests that if Japan raises the density of its land utilization, many, if not all, of the problems associated with land will evaporate.

According to a study made by the National Land Agency, a large number of housing units, each with 90 square meters (107 square yards) of floor space for a family of four, graced with wide streets and parks, can be built on the land existing within the city limits of Tokyo, large enough to accommodate not just its existing population of eight million but also an addition five million people. As far as the physical land space is concerned, both Japan as a whole and Tokyo have plenty of land to meet their housing needs.

So far, I argued that the structural reason for high land price in Japan is underutilization of land. In what follows, I examine the factors underlying this phenomenon.

### (3) Land as a Marketable Asset

The crux of the land problem is the general attitude which treats land as a piece of marketable asset. Land is—and should be—an important economic resource on which houses, factories or office and commercial buildings are built to support the economic activity. It is true that it can also be held or traded as a piece of marketable asset. It can be sold for each to meet its owner's financial need. In fact, the rapid and continuing rise in land prices since the 1950s encouraged its owners to treat land as a source of making capital gains.

In general, value of land as an asset is highly doubtful. For one thing, land is highly illiquid. Chances are that one cannot find a buyer when one wants to sell it quick. As there is no organized market on which one can list his holdings for trading as stocks are traded on stock exchanges, it is difficult to value one's property objectively. What is more,

it is often difficult, if not impossible, to break up a piece of land holding into smaller, easy-to-sell units. Such being the attributes unique to land, it does not lend itself easily to trading as a marketable asset. In fact, the perception of land as a piece of marketable asset is not as prevalent in other countries as it is in Japan. It can therefore be concluded that this attitude is rooted in the social system of this country relating to land.

#### (4) Low Effective Property Tax Rate

One problem lies in the way the property tax is assessed. The statutory standard property tax rate stands at 1.4%. Actually, however, valuation of land made for the purpose of property tax is very low, and the effective tax rate is further lowered by special measures to one quarter of the standard tax rate in the case of small residential sites. In the early 1980s, effective property tax rate stood at about 0.1% of the market price of the land. As the government did not raise valuations in accordance with the rising market prices in recent years, effective tax rate in the metropolitan area of Tokyo has actually dropped to about 0.05%. Thus, the tax liability for owning a piece of housing land has virtually been reduced to a negligible amount.

Take a family living in Tokyo on a 200 m<sup>2</sup> lot, for example. This family pays somewhere between ¥100,000 and ¥150,000 (\$700 to \$1,000) a year in property tax (including that on his house) and city planning tax. By contrast, some of the citizens pay ¥1 million (\$7,000) in inhabitance tax.

The negligibly small tax liability for owning a piece of land is a major factor which encourages people to treat land as a piece of asset. If it is costly to carry a piece of land, not many people may be tempted to run the risk of piling up tax liability by holding on to it.

It is fashionable to say that "the Japanese are deeply attached to the land they own." This is no more true than the contention that "Japan is short of land." This can be verified by the story about "nawanobi"—the difference between the area of farmland officially registered with the government and its actual size. In its early years, the Meiji government (1868–1912) tried to survey the nation's farmland to use the data for assessing land tax, but the resistance of farmers was so strong that it gave up the idea. Instead, it surveyed a few samples where possible at different locations and accepted voluntary reports filed by farmers. As a result, the bulk of the nation's farmland was under-reported.

The land tax rate enforced thereafter averaged at 2% of present value of rentals. One may argue that farmers of the Meiji period had underreported to reduce their tax liabilities because the smaller size they had officially registered would not matter because they had no intention to sell it on the market. If the tax rate were as low as the current property tax rate, they must have reported the full size of their farmland to protect its commercial value. Today, people hold on to their land in anticipation of higher prices because their exposures to property tax is at a minimal—serving to underscore that the tax rate, not the attachment to land, has profoundly swayed their attitude to land ownership.

#### (5) Undervaluation for Inherited Tax

The second factor often cited in the debate over the land problem is the way inheritance tax is assessed. The point at issue is the fact that inherited land is also undervalued—at



70% of the bench mark price of land reported by the government, which itself is under-valued at 70% of market price. In other words, inherited land is valued at about half the market price for taxation purposes. It is true that the assessed prices have been raised to reflect recent rises in market prices, but they were raised at a much lower rate, with the result that inherited land is valued at less than one half of the market price. The lower inheritance tax liabilities have thus encouraged the people to hold inheritable assets in the form of land.

As a growing number of families were faced several years ago with large inheritance tax liabilities in the wake of sharp rises in land and stock prices, a myriad of how-to-save-inheritance-tax books hit the shelves of bookstores. A piece of advice contained commonly in these books was "convert your inheritable assets into land holdings." Some urged their readers to borrow money and buy land for inheritance, the reasoning behind this being that the full amount of the debt incurred by the bequeathed is tax deductible while the land bought with the borrowed money is valued at a sharp discount from its purchase price. The various wrinkles which tax accountants give their clients are all aimed at taking advantage of the system undervaluing inherited property. And such peculiarity of the property tax and the inheritance tax is responsible for encouraging the people to hold on to their extra pieces of land.

#### (6) The Land Lease Law

Another problem lies in the Land Lease Law and the Building Lease Law, more particularly the former. The Land Lease Law was strengthened during the war as a social legislation with the aim of strengthening the right of the lessee by bending the principle of freedom of contract provided in the Civil Code. During the war, a large number of families were faced with the danger of being evicted from their leased land or houses while their heads were called away for military duty, and this had caused a serious social problem. With a view, therefore, to protecting the right of the lessee and tenant, the government strengthened these laws making it unlawful for the landlord to evict the lessee or the tenant "without due justifiable cause" even when the leasehold expires or even if the landlord wanted to use the land or the house for himself. And in almost all cases, the court interpreted the terms "due justifiable cause" in a very narrow sense and denied the claim of the landlord. In fact, it has since become common perception that if any lessee or tenant wanted to stay on, he could have his own way.

It is true that these two laws had played a role in protecting the interest of the under-class during the years following their enactment. Now, however, they have outlived their relevance to the changed market reality, because they have in effect dissuaded landowners from leasing their holdings. To them, leasing is tantamount to selling the land at a deep discount. By contrast, they stand to make huge capital gains by simply holding on to it without incurring too much property tax liabilities. If, on the other hand, a landowner lets his land to another person and the leaseholder builds a building on it, the land will generate certain incomes. However, if the landowner wants to sell the land thereafter, its market value will sharply depreciate on account of the building standing on it.

Under such social system, utilization of land actually penalizes its owner, so that the wisest way of managing a piece of land is to idle it or use it as a temporary parking lot, that is, until such time as he can make fat capital gains on it. This is why there are so many

vacant lands and underutilized lands at unlikely places in Tokyo. This is why there is such a chronic shortage of housing land in Japanese cities.

In short, the problem we have to address is not an absolute shortage of land but the entrenched tendency among landowners to hold on to their land as a piece of marketable asset. The dizzying pace of rise in land prices should be squarely blamed on the distorted social system—more specifically, on the distorted system of property and inheritance taxes and on the outdated Land and Building Lease Laws.

### III. *Land Related Policies*

Next, I would like to discuss land policies. I will first discuss two short-term policies, then long-term policies.

#### (1) Abolition of the Land Price Surveillance System

In the Japan-US Structural Impediments Initiative (SII), the U.S. side suggested that the land price surveillance system should be abolished. The Japanese side maintained that the land price surveillance system is a critical tool for implementing land-use policy. It seems that the Americans suggestion is more convincing.

This does not mean that the land price surveillance system has no roles to play. The point is that the system could make a difference only if it was activated at an early stage of speculative binge, not when land speculation reached its peak. If it was activated when land prices began to simmer down, the system would actually prop up land prices at their current level.

What is more, the land price surveillance system is not designed to address the causes of the land problem. As rises in land prices have been brought about by various causes, the government cannot make a dent on the land problem unless these causes are removed. The system can at best be a palliative, not a cure. The act that the government considers the system as a basic tool of its land-use policy betrays its ineptitude. In this sense, the U.S. has done a good job by pointing out at the Structural Impediments Initiative talks the misguided thinking underlying the land-use policy of this country.

#### (2) The Necessity for Tightening the Credit Reins

A more important short-term remedy is the tightening of credit spigot. Under the administrative guidance of the Ministry of Finance, real-estate loans have been restrained. Although it will have some effect on dampening the speculative fever, the curb of real-estate loans alone cannot solve the land problem, because property developers can invest in land through their dummy companies. Unless these activities are effectively curbed, speculative demand for land will not go away. To accomplish this, selective restraint of bank lending alone is not enough. Credit reins must be tightened. However, as an across-the-board tightening of credits may hurt the business activity in other areas, it is difficult for the central bank to walk a fine line between curbing real-estate speculation and supporting the business activity of other sectors.

### (3) Is the Strengthening the Property Tax on Farmland Effective?

In principle, farmland located within city limits is subject to property tax at the same rate as that levied on housing land. As an exception, however, farmland committed to semi-permanent farming is exempted from the property tax, and its owners have to pay only farmland tax which is one thirtieth or one fortieth of the housing land tax.

At the first meeting of Japan-US Structural Impediments Initiative held in September 1989, the U.S. side strongly urged the Japanese government to scrap the exemption of farmland.

Until a few years ago, editorial writers of many newspapers had asserted that the housing land tax should not be levied on city-bound farmland by arguing that it would lead to a sharp decrease in greenery in cities. Recently, however, they have changed their tune and now contend that the exemption of city-bound farmland from the housing land tax is the main culprit behind the land problem and that imposition of the housing land tax on city-bound farmland is the key to solving the land problem. However, they did not provide any quantitative ground for their claim. It is dangerous that such opinion makers should try to change the public perception without showing the grounds for such a change, because the imposition of housing land tax on farmland alone will not make headway in solving the land problem.

It is true that the imposition of housing land tax on city-bound farmland is necessary to distribute tax burden among all segments of the population. As noted earlier, city-bound farmland is quasi-housing land in the sense that it can be readily converted into housing land, and it is impermissible in the interest of fair distribution of tax burden that its owners can get away with a tax liability as small as one thirtieth or one fortieth of the regular housing land lying next to it. Moreover, given the necessity to raise the property tax rate itself, the housing land tax should be extended to city-bound farmland. Under the present conditions where city-bound farmland is under-taxed far below housing land, it is politically difficult to raise the property tax alone.

However, the effect of imposing housing land tax on city-bound farmland would be only negligible. It will neither increase the supply of housing land nor bring down land prices, because the effective property tax rate on residential land is at a minuscule 0.05%. Most of those who hold on to their farmland are aiming at realizing hefty capital gains. Compared to the annual increase in land price, the change in the property tax burden is negligible, and hence, expected after-tax capital gains would hardly be affected.

### (4) An Increase in the Property Tax

In order to make the scrapping of the exemption of city-bound farmland from the housing land tax really effective, the property tax rate on residential land has to be raised. Unless the property tax is raised to a level matching the difference between the rate of increase in land price and the interest rate, landowners will not budge. More specifically, unless the property tax is raised to somewhere around 1%, imposition of residential land tax on farmland will not produce desired effects.

There is strong opposition to rising the property tax rate, but the opposition is mis-

guided. Many people have the perception that the property tax even at its present rate is very high. However, as mentioned earlier, the property tax in Japan is very low. The owner of a piece of housing land within the city limits of Tokyo has to pay only ¥100,000 a year, and this is far lower than the inhabitant tax he had to pay. In spite of this fact, many people believe that the property tax burden has become too heavy to bear and that with land prices rising as they have in recent years, many of them will have to give up the ownership of their housing land. But they are overlooking the fact that the property tax has not risen as sharply as the rises in their land prices. The government has taken a number of mitigating measures to hold down the property tax.

More surprising is the fact that all political parties are united in their opposition to raising the property tax rate. It is understandable that the Liberal Democratic Party is opposed to the tax hike, but is baffling to see even the Communist Party rise up in arms against a property tax hike. A spokesman of the Communist Party argues that his party is opposed because an increase in the property tax rate would add that much to the rent paid by low-income tenants. However, he is conveniently forgetting the fact that even if the property tax were doubled, the increment in the rent would be negligibly small.

More important, salaried workers must understand the necessity of raising the property tax. On average, salaried workers living on their own land in or near Tokyo pay approximately ¥100,000 a year in property tax. If the property tax were doubled, it would boost the tax revenues of their municipal governments, giving them elbowroom in cut their inhabitant tax. Prefectural and municipal governments are heavily dependent on inhabitant tax to finance their administration. If they double the property tax and cut the inhabitant tax by an amount matching the increase property tax revenue, it would be hard on landowners but salaried workers stand to benefit from such tax revision. A rough estimate shows that a salaried worker with an annual income of ¥10 million would save on the order of ¥300,000 to ¥400,000 a year by this tax reform. Salaried workers must realize that a raise in the property tax is a very important policy option not merely for the solution of the land problem but also for the sake of fair distribution of tax burden between them and the landowning class.

#### (5) Total Liberalization of the Land Lease Law

As acknowledged earlier, the Land and Building Lease Law had played important social roles in its early years. Today, however, they have become a major cause of the land problem, because they have choked the new supply of housing land for lease. Therefore, solution of land problems must start with the deregulation of restrictions imposed by the Land and Building Lease Laws.

Total liberalization of new leasehold will not give rise to any serious problems. A liberalized leasehold would encourage landowners to lease their land without forfeiting their legitimate rights, thus potential lessees would have the benefit of increases in supply.

Some worry that if leasehold is completely liberalized, lessees may be put at a disadvantage, because lessors would naturally opt for a short-term contract and lessees may have little choice but swallow lessors dictate. However, their worry will prove groundless, because when the leasehold is completely deregulated, market mechanism will come into play creating a situation where competitive pressure will generate enough choice for lessees enabling

them to choose short-term contracts in exchange for a lower rent and long-term contracts for a relatively higher rent.

The Legislative Council of the Ministry of Justice has for some time been studying various options for overhauling the Land and Building Lease Laws and released an exposure draft amendment bill February 1989 for introduction before the regular session of the Diet in 1990. As it stands now, it recognizes a new type of leasehold called "fixed-term leasehold" and this is a step forward. For example, a piece of land can be leased for a fixed period of ten years for business use. The draft bill also authorizes leasehold for residential purposes up to 50 years. However, the latter is too long to induce landowners to lease their land for residential purposes, because few would be persuaded to look their land into a leasehold for 50 years when social conditions are changing at such a rapid pace as they do now.

As neither the lessor nor the lessee stands to lose under a completely liberalized leasehold, nobody should oppose it. Unfortunately, however, the drafters of the amendment bill has failed to recognize this vital point. Hence, the draft amendment now in the making, when seen from the pro-liberalization standpoint, does not go far enough to address the root causes of the land problem.

If the Land and Building Lease Laws are liberalized and the property tax raised, the land problem we face today will be far less formidable than it is now. Under liberalized Land and Building Laws, land supply would increase substantially, and the prediction of the National Land Agency, cited earlier, that Tokyo should have enough land supply to accommodate an additional five million people in an environment far more comfortable could become a reality. In this respect, the proposed draft bill is a far cry from such a possibility.

#### (6) Securitization of Property

Lastly, I would like to discuss securitization of real estate. Real Estate Investment Trust (REIT) which has long been in existence in the United States is a typical example of securitized property. Under this system, a joint stock company which holds nothing but land is established, and investors can own an equity in that company by subscribing to, or buying on the market, its shares. As the REIT is exempted from the corporate income tax, dividends it pays are not double-taxed, and investors can own real estates it manages. Another form of indirect ownership of real estate is available as the Master Limited Partnership (MLP). More recently, various forms of securitization have emerged, and they play an important role in spurring innovations of the financial markets.

Securitized ownership of real estate is a mixture of pure financial assets and real estate. As real estate has large potential for generating capital gains, securitized ownership of real estate can play a useful role in hedging against inflation. However, one drawback is its illiquidity. By contrast, financial assets enjoy higher liquidity but their returns are vulnerable to inflation. In this sense, securitized ownership of real estate can be characterized as an instrument lying between the two.

To the extent that the land problem in Japan is rooted in the widespread attitude of treating land as a piece of marketable assets, there is no reason why landowners should oppose the securitization of their ownership. If the owners of idling land agree to securitizing their ownership, their land can be used for the returns-producing purposes by building

houses or commercial buildings. This would mean the separation of ownership and the right to utilize the land.

The leasing of a piece of land means that its owner derives economic benefits from the ownership, while the land is used by others, but few of the landowners are willing to do this because of the disadvantage arising under the existing Land Lease Law. And the proposed amendment bill is a far cry from liberalization of leasehold. Under such circumstances, securitized ownership of land would serve a very useful purpose by separating the ownership and the utilization right.

As a matter of fact, similar arrangements are being made in this country in the form of land trust, and it has become an effective tool for separating ownership from utilization right despite the restriction imposed by the Land Lease Law. Under this system, owners of land receive economic benefits as a beneficiary of land trust and the land itself is managed by a trust bank. In this sense, ownership and utilization right are separated, if on a limited scale.

Land trust is somewhat similar to the securitized ownership of land but it has certain limitations. For one thing, as the liquidity of beneficiary certificates of a land trust is considerably limited, they cannot be considered as a full-fledge security. For another, land that can be utilized as a land trust is severely limited. Only the kind of land which lends itself to commercially viable use can be incorporated into land trust. If the government wanted to use land for a public park or a road, no owner of such land would commit his land to such trust because the land trust established thereon would not yield dividends. To be sure, land trust is an important form of land used but not a panacea.

One possibility is for the government to issue new government bonds whose value appreciates in step with a rise in the market price of the land. Under this arrangement, the interest of its original owners will be protected. This bond may be called "the land price indexed bond." It is true that there are certain obstacles to overcome before it can be issued, such as the restrictions imposed by the Securities and Exchange Law and technicalities of taxation. These notwithstanding, in view of the fact that the widespread attitude of treating land as a piece of marketable asset lies at the root of the land problem we face today, it is high time that we took a hard look at such options open to us.

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