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Real Estate Markets and Financial Crises[2] – From the "Gründerkrise" to the "Subprime Mortgage Crisis"

Abstract

There are significant hints of a strong relationship between the dynamics of real estate markets and financial crises from the second half of the 19th century until today. In spite of research accumulation, it is seemingly ignored that since the late 19th century several financial crises were caused by real estate bubbles, depending on the distinct characteristics of real estate markets. The paper supports the idea that real estate and financial crises show indeed similar and congruent characteristics since the 19th century. This concerns (1) the inherent tendency towards speculative bubbles, (2) the growing significance of globalized finance, (3) credit practices, (4) the close relationship between the banking system and real estate markets and (5) between the real estate business and the stock market. However, the investigation into real estate markets is not only interesting for understanding and explaining the genesis of modern economic crises, but also contributes to the understanding of the emergence of practices of specula-

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tion, the indebtedness of private households and social inequalities. Further research on real estate markets promises the contribution towards a better understanding of actors, practices and institutions in modern market society.

Key words
real estate markets, financial crises, finance, economic sociology, economic history

1. INTRODUCTION

The latest "financial crisis" which originated in the US-mortgage bubble and its sequel, the "sovereign debt crisis" have reminded us that bubbles, collapses and crises are recurring phenomena in modern economic history[3]. Although the real estate crisis of 2007/2008 took a dramatic course, the relationship between dynamics in real estate markets and financial crises is not a completely new phenomenon in history[4]. There exist significant hints of a strong relationship between the dynamics of real estate markets and financial crises from the second half of the 19th century until today.

In spite of research accumulation, it is seemingly ignored that since the late 19th century – when urbanization, the growth of metropolises and migration flows, along with economic expansion, technological innovation, heavy increases in wealth, and the appearance of novel finance instruments caused substantial growth in real estate markets[5] – several financial crises were caused, triggered or intensified by real estate bubbles, depending on the distinct characteristics of real estate markets.

That markets are subject to fluctuations and "*cycles*" has been accepted at least since the Napoleonic Wars, with their reappearing booms and crashes in the beginning of the 19th century. Economic crises can already be found in the 17th

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3 *Markets on Trial: The Economic Sociology of the U.S. Financial Crisis*, M. Lounsbury and P.Hirsch (eds.), Bingham 2010; C.M. Reinhart, K.S. Rogoff, *This Time Is Different: Eight Centuries of Financial Folly*, Princeton 2009.

4 E.g. C.P. Kindleberger, R.Z. Aliber, *Manias, Panics, and Crashes: A History of Financial Crises*, Hoboken 2005, 117ff; C.P. Kindleberger, *A Financial History of Western Europe*, London 1984; C.D. Long, *Building Cycles and the Theory of Investment*, Princeton 1940.

5 N.J.G. Pounds, *An Historical Geography of Europe*, Cambridge 1990, 347ff; R. Michie, *The Global Securities Market: A History*, Oxford 2006; A. Preda, *The Investor as a Cultural Figure of Global Capitalism* [in:] *The Sociology of Financial Markets*, K. Knorr-Cetina, A. Preda (eds.), Oxford 2005; N. Ferguson, *The Ascent of Money. A Financial History of the World*, London 2008.

century, demonstrated by the *Kipper-und Wipperzeit* and the *Tulip Craze*. Generally speaking, crises with their effects on economic life have existed "always and everywhere"[6], including the Ancient World as well as Far Eastern and Oriental societies[7]. However, the first "modern" crises – described by rational speculation and calculation – occurred in the first half of the 19th century[8].

This paper starts with an investigation of a few late 19th century financial market crises which were caused and triggered – or at least intensified – by real estate bubbles. After a brief outline of the character of real estate markets of that time, the relationship between dynamics in modern real estate markets and the emergence of financial crises are described along five distinct elements which can be found over the course of modern economic history. The last part sums up the main results and discusses them with regard to contemporary dynamics and future research. From that background, the paper has to be understood as a first getting-in-touch with the field, a discussion of research perspectives, and an impulse for further research.

2. REAL ESTATE BUBBLES AND FINANCIAL CRISES IN THE LATE 19th CENTURY

Urban real estate markets played a significant role in a number of heavy banking and financial crises in the period between mid-19th century and the beginning of the 20th. These crises had global effects due to close interrelations of financial markets in Europe and the United States.

One of the first heavy real estate crises was the *Gründerkrise (founder crisis)* of 1873 – also known as *Gründungsfieber (founding fever)* – in Germany and Austro-Hungary, which was a global crisis and which is generally accepted as the first significant one[9]. The domestic boom in Germany and Austria around 1870 was significantly driven by a construction boom in the city centers. In 1873, stock exchange collapses in Austria, Germany, England and the US resulted from the

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6 M. Weber, *General…*, op.cit., p. 217.

7 I. Morris, J.G. Manning, *The Economic Sociology of the Ancient Mediterranean World* [in:] *The Handbook of Economic Sociology*, N.J. Smelser, R. Swedberg (eds.), Princeton 2005.

8 M. Weber, *General…*, op.cit.; C.P. Kindleberger, R.Z. Aliber, op.cit.

9 C.P. Kindleberger, op.cit., p. 125; R.R. McCartney, *Crisis of 1873*, Minneapolis 1935, p. 58; M. Wirth, *The Crisis of 1890*, "Journal of Political Economy" 1893, No. 1; O. Glagau, *Der Börsen- und Gründungsschwindel in Deutschland* [The Stock Market and Founding Fraud in Germany], Leipzig 1877, 36ff.

insolvency of banks and construction companies which had engaged heavily in real estate speculation. Due to strong international interdependencies, effects hit the rest of Europe and the United States as well. The crisis erupted in Germany and Austria in May, reached Italy, Holland, Belgium, and then the United States in September. Later it involved Great Britain, France and Russia. For instance, between mid of 1873 and the end of 1876 – as the effects of the stock market crashes in Berlin and Vienna spread to Italy – 67 Italian banks (nearly 25 per cent of the existing institutions) either failed or were forced into liquidation[10].

Since the 1880s, however, a number of further financial crises can be discovered, which were caused, triggered or intensified by real estate speculation. This holds true for the stock market crash in France in 1882, but this also counts for real estate crises that occurred in Italy in 1887, in Argentina in 1890, in the United States around 1890 and in Australia in 1893.

After a construction boom-period, the real estate market in Rome experienced a sharp decline in 1887. Due to a tariff war, several French banks withdrew from Italian credit markets and interest rose so high that many construction companies got into payment problems[11]. By 1891, the liquidity crisis spread rapidly among banks which had invested large sums into real estate businesses. Large Italian banks tumbled into bankruptcy due to losing large sums in real estate speculation. Within just a few days, the entire Italian financial system collapsed. Numerous companies went bankrupt and the country witnessed a deep recession which lasted many years. Australia was struck by a heavy real estate crisis in 1891, which shocked the banking system and the economy as a whole[12]. In the following years, the national product and the price level experienced heavy decreases. Many real estate companies went bankrupt and a lot of banks and financial institutes did not survive the crisis[13]. Also the *Baring Crisis* of 1890 was intensified by the burst of a real estate bubble in Argentina which had witnessed steady growth since 1870, mainly due to the rapid development of Buenos Aires and La Plata. High foreign investment, rapid population growth, and exceptional economic dynamics resulted

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[10] A. Polsi, *Financial Institutions in Nineteenth-Century Italy. The Rise of a Banking System*, "Financial History Review" 1996, No. 2, p. 127.

[11] F. Cammarano, *Storia politica dell'Italia liberale: L'età del liberalismo classico 1861–1901* [The Political History of Liberal Italy: The Age of Classical Liberalism 1861–1901], Bari 1999.

[12] A. Ellis, *The Australian Banking Crisis*, "Economic Journal" 1893, No. 3.

[13] G. Wood, *Borrowing and Business in Australia*, London 1929; D.T. Merrett, *Australian Banking Practice and the Crisis of 1893*, "Australian Economic History Review" 1989, No. 1; E.A. Boehm, *Prosperity and Depression in Australia 1887–1897*, Oxford 1971.

in extremely increasing real estate prices within only a few years[14]. When the prices fell abruptly, the country was forced with a deep economic crisis which, in addition, was worsened by the country's high foreign debts[15].

3. BACKGROUND: LATE 19th CENTURY REAL ESTATE MARKETS

The expansion of the market into the spheres of land and housing has to be viewed as an emergent feature of modern capitalism.

"[…] the city, from the beginning of the nineteenth century on, was treated not as a public institution, but a private commercial venture to be carved up in any fashion that might increase the turnover and further the rise in land values"[16].

Business in residential and commercial real estate expanded heavily as a consequence of 19th century urbanization, international and regional migration, industrialization, and the growing significance of finance. Mainly since mid-19th century, the growth of cities accelerated[17]. In particular, this holds true for metropolises like London, Paris, Budapest, Berlin, St. Petersburg, Buenos Aires, New York, and Chicago. The rebuilding of inner-city centers in metropolises like Rome, Paris or London played an important role. In many European centers, modern local traffic systems initiated voluminous municipal investments and at the same time initiated the expansion of urban districts to the outskirts and suburbs[18]. Construction of working-class tenements as well as petty-bourgeois owner-occupied homes in the suburbs turned out to be a lucrative business[19].

After the Italian unification in 1861, Rome had to be improved as the new *capitale*. At the peak of the construction boom in the years between 1882 and 1886 the volume of investments amounted to more than one billion Lire – 10 percent of the

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[14] R. Cortés Conde, *The Growth of the Argentine Economy, 1870–1914* [in:] *The Cambridge History of Latin America*, L.Bethell (ed.), Cambridge 1986.

[15] C.A. Conant, *A History of Modem Banks of Issue*, New York 1915.

[16] L. Mumford, *The City in History: Its Origins, Its Transformations, and Its Prospects*, San Diego 1961, p. 507.

[17] N.J.G. Pounds, op.cit.

[18] E.g. C.G. Pooley, *Housing Strategies in Europe: 1880–1930*, Leicester 1992; A. Sutcliffe, *Towards the Planned City. Germany, Britain, the United States and France 1780–1914*, Oxford 1981.

[19] H.J. Dyos, *The Speculative Builders and Developers of Victorian London*, "Victorian Studies" 1968, No. 2.

Italian GDP – of which 300 million were financed by foreign credits[20]. In Germany, investments in construction and building had increased tenfold between 1850 and 1900[21]. Around the turn of the century, there were as many people employed in the construction business as in the metal-working industry[22]. In England, investments in urban buildings and infrastructure add up to 100 million pounds in 1900 and therefore constituted about 40 percent of all public and private investments[23].

Although the railroad business is mostly regarded as the major object of investment in the 19th century[24], real estate and building construction seems not to have been of marginal significance. In Europe, investment volumes witnessed steady increases in the second half of the 19th century[25]. The building and construction business belonged to the most lucrative branches in the second half of the 19th century because building sites and building prices increased continuously[26]. During the first five years after Rome had become Italian *capitale*, building site values increased a hundredfold along the *Via Nazionale*. Altogether, in this period the price increases in land value in Rome accounted for 20 percent of the annual Italian GNP[27].

Market actors like site-holding companies gained importance. These companies purchased big areas of land around the city, parceled and sold them or engaged into construction and building activities themselves – in many cases the buying-price of these big areas was paid with company shares[28]. Nevertheless, also municipal administrations and communal construction companies profited from the real

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[20] F.J. Bauer, *Rom im 19. und 20. Jahrhundert. Konstruktion eines Mythos* [Rom During the 19th and 20th Century. Construction of a Myth], Regensburg 2009, p. 163.

[21] K. Borchardt, *Realkredit- und Pfandbriefmarkt im Wandel von 100 Jahren* [Real Credit and Bond Market in the Change of 100 Years] [in:] *100 Jahre Rheinische Hypothekenbank* [100 Years of Rheinische Hypothekenbank), Rheinische Hypothekenbank (ed.), Frankfurt am Main 1971.

[22] W. Fischer, *Bergbau, Industrie und Handwerk 1850–1914* [Mining, Industry and Craft 1850–1914] [in:] *Handbuch der deutschen Wirtschafts- und Sozialgeschichte* [Handbook of German Economic and Social History], H. Aubin, W. Zorn (eds.), Stuttgart 1976, p. 537.

[23] H.J. Dyos, op.cit.

[24] R. Michie, *The London Stock Exchange: A History*, Oxford 1999; R. Michie, *The Global Securities Market*, op.cit.; A. Preda, *The Rise of the Popular Investor: Financial Knowledge and Investing in England and France, 1840–1880*, "The Sociological Quarterly" 2001, No. 2.

[25] E.g. K. Borchardt, *Realkredit…*, op.cit.; W. Fischer, op.cit.; F.J. Bauer, op.cit.

[26] E.g. H.J. Dyos, op.cit; A. Caracciolo, *Roma Capitale: Dal Risorgimento alla Crisi dello Stato Liberale* [The Capital of Rome: From Risorgimento to the Crisis of the Liberal State], Rom 1984.

[27] A. Caracciolo, op.cit., p. 198.

[28] S. Fisch, *Grundbesitz und Urbanisierung. Entwicklung und Krise der deutschen Terraingesellschaften 1870–1914* [Property Ownership and Urbanization. Development and Crisis of the

estate business as exemplified by the case of the municipality of Cologne around 1900[29]. In fact, the construction and real estate business was not part of a small-scale craftsmen scene any longer but developed into a field for major companies and global players[30].

Profit expectations made numerous investors enter the real estate business[31]. A large amount of the literature of the second half of the century dealt with the overturning and changing experiences and perceptions of economic risk. Émile Zola's "La Curée" (1872) and "L'Argent" (1889) or Giovanni Vergas's "Don Gesualdo" (1889) which deal with speculations in the bank and real estate sector provide good examples. But also novels like Charles Dickens's "Little Dorrit" (1857), Honoré de Balzac's "César Birotteau" (1837), Robert Louis Stevenson's "The Wrecker" (1892) or Friedrich Spielhagen's "Sturmflut" (1877) are dedicated to economic action in financial markets and speculative businesses.

The real estate business – highly speculative in nature – seems to have played a role to this cultural and mental shift because as a mass-business it involved a large number of people from different social strata. For instance, in the Chicago of the 1880s, one half of the male population and one fourth of the female population had invested in real estate[32]. The dynamics of real estate markets and its association with speculative investment caused criticism by various actors. Site-holding companies and real estate-brokers became the epitome of fraudulent speculation practices in Germany[33]. Such comments can be interpreted as indication of a widespread rejection of speculation and capitalistic market logic[34]. However,

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German Building-Site Companies 1870–1914], "Geschichte und Gesellschaft" [History and Society] 1989, No. 1.

[29] H. Böhm, *Bodenpolitik deutscher Städte vor dem Ersten* Weltkrieg [Land-Politics of German Cities before World War I] [in:] *Investitionen der Städte im 19. und 20. Jahrhun*dert [Cities' Investments in the 19th and 20th Century], K.H. Kaufhold (ed.), Köln 1997.

[30] H.J. Dyos, op.cit.

[31] F.J. Bauer, op.cit.; H. Hoyt, *One Hundred Years. The Relationship of the Growth of Chicago to the Rise in Land Values*, Chicago 1933, p. 102.

[32] H. Hoyt, op.cit., p. 102.

[33] R. Eberstadt, *Die Spekulation im neuzeitlichen Städtebau. Eine Untersuchung des städtischen Wohnungswesens. Zugleich eine Abwehr der gegen die systematische Wohnungsreform gerichteten Angriffe* [Speculation in Modern City Building. An Investigation of Urban Dwelling. At the Same Time a Defense Against the Attacks on the Systematic Dwellings-Reform], Jena 1907; M. Wirth, op.cit.; O. Glagau, op.cit.

[34] M.H. Geyer, *Defining the Common Good and Social Justice. Popular and Legal Concepts of Wucher in Germany from the 1860s to the 1920s* [in:] *Private Law and Social Inequality in the Industrial Age. Comparing Legal Cultures in Britain, France, Germany, and the United States*, W. Steinmetz (ed.), London 2000.

such debates also show how much speculation had already become integral part of economic action. The historical developments of discourses in Western Europe and the United States show that the figures of "speculator" and "investor" were perceived as ambivalent indeed, but increasingly became popular figures whose importance for economic life was increasingly accepted[35].

4. EFFECTS OF REAL ESTATE CRISES ON FINANCIAL MARKETS

Why are real estate markets of such significance for the emergence of financial crises? Why real estate markets seem to be so crisis-prone – today as well as during the decades before World War I? When investigating the relationship between the dynamics of real estate markets and financial crises from the second half of the 19th century until today, it is possible to outline five main characteristics apart from the economic relevance of the construction business in general.

REAL ESTATE MARKETS AND SPECULATIVE BUBBLES

An issue recognized relatively early by scholars is that real estate markets are characterized by a strong tendency towards market bubbles. This tendency can be explained by a certain market logic described by a sequence of successive building cycles[36]. Regarding the years before 1914, *Kuznet cycles* took an interval of 12 to 20 years in urban real estate markets[37]. Between 1850 and 1914 one can find four different construction cycles in Germany and similar trends can be observed in other countries[38]. By means of a number of indicators like occupation rates, housing prices, rent levels, new buildings, and compulsory home auctions – such cycles can be discovered in nearly all European and North American centers of

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[35] A. Preda, *The Investor…*, op.cit.; A. Preda, *Framing Finance: The Boundaries of Markets and Modern Capitalism*, Chicago 2009; U. Stäheli, *Spectacular Speculation: Thrills, the Economy and Popular Discourse*, Stanford 2013; A. Engel, *Futures and Risk: The Rise and Demise of the Hedger-Speculator Dichotomy*, "Socio-Economic Review" 2013, No. 4.

[36] C.D. Long, op.cit.; H. Hoyt, op.cit.; S. Kuznets, *Long Swings in Population Growth and Related Economic Variables* [in:] *Economic Growth and Structure. Selected Essays*, S. Kuznets (ed.), London 1965; S. Fenoaltea, *International Resource Flows and Construction Movements in the Atlantic Economy: The Kuznets Cycle in Italy, 1861–1913*, "Journal of Economic History" 1988, No. 3.

[37] J.A. Schumpeter, *Business Cycles: A Theoretical, Historical and Statistical Analysis of the Capitalist Process*, New York 1939, 161ff.

[38] M. Gottlieb, *Long Swings in Urban Development*, New York 1976; W.H. Newman, *The Building Industry and Business Cycles*, Chicago 1935.

that time. However, strength as well as shape and course of these cycles varied from one place to another which hints at the significance of local factors[39].

From a perspective of economic sociology, economic outcomes can be understood as the interplay of social forces – institutional configurations, social networks and cognitive orientations[40]. Thus, for understanding crises and bubbles, institutional market structures like regulations and laws as well as interest constellations between professionals, insiders and state regulators have to be considered[41]. Especially during boom periods, real estate investors, lenders and insurers tend to relax their standards and become less enamored with state regulation. Like in other markets, "fictional expectations"[42] and "fashions"[43] – often described as "*herding*" or "*collective contagion*" – play a crucial role and work as "self-fulfilling prophecies"[44]. Speculative motives played a significant role in many real estate dealings. In a number of cases (e.g. Rome, Vienna, Chicago, etc.), buildings and building sites were purchased because of belief in rapid value increases[45].

In 1871, the Prussian victory over France, the Franco-Prussian indemnity and the subsequent unification caused boundless optimism and the idea of unlimited economic possibilities in Germany[46]. A feeling of strength towards inside and outside forced economic expectations nourished by the experiences of a rapid economic upswing and related trends of liberalization in Germany since mid-19th century. From the beginning of the 1870s onwards, investment in general and investment in building construction witnessed intense increases[47]. This spirit was additionally intensified by state deregulation and a liberalization of laws for joint-stock companies, which led to widespread speculation and fraud. Mortgages

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39 S. Fenoaltea, op.cit.

40 J. Beckert, *The Social Order of Markets*, "Theory & Society" 2009, No. 38.

41 M. Abolafia, M. Kilduff, *Enacting Market Crisis: The Social Construction of a Speculative Bubble*, "Administrative Science Quarterly" 1988, No. 2.

42 J. Beckert, *Capitalism as a System of Expectations: Toward a Sociological Microfoundation of Political Economy*, "Politics & Society" 2013, No. 41.

43 B.S. Visano, *Financial Manias and Panics: A Socioeconomic Perspective*, "American Journal of Economics and Sociology" 2002, No. 4.

44 R.K. Merton, *The Self-Fulfilling Prophecy* [in:] *Social Research and the Practicing Professions*, A. Rosenblatt, T.F. Gieryn (eds.), Cambridge 1948.

45 F.J. Bauer, op.cit., 166ff; O. Glagau, op.cit., 36ff; H. Hoyt, op.cit.

46 C. Burhop, *Die Kreditbanken in der Gründerzeit* [Credit Banks in the Founder Period]. Stuttgart 2004, 11ff; C.P. Kindleberger, op.cit., 125f.

47 K. Borchardt, *Wirtschaftliches Wachstum und Wechsellagen 1800–1914* [Economic Growth and Changes 1800–1914] [in:] *Handbuch der deutschen Wirtschafts- und Sozialgeschichte* [Handbook of German Economic and Social History], H. Aubin, W. Zorn (eds.), Stuttgart 1976.

were accessible easier than before and land values seemed to rise continually. Borrowers increasingly assumed more and more credit, with un-built or half-built residences as collateral. "Easy money" helped fuel speculation, turnover, inflation, excessive land subdividing, overbuilding, and several other phenomena giving rise to developments of inferior quality and dubious business ethics. Additionally, speculation in land and stocks was driven by the situation on residential real estate markets which were unable to absorb expansive population growth and urban migration[48].

REAL ESTATE MARKETS AND GLOBAL FINANCIAL INTEGRATION

The high degree of internationalization of economic relations is of crucial importance for understanding the close relationship between real estate crises and financial crises. Real estate finance of residential and commercial property is enmeshed within the flows of global financial markets[49]. This concerns the emission of mortgage bonds, or the use of housing as a "securitized asset on the world market"[50] as well as foreign (direct) investment.

The high degree of international financial integration at the end of the 19th century resulted in urban growth in countries characterized by weak domestic capital formation[51]. This was true of Southern and Eastern Europe, the Ottoman Empire, the Latin American countries, and large parts of the British Empire. This

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48 M. Grabas, Die *Gründerkrise von 1873/79 – Fiktion oder Realität? Einige Überlegungen im Kontext der Weltfinanz- und Wirtschaftskrise von 2008/2009* [The Founder Crisis of 1873/79 – Fiction or Reality? Some considerations in Context of the Global Financial and Economic Crisis of 2008/2009], "Jahrbuch Wirtschaftgeschichte" 2011, No. 1

49 Eg. C. P.Kindleberger, op.cit.; C.P. Kindleberger, R.Z. Aliber, op.cit.; K.F. Gotham, *The Secondary Circuit of Capital Reconsidered: Globalization and the U.S. Real Estate Sector*, "American Journal of Sociology" 2006, No. 1.

50 M.B. Aalbers, *The Financialization of Home and the Mortgage Market Crisis*, "Competition & Change" 2008, No. 2.

51 The decades before 1913 were considered a "golden age" of international investment and trade. Prior to the disruptions of the two World Wars and the collapse of commodity and financial markets in the Great Depression, capital markets were as internationalized and integrated as since the 1980s. See G. Gereffi, *The Global Economy: Organization, Governance, and Development* [in:] *The Handbook of Economic Sociology*, N.J. Smelser, R. Swedberg (eds.), Princeton 2005, p. 162; A.G. Kenwood, A.L. Lougheed, *The Growth of the International Economy, 1829–1990*, London 1994; K.H. O'Rourke, J.G. Williamson, *Globalization and History: The Evolution of a Nineteenth-Century Atlantic Economy*, Cambridge 1999; B.Eichengreen, *Historical Research on International Lending and Debt*, "The Journal of Economic Perspectives" 1991, No. 2, p. 150; T. Koechlin, *The Globalization of Investment*, "Contemporary Economic Policy" 1995, No. 13.

dependency, however, initiated heavy crises when foreign investors withdraw from markets in the short run – like in the cases of Italy 1887 and Argentina 1890. Foreign investment was central to the economic and structural performance of most late 19th century recipients[52]. Countries like Argentina, Australia, Brazil, and Canada experienced waves of capital imports throughout the whole century, which indicates their dependence on a steady flow of funds from abroad – mainly from Western Europe. In Rome, predominantly French and later German banks invested in the real estate and building business[53], while British investors engaged mainly in Argentina and Australia[54].

The *Barings Crisis* of the late 19th century demonstrates that not only US and European markets were marked by close interrelations, but financial transactions and relations contained – unlike 1873 – other world regions as well. During the 1980s, large investments aimed at the expansion of the infrastructure and the urban centers. Within only a short period of time Argentina became the chief debtor worldwide[55]. In 1889, Argentina absorbed between 40 and 50 percent of all British foreign credits. About the half of these credits were linked to investments in railroad and building construction. When the boom found an end in 1890, the country could not service its debts and the whole world was threatened with a financial crisis. In particular, the British Barings Bank had provided high loans and got into big troubles[56]. Due to the systemic importance of the Barings Bank, an international rescue fund under British leadership was established, which involved about 100 banks including English, French and Russian banks of issue. The collapse of the international financial system could be prevented because of the high degree of international cooperation[57]. Nevertheless, the crisis had far reaching consequences for all capital-importing economies in different regions of the globe. Not only

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52 A. Fishlow, *Capital Markets During the 19 Century and the Interwar Period*, “International Organization” 1985, No 3.

53 A. Caracciolo, op.cit., p. 198.

54 J.F. Rippy, *British Investments in Latin America, 1822–1949. A Case Study in the Operations of Private Enterprise in Retarded Regions*, Minneapolis 1959, p. 159; C.P. Kindleberger, op.cit.; G.Wood, *Borrowing and Business in Australia*; E.A. Boehm, 1971.

55 A.G. Ford, *Argentina and the Barings Crisis of 1890*, “Oxford Economic Papers” 1956, No. 2, p. 134; O. Morgenstern, *International Financial Transactions and Business Cycles*, Princeton 1959.

56 C.P. Kindleberger, R.Z. Aliber, op.cit., 217f; L.S. Pressnell, *The Sterling System and Financial Crises before 1914* [in:] *Financial Crises: Theory, History and Policy*, C.P. Kindleberger, J.-P. Laffargue (eds.), Cambridge 1982.

57 C.P. Kindleberger, R.Z. Aliber, op.cit., p. 253.

Argentina, but also other countries (like Australia) got into financial problems because European banks cut off new credits.

The enmeshment of real estate into global financial markets means that certain locals are influenced by global dynamics, while local incidents may have worldwide consequences[58]. These global effects of local real estate crises can be observed since the 19th century until today. The troubles and volatilities in local real estate markets had considerable effects on financial systems, international and regional markets, as well as government finance and currency systems.

REAL ESTATE MARKETS AND MORTGAGE FINANCE

Credit and mortgage finance and their close intertwinement with dynamics of real estate markets can be regarded as being of major significance[59]. High indebtedness and easy credit conditions initiate the emergence of something like a subprime market. Of course, these dynamics are linked to certain understandings of credit and debt, which amount to lax or even reckless borrowing and lending practices. The second half of the 19th century witnessed a cultural shift concerning the speculator-investor discourse[60] and a general spread of practices of indebtedness[61].

High loan-to-value ratios in German cities in the second half of the 19th century – which were fought with a mortgage-bank law of 1900 that limited the level of encumbrance to 60 per cent of the housing value, while the encumbering of undeveloped building sites was completely prohibited[62] – indicate an increasing tendency to run into debts for real estate investments. Also increasing numbers of compulsory auctions in European centers since the turn of the century provide an indication for the massive indebtedness as well as for the lax borrowing practices[63].

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58 K.F. Gotham, op.cit.; M.B. Aalbers, op.cit.

59 Ibidem; M. Lescure, *Les Sociétés Immobilières en France au XIXe siècle. Contribution à l'histoire de la mise en valeur du sol urbain en économie capitaliste* [The Real Estate Companies in France in the 19th Century. Contribution to the History of Development of Urban Land in a Capitalist Economy], Paris 1980.

60 A. Preda, *Framing Finance*, op.cit.

61 R.-M. Gelpi, F. Julien-Labruyère, *The History of Consumer Credit. Doctrines and Practices*, London 2000; D.Marron, *Consumer Credit in the United States A Sociological Perspective from the 19 Century to the Present*, New York 2009; B.G. Carruthers, L. Ariovich, *Money and Credit: A Sociological Approach*, Cambridge 2010.

62 P. Ehrlich, *Das Reichshypothekenbankgesetz in seiner wirtschaftlichen Bedeutung* [The Imperial Mortgage Bank Law in its Economic Significance], Berlin 1909.

63 V. Carthaus, *Zur Geschichte und Theorie der Grundstückskrisen in deutschen Großstädten*

Until mid-19th century, taking consumer credit was not common practice – hire purchase and borrowing money in pawnshops embodied the stigma of working class life conduct and thus both were avoided by the middle-classes[64]. Further indications for these "new" economic practices are provided by the development of accounting standards, the imposition of regulatory requirements as well as the emergence of credit-rating, which all made it easier for creditors to evaluate debtor finances[65]. Laws, intermediaries and standardization increased the flow of funds as debtors and creditors relied less on traditional practices and forms of "insider-lending".

REAL ESTATE MARKETS AND THE ROLE OF BANKS

The role of credit and mortgages leads directly to the significant role of banks. Real estate crises had a massive effect on the economy around 1900 because the real estate sector was strongly interwoven with the banking system, mainly as a result of its capital intensity. Above all, real estate businesses work with other people's money. Property financing is greatly leveraged through mortgage loans and a myriad of other debt instruments. As a result of rapid economic expansion in the late 19th and early 20th century, banks routinely supplied capital to entrepreneurs, which established private lenders as both powerful and central to financial markets in the United States and Europe[66].

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mit besonderer Berücksichtigung von Berliner Vororten [Towards the History and Theory of Building Site Crises in German Centers with Special Emphasis on Berlin's Suburbs], Jena 1917, p. 232; S. Fisch, op.cit., p. 46; M. Lescure, op.cit.

64 M. Finn, *The Character of Credit: Personal Debt in English Culture, 1740–1914*, Cambridge 2003; L. Calder, *Financing the American Dream: A Cultural History of Consumer Credit*, Princeton 1999; M. Prinz, *Die konsumgesellschaftliche Seite des „Rheinischen Kapitalismus"* [The consumer society side of „Rhinish Capitalism"] [in:] *Gibt es einen deutschen Kapitalismus? Tradition und globale Perspektiven der sozialen Marktwirtschaft* [Is There a German Capitalism? Tradition and Global Perspectives of Social Market Society], V. Berghahn, S. Vitols (eds.), Frankfurt 2006; R.-M. Gelpi, F. Julien-Labruyère, op.cit.

65 B.G. Carruthers, *The Sociology of Money and Credit* [in:] *The Handbook of Economic Sociology*, N.J. Smelser, R. Swedberg (eds.), Princeton 2005; B.G. Carruthers, *From Uncertainty toward Risk: The Case of Credit Ratings*, "Socio-Economic Review" 2013, No. 4; H. Berghoff, *Civilizing Capitalism? The Beginnings of Credit Rating in the United States and Germany,* "Bulletins of the German Historical Institute" 2009, No. 45.

66 N. Lamoreaux, *Bank Mergers in Late Nineteenth-Century New England: the Contingent Nature of Structural Change,* "Journal of Economic History" 1991, No. 3; L.A. Keister, *Financial Markets, Money, and Banking*, "Annual Review of Sociology" 2002, No. 28.

In the 19th century, private building construction represented the sector characterized by the highest share of outside financing next to railroad construction[67]. Banks supposed these high credit shares as unproblematic because the real estate served as collateral. In Germany, public mortgage banks were heavily involved in lending to the *Terraingesellschaften* (site-holding companies) which engaged in land speculation and tenement building construction[68]. Mortgage banks – founded in many places since the 1840s – were involved in regional, national and even international financial transactions. In Italy since the 1870s, banks increased the supply of credit which meant the indirect financing of companies and banks strongly connected with property speculation in the large Italian cities. Real estate dealings drew on a low rate of interest and of state funds which were provided during the early 1880s for city center renewal[69]. However, when house prices and urban land prices fell, a long and massive series of bankruptcies and liquidations followed. In many cases, real estate companies operated in the credit business themselves – by taking credits for financing investments as well as by providing loans to construction firms or homebuyers at the same time. This development can be exemplified by the site-holding companies which entered the land and mortgage-credit business since mid-19th century[70].

REAL ESTATE MARKETS AND THE STOCK MARKET

Nevertheless, the interplay of credit finance and the banking system can only be understood to full extent by considering the role played by capital markets. The fluctuations and dynamics of capital markets are crucial to the rise and fall of individual fortunes, financial institutions as well as to the construction and pattern of real estate cycles in general. Real estate companies and mortgage-banks refinance via the capital market on a large scale. Already during the mid-19th century, a large part of big real estate companies and banks were listed as joint-stock companies which made them "customers" of the stock exchanges[71]. Mortgage banks which could not cover their need for capital with deposits started to look for resources on the capital market. The issuance of mortgage bonds for refinancing credits,

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67 K. Borchardt, *Realkredit…*, op.cit.

68 N. Bullock, *Berlin* [in:] *Housing the Workers, 1850–1914: A Comparative Perspective,* M.J. Daunton (ed.), Leicester 1990.

69 A. Polsi, op.cit.

70 M. Lescure, op.cit.

71 V. Carthaus, op.cit., p. 231; S. Fisch, op.cit, p. 51.

which then were traded on the national capital market and increasingly on an international market as well, represented a common business strategy. Assets held by mortgage banks and mortgage institutions grew heavily during the time period from 1860 to 1900[72]. Whereas at the beginning mortgage credits were largely financed by banks' own resources, the amount of circulating mortgage bonds made up to 75 per cent of the whole stock of mortgages in Germany in 1870[73]. Similar high levels of funding can be observed for other countries as well. However, due to these dynamics, mortgage banks were completely exposed to fluctuations and volatilities in the stock markets.

The wide-ranging boom in stocks and shares in the United States and Europe in the second half of the 19th century – since the rapid expansion in the formation and growth of stock exchanges[74] – contributed to these developments in business strategies. From 1850 to 1913 financial assets owned by persons in Britain rose from 39 percent of all assets to a proportion of 64 percent[75]. In the late 19th century, ownership of financial securities was relatively widespread in France, Great Britain and the United States, even among farmers and factory workers[76]. The middle classes – described by "spinsters, widows, retired naval and army officers, magistrates, retired merchants, parsons and orphanages"[77] – actively engaged in financial speculation.

5. CONCLUSION

This paper presents a rudimental narrative analysis of the interrelation of dynamics of real estate markets and the emergence of real estate crises from a historical perspective. It should be mentioned, however, that real estate markets represent only one "factor" among many others which may cause, trigger or intensify a financial crises. The "nature" of real estate markets – including their capital-intensity,

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72 R. Tilly, *Verkehrs- und Nachrichtenwesen, Handel, Geld-Kredit- und Versicherungswesen 1850–1914* [Traffic and Newscast, Trade, Money-Credit and Insurance 1850–1914] [in:] *Handbuch der deutschen Wirtschaftsgeschichte* [Handbook of German Economic History], W. Zorn (ed.), Stuttgart 1976, p. 591.

73 K. Borchardt, *Realkredit…*, op.cit., 120f.

74 R. Michie, *The Global Securities…*, op.cit.

75 R. Michie, *The London Stock Exchange*, op.cit., 71f.

76 M. Weber, *Die Börse* [The Stock Market] [in:] *Gesammelte Aufsätze zur Soziologie und Sozialpolitik* [Collected Essays on Sociology and Social Policy], Tübingen 1924, p. 268.

77 C.P. Kindleberger, R.Z. Aliber, op.cit., p. 268.

size, “glocalized” form and social connectivity – in line with the crisis scenario of 2007/2008 make real estate markets an interesting and promising sociological research topic.

In a first place, the findings demonstrate that financial crises in general and real estate crises in specific are not a novel phenomenon – as already recognized widely[78]. Second, the analysis above often shifted from one context to another, thus aiming at presenting rather an overall picture. However, we should of course be more careful since economic practices in markets are embedded in a broader social context, which can be described by the interplay of institutions, social networks and cognitive frames[79]. Third, instead of referring to the Great Depression of the 1930s, we should take the second half of the 19th century and pre-WWI economic crises as a yardstick for current crises and actual crises-discourses. The period at the end of the 19th century possesses some distinct parallels with the period we experience since the 1980s[80]. Especially, this concerns the degree of global economic and financial integration[81], the unleashing of market forces[82], as well as international migration flows[83]. Thus, it seems to be a helpful exercise to go back in history and try to understand the genesis of financial crises of that time. In fact, essential elements of more recent heavy real estate crises can be found already during the 19th century. For example, this holds true for the crisis in Japan and Scandinavian countries in the 1990s, the crisis of 1997 and 1998 in Thailand, Indonesia, Malaysia, Korea, Russia, and Brazil as well as for the US mortgage-crisis of 2008. This is directly linked to a further point. The findings reveal that the basic elements of crises – the emergence of market bubbles, financial globalization, credit practices as well as the role of banks and the stock market – have not radically changed over the course of modern economic history. Even though, it should be noted that there seems to exist a “gap” in the occurrence of significant and reverberating real estate crises regarding the time period between the Great

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78 E.g. C.P. Kindleberger, R.Z. Aliber, op.cit.; M. Weber, *General…*, op.cit.; L. Neal, *A Shocking View of Economic History*, “Journal of Economic History” 2000, No. 2; N. Ferguson, op.cit.

79 J. Beckert, *The Social* Order…, op.cit.; N. Fligstein, *The Architecture of Markets*, Princeton 2001.

80 B. Eichengreen, M. Bordo, *Crises Now and Then: What Lessons from the Last Era of Financial Globalization?*, “NBER Working Paper Series” 2002, No. 8716.

81 P. Bairoch, *Globalization, Myths and Realities: One Century of External Trade and Foreign Investment* [in:] *States against Markets*, R. Boyer, D. Drache (eds.), London 1996; K.H. O’Rourke, J.G.Williamson, op.cit.

82 A. Preda, *Framing Finance*, op.cit.; K.Polanyi, *The Great Transformation*, Boston 1944.

83 N.J.G. Pounds, op.cit.

Depression of the 1930s and the 1970s. Thus, future research may concentrate on this apparent phenomenon.

However, the investigation of real estate markets is not only interesting for understanding and explaining the genesis of modern economic crises, but contributes also to the understanding of the emergence of practices of speculation as well as the indebtedness of private households and arising social inequalities. This gains considerable significance since a house is the largest single asset of most households and thus represents the most important form of family wealth and/or debt respectively[84]. Here, the complex interactions between individual households, local practices and global economic forces are of substantial interest.

In a broader view, the findings show that modern financial crises are only superficially a question of credit boom and bust[85]. At the core one finds the "unraveling of the social organization of money"[86] that the world has been dominated by for a century and a half. Here, I want to suggest the need for further research on real estate markets for a better understanding of institutions, actors and practices of modern market society.

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84 E.g. *Home Ownership and Social Inequality in Comparative Perspective*, K. Kurz, H.-P. Blossfeld (eds.), Stanford 2004; P. Bourdieu, *The Social Structures of the Economy*, Cambridge 2000; M. Pattillo, *Housing: Commodity Versus Right*, "Annual Review of Sociology" 2013, No. 39.

85 B.G. Carruthers, *Historical Sociology of Modern Finance* [in:] *The Sociology of Finance*, K. Knorr-Cetina, A. Preda (eds.), Oxford 2012; M. Amato, L. Fantacci, *The End of Finance*, London 2012.

86 K. Hart, *The Financial Crisis and the End of All-Purpose Money*, "Economic Sociology: The European Electronic Newsletter" 2011, No. 2.

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