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► **To cite this version:**

Alexandru Pătruți. Review of Mark Thornton, *The Skyscraper Curse: And How Austrian Economists Predicted Every Major Economic Crisis of the Last Century*, Auburn, Alabama, Mises Institute, 2018, 275 pp., pb, ISBN 978-1-61016-684-3. 2020, 10.46298/jpe.10745 . hal-03711077

HAL Id: hal-03711077

<https://hal.science/hal-03711077>

Submitted on 1 Jul 2022

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THE JOURNAL OF
PHILOSOPHICAL ECONOMICS:
REFLECTIONS ON ECONOMIC
AND SOCIAL ISSUES

Volume XIII Issue 2
Spring- Autumn 2020

ISSN 1843-2298

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ROSETTI

Review of Mark Thornton, *The Skyscraper Curse: And How Austrian Economists Predicted Every Major Economic Crisis of the Last Century*, Auburn, Alabama, Mises Institute, 2018, 275 pp., pb, ISBN 978-1-61016-684-3

Alexandru Pătruți

How can one appreciate the validity of an economic theory? Internal consistency would some people say. Its capacity to predict major economic phenomena, would others point out. Whatever the choice, Mark Thornton argues that Austrian business cycle theory has passed any test. In *The Skyscraper Curse*, he attempts to show that business cycle theory can be used both to interpret past events and to predict with a decent amount of precision future booms and busts. Although it has already been argued many times, the way in which the author goes about his task is indeed innovative.

Thornton rediscovers the so-called Skyscraper Index, originally developed in 1999 by Andrew Lawrence, who worked as a property analyst at a private bank. When Lawrence published his paper, it was intended to be little more than a joke, claiming that whenever investment in skyscraper construction peaks, an economic crisis is just around the corner. However, Thornton takes this claim to a new level by presenting the Austrian business cycle theory as the explanation behind this bizarre coincidence between the construction of ground-breaking towers and economic cycles. And if this is not a good enough hook to attract people to read a book that deals with mundane economic problems, the author claims that he has correctly predicted the last crisis based on these theoretical elements as early as 2007.

Received: 4 August 2020

One of the most interesting aspects of the book consists precisely in author's unending struggle to publish his results in academic papers. His original article 'Skyscrapers and business cycles', after being rejected by numerous mainstream journals, was finally published in the *Quarterly Journal of Austrian Economics* in 2005. From 2005 to 2007, Thornton also wrote two pieces in which he claimed that the housing market, which at the time was in full swing, was just another artificially inflated economic bubble generated by state intervention. But nothing strikes the reader as the fact that in 2007, when the renowned building of Burj Dubai broke the word height record, the author wrote (see 'New Record Skyscraper (and depression?) in the making', published in *Mises Wire*):

There is a new record setting skyscraper in the making in the United Arab Emirates. The Skyscraper Index predicts economic depression and/or stock market collapses to occur prior to the completion of the skyscraper.

Although one would expect that this prediction alone would grant the author a great deal of media attention, that was apparently not the case since Thornton claims that: 'As a side note, the majority of major media who write about my work and this phenomenon fail to cite me as a source, although they have clearly been drawing from my publications' (p. 19). The only notable exceptions here were an article (Barr et al. 2015) and a reference to it made by the editorial in *The Economist* of the same year. Both of them were aimed at discrediting Thornton's work. Barr et al. (2015) argues that there is little correlation between announcement and completion dates of skyscrapers and business cycles (p. 156) and that 'height does not Granger cause output' (p. 148). However, as Thornton pointed out on numerous occasions, the announcements and completion dates are not good indicators and should be substituted with the date when structures break the current height record, there being organized ground-breaking ceremonies in this sense. Additionally, no one claimed that skyscrapers *cause* business cycles, but they can be used as indicators for economic bubbles. The author attempted to write a reply to the article in *Applied Economics* in order to voice these concerns, but his letter was rejected.

Leaving this nevertheless curious publishing history behind, the real theoretical innovation in Thornton's book lies with the three Cantillon effects [1] that disturb the building industry (pp. 68-72). The first one consists in the fact that an artificial reduction in the interest rate provides investors with cheaper funds. This increases the demand for real estate and boosts prices for land and buildings. Moreover, net present values for long-term investment projects increase due to low price of capital. In the real estate segment, this translates into taller buildings. The second effect of

lower interest rates affects the size of companies. Lower capital cost tends to cause mergers and acquisitions, and larger companies need larger headquarters. The price of real estate increases again because of the additional demand of bigger businesses to buy office space. The last Cantillon effect mentioned by Thornton, in my opinion, is the most interesting. Reduced interest rates tend to make building technology more profitable. Investment increases in this sector enabling builders to break the height record for skyscrapers. This is why the author insists that new records are relevant and not announcement or completion dates. If a ground-breaking ceremony has been announced, then this must mean that the structure of production had already been distorted and resources drawn into the building sector. Land has been bought along with construction materials, people have been hired and investments made in construction technology. Thornton successfully manages to provide the theoretical basis for the Skyscraper Curse by linking these 'Cantillon effects' to the original thesis of Andrew Lawrence. Thus, the Skyscraper Index appears to be a reasonable proxy for illustrating Austrian business cycle theory and (why not!) predicting economic crises.

Of course, not all the material presented in the book is innovative. Thornton's merit here is that he did find a novel way to of presenting the business cycle theory and linking it to a useful indicator that can be loosely employed to 'predict' economic downturns. The second chapter of the book 'The history of the Skyscraper Curse re-examined' (pp. 31-43) is also useful because the author succeeds in showing that the completion dates for new high records for relevant tall buildings do offer us a reliable signal for stock market bubbles. Thornton extends the initial documentation made by Andrew Lawrence's in his original study. He shows that the Skyscraper Index succeeded in offering relevant information between 1889 and 2010.

The author also puts a lot of effort (maybe too much) into showing that Austrian economists were successful in predicting all major economic crises of the last 100 years. He starts with Irving Fisher's renowned failure of 1929 when he announced that stocks had reached 'a permanently high plateau' just before the crash. He compares this with Ludwig von Mises's successful prediction of 1924 on the fall of one of Austria's largest banks, the Credit Anstalt. In 1928, Mises also argued that Fisher's schemes were faulty and that a crisis was clearly looming (pp. 119-120). From the Great Depression until today, Thornton claims that Austrians have forecasted every crisis. He even made a survey (p. 167), in which he centralized the names of the people who predicted the stock market bubble of the 1990s and showed that most of them belonged to the Austrian tradition.

However, from a theoretical point of view, the book has some shortcomings. It basically presents the conventional approach of the Austrian business cycles theory over several chapters and with a great deal of redundancy. This is probably less useful in the sense that there are many published studies presenting Austrian business cycle theory in a more systematic way. Theoretical ideas steaming from other schools of thought regarding economic fluctuations can be found in the book, although presented in an extremely schematic form. The attitude of the author in this respect can be easily seen in chapter 24 'What is wrong with ABCT?', where, surprisingly, the reader does not receive an answer but a reinforcement of the theory.

There are also strange chapters in the book that, in my opinion, confuse the reader. Chapter 11 'Razorbacks and Wolverines' is one such example. The author attempts here to answer whether it is possible to apply the Skyscraper Index on a continental, national or local level. He states from the beginning that 'My answer to those questions is yes, but that is only based on anecdotal evidence' (p. 101). However, the cited article by Kaza (2010) seems to show that in Arkansas and Michigan, where he attempted to test the theory, the Skyscraper Index failed because the tallest structures had been built during economic recessions. The structure of the book itself is strange given that it is divided into two main parts, which are only loosely connected to each other. First part deals with the Skyscraper Index and the second one with Austrian predictions of cycles, not necessarily based on the above-mentioned index.

Nevertheless, the book has an extremely interesting plot and Thornton successfully links the Austrian business cycle theory to Andrew Lawrence's Skyscraper Index. The analysis of the Cantillon effects in the real estate sector provides a solid theoretical background in this sense and it is innovative. Moreover, the fact that Thornton has correctly predicted the crisis based on this indicator in 2007, although being denied the expected credit for it, is a good enough reason to read *The Skyscraper Curse*.

Endnote

[1] Richard Cantillon, in his *Essay on the Nature of Commerce*, is the first author who put forward an advanced version of the quantity theory of money. He argued that the way in which money enters into an economy is relevant for the following increase in prices and wages. The fact that prices rise in case of increase in money

Pătruți, Alexandru (2020), 'Review of Mark Thornton, *The Skyscraper Curse: And How Austrian Economists Predicted Every Major Economic Crisis of the Last Century*', *The Journal of Philosophical Economics: Reflections on Economic and Social Issues*, XIII: 2, 226-230

supply, does not necessarily imply that all prices must rise *at the same time*. The term 'Cantillon effect' was later coined by Mark Blaug in his *Economic Theory in Retrospect*. Cantillon effects quickly became a hallmark of modern Austrian economists, who argue that the gradual way in which inflation occurs creates path-specific (real) redistributive effects in society.

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