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Why the market value of residential premises and the costs of its purchase differ: The examples of Belarus and Poland

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ABSTRACT

The purpose of this study is to investigate features of transaction costs (fees and taxes) regarding real estate deals and to analyze transaction costs in the real estate market in emerging and established economies in order to research the link between the extent of market development and transaction costs. The authors' methodological approach to estimation of transaction costs consists of qualitative and quantitative stages and is based on descriptive, normative and statistical information, which allows estimation and comparison of transaction costs as well as their structure and sources of occurrence by types. The two cases were chosen for practical implementation of the method: a transition economy of Belarus and a relatively established market economy of Poland. In order to measure transaction costs, the authors use the example of a residential property in order to provide a comparable basis for further analysis. Application of the method to the most prevalent pattern of real estate deals shows sufficient comparability of transaction costs (ca. 2.5%) and a slight difference (ca. 4%) caused by the absence of transaction tax in Belarus.

1. Introduction

Success of deals in the market, as well as the market development itself, is largely determined by the costs incurred by market actors in preparation, organization and control of the contract (Williamson, 1985; Mattarocci, 2015; Hayunga and Pace, 2017).

The structure, content and amount of transaction costs can either stimulate or slow down the activity of a variety of stakeholders (Vitikainen, 2007). Factors such as bounded rationality behavior or asset specificity to a large extent form the amount and content of transaction costs (Williamson, 1975).

The problem of transaction costs is especially important for non-productive markets with high risk and uncertainty, e.g. a real estate market, which is characterized by uniqueness of real estate, low frequency of transactions, relative high prices and difficulties of objective determination of the prices (Quan, 2002; Cannon et al., 2006; Garrick et al., 2013; Salzman and Zwinkels, 2017). Transaction costs and conditions conducive to their occurrence can significantly affect development of a real estate market (Qian et al., 2013). It is worth noting that real estate agents' incentives are also influenced by transaction costs in a way that the higher the transaction costs are, the longer it takes to find a real estate and bargain, and thus the lower the probability of a deal is (Bian et al., 2016).

Despite a growing interest in the issue of transaction costs among both scholars and practitioners, very few studies are devoted to their practical evaluation/assessment in relation to real estate markets in various economies. In addition, an interesting research question is determination of a relationship between the size and structure of transaction costs and the type of economy, for example, a developed one and a developing one, which also is not sufficiently covered in the existing literature. Besides, international developers and institutional investors, such as pension funds, are also interested in the cost of real estate transactions in different countries (Tuzimek and Bańkowski, 2005). The cost of transaction is also an important parameter in the rating classification of the real estate market (Renigier-Biłozor et al., 2017). Governments of many countries attach great importance to the problem of the purchase cost of real estate, especially residential housing. For example, Poland has recently undertaken action to reduce housing deficit through development of rental housing. The housing system would be intended to alleviate the difficult housing situation of a great number of families.

In literature (Hardt, 2005), it is emphasized that the more is invested in obtaining and pre-analyzing information prior to the purchase of a real estate (ex ante costs), the lower the risk involved in buying it,

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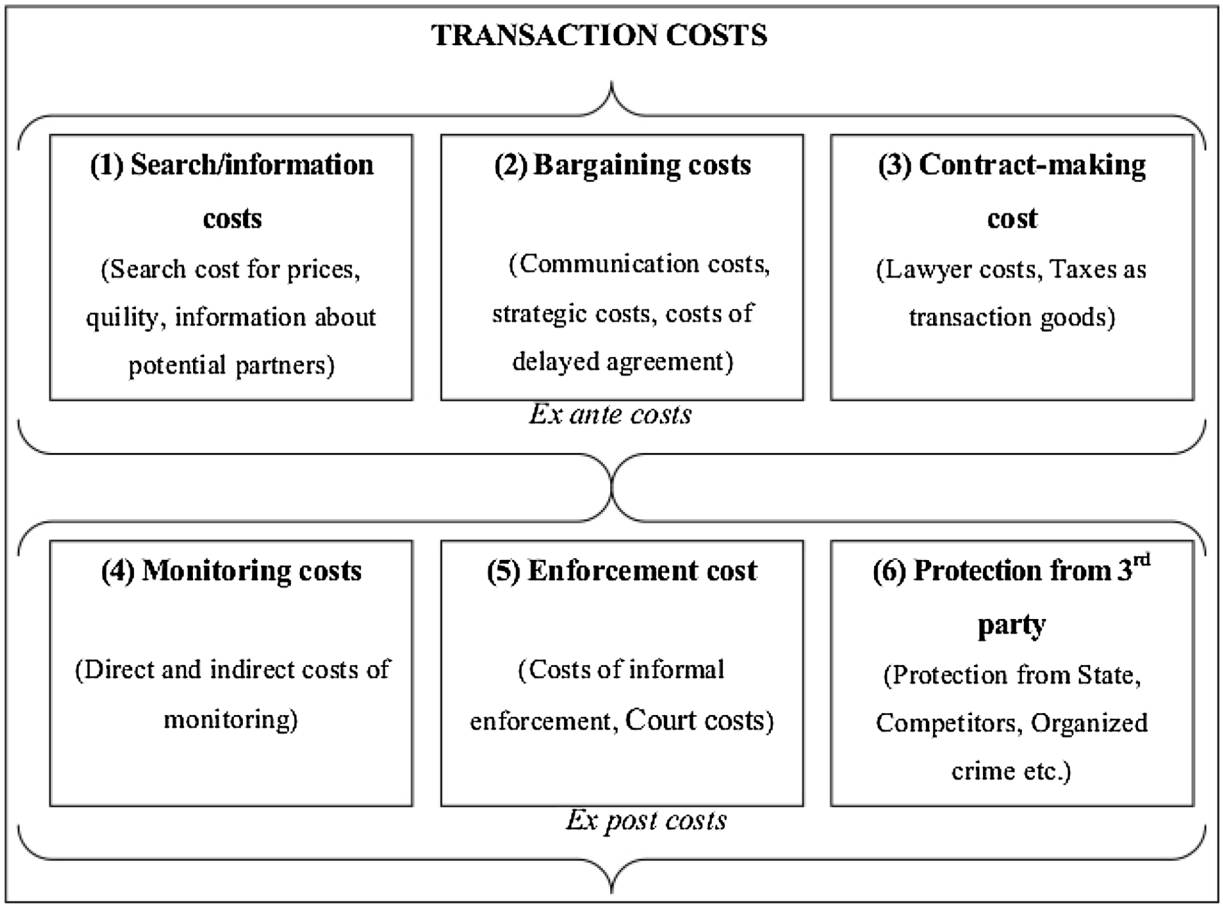

Fig. 1. Transaction cost typology (based on North, 1990 and Eggertsson, 1990).

e.g. the risk resulting from outstanding ownership or mortgaging. This results in lower ex post costs, as the better the deal is, the lower the risk of a costly litigation. However, in order to ensure that ex ante costs are not excessively high, the transactions take place in an institutional environment (legislation, codes of professional ethics of real estate agents).

That is the reason why this article turns to the issue of estimating transaction costs in real estate markets (with particular regard to the housing market) of Poland and Belarus as representatives of a relatively established market and a developing economy, respectively.

The article is structured as follows: the following chapter introduces the conceptual framework of transaction costs in a real estate market. Chapter 3 discusses the methodology that the authors adopted. Chapter 4 analyses transaction costs in real estate markets in Belarus and Poland. Chapter 5 is devoted to the conclusions.

2. Transaction costs in property market: conceptual framework

2.1. Transaction costs theory

The transaction costs theory was developed by Ronald H. Coase in order to understand the working of an economic system and in order to analyze many of its problems in a useful way (Coase, 1988). The term 'transaction costs' that Coase introduced in his work *The Nature of the Firm* (Coase, 1937) refers to the cost of using the price mechanism. By analogy with physics, transaction costs play the role of friction force in economic systems (Williamson, 1985).

Despite a considerable body of literature devoted to the problem of transaction costs, there is no consensus on the definition of this phenomenon (Allen, 1991; Klaes, 2000; Wang, 2003). Apart from the approaches of Coase and Williamson mentioned above, there are a considerable number of definitions. Some scholars consider transaction costs as the costs of time (Miller, 1965), others as the costs of information (Malmgren, 1961). Other researchers generalize the definition by interpreting transaction costs as any costs other than production costs (e.g. Butter, 2010; Reutz, 2011) or as the costs of running the economic system (Arrow, 1969).

This article's aim is not to analyze the pros and cons of the existing approaches nor to develop the authors' own definition of transaction costs but to study the subject further. The authors interpret transaction costs as the costs connected with closing a real estate sale deal, and included in the contract in addition to the initial agreed price of sale of the property.

Separating transaction costs into different types helps (i) to understand their nature better, (ii) to measure them (at least theoretically), and (iii) to facilitate the collection of data on transaction costs (McCann et al., 2005). There are numerous approaches dedicated to different types of transaction costs depending on the attribute considered in the classification. For example, for business entities, all transactions include *external* (market) transaction costs (price determination costs, negotiation costs, the cost of information failure) and *internal* (bureaucratic) transaction costs (primarily associated with administration, resource misallocation, demotivation) (Vitikainen, 2007). Differences in the magnitude of external and internal transaction costs provide the explanation of the differences in efficiency and attractiveness of different sectors and companies to investors in a number of ways. Thompson (1999) considers transaction costs in the institutional context and distinguishes *enactment costs* as well as *implementation and monitoring/enforcement costs*. Transaction costs could be separated into *ex ante* costs (e.g. the costs of drafting, negotiating and safeguarding an agreement) and *ex post* costs (e.g. enforcement costs) referring to the time prior to and following the transaction (Williamson, 1985). In continuation of